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Calif. Justices Stress Employers' Wage Statement Duties

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On Feb. 7, 2019, the California Supreme Court struck a decisive victory in favor of payroll companies, issuing a unanimous opinion that an employee is not a third-party beneficiary of the contract between her employer and its payroll service provider.

The court held that an employee-plaintiff has no standing to sue her employer's payroll company for an alleged failure to pay wages under California's employee-friendly labor laws.

In the closely watched case of Sharmalee Goonewardene v. ADP LLC, et al.[1] the plaintiff-employee sued her former employer, travel agency Altour International Inc., for discrimination, missed overtime and breaks, wrongful termination, and other claims. She added ADP LLC, the outside vendor who processed payroll for Altour, as a defendant, claiming ADP committed unfair business practices for not giving her accurate checks — errors which amounted to $6,144 in damages.

The case came before California's high court after the court of appeal allowed the plaintiff to proceed with her claims against ADP for third-party breach of contract, negligence and negligent misrepresentation. However, the California Supreme Court overturned the lower court's ruling on all three claims.

Employees are not third-party beneficiaries of their employer's payroll services contract.

First, the high court found that the plaintiff-employee could not maintain a breach of contract claim against the payroll company under the third-party beneficiary doctrine, which requires the third party to establish (1) it is likely to benefit from the contract; (2) a motivating purpose of the contracting parties in entering into the contract was to provide a benefit to the third party; and (3) allowing the third party to proceed as requested is consistent with the objectives of the contract and the reasonable expectations of the contracting parties.

The court found that although the first element may be met here, the "relevant motivating purpose" of an employer contracting with a payroll company "is to provide a benefit *to the employer* ..." Further, the chief justice found that allowing employees to sue payroll providers would impose considerable litigation defense costs upon the payroll company, which was likely to then pass those costs on to the employer. Such a result, the court held, would be inconsistent with the contract and the contracting parties' reasonable expectations.

California policy considerations prevent claims of negligence against payroll companies for miscalculating wages.

The court also held that the plaintiff-employee's claims for negligence and negligent misrepresentation were likewise without merit. After analyzing a multitude of policy considerations, the court found that it is neither necessary nor appropriate to impose a tort duty of care upon a payroll service provider regarding the obligations owed to an employee under California's wage and hour laws.

First, the plaintiff argued that many of the factors identified by the California Supreme Court in Biakanja v. Irving[2] support imposing a tort duty of care to a third party in the absence of privity of contract. The plaintiff claimed that a duty of care should be imposed in this context "because if a payroll company is negligent in failing to properly calculate an employee's wages pursuant to the applicable labor statutes and wage orders, the employee will suffer a foreseeable, direct, and readily ascertainable economic loss and will be denied the protection afforded by those remedial labor statutes and wage orders."[3]

In that regard, the court held that the plaintiff's argument "ignores the fundamental point" that, under such circumstances, California law already provides a full and complete remedy to an employee for any wage loss sustained as a result of a payroll company's negligent conduct.[4]

Whenever a payroll company's negligence in calculating an employee's wages results in a violation of the applicable labor statutes or wage orders, the employee has a "well-established right under the labor statutes to recover in a civil action against the employer the full wages and other significant remedies (including attorney fees and potential civil penalties) that are authorized under those statutes."[5]

Because an employee already has an adequate remedy against the employer alone, the court held that allowing payroll companies to be brought into wage-and-hour cases by the employers' employees would likely mean "an unnecessary and potentially burdensome complication to California's increasing volume of wage and hour litigation."

Where an employee believes that he or she has failed to receive the proper amount of wages due, the employee will generally have no way of discerning whether the underpayment is due to the action or inaction of the employer, the payroll company or both. For this reason, employees would likely join their employer's payroll service provider as an additional defendant in virtually every wage-and-hour case if a duty of care was imposed upon the payroll company. The court held that such a result would impermissibly increase the substantial burden already imposed upon the judicial system without resulting in any greater benefit to the employee.

The court also found the payroll company has no "special relationship" with its client's employees that would warrant recognition of a duty of care under California's third-party beneficiary doctrine, and that imposing tort liability upon the payroll provider was an

unnecessary deterrent against negligent conduct, as the payroll company is already obligated to act with due care in performing its duties under its contract with the employer.[6]

For the foregoing reasons, the court concluded that it is not appropriate to impose upon a payroll company a tort duty of care to an employee with respect to the obligations imposed by the applicable labor statutes and wage orders.

Because the court found that the plaintiff's negligence claim was without merit, it likewise held that her claim for negligent misrepresentation failed as well. Although the court had previously recognized a narrow exception in Bily v. Arthur Young & Co.,[7] allowing a negligent misrepresentation claim by "specifically intended beneficiaries" of the contract to proceed where their negligence claim failed, such exception was not applicable here because ADP's contract with Altour was not entered into for the benefit of Altour's employees (including the plaintiff) and the plaintiff was not an intended beneficiary of ADP's services.[8]

The decision came as a welcome relief for the 1,100 payroll service companies in California. Had the court adopted the plaintiff's position, payroll providers would almost surely have become named defendants in each of the thousands of wage-and-hour cases filed each year in the state. Such a result would have imposed a considerable increase in litigation defense costs and business disruption for payroll companies.

Finding that payroll companies owed a duty of care to its clients' employees would have redefined the ultimate responsibility for validating the accuracy of employees' pay stubs and could have created upheaval in the entire payroll outsourcing industry. As the court noted, however, payroll service providers do still face possible liability, by way of a breach of contract claim, if it improperly processes the information provided by the employer which results in an underpayment of wages to an employee or an improper wage statement.

As the Goonewardene case makes clear, the employer retains the ultimate responsibility for ensuring that its employees are provided adequate documentation and records regarding their compensation, and employers can face significant liability for the failure to do so. The California Labor Code sets out specific requirements for employees' wage statements, which generally require an employer to provide employees with an accurate record of the hours they work, their rate of pay, the wages they were paid, and deductions from their gross wages.[9]

Employers must also notify employees each pay period of the paid sick leave they have accrued; if an employer provides paid sick leave through a paid time off policy, the employer must provide the employee's PTO balance.[10] Employers in cities with local paid sick leave ordinances may also be subject to specific record-keeping requirements in addition to those imposed under state law.

Where an employer knowingly and intentionally fails to provide the itemized wage

statement in the manner required by law, and the employee suffers an injury as a result, the employee is entitled to recover the *greater of* (1) $50.00 for the initial pay period in which the violation occurs plus $100.00 for each subsequent pay period in which the violation occurs, up to a total of $4,000.00; or (2) the employee's actual damages.[11] Moreover — and in many cases, more substantially — employees are also entitled to recover their attorneys' fees and costs incurred in seeking a remedy for their injuries.[12]

In addition to California's main wage statement penalty, employers can also be subject to a civil fine when the employer either (1) fails to provide an employee with any wage statement at all; or (2) fails to keep records of wage payments as required by California law.[13] Either circumstance can subject the employer to a civil penalty of $250 per employee for the initial violation and $1,000 per employee for subsequent violations.[14] Because those penalties are in addition to the other penalties discussed above, the liability for a wage statement violation can be considerable.

Following the holding in Goonewardene that an employee's employer bears full responsibility for any liability arising from wage statement errors, employers should review their payroll processes and ensure they are compliant with all federal, state, and local laws. Otherwise, the potential penalties can be very costly.

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[1] Goonewardene v. ADP, LLC, No. S238941, 2019 Cal. LEXIS 755, 2019 WL 470963 (2019).

[2] Biakanja v. Irving, 49 Cal. 2d 647, 650, 320 P.2d 16, 19 (1958).

[3] Goonewardene at *37-38.

[4] Id. at *40.

[5] Id. at *39-40.

[6] Id. at *40-41. Accord Goodman v. Kennedy 18 Cal.3d 335, 343-344, 556 P.2d 737, 134 Cal. Rptr. 375 (1976).

[7] 3 Cal. 4th 370, 406-07, 11 Cal. Rptr. 2d 51, 73, 834 P.2d 745, 767 (1992)

[8] Goonewardene at *45-46.

[9] See Labor Code § 226(a).

[10] Labor Code § 246(i).

[11] Labor Code § 226(e)(1).

[12] Id.

[13] Labor Code § 226.3.

[14] Id.