NO. 952469

SUPREME COURT OF THE STATE OF WASHINGTON

SWANSON HAY COMPANY, a Washington corporation, HATFIELD ENTERPRIZES, INC., a Washington corporation, and SYSTEM-TWT TRANSPORT, a Washington corporation,

Petitioners,

v.

STATE OF WASHINGTON EMPLOYMENT SECURITY DEPARTMENT,

Respondent.

RESPONDENT'S ANSWER TO PETITIONS FOR REVIEW

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I. INTRODUCTION

This case involves a straightforward application of the Employment Security Act's independent contractor test, RCW 50.04.140, to the employment relationship between the Petitioner motor carriers and their truck drivers who own their own trucks ("owner-operators"). The Court of Appeals held that the Commissioner of the Employment Security Department correctly ruled that the carriers did not prove all parts of the test, upholding the unemployment tax assessments issued to the carriers for the wages they paid to their owner-operators. Substantial evidence supports the Commissioner's findings, and the conclusions are free of legal error.

The Petitioners obfuscate this straightforward application of law to facts by raising arguments that have no legal support. First, they claim that having to treat owner-operators as in covered in employment for purposes of ensuring Title 50 RCW coverage will lead to a wholesale "restructuring" of the trucking industry. Therefore, the carriers argue, federal motor carrier law preempts the tax assessments. The Court of Appeals properly found their "restructuring" argument legally unsupported and their preemption argument off base. *Swanson Hay Co., et al. v. Emp't Sec. Dep't*, 1 Wn. App. 2d 174, 188-203, 404 P.3d 517 (2017).

Second, they challenge a 2002 Court of Appeals conclusion that federally required contractual provisions may be considered when

evaluating whether owner-operators are free from carriers' "control or direction" under one element of the independent contractor test. *See Western Ports Transportation, Inc. v. Employment Security Department*, 110 Wn. App. 440, 41 P.3d 510 (2002). The *Swanson Hay* court thoroughly analyzed this question and found no reason to depart from the long-standing precedent. *Swanson Hay Co.*, 1 Wn. App. 2d at 208-12. A ruling that complies with established precedent does not warrant review.

And third, System-TWT Transport and Hatfield Enterprizes challenge the conduct of the tax audit as being arbitrary and capricious and a violation of their due process rights. They pursue this counter-factual argument even though they had de novo appeals of the validity of their tax assessments before a neutral hearing examiner, where they suffered no prejudice in their ability to put on a defense. The Court of Appeals properly rejected these arguments, too. *Id.* at 219-23.

In short, four levels of review—from the administrative law judge, to the Department's Commissioner, to the superior court, and finally to Division III of the Court of Appeals—have dismissed all of the carriers' contentions. And now in related appellate cases, where other trucking carriers are represented by the same counsel and have made the same arguments, Divisions I and II of the Court of Appeals have ruled the same way. *MacMillan-Piper Inc. v. Emp't Sec. Dep't*, No. 75534-0-I, 2017 WL

6594805 (Wash. Ct. App. Dec. 26, 2017) (unpublished); *Gulick Trucking, Inc. v. Emp't Sec. Dep't*, No. 49646-1-II, 2018 WL 509096 (Wash. Ct. App. Jan. 23, 2018) (unpublished).[1] The Court should see through the arguments in the petition and recognize that they do not involve any conflict with prior decisions or an issue of substantial public interest requiring a determination by this Court. RAP 13.4(b)(1), (4). Review should be denied.

II. COUNTERSTATEMENT OF THE ISSUES

If review were granted, the following issues would be presented:

1. Did the Commissioner correctly rule under RCW 50.04.140—the statutory independent contractor test for unemployment insurance—that the carriers failed to prove its owner-operators were free from the carriers' control or direction over the performance of services, and that Swanson Hay and System-TWT Transport failed to prove the owner-operators had independently established businesses?
2. Does the Federal Aviation Administration Authorization Act, which preempts state laws that relate to the prices, routes, or services of a motor carrier, preempt applying Washington's Employment Security Act to the services of owner-operators, when the Act applies generally to all Washington employers, poses only a minor cost increase, and affects worker classification only under the Act?
3. With respect to carriers System-TWT Transport and Hatfield Enterprizes, who sought judicial review under RCW 34.05.570(3) (review of agency orders in adjudicative proceedings), should the Court consider their challenges to how their tax audits were conducted where there is no showing of error in the findings or conclusions of the formal adjudicative proceeding? If the Court considers those arguments, did the carriers fail to establish arbitrary and capricious or unconstitutional audit conduct when there was room for two positions as to the amount to be assessed, and the

[1] Gulick did not raise arguments about the audit conduct.

carriers had de novo hearings in which they suffered no prejudice in their ability to present a defense?

III. COUNTERSTATEMENT OF THE CASE

The Petitioners are trucking carriers that contract with "owner-operators" to haul freight for their customers. The owner-operators own trucking equipment, and the carriers enter into "lease agreements" with them to have the owner-operators use their trucks to haul freight for the carriers. Agency Record Swanson Hay Co. Vol. 6 (ARSH6) Ex. P; Agency Record System-TWT Transport Vol. 1 (ARST1) 6-38; Agency Record Hatfield Enterprizes, Inc. Vol. 1 (ARH1) 135-43.

The carriers classify their owner-operators as independent contractors. The Department audited each carrier to determine whether that classification was correct under the Employment Security Act.[2] The auditors each determined the owner-operators did not meet the independent

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[2] The Employment Security Act offers to methods to establish the independent contractor exception, RCW 50.04.140(1) and (2). All Petitioners only sought to prove exception under subsection (1), which provides that services performed by an individual for remuneration shall be covered employment "unless and until it is shown to the satisfaction of the commissioner" that:

(a) Such individual has been and will continue to be free from control or direction over the performance of such service, both under his or her contract of service and in fact; and

(b) Such service is either outside the usual course of business for which such service is performed, or that such service is performed outside of all the places of business of the enterprises for which such service is performed; and

(c) Such individual is customarily engaged in an independently established trade, occupation, profession, or business, of the same nature as that involved in the contract of service.

RCW 50.04.140(1).

contractor test and issued unemployment tax assessments to the carriers for the wages paid to the owner-operators. ARSH1 19; ARST1 4; ARH1 5.

The carriers filed separate administrative appeals, which were independently adjudicated at the Office of Administrative Hearings. In those appeals, the carriers argued that the owner-operators were independent contractors under the Act, that federally-required controls should not be considered in assessing the Act's coverage provisions, and that the Federal Aviation Administration Authorization Act (FAAAA) preempts the Act. ARSH2 252-60; ARST3 52-86; ARH1 8-25. System and Hatfield also argued the audits themselves were faulty and that the assessments were inflated for improper purposes, both requiring dismissal of the assessments. ARST3 52-86; ARH2 220-71.

As to the independent contractor assertion, the carriers tried to prove the owner-operators were free from control or direction over performance of services under RCW 50.04.140(1)(a). But several contract provisions defeated that claim, including:

- The carriers had exclusive control and possession of the owner-operators' trucking equipment;
- Swanson and Hatfield's agreements required marking the equipment with the carrier's name, address, and operating authority number;
- Swanson and System required notification of any accidents;
- Swanson required owner-operators to photograph freight on request;
- Swanson and System required owner-operators to regularly submit delivery and other paperwork, and Hatfield required owner-operators to comply with all rules and regulations applicable to their operations;

- Swanson paid owner-operators even if a customer failed to pay Swanson (unless it was the owner-operator's fault), and System paid even if a customer did not pay System;
- Swanson's owner-operators could find their own loads on return trips, but they needed Swanson's permission, and Swanson handled billing;
- System required all drivers to meet its qualifications and comply with its drug and alcohol policy, and required owner-operators to operate the equipment in compliance with System's other rules and regulations, and could terminate the agreement if the owner-operator committed an act of misconduct detrimental to System's business;
- System's contract prohibited assignment, subcontracting, or trip leasing without System's written consent;
- System prohibited passengers without prior approval, and it could take physical possession of owner-operators' equipment at its discretion;
- Hatfield's owner-operators were required to maintain the equipment in good repair, mechanical condition, running order, and appearance, including by washing and cleaning it to maintain good public image;
- Hatfield retained the right to discuss and recommend actions against an owner-operator's agents and could take possession of the owner-operator's equipment and cargo if it believed the owner-operator had breached the contract in a manner creating liability for Hatfield; and,
- Hatfield required inspections of equipment every 90 days.

Swanson Hay Co., 1 Wn. App. 2d at 213-15; ARSH6 Ex. P; ARST1 6-38; ARH1 135-43. Some of these provisions are required by federal regulations, but each carrier imposed additional, non-federally required controls over performance of services. ARSH2 273-74; ARST2 372-73; ARH4 1196-97.

While System and Swanson attempted to show its owner-operators were engaged in independent businesses under RCW 50.04.140(1)(c), they did not prove that the owner-operators: had their own federal operating authority, which is required to haul freight for others; did any business for other carriers; had business licenses or uniform business identifier numbers

or had accounts with the Department of Revenue; or advertised their driving services to others. ARSH2 236, 277-79; ARST2 378-80.

The administrative law judges ruled in each case that: the owner-operators were in the carriers' employment and not excepted as independent contractors for purposes of Employment Security taxes; federal law did not preempt the assessments; and, under *Western Ports Transportation, Inc. v. Employment Security Department*, it is proper to consider, rather than ignore, federally-required controls when applying the independent contractor statute. ARSH2 233-44; ARST2 319-25; ARH4 1140-47. The ALJs in System and Hatfield declined to dismiss the assessments based on claims about audit conduct because the carriers did not establish arbitrary and capricious or unconstitutional action. ARST2 323-24; ARH2 672-79.

In System, the ALJ upheld the assessment in a modified amount stipulated by the parties. ARST2 319-25. In Swanson, the ALJ upheld the assessment but, on the parties' agreement, removed one driver who had his own operating authority. ARSH2 233-44. And in Hatfield, the ALJ reduced the assessment amount based on testimony that only 30 percent of the payments to owner-operators was for driving services rather than equipment rental, and the ALJ waived penalties. ARH4 1140-47, 1145 ¶ 5.14.

System and Swanson sought review by the Commissioner. In Hatfield, both the carrier and the Department sought review. The

Commissioner upheld the rulings of the ALJ, modifying and adding findings and conclusions. ARSH2 268-82; ARST2 350-82; ARH4 1179-1206. In System and Swanson, the Commissioner ruled that the carrier failed to establish the first and third elements of the independent contractor statute: the drivers were not free from control or direction over the performance of services, nor engaged in independent businesses. RCW 50.04.140(1)(a), (c); ARSH2 269-79; ARST2 372-80. In Hatfield, the Commissioner ruled that the carrier failed to establish the first independent contractor element without reaching other elements. ARH4 1196-98.

The carriers each sought judicial review in Spokane County Superior Court. For their arguments about "audit conduct" that preceded the assessments and final orders, System and Hatfield sought judicial review under RCW 34.05.570(3), apparently claiming it showed an error in the final Commissioner orders. CP 98-101, 318-21. The superior court affirmed the Commissioner's orders in each case. The carriers appealed to the Court of Appeals, which again affirmed.

IV. ARGUMENT WHY REVIEW SHOULD BE DENIED

The issues in this case are factually tied to specific trucking carriers who challenge tax assessments and present no reason for review. First, the Petitioners failed to show their drivers are independent contractors under the Act. That ruling does not involve a conflict with precedent or a question

of broad public interest. Second, the claim of FAAAA preemption is consistent with precedent and, again, Petitioners show no reason why this Court should review their flawed arguments. Third, System and Hatfield's "audit conduct" theories ring hollow since they show no error in the final orders, and they had formal, de novo hearings where they achieved reductions in the assessment amounts. Such misdirected arguments, unmoored from any showing of erroneous final orders, do not merit review.

A. The Court of Appeals Decision Does Not Conflict with any Washington Supreme Court Decisions

By challenging in Division III the holdings of Division I's 2002 decision in *Western Ports*, the carriers had hoped to create a conflict that would warrant review under RAP 13.4(b)(2). But the *Swanson Hay* court agreed with the *Western Ports* court in all relevant respects, and now Division I has reaffirmed its holdings, and Division II has agreed too. *MacMillan-Piper Inc.*, No. 75534-0-I, 2017 WL 6594805 (Wash. Ct. App. Dec. 26, 2017) (unpublished); *Gulick Trucking, Inc.*, No. 49646-1-II, 2018 WL 509096 (Wash. Ct. App. Jan. 23, 2018). There are now 16 years of uniform decisions rejecting Petitioners' arguments that owner-operators are exempt from the Act, that the state law independent contractor test should artificially ignore the control the carriers exercise over their drivers that originates in federal requirements, and that federal law preempts the Act.

Faced with no real conflicts, the carriers attempt to manufacture a conflict with a 1945 decision of this Court, which interpreted a definition of "employment" in Title 50 RCW that pre-dated the current definition. They also suggest that review is warranted under RAP 13.4(b)(1) because the Court of Appeals decision conflicts with the decisions of *other jurisdictions*. This is not grounds for review. Finally, the carriers mischaracterize this Court's opinion in *Washington Trucking Associations, et al. v. Employment Security Department, et al.*, 188 Wn.2d 198, 393 P.3d 761 (2017), by claiming that it held that the administrative appeals must provide the carriers relief based on their arguments about the audit conduct. This Court said no such thing. None of the claimed conflicts exist or warrant review.

1. The Court of Appeals decision does not conflict with *Seattle Aerie No. 1* or any other Washington Supreme Court decision

System and Hatfield argue the Court of Appeals decision conflicts with a case from 1945: *Seattle Aerie No. 1 of the Fraternal Order of Eagles v. Commissioner of Unemployment Compensation and Placement*, 23 Wn.2d 167, 160 P.2d 614 (1945). They contend that it supports relying on the common law definition of "control" when analyzing the first element of the Employment Security Act's independent contractor test, RCW 50.04.140(1)(a) (whether the owner-operators were free from the carriers' "control or direction" over the performance of services).

But, as the Court of Appeals noted, *Seattle Aerie* was decided just days before the Legislature broadened the definition of "employment" to expressly include "personal service . . . *unlimited by the relationship of master and servant as known to the common law or any other legal relationship* . . . ."[3] RCW 50.04.100 (emphasis added). Accordingly, the Commissioner has not followed the *Seattle Aerie* decision for determining the scope of "employment."

System and Hatfield mischaracterize the Court of Appeals as permitting the Commissioner to "effectively state that this Court's opinion . . . is no longer good law." System/Hatfield Pet. 18 n. 28. Not so. *This Court* later effectively stated that its decision in *Seattle Aerie*—at least as to the scope of "employment" in the Act—is no longer good law. *See Swanson Hay Co.*, 1 Wn. App. 2d at 206. In 1947, reflecting on the 1945 amendment to the definition of "employment," this Court stated:

> It is apparent that the 1945 legislature intended and deliberately concluded to extend the coverage of the 1943 unemployment compensation act and by express language, to preclude any construction that might limit the operation of the act to the relationship of master and servant as known to the common law or any other legal relationship.

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[3] *Seattle Aerie* was decided on June 28, 1945, and the current definition of "employment" became effective on July 1, 1945. Laws of 1945, ch. 35, § 11 (definition); ch. 36, § 192 (effective date); *Swanson Hay Co.*, 1 Wn. App. 2d at 205-06. It has not been meaningfully amended since.

Swanson Hay Co., 1 Wn. App. 2d at 207 (quoting *Skrivanich v. Davis*, 29 Wn.2d 150, 158, 186 P.2d 364 (1947)). System and Hatfield's continued reliance on *Seattle Aerie* is thus misplaced, and they show no conflict.

As for the carriers' apparent argument that common law cases defining control in other legal contexts should apply when assessing whether the owner-operators were free from "control or direction" under RCW 50.04.140(1)(a), the Court of Appeals properly rejected that too. The Washington Legislature did not incorporate "control" that distinguished servants and independent contractors under Washington common law. *Swanson Hay Co.*, 1 Wn. App. 2d at 207. Hence, as the Court of Appeals properly held, "when it comes to applying the 'free[dom] from control or direction over the performance of services' required for exemption under RCW 50.04.140(1), it is cases applying Title 50, not common law cases, that are controlling." *Id.* at 208.[4]

The Court of Appeals recognized at the outset that the context in which worker classification arises is critical, since in employment security law, "the relationship is more likely than any other to be viewed as

[4] System and Hatfield also suggest in a footnote that the Court of Appeals decision conflicts with *Kamla v. Space Needle Corporation*, 147 Wn.2d 114, 52 P.3d 472 (2002). System/Hatfield Petition 18 n.27. But that case addressed whether an employer retained the right to direct a contractor's work so as to bring the employer within the "retained control" exception to the general rule of non-liability for injuries of a contractor. *Kamla*, 147 Wn.2d at 119. It is not an unemployment case, and it did not discuss Title 50 RCW.

employment." *Swanson Hay Co.*, 1 Wn. App. 2d at 180. This is both correct and hardly novel. Courts throughout the state—including this Court—have routinely recognized the breadth of employment coverage under the Employment Security Act. *E.g.*, *Wash. Trucking Ass'ns*, 188 Wn.2d at 203 ("Persons engaged in 'employment' include independent contractors so long as they perform 'personal services' under a contract and an exemption does not apply."); *W. Ports*, 110 Wn. App. at 458 (Act's definition of "employment" is "exceedingly broad"). Thus *Swanson Hay* was right: the common law tests for "employment" and "control" do not apply in the employment security context. There is no conflict to review.

2. A conflict with other jurisdictions is not grounds for review

System and Hatfield suggest review is warranted because the Court of Appeals decision is inconsistent with other jurisdictions' decisions, including a decision from the Oregon Court of Appeals. System/Hatfield Pet. 14 and n.22, 23, 16 and n.25. This is not a true conflict warranting review. Many of the cited cases are not unemployment cases, and other state courts have applied their own laws to different facts.[5] The different results

[5] *See* System/Hatfield Pet. 14 n.22. For example, the contractual relationship in *Hammond v. Department of Employment*, 480 P.2d 912 (Idaho 1971), involved "a series of trip-by-trip contracts with the drivers doing little more than renting trailers from" the carrier, and the drivers were "entirely free from any control whatsoever in the performance of their work." In *Wisconsin Cheese Service, Inc. v. Department of Industry, Labor & Human Relations*, 340 N.W.2d 908 (Wis. Ct. App. 1983), the *only* showing of control was

the Petitioners cite are, therefore, unremarkable. Accordingly, these arguments cannot be grounds for review under RAP 13.4(b)(1), which requires a conflict with a decision of *this* Court.

The Court of Appeals properly rejected these other authorities as both "unhelpful" and "unpersuasive." *Swanson Hay Co.*, 1 Wn. App. 2d at 210-12. The plea to rule differently does not merit review.

3. The Court of Appeals conclusion that System and Hatfield did not prove violations of their constitutional rights does not conflict with this Court's decision in *Washington Trucking Associations, et al. v. Employment Security Department, et al.*

System and Hatfield wrongly assert that this Court's ruling last year in *Washington Trucking Associations* held that "ESD's adjudicative process must provide System/Hatfield a remedy for ESD's improper means or motive in imposing the assessment." System/Hatfield Pet. 24 (citing 188 Wn.2d at 224-25). Rather, this Court held that the state administrative procedure to review and correct an assessment is the only *process* by which the carriers may pursue claims about audit motives and means, but they still must prove those claims. *Wash. Trucking Ass'ns*, 188 Wn.2d at 224-26.

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the power to terminate the leases. And in *Hough Transit, Ltd. v. Harig*, 373 N.W.2d 327 (Minn. Ct. App. 1985), Minnesota had a different definition of "employment," and the drivers in question were specifically excluded from the unemployment law. The *Western Ports* court acknowledged that different states have ruled differently concerning owner-operator unemployment coverage. *W. Ports*, 110 Wn. App. at 461-62. Besides, courts in some states have since approved of *Western Ports*. *See C.R. England, Inc. v. Dep't of Emp't Sec.*, 7 N.E. 3d 864, 876-78 (Ill. App. Ct. 2014); *SZL, Inc. v. Indus. Claim Appeals Office*, 254 P.3d 1180, 1188 (Colo. Ct. App. 2011).

Moreover, the Court did not comment on how a taxpayer might seek review based on an auditor's conduct—i.e., whether trying to show error in the final order under RCW 34.05.570(3), or under another theory of relief for review of "other agency action" under RCW 34.05.570(4). *See id.* at 226 (stating that the carriers must "rely exclusively on the procedures set out in Title 50 RCW" to pursue their claims); *see also* RCW 50.32.120.

Regardless of how a carrier seeks review, it still must prove the Department's action was arbitrary and capricious or unconstitutional. RCW 34.05.570(3), (4). Nothing in this Court's opinion in *Washington Trucking Associations* or in Division III's opinion in *Swanson Hay* affects the standards for proving arbitrary and capricious or unconstitutional action. As the below tribunals ruled, System and Hatfield did not meet those standards.

Because the Court of Appeals decision does not conflict with any decisions of this or any other Washington court, review should be denied.

B. There Is No Issue of Substantial Public Interest Requiring This Court's Determination

The carriers hyperbolically claim that this case is "make-or-break" or will have "a substantial impact on the future of" the trucking industry, because they claim treating owner-operators as in employment under the Employment Security Act will lead to them being treated as employees for all other purposes. System/Hatfield Pet. 5; Swanson Pet. 12. As a matter of

law, they are wrong. The Court of Appeals ruling is explicitly based on—and limited to—the unique provisions of the Employment Security Act. The ruling is a correct application of the Act to the facts, and it requires payment of unemployment taxes only; it has no other legal effect. Accordingly, the Court of Appeals' rejection of the carriers' argument that the Federal Aviation Administration Authorization Act (FAAAA) preempts applying the Employment Security Act to trucking carriers was correct and does not present an issue of substantial public interest requiring this Court's review.

Further, permitting the consideration of federally required leasing provisions in applying the "control" test in the independent contractor statute, RCW 50.04.140(1)(a), is not an issue of substantial public interest, especially when the carriers exerted control beyond the federal requirements anyway.

1. The Court of Appeals conclusion that the FAAAA does not preempt a state law like the Employment Security Act is widely accepted, including by this Court

System and Hatfield have raised a theory of federal preemption that depends on the false assumption that the tax will result in a "restructuring" of the trucking industry. Therefore, they argue, the assessment is preempted by the FAAAA, which provides that a "State . . . may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service of any motor carrier . . . with respect to

the transportation of property." 49 U.S.C. § 14501(c). Under this law, the test for preemption is met only where the state law aims directly at transportation, or where the law's impact on transportation is indirect but *significant*. *See Rowe v. N.H. Motor Transp. Ass'n*, 552 U.S. 364, 371, 128 S. Ct. 989, 169 L. Ed. 2d 933 (2008). Because the carriers claim that having to pay unemployment taxes will result in trucking businesses having to treat owner-operators as employees for all other purposes, the argument goes, the FAAAA preempts any unemployment tax imposition. They are wrong.

As a matter of law, the Employment Security Act requires employers to pay unemployment taxes only; it does not affect worker classification for any other purpose. This Court stated as much as early as 1945: "The only employment defined by the act is the employment intended to be covered by the act for the purposes of the act and none other." *State Unemp't Comp. & Placement v. Hunt,* 22 Wn.2d 897, 899, 158 P.2d 98 (1945). Division I reiterated the point in *Western Ports*, 110 Wn. App. at 458 ("an individual may be both an independent contractor for some purposes, and engaged in 'employment' for purposes of the Act"), as did Division III in *Swanson Hay Co.*, 1 Wn. App. 2d at 192 ("chapter 50.04 RCW defines employment and identifies its exemptions solely for unemployment insurance tax purposes"). This question is well settled, and

the Court of Appeals properly rejected the carriers' contention to the contrary. *Id.* at 192-94. There is no need to review this question further.[6]

Laws that have a "tenuous, remote, or peripheral" relationship to carrier prices, routes, or services are not preempted. *Rowe*, 552 U.S. at 371. The fact that a law is likely to increase a motor carrier's operating costs "alone does not make such law[] 'related to' prices, routes or services." *Dilts v. Penske Logistics, LLC*, 769 F.3d 637, 646 (9th Cir. 2014), *cert. denied*, 135 S. Ct. 2049 (2015). Rather, laws that "do not directly or indirectly mandate, prohibit, or otherwise regulate certain prices routes or services—are not preempted by the FAAAA." *Id.* at 647.

Here, the impact of having to pay unemployment taxes on owner-operators' wages is modest. The *highest* unemployment insurance tax rates are 6–6.5 percent of payroll, and not all wages are taxed. RCW 50.29.025; RCW 50.24.010. The potential for a small increase in taxes is far removed from the nearly 100 percent increase in costs associated with the wholesale reclassification of independent contractors as employees for purposes of multiple laws, as was the case in the First Circuit decisions the carriers rely

[6] Because it is settled as a matter of law that the Act affects classification only for the Act's purposes, System and Hatfield's claim that the Commissioner ignored "*unrebutted* evidence" of the impact on carrier prices, routes, and services based on converting owner-operators to employees, and their rhetoric about a multi-agency task force "bent on eliminating independent contractor relationships," System/Hatfield Pet. 9, 11, are red herrings.

on. *See Massachusetts Delivery Ass'n v. Coakley*, 769 F.3d 11, 15 (1st Cir. 2014). As the Court of Appeals acknowledged, those cases—and the Massachusetts independent contractor law at issue in them—are "inapplicable." *Swanson Hay Co.*, 1 Wn. App. 2d at 196-98.

The unemployment tax is precisely the kind of "generally applicable background regulation[] that [is] several steps removed from prices, routes, or services" that the Ninth Circuit and other courts—including this one—has found to not be preempted. *Dilts*, 769 F.3d at 646 (FAAAA does not preempt California's meal and rest break laws); *Californians for Safe & Competitive Dump Truck Transp. v. Mendonca*, 152 F.3d 1184, 1189 (9th Cir. 1998) (FAAAA did not preempt California's prevailing wage act, despite motor carrier's assertion the act "increases its prices by 25%, causes it to utilize independent contractors, and compels it to re-direct and re-route equipment to compensate for lost revenue"); *Bostain v. Food Express, Inc.*, 159 Wn.2d 700, 721 n.9, 153 P.3d 846 (2007) (following reasoning of *Mendonca*, FAAAA does not preempt state overtime requirements for interstate truck drivers); *Filo Foods, LLC v. City of SeaTac*, 183 Wn.2d 770, 357 P.3d 1040 (2015) (SeaTac's $15-per-hour minimum wage law for employees in the hospitality and transportation industries not preempted by nearly identical preemption provision in the Airline Deregulation Act).

Other courts also have dismissed contentions that imposing an

unemployment tax would require motor carriers to change their business models and reclassify their drivers for other purposes. Far from demonstrating "obstinan[ce]," System/Hatfield Pet. 11, the Court of Appeals conclusion is consistent with that of other courts who have rejected carriers' similar "slippery slope" arguments, asserted without authority, as here. *See Costello v. BeavEx, Inc.*, 810 F.3d 1045, 1056 (7th Cir. 2016) (court rejected carrier's "bare assertion" that complying with the Illinois Wage Payment and Collection Act would require it to classify its drivers as employees for all purposes); *C.R. England, Inc.*, 7 N.E.3d at 880 (applying Illinois' Unemployment Insurance Act to a carrier would not "prohibit motor carriers and drivers from establishing independent contractor relationships outside the context of the Act"). The carriers cite no case holding that the FAAAA or the Airline Deregulation Act on which it is based preempts any tax. The Department is aware of none. To find the unemployment tax preempted would put a cloud over everything from fuel taxes, to business and occupation taxes, to property taxes, and more, because each can be attacked like the unemployment tax.

There is sufficient, uniform judicial guidance concluding that the impact of a state law like Washington's Employment Security Act on motor carriers' prices, routes, and services is too remote and tenuous to invoke FAAAA preemption. Accordingly, this is not an issue of substantial public

importance requiring this Court's determination. RAP 13.4(b)(4).

2. Considering federally mandated controls when applying the Act's independent contractor test has long been the law in Washington, and even if it were not, the carriers exerted control above and beyond the federal regulations

The carriers contend that the Court of Appeals' "reliance on *Western Ports*" to hold that federally mandated controls may be considered when evaluating an employer's control or direction over its workers under the independent contractor test, RCW 50.04.140(1)(a), warrants review under RAP 13.4(b)(4). System/Hatfield Pet.17; Swanson Pet.11-12. They are wrong. The Court of Appeals did not unquestioningly rely on *Western Ports* on this point. Rather, the court engaged in a thorough review of the relevant state statutes and federal regulations and ultimately reached the same conclusion: federally mandated control counts. *Swanson Hay Co.*, 1 Wn. App. 2d at 208-12.

This conclusion is based on the text of the Employment Security Act itself, which must be "liberally construe[d] . . . , viewing with caution any construction that would narrow coverage." *Penick v. Emp't Sec. Dep't*, 82 Wn. App. 30, 36, 917 P.2d 136 (1996); *W. Ports*, 110 Wn. App. at 451 ("[E]xemptions from taxation statutes are strictly construed in favor of applying the tax."). If individuals are in "employment" under RCW

50.04.100, the employer must pay unemployment taxes on their wages "unless and until it is shown to the satisfaction of the commissioner" that:

> (a) Such individual has been and will continue to be free from control or direction over the performance of such service, both under his or her contract of service and in fact; and
> (b) Such service is either outside the usual course of business for which such service is performed, or that such service is performed outside of all the places of business of the enterprises for which such service is performed; and
> (c) Such individual is customarily engaged in an independently established trade, occupation, profession, or business, of the same nature as that involved in the contract of service.

RCW 50.04.140(1); *Affordable Cabs, Inc. v. Emp't Sec. Dep't*, 124 Wn. App. 361, 369, 101 P.3d 440 (2004) (employer must prove all three parts).

To satisfy the first element of the exception test, the carriers needed to prove their drivers were "free from control or direction" over the performance of services, both under the contract of service and in fact. RCW 50.04.140(1)(a). In *Western Ports*, Division I concluded that it is permissible to consider federally required controls in applying the statutory exception test—including the written lease requirements under 49 C.F.R. § 376.12. *W. Ports*, 110 Wn. App. at 453-54. The court explained:

> It would make little sense for the Legislature to have specifically included service in interstate commerce as "employment" only to automatically exempt such service under RCW 50.04.140 based on federal regulations that

> require a high degree of control over commercial drivers operating motor vehicles in interstate commerce . . . .

Id. at 453-54. The court held alternatively that even if it did not consider the federal controls, it would still find Western Ports did not prove this element because it exerted several controls beyond those required by law. *Id.* at 454.

In evaluating the Petitioners' arguments that the *Western Ports* court got it wrong in 2002, Division III examined the Employment Security Act's language and the out-of-state cases that the carriers and amici relied on, and ultimately reached the same conclusion as *Western Ports*: "We see no room in the plain language of the 'freedom from control' requirement for excluding federally mandated control exercised by an employer, and we find nothing strained or unrealistic about including that control in the analysis." *Swanson Hay Co.*, 1 Wn. App. 2d at 212 (analysis at 208-12). This straightforward statutory analysis does not present a reason for review.

The Petitioners assert that federal regulations, specifically 49 C.F.R. § 376.12, are inconsistent with the Commissioner's and Court of Appeals' decisions. Swanson Pet. 11-12; System/Hatfield Pet. 17. 49 C.F.R. § 376.12(c)(4) provides:

> Nothing in the provision required by *paragraph (1)(c)* of this section is intended to affect whether the lessor . . . is an independent contractor or an employee of the authorized carrier lessee. An independent contractor relationship *may* exist when a carrier lessee complies with 49 U.S.C. § 14102 and attendant administrative requirements.

49 C.F.R. § 376.12(c)(4) (emphasis added). "[P]aragraph (1)(c) of this section" includes the required leasing provisions. But the qualifying language about "paragraph (1)(c)" being not "intended to affect" employment classification does not extend to *other* federal safety regulations, such as those contained in 49 C.F.R. Part 395 or Part 396, and which the carriers' owner-operator contracts include.[7] Nothing in the language of 49 C.F.R. § 376.12(c)(4) bars the Department from looking to federally-required contract provisions when assessing employer control.[8]

For this Court's present purposes, longstanding legislative acquiescence in *Western Ports* signals the Legislature's intent. *City of Federal Way v. Koenig*, 167 Wn.2d 341, 346-47, 217 P.3d 1172 (2009). If anything, the *Legislature* may consider the issue of whether the Department

[7] Moreover, the Interstate Commerce Commission's guidance says nothing about barring consideration of the numerous federal regulatory requirements under the state law inquiry. Rather, the ICC has stated that it "take[s] no position on the issue of independence of lessors." 8 I.C.C.2d 669, 671 (1992). While the ICC has made clear that the control regulation should not be deemed "prima facie evidence of an employer-employee relationship," it also has sought to "reinforce [its] view of the neutral effect of the control regulation." *Id.* Thus the ICC is "explicitly agnostic on the issue of the carrier-driver relationship." *Remington v. J.B. Hunt Transport, Inc.*, 2016 WL 4975194 at *5 (D. Mass 2016). Besides, the ICC guidance does not supplant the plain language of the Act, which offers no basis for ignoring required control. *Swanson Hay Co.*, 1 Wn. App. 2d at 210-12.

[8] An independent contractor relationship *may* exist when a carrier lessee complies with 49 U.S.C. § 14102 and attendant administrative requirements." 49 C.F.R. § 376.12(c)(4). The carriers essentially argue this language means an independent contractor relationship "must exist" when a lessee complies with federal regulations. That is not what is says. Whether an independent contractor relationship exists depends on the context and the specific statutory test. Here, given the breadth of unemployment insurance coverage and the specific statutory language, the carriers did not meet the test.

may consider federal controls when applying the independent contractor test.[9] But given the language of the Employment Security Act and the federal regulations, it is not an issue of substantial public interest for this Court. *Swanson Hay Co.*, 1 Wn. App. 2d at 208-12.

Even if this Court granted review to reevaluate whether federal controls may be considered, any conclusion would be immaterial because each carrier imposed additional controls beyond those that are federally required.[10] Thus just as in *Western Ports*, the carriers still would not have established freedom from control or direction because of these additional controls. Accordingly, review should be denied. RAP 13.4(b)(4).

3. The owner-operators' lack of federal operating authority was one of many reasons why Swanson and System did not prove the owner-operators were engaged in independent businesses under RCW 50.04.140(1)(c)

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[9] Indeed, the Legislature has specifically exempted owner-operators from coverage under the Industrial Insurance Act in 1982. RCW 51.08.180; Laws of 1982, ch. 80, § 1. It has never provided for such an exemption under the Employment Security Act.

[10] *See, e.g.*, ARSH2 272-74 (Swanson's requirements to supply auxiliary equipment; to take photos of loads; to make owner-operators bear the costs for damage to freight; and to provide for transfer of shipments if equipment is not in good operating condition); ARST1 25-26, 28, ARST2 372-73 (System's requirements to comply with its policies and procedures and participate in its drug and alcohol program; to cooperate in any investigation, legal action, or regulatory hearing; to equip trucks with all safety devices System required; and, providing for termination for misconduct detrimental to System's business, and requiring operation as System's dispatchers deem necessary); ARH4 1196-97 (Hatfield's requirements to wash and clean equipment and maintain a good public image; to furnish tie-downs and cargo protection gear; to permit Hatfield the right to discuss and recommend actions against agents when they damage customer relations; and to permit Hatfield to take possession of equipment upon breach creating liability to others).

Swanson and System failed to prove the third element of the independent contractor test: that their owner-operators were "customarily engaged in an independently established trade, occupation, profession, or business, of the same nature as that involved in the contract of service." RCW 50.04.140(1)(c); *Swanson Hay Co.*, 1 Wn. App. 2d at 219. This element requires evidence of "an enterprise created and existing separate and apart from the relationship with the particular employer, an enterprise that will survive the termination of that relationship." *Jerome v. Emp't Sec. Dep't*, 69 Wn. App. 810, 815, 850 P.2d 1345 (1993) (quoting *Schuffenhauer v. Dep't of Emp't Sec.*, 86 Wn.2d 233, 238, 543 P.2d 343 (1975)).

Swanson and System argue that the Commissioner should not have considered lack of motor carrier authority in assessing whether the owner-operators had independently established businesses. Swanson Pet.18-20; System Pet. 22.[11] But the Court of Appeals correctly noted that "[t]he Commissioner's point, and a legitimate one, is that if the truck owner's lease ends, he or she will have more entrepreneurial options by holding his or her own operating authority." *Swanson Hay Co.*, 1 Wn. App. 2d at 217.

[11] Swanson and System erroneously claim that owner-operators cannot lawfully use their own motor carrier authority. Swanson Pet. 12-13, 18; System/Hatfield Pet. 22. The Court of Appeals rightly recognized this argument as semantics. *Swanson Hay Co.*, 1 Wn. App. 2d at 217. Nothing in 49 C.F.R. § 376.22, which governs leases *among carriers*, prevents owner-operators from obtaining and hauling under their own authority. They may operate independent businesses if they do so.

Moreover, "The carriers' own evidence and argument suggests that having operating authority is relevant." *Id.* at 218. As another court explained, if owner-operators without their own motor carrier authority "were terminated by [the carrier], in all likelihood they would be out of work until they could make similar arrangements with another carrier." *Stafford Trucking, Inc. v. Dep't of Indus., Labor & Human Rel.*, 306 N.W.2d 79, 84 (Wis. Ct. App. 1981). During the period while they are unemployed and searching for new work, the owner-operators should be covered by unemployment benefits.

Besides, lack of motor carrier authority was only one of many unchallenged findings that supported the Commissioner's conclusion that the carriers failed to prove the independent business element. Those unchallenged findings included that: none of the owner-operators had worked for another carrier in the assessment period; the owner-operators were protected from risk of injury of customer nonpayment; not all of Swanson's owner-operators had registered businesses, and—for those that did—Swanson's contracts were with the individual drivers as opposed to the business entities; and, System presented no evidence that any of its owner-operators had business registrations or licenses, or uniform business identification numbers, or Department of Revenue accounts. *Swanson Hay Co.*, 1 Wn. App. 2d at 217-19; ARSH2 277-79; ARST2 378-80. The Court should reject the carriers' misguided request for review based on the

Commissioner's consideration of one factor. Even if review were granted, and the Court declined to consider lack of motor carrier authority as a factor in the independent business test, the tax assessments would still be affirmed.

The carriers failed to show that the Commissioner's application of the independent contractor statute was wrong under the law or the facts. There is no conflict or issue of public interest. Review should be denied.

4. Even if System and Hatfield had properly challenged the Department's audit conduct, the carriers could not prove that the assessments are arbitrary and capricious or in violation of the carriers' rights

The Court of Appeals declined to consider System and Hatfield's assertions of audit impropriety, because they did not bring that challenge under RCW 34.05.570(4) (for other agency action), but instead proceeded entirely under .570(3), seeking relief from final orders in adjudicative proceedings. *Swanson Hay Co.*, 1 Wn. App. 2d at 219-20. Hence, the "question on appeal, then, is whether their constitutional rights were violated in the administrative appeals process." *Id.* Neither carrier showed how the auditing actions prior to their formal hearing violated their rights.

But even if System and Hatfield had properly sought judicial review of the audits as "agency action" that occurred before the adjudicative proceeding, there is no reason for this Court to grant review or relief. First, as to System and Hatfield's due process claims that the audits were

predetermined, politically motivated, and did not comply with internal manuals, the Court of Appeals properly ruled that System and Hatfield are not legally entitled to particular audit procedures when applying the Act. *Swanson Hay Co.*, 1 Wn. App. 2d at 222. Internal audit procedures are not law. *Joyce v. Dep't of Corr.*, 155 Wn.2d 306, 323, 119 P.3d 825 (2005). And, as the Court of Appeals held, a substantive due process claim requires deprivation of life or a protected liberty or property interest. *Swanson Hay Co.*, 1 Wn. App. 2d at 223. System and Hatfield's petition does not argue how this showing is met, and the Court of Appeals properly held it is not, *id.*, which is fatal to the constitutional claims.

While some of System and Hatfield's other allegations about arbitrary and capricious conduct were not addressed by the Court of Appeals given its rulings, their arguments are devoid of merit. For example, the claims they label as "arbitrary and capricious action" are really requests to reweigh evidence and make new findings.[12] Further, System and Hatfield

[12] Based on evidence presented at the de novo administrative hearing, the Commissioner found no impropriety in System's audit—*see* ARST2 365-66 (finding the auditor conducted pre-audit research, suggesting that employers selected for audit had most likely erred in classifying workers as independent contractors); ARST3 193, 222-23 (auditor deposition); ARST3 191 (auditor deposition testimony that another carrier "didn't disagree that they should be reporting, but they asked that we continue auditing trucking companies because they want to be able to play on a level playing field")—or in Hatfield's audit—*see* ARH4 1141-42, ¶¶ 4.9, 4.18 and ARH2 378 and ARH4 1141, ¶¶ 4.4, 4.5; ARH1 135-43; ARH8 Ex. Q, R, X, Y, Z (assessment calculated based on total remuneration reported on IRS 1099 forms as "nonemployee compensation," with none reported as "rents" for equipment); ARH2 674-75 ¶ 4.8 and ARH2 395, 586-87 (Hatfield provided no records on which a contrary calculation could be made); ARH2 408 (bifurcation of

cannot establish the audit process violated their rights when they had de novo hearings to try to prove the assessments were incorrect and in which they were not prejudiced in their ability to present a defense. *Motley-Motley, Inc. v. State*, 127 Wn. App. 62, 81, 110 P.3d 812 (2005). They failed to show any error in the findings or legal conclusions that the tax applies here.

The Commissioner found that the Department did not act with improper motive or otherwise act arbitrarily or capriciously, and the Commissioner's findings are supported by substantial evidence; it is not this Court's role to make new or contrary findings, as System and Hatfield's assertions would require. *See* System/Hatfield Pet. 23-24.

V. CONCLUSION

The Department respectfully asks the Court to deny review.

RESPECTFULLY SUBMITTED this 29th day of January, 2018.

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payments as equipment rental and wages had been applied in settlement negotiations in other cases, but that did not apply to this case); ARH2 399 (testimony that Department would consider reducing the assessment if the carrier produced records showing wage payment amounts for personal services performed, which it did not do); ARH2 378 (auditor testimony that he believed he followed the statute on taxes on wages). It cannot be said based on the records of the cases that the Department's action was willful and unreasoning or in disregarding of attending facts and circumstances. *Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n*, 148 Wn.2d 887, 904, 64 P.3d 606 (2003).

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I certify under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

DATED this 29 day of January, 2018, at Olympia, Washington.

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