

California Supreme Court Announces a Win for Payroll Outsourcing Industry

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Last week, the California State 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.*](#), 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 State 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. In that regard, the court stated:

First and perhaps most significantly, plaintiff's argument ignores the fundamental point that whenever a payroll company's negligence in calculating an employee's wages results in a violation of the applicable labor statutes or wage orders, California law already provides the employee with a full and complete remedy for any wage loss the employee sustains as a result of the payroll company's negligent conduct. An employee's interest in this regard is fully protected by the employee's 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.

The court also noted, among other considerations, 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, and that the payroll company has no "special relationship" with the employee that would warrant the imposition of a duty of care. Accord [*Goodman v. Kennedy* 18 Cal.3d 335, 343-344, 556 P.2d 737, 134 Cal. Rptr. 375 \(1976\)](#). The chief justice wrote that allowing payroll companies to be brought into wage-and-hour cases by its client's employees would likely mean "an unnecessary and potentially burdensome complication to California's increasing volume of wage and hour litigation."

The decision came as a welcome relief for the 1,100 payroll service companies in California who could have been named as defendants in the thousands of wage-and-hour cases filed each year in the state had the lower courts' decisions been affirmed. Such a result would have redefined the ultimate responsibility for validating the accuracy of employees' pay stubs and could have created upheaval in the entire payroll outsourcing company.

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