FILED
COURT OF APPEALS
DIVISION II
2017 MAR -1 AM 10: 11
STATE OF WASHINGTON
BY

No. 49646-1-II

COURT OF APPEALS,
DIVISION II,
OF THE STATE OF WASHINGTON

GULICK TRUCKING, INC., a Washington corporation,

Appellant,

v.

STATE OF WASHINGTON, EMPLOYMENT SECURITY DEPARTMENT,

Respondent.

APPELLANT'S OPENING BRIEF

Aaron P. Riensche, WSBA #37202
Attorneys for Appellant
OGDEN MURPHY WALLACE, P.L.L.C.
901 Fifth Avenue, Suite 3500
Seattle, Washington 98164-2008
Tel: 206.447.7000/Fax: 206.447.0215

ORIGINAL

TABLE OF CONTENTS

Page

A. INTRODUCTION AND SUMMARY OF ARGUMENT 1
B. ASSIGNMENT OF ERROR 3
The Error Below 3
Issues Pertaining to Assignment of Error 3
C. STATEMENT OF THE CASE.....4
1. Owner-Operators in the Trucking Industry.....4
2. Gulick's Operations 5
3. The Gulick Audit 8
4. Procedural History 9
a. Pretrial Matters.....9
b. Trial.....10
c. Further Appeal 11
D. ARGUMENT.....11
1. Standard of Review.....11
2. Owner-operators are independent contractors. 12
a. Owner-operators are free from control over the methods and details of their work. 13
i. The CRO should not have considered federally required terms. 15
ii. General contractual rights do not establish control. 19
iii. Control over leased equipment is not control over the worker. 22
iv. The mere fact that a contract sets out the contractor's obligations does not mean that the contractor is controlled as to the methods and details of the work. 23
v. Liquidated damages are not evidence of control. 24
b. Owner-operators work over the open road, not at Gulick's places of business. 25
c. Owner-operators are engaged in an independently established trade, occupation, or business. 27
d. Gulick proved the independent-contractor exception. 30

3. Federal law preempts ESD's interference with Gulick's business model. 31
a. FAAAA preemption is broad. 31
b. Preemption arises when a state reclassifies owner-operators as employees. 34
c. The cases relied upon by ESD are inapposite. 38
d. ESD's reclassification scheme relates to carriers' prices, routes, or services. 42
i. ESD attempts to restructure the trucking industry by prohibiting the use of independent contractors. 42
ii. The unemployment tax interferes with Gulick's incentive structure. 47
iii. ESD's punitive tax rate penalizes the use of owner-operators as a flexible supply of equipment. 48
E. CONCLUSION 49

APPENDIX A-1

TABLE OF AUTHORITIES

Page

Tables of Cases

AGAT Transp., Inc. v. Employment Dep't
256 Or. App. 294, 305 P.3d 122 (2013).....21

Am. Trucking Associations, Inc. v. City of Los Angeles
559 F.3d 1046 (9th Cir. 2009) 34

Am. Trucking Associations, Inc. v. City of Los Angeles
No. CV 08-4920CASCTX, 2009 WL 1160212, (C.D. Cal. Apr., 28, 2009)
affirmed in part, 596 F.3d 602, 604-05 (9th Cir. 2010).....34

Ashley v. Lance
80 Wn.2d 274, 493 P.2d 1242 (1972).....24

Bostain v. Food Express, Inc.
159 Wn.2d 700, 153 P.3d 846 (2007).....41

Bozung v. Condo. Builders, Inc.
42 Wn. App. 442, 711 P.2d 1090 (1985).....20

CEVA Freight, LLC v. Employment Dep't
279 Or. App. 570, 379 P.3d 776, 781,
review denied, 360 Or. 751 (2016) 18, 21 22

C.R. England, Inc. v. Dep't of Employment Sec.
2014 IL App (1st) 122809, 7 N.E.3d 864 (2014) 41

Californians for Safe & Competitive Dump Truck Transp. v. Mendonca
152 F.3d 1184 (9th Cir. 1998) 40

Caplan v. Sullivan
37 Wn. App. 289, 679 P.2d 949 (1984).....20

Cole v. City of Dallas
314 F.3d 730 (5th Cir. 2002) 31

Cornelius v. Wash. Dep't of Ecology
182 Wn.2d 574, 344 P.3d 199 (2015).....12

Costello v. BeavEx, Inc.
810 F.3d 1045 (7th Cir. 2016) 41, 42

Dan's City Used Cars, Inc. v. Pelkey
133 S. Ct. 1769, 185 L.Ed.2d 909 (2013) 33

DiFiore v. Am. Airlines, Inc.
646 F.3d 81 (1st Cir. 2011) 36

Dilts v. Penske Logistics, LLC
769 F.3d 637 (9th Cir. 2014) 40

Filo Foods, LLC v. City of SeaTac
183 Wn2d 770, 357 P.3d 1040 (2015) 40

Forest Mktg. Enterprises, Inc. v. State, Dep't of Natural Res.
125 Wn. App. 126, 104 P.3d 40 (2005) 24

Hennig v. Crosby Group, Inc.
116 Wn.2d 131, 802 P.2d 790 (1991) 21

Hernandez v. Triple Ell Transp., Inc.
175 P.3d 199 (Idaho 2007) 18

In re EVIC Class Action Litig., No. 21md84 et al.
2002 WL 1766554 (S.D. N.Y. July 31, 2002 34

In re Fed. Preemption of Provisions of the Motor Carrier Act
223 Mich. App. 288, 566 N.W.2d 299 (1997)
review denied, 587 N.W.2d 632 (Mich. 1998)
cert. denied, 525 U.S. 1018 (1998) 35

In re Marriage of Gimlett
95 Wn.2d 699, 701, 629 P.2d 450 (1981) 20

Jerome v. Employment Sec. Dep't
69 Wn. App. 810, 850 P.2d 1345 (1993) 13, 27

Kamla v. Space Needle Corp.
147 Wn.2d 114, 52 P.3d 472 (2002) 20, 21

Lane v. Wahl
101 Wn. App. 878, 6 P.3d 621 (2000) 23

Massachusetts Delivery Ass'n v. Coakley
769 F.3d 11 (1st Cir. 2014) 32, 34

Massachusetts Delivery Ass'n v. Healey
821 F.3d 187 (1st Cir. 2016).....35, 37, 38, 42, 47

Miller v. Employment Sec. Dep't
3 Wn. App. 503, 476 P.2d 138 (1970).....13

Morales v. Trans World Airlines, Inc.
504 U.S. 374, 112 S. Ct. 2031,
119 L.Ed.2d 157 (1992).....32, 33, 39

Morris v. JTM Materials, Inc.
78 S.W.3d 28 (Tex. App. 2002).....17

N. Pac. Ry. Co. v. Longmire
104 Wash. 121, 176 P. 150 (1918).....40

Nat'l Electrical Contractors Ass'n v. Employment Sec. Dep't
109 Wn. App. 213, 34 P.3d 860 (2001).....11

Penick v. Emp't Sec. Dep't
82 Wn. App. 30, 917 P.2d 136 (19960 44

Pouliot v. Paul Arpin Van Lines, Inc.
292 F.Supp.2d 374 (D. Conn. 2003).....19

Risher v. Dep't of Labor & Indus.
55 Wn.2d 830, 350 P.2d 645 (1960).....13

Rowe v. New Hampshire Motor Transport Ass'n
552 U.S. 364, 128 S. Ct. 989,
169 L.Ed.2D 933 (2008).....32, 33, 34, 39, 40, 45

Ruiz v. Affinity Logistics Corp.
887 F.Supp.2d 1034, (S.D. Cal. 2012).....19

S.S. v. Alexander
143 Wn. App. 75, 177 P.3d 724 (2008).....39

SZL, Inc. v. Indus. Claim Appeals Office
254 P.3d 1180 (Colo. App. 2011).....40

Schwann v. FedEx Ground Package Sys., Inc.
813 F.3d 429 (1st Cir. 2016).....35, 36, 37, 38, 42, 45, 47, 48

Seattle Aerie No. 1 of Fraternal Order of Eagles v. Commissioner of Unempl. Comp. and Placement
23 Wn.2d 167, 160 P.2d 614 (1945) 19, 20, 21

Sida of Hawaii, Inc. v. NLRB
512 F.2d 354 (9th Cir. 1975) 19

Tamez v. SW. Motor Transp., Inc.
155 S.W.3d 564 (Tex. App. 2004) 17, 18, 19

UPS Store, Inc. v. Hagan
No. 14CV1210, 2015 WL 9256973
(S.D. N.Y. Nov. 18, 2015) 34

United Parcel Serv., Inc. v. Flores-Galarza
318 F.3d 323 (1st Cir. 2003) 34

Washington Trucking Ass'ns v. State, Emp't Sec. Dep't
192 Wn. App. 621, 369 P.3d 170
review granted sub nom.,
186 Wn.2d 1016, 380 P.3d 522 (20160 43

Watson v. Ingram
124 Wn.2d 845, 881 P.2d 247 (1994) 24

Western Ports Transp., Inc. v. Employment Sec. Dep't of State of Wash
110 Wn. App. 440, 41 P.3d 510 (2002) 18, 38, 39, 40

Wilkinson v. Palmetto State Transp. Co.
676 S.E.2d 700 (S.C. 2009)
cert. denied, 130 S. Ct. 741 (2009) 19

Statutes

49 U.S.C. § 14102 ..... 6, 16
49 U.S.C. § 14501 ..... 2, 31, 32, 36, 38, 39, 50
49 U.S.C. § 14502 38
MASS. GEN. LAWS ch. 149 § 148B(a) 35
RCW 34.05.570 12
RCW 50.04.100 10

RCW 50.04.140 ..... 2, 3, 10, 11, 13, 20,25, 26, 27, 30 31, 35, 44, 49
RCW 50.20.050 47
RCW 50.24.160 48
RCW 50.29.021 48
RCW 50.29.025 48
RCW 50.32.120 12
RCW 50.32.150 12
RCW 50.32.180 12

Regulations and Rules

49 C.F.R. § 376.11 ..... 6, 16
49 C.F.R. § 376.12 ..... 6, 16, 17, 38
49 C.F.R. § 376.22 16
49 C.F.R. § 379, app. A 16
49 C.F.R. § 385.5 16
49 C.F.R. § 390.11 16
49 C.F.R. § 390.21 29
49 C.F.R. § 392.60 16
49 C.F.R. § 396.3 16
WAC 192-320-005 48

Other Authorities

1994 U.S.C.C.A.N. 31

H.R. CONF. REP. NO. 103-677 ..... 31, 32

Lease & Interchange of Vehicles — Declaratory Order"
1994 Fed. Carrier Cas. P 38121, 1994 WL 70557
(I.C.C. March 8, 1994) 16

Petition to Amend Lease & Interchange of Vehicle Regulations
8 I.C.C.2d 669 (I.C.C. June 29, 1992) 17

A. INTRODUCTION AND SUMMARY OF ARGUMENT

For as long as people have used trucks to haul freight, the American trucking industry has been organized around the use of independent "owner-operators," truck drivers who own their own trucks. This century-old business model provides trucking companies—typically called "motor carriers" or simply "carriers"—operational flexibility. Most carriers have "employee drivers," also called "company drivers," who drive equipment owned by the carrier. But if a carrier does not have equipment available to transport a load, it may offer the work to an owner-operator. In this way, carriers can respond to fluctuating demand for hauling services without having to keep expensive equipment on hand that would sit idle during leaner times. Owner-operators, in turn, are able to establish small businesses with greater freedom and earning potential than they would have as company drivers.

This case is about Washington State's attempts to disrupt that long-established business model. Although owner-operators have historically been considered independent contractors, respondent Employment Security Department ("ESD") now seeks to require all carriers in the state to treat owner-operators as employees. To this end, ESD assessed unemployment taxes, penalties, and interest on Gulick Trucking, Inc.

("Gulick") for remuneration paid to owner-operators, and ESD's commissioner affirmed that assessment after an administrative trial.

Gulick appeals that decision on two grounds. First, owner-operators are independent contractors as that term is defined in the Employment Security Act. Under RCW 50.04.140(1), a worker is an independent contractor, and therefore not subject to unemployment taxes, if the employer establishes three elements. ESD has adopted a legally erroneous interpretation of these elements under which no owner-operator could ever qualify as an independent contractor. Under any reasonable interpretation, Gulick established these elements overwhelmingly at trial.

Second, ESD's attempt to deprive the entire trucking industry of the benefits of the independent-contractor exception is a deliberate interference in a federally protected industry. The Federal Aviation Administration Authorization Act ("FAAAA"), at 49 U.S.C. § 14501(c)(1), prohibits any state action "related to a price, route, or service" of any carrier. ESD directly violates that prohibition by attempting to force the State's preferred business model onto carriers. As such, this Court must reverse the ESD commissioner's decision, with instructions to set the improper assessment aside.

B. ASSIGNMENT OF ERROR

The Error Below

The trial court erred in entering its October 11, 2016 order entitled "Findings of Fact Conclusions of Law and Order; Judgment; Judgment Summary," which affirmed ESD's erroneous August 28, 2015 Decision of Commissioner.

Issues Pertaining to Assignment of Error

1. Under RCW 50.04.140(1), workers are independent contractors if they work free from the employer's control and outside its places of business and are independently established. The evidence showed that: (a) Gulick does not control the method and detail of owner-operators' work; (b) owner-operators work on the open road; and (c) owner-operators make an enormous investment in establishing their own small businesses. Does the independent-contractor exception apply?

2. The FAAAA preempts state action that relates to a price, route, or service of any motor carrier. By forcing carriers to treat owner-operators as employees, ESD restructures longstanding industry dynamics, interferes with carriers' choices of business model, and penalizes carriers for using a system that responds efficiently to customers' needs. Is ESD's *en masse* owner-operator reclassification preempted by federal law?

C. STATEMENT OF THE CASE

1. Owner-Operators in the Trucking Industry

Owner-operators have long been important in the trucking industry. CR1[1] at 92. They are used in most, if not all, sectors of the industry, including long-haul trucking, household-goods moving, and intermodal operations. *Id.* The contemporary American trucking industry, as a business with dramatically fluctuating demand, is structured around independent owner-operators who contract with carriers for the lease of trucking equipment. *Id.*

An independent-contractor relationship is attractive to carriers and owner-operators alike. For carriers, working with owner-operators allows them to simplify their operations. *Id.* at 93. Owner-operators also have a commitment to their businesses, with its attendant risks and rewards, which promotes a more profitable arrangement for both the carrier and the owner-operator. *Id.* at 98.

For owner-operators, an independent-contractor relationship offers great benefits. Today's shippers are sophisticated and now look for "one stop" shopping for their shipping needs. *Id.* at 94. It would thus be extremely difficult for an individual owning a single truck to compete for shipping business. *Id.* By working with large carriers as independent

[1] The Commissioner's Record is cited herein as "CR" followed by the volume number.

contractors, owner-operators can overcome this obstacle and still maintain the freedom and potential profits associated with being small-business owners. *Id.* The carriers give owner-operators access to higher-paying freight than they would have if they operated under their own authority. *Id.* at 105–06. Carriers also handle administrative tasks that would be difficult for an individual owner-operator to manage alone while also driving a truck full time. CR2 at 828, 899, 923–24, 939.

2. **Gulick's Operations**

Willard Gulick, Sr. founded Gulick in 1973. CR2 at 794. The company is now owned by his two sons and their childhood friend. *Id.* Gulick is a "refrigerated carrier," meaning that most of the freight it hauls consists of refrigerated goods. *Id.* at 808.

Although Gulick is based in Washington State, it has operations throughout the 48 contiguous United States, and only a small percentage of its mileage is actually driven in Washington. CR1 at 97. As such, it competes with many different carriers throughout the country. *Id.* at 100. Because it is headquartered in Vancouver, Washington, some of its competitors are located just a few miles away, in the Portland, Oregon area, and are not subject to ESD's jurisdiction. *Id.* at 99.

Like many carriers, Gulick relies on independent owner-operators to meet fluctuating demand. *Id.* at 97. It hires employee drivers, who drive equipment owned by Gulick, and it contracts with owner-operators who provide equipment that they own. During the pertinent time, it had contracts with 152 owner-operators. *Id.* Gulick engages owner-operators with the understanding that there will likely be periods in the near future in which their services are not needed due to shifts in demand. *Id.* at 101.

Federal law requires Gulick to engage owner-operators through an equipment-lease contract.[2] 49 U.S.C. § 14102; 49 C.F.R. § 376.11(a). Federal regulations provide detailed terms that must be included in the contract. *See, e.g.*, 49 C.F.R. §§ 376.11, 376.12. The purpose of those requirements is to promote safety by ensuring that all commercial motor vehicles are adequately insured and by facilitating the collection of safety data. CR1 at 92–93.

Although the equipment is leased to Gulick, owner-operators are free to accept or reject the loads that Gulick makes available. CR2 at 892-93, 922–23, 940–41. Gulick typically offers loads to owner-operators via an electronic telecommunications device, called MobileComm or QualComm, installed in the truck. *Id.* at 880, 891. Gulick conveys the

[2] The parties each submitted three sample contracts into the record, one from each year in question. *See* CR1 at 327–56, 593–621. There is no material difference among these versions. *See* CR2 at 842–44.

essential information (price, origin, destination) along with any special instructions from the customer (such as the pickup appointment and the required delivery date). *Id.* at 892. Gulick provides no instructions beyond those passed on from the customer. *Id.* at 803.

If owner-operators choose to accept a load, they decide what route to take from the origin to the destination. *Id.* at 894, 923, 940. Once they deliver the load, Gulick will typically offer them another. *Id.* at 902. The new load might take them back home or to somewhere else in the country. *Id.* at 905. If owner-operators do not like the loads offered by Gulick, they will often find their own loads. *Id.* at 904, 941.

Gulick and the owner-operators split the fee paid by the customer, 80% to the owner-operator and 20% to Gulick. *Id.* at 898, 924, 937. Owner-operators take 87% if they use their own trailers. CR1 at 597, CR2 at 938. The work usually also includes a "fuel surcharge," which is paid 100% to the owner-operator. *Id.* at 829.

From their shares, owner-operators must pay all costs associated with operating the equipment, including fuel, maintenance, repairs, insurance, etc. CR2 at 899–900, 925–26, 937-38. Gulick advances some costs to owner-operators, but ultimately deducts those charges from the owner-operators' settlement. *Id.* at 836. Some owner-operators hire

employees to operate the equipment and are responsible for all payroll costs. CR1 at 595; CR2 at 922.

3. **The Gulick Audit**

The Gulick audit was conducted by Darith Lim ("Lim"), an auditor in ESD's Underground Economy Unit. CR2 at 656. The Legislature created the Underground Economy Task Force in 2007 to study the impact of the "underground economy" in the construction industry.[3] This was a joint effort among ESD, the Department of Revenue, and the Department of Labor & Industries.[4] Rather than focus on construction, ESD's Underground Economy auditors targeted the trucking industry.

In his 3.5 years as an ESD auditor, Lim audited more trucking companies than he could count. *See* CR2 at 657. He estimated the number at between fifty and sixty. *Id.* at 658. The mere fact that a coworker had seen trucks parked near her home on State Route 500 was sufficient to trigger the Gulick audit. *Id.*

ESD approached this audit with liability predetermined. At the beginning of the audit, Lim and his supervisor, Una Wiley, met with Gulick's controller, Don Adams ("Adams"). *Id.* at 845. Before the auditors had reviewed any Gulick documents, and before they had even

[3] http://www.lni.wa.gov/Main/Docs/UEBenchmarkFY2011.pdf, at p. 23 (last visited June 7, 2016).
[4] *See id., passim.*

seen the contract on which ESD would later claim to base its decision, they told Adams that they did not have authority to rule that owner-operators could be anything other than employees. *Id.* at 846–47.

4. **Procedural History**

In April 2013, Lim notified Gulick that he had reclassified 120 independent contractors as Gulick's "employees." CR1 at 386. Based on this predetermined result, ESD issued its assessment in May 2013. CR1 at 306. It assessed unemployment taxes, penalties, and interest against Gulick in the amount of $155,133.33. *Id.* at 307. Gulick timely appealed to the Office of Administrative Hearings ("OAH"). *Id.* at 309.

a. Pretrial Matters

Because the assessment failed to specify which workers were reclassified as employees or the grounds on which this reclassification was made, Gulick was forced to request this information through written discovery. ESD eventually provided a list of reclassified workers. CR1 at 47, 52–60. With one exception, all were owner-operators. *Id.* at 102.

Gulick moved for summary judgment, arguing that owner-operator reclassification was preempted by the FAAAA. The OAH denied the motion. CR1 at 172–73. The parties agreed that this ruling decided the preemption issue in ESD's favor as a matter of law. *Id.* at 294.

b. Trial

The matter proceeded to trial in September 2014. The parties stipulated to a corrected assessment amount of $112,855.17.[5] CR1 at 282. With the amount stipulated and the preemption issue already decided, the sole question was whether the owner-operators were properly reclassified as Gulick's employees under the Employment Security Act. CR1 at 282.

Lim was ESD's only witness. His testimony consisted primarily of legal opinions about terms in the Gulick/owner-operator lease agreement and how they should be viewed under the Employment Security Act. *See* CR2 at 671–90.

Gulick presented four witnesses. In addition to Adams, three owner-operators—Kelly Matlock ("Matlock"), Latina DeJean ("DeJean"), and Hardy Carnes ("Carnes")—testified regarding their operations and their relationships with Gulick. *See id.* at 791–946.

The OAH issued an Initial Order in November 2014. CR2 at 1085. It found that ESD had shown that owner-operators provided personal services for wages to Gulick under RCW 50.04.100. *Id.* at 1088. It further found that Gulick could not establish the independent-contractor exception under RCW 50.04.140(1). *Id.* at 1089. On this latter point, it

[5] The reduction was based on the statute of limitations, which required ESD to exclude certain quarters that had been erroneously included in the assessment. *See* CR1 at 281.

found that Gulick could not meet the first element of the test—i.e. that Gulick could not show that owner-operators were free from its direction or control—and that it was thus unnecessary to address the other two elements. *Id.*

c. Further Appeal

Gulick timely petitioned for review by the ESD Commissioner's Review Office ("CRO"). CR2 at 1093. In addition to affirming the OAH's findings (*id.* at 1128–33), the CRO entered additional findings on the second and third elements of RCW 50.04.140(1), finding Gulick had not shown that owner-operators perform their work outside of Gulick's places of business or that they were engaged in an independently established business, trade, or occupation. *Id.* at 1133–39. The CRO affirmed the assessment in the stipulated amount. *Id.* at 1139. Gulick appealed to the Clark County Superior Court, which affirmed the CRO. CP 192. Gulick then filed a timely notice of appeal to this Court. CP 197.

D. ARGUMENT

1. Standard of Review

The Administrative Procedures Act ("APA"), Ch. 34.05 RCW, governs judicial review of agency decisions on unemployment taxes. *Nat'l Electrical Contractors Ass'n v. Employment Sec. Dep't*, 109 Wn.

App. 213, 219, 34 P.3d 860 (2001). The Employment Security Act provides that review must be had in accordance with RCW 34.05.570. *See* RCW 50.32.120.

On appellate review, this Court sits in the same position as the trial court and applies the APA to the administrative record. *Cornelius v. Wash. Dep't of Ecology*, 182 Wn.2d 574, 585, 344 P.3d 199 (2015). The APA identifies certain errors for which relief is mandatory, including that an agency order violates the Constitution, that the agency has erroneously applied the law, and that the order is not supported by substantial evidence. RCW 34.05.570(3). The Court must reverse or modify if it determines that the commissioner has not correctly construed the law. RCW 50.32.150. In such a case, the Court "shall refer the same to the commissioner with an order directing him or her to proceed in accordance with the findings of the court." *Id.* The Court may determine the "justness or correctness" of an assessment. RCW 50.32.180.

2. **Owner-operators are independent contractors.**

The CRO erred in finding that Gulick had not established the statutory independent-contractor exception. This exception applies where: (a) the worker is "free from control or direction" over the performance of services; (b) the worker performs such services outside of the employer's

"usual course of business" or "places of business"; and (c) the worker is engaged in an "independently established trade, occupation, profession, or business." RCW 50.04.140(1). A worker is exempt from coverage under the Employment Security Act if the employer proves all three statutory requirements. *Miller v. Employment Sec. Dep't*, 3 Wn. App. 503, 505, 476 P.2d 138 (1970). All three are satisfied here.

a. Owner-operators are free from control over the methods and details of their work.

The first element contemplates control over the "***methods and details of doing the work***." *Jerome v. Employment Sec. Dep't*, 69 Wn. App. 810, 816, 850 P.2d 1345 (1993) (emphasis added) (quoting *Risher v. Dep't of Labor & Indus.*, 55 Wn.2d 830, 834, 350 P.2d 645 (1960)). ESD's Status Manual advises auditors that "direction or control" in the truck-driving context, means close supervision:

> Test (1)(a) can be met if there is ***no close or continued supervision*** of the operation of the truck by the lessee. This means that the owner-operator (leaser) of the truck normally has the right to ***hire and fire any driver of that truck, set wage amounts, select routes to be driven and establish or approve procedures for loading and unloading***.

CR1 at 545 (emphasis added).

The CRO essentially conceded that this standard was met, noting that the following facts show owner-operators' autonomy:

- Owner-operators "are free to accept or reject any loads offered by Gulick";
- They "can contact other brokers directly and arrange their own loads";
- They "select the routes they use in making the deliveries";
- They "are responsible for proper and secure loading";
- They are "responsible for all costs incurred in operation and maintenance of the equipment, including fuel and service costs, repair and maintenance costs, taxes, tolls, and other charges, fines, and fees";
- They "maintain various insurances, such as liability and property damage insurance, collision and specified insurance, and non-trucking use/bobtail liability insurance, at their own expense"; and
- They "have the right to employ drivers and are solely responsible for hiring, firing, supervision, training, working conditions, hours and compensation of their employees."

CR2 at 1128–29.

What the CRO omitted is the lease agreement's express provision that Gulick "shall have no right to and shall not control the manner or prescribe the method of accomplishing the services required by this Agreement, except as necessary for the Carrier to comply with applicable law." CR1 at 349. Thus, it would be a breach of contract for Gulick to exert any control over owner-operators beyond legal requirements.

The CRO, however, found that Gulick had not proven this element. It did so by culling through the lease agreement and highlighting various provisions that are "generally incompatible" with freedom from direction or control. CR2 at 1130. That superficial analysis was legally wrong.[6]

The terms relied on by the CRO all fit into at least one of five categories: (1) terms required by federal law; (2) general contractual rights; (3) terms showing control over the leased equipment; (4) terms that merely set out obligations undertaken by owner-operators in exchange for consideration; and (5) liquidated damages. It was error to consider these terms as evidence of control.

i. The CRO should not have considered federally required terms.

Most of the contract terms that the CRO identified as showing control were mandated by federal leasing regulations under authority

[6] For the Court's reference, the CRO's list of terms allegedly showing control, along with a summary of Gulick's arguments about those terms, is attached hereto as an Appendix.

delegated by Congress in 49 U.S.C. § 14102.[7] Using those terms to establish an employment relationship contravenes the letter and spirit of those regulations. By their express terms, the leasing regulations are ***not*** "intended to affect whether the lessor or driver provided by the lessor is an independent contractor or an employee of the authorized carrier lessee," and 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 Interstate Commerce Commission ("ICC") promulgated these regulations to make it easier for injured third parties to assign responsibility for trucking accidents. *See Lease & Interchange of Vehicles – Declaratory Order*, 1994 Fed. Carrier Cas. P 38121, 1994 WL 70557, *6 (I.C.C. March 8, 1994). It did so by requiring the carriers to lease owner-operators' equipment and "assume full direction and control of the

[7] *See* CR2 at 1129–30. *Cf.* 49 C.F.R. §§ 376.11(c) (requiring carrier to identify leased equipment as being in its service), 376.11(d)(1) (documentation must clearly indicate that the transportation is under the carrier's responsibility), 376.12(c)(1) (requiring carrier to take exclusive, use, possession, and control of and full responsibility for the leased equipment), 376.12(e) (requiring the lease to clearly specify which party is responsible for removing identification devices from the equipment upon lease termination), 376.22 (requiring written agreement for a carrier to lease equipment that is under lease to another carrier), 379 app. A (specifying required retention periods for various categories of records and reports, including shipping documents and inspection and repair reports), 385.5 (unqualified drivers and improperly driven vehicles adversely affect carrier's safety rating), 390.11 (carrier must require drivers to observe all duties imposed by Federal Motor Carrier Safety Regulations), 392.60 (requiring carrier to give written authorization for any passengers), 396.3 (carriers must systematically inspect or cause to be inspected all vehicles subject to their control and keep inspection and maintenance records).

vehicles . . . 'as if they were the owners of such vehicles.'" *Tamez v. SW. Motor Transp., Inc.*, 155 S.W.3d 564, 572 (Tex. App. 2004) (quoting *Morris v. JTM Materials, Inc.*, 78 S.W.3d 28, 37 (Tex. App. 2002)).

The ICC later enacted 49 C.F.R. § 376.12(c)(4) specifically to prevent states from using regulatory compliance as proof of an employment relationship in contexts beyond responsibility for accidents. The ICC explained that "***most courts have correctly interpreted the appropriate scope of the control regulation and have held that the type of control required by the regulation does not affect 'employment' status*** . . . ." *Petition to Amend Lease & Interchange of Vehicle Regulations*, 8 I.C.C.2d 669, 671 (I.C.C. June 29, 1992) (emphasis added). But "some courts and State workers' compensation and ***employment agencies***" had improperly used compliance with the leasing regulations as "prima facie evidence of an employer-employee relationship" and had erroneously found that it "evidences the type of control that is indicative of an employer-employee relationship." *Id.* (emphasis added). The ICC thus adopted § 376.12(c)(4) to reinforce its "view of the ***neutral effect of the control regulation***" and to save tribunals time and "***lessen the likelihood that they will reach the wrong conclusions***." *Id.* (emphasis added).

Division One of this Court does not appear to have been aware of that history when it wrongly permitted ESD to consider federally required contract terms as evidence of control in *Western Ports Transp., Inc. v. Employment Sec. Dep't of State of Wash.*, 110 Wn. App. 440, 453–54, 41 P.3d 510 (2002). There, the court focused on the fact that the federal leasing regulations require the same degree of control whether the drivers are designated as employees or independent contractors. *Id.* at 454. But, again, the federal regulations are designed to make carriers responsible for accidents whether the equipment was driven by an independent contractor or an employee. *See Tamez*, 155 S.W.3d at 573. It is thus unremarkable that they require the same control over both types of drivers.

Multiple courts around the country since *Western Ports* have rejected the notion that a state can use compliance with the leasing regulations as evidence of an employment relationship. *See, e.g.*, *Hernandez v. Triple Ell Transp., Inc.*, 175 P.3d 199, 205 (Idaho 2007) ("adherence to federal law" was not evidence of a carrier's control over an owner-operator); *CEVA Freight, LLC v. Employment Dep't*, 279 Or. App. 570, 379 P.3d 776, 781, *review denied*, 360 Or. 751 (2016) (federal requirements "do not suggest a conclusion one way or the other concerning [carrier]'s relationship with its owner-operators or whether

they were employees or independent contractors").[8] This Court should do the same and hold that the CRO erred to the extent it relied on federally required contract terms in finding an employment relationship.

ii. General contractual rights do not establish control.

Our Supreme Court has long held that a principal may retain certain general contractual rights without destroying a contractor's independence. *See Seattle Aerie No. 1 of Fraternal Order of Eagles v. Commissioner of Unempl. Comp. and Placement*, 23 Wn.2d 167, 172, 160 P.2d 614 (1945). In *Seattle Aerie No. 1*, the court held that the Eagles were not obligated to pay unemployment compensation for musicians performing at Eagles' dances, noting that an independent contractor is "one who, exercising an independent employment or occupation, contracts to do a piece of work according to his own idea or in accordance with plans previously furnished to him by his employer and has the right to select his own assistants." *Id.* "A reservation by the employer of the right

[8] *See also Wilkinson v. Palmetto State Transp. Co.*, 676 S.E.2d 700, 705 (S.C. 2009), *cert. denied*, 130 S. Ct. 741 (2009) (federal regulation "is not intended to affect" the independent-contractor determination under state law); *Tamez*, 155 S.W.3d at (leasing regulations are not intended to "have any impact on the type of relationship that exists between the carrier-lessee and the contractor-lessor") (quoting *Pouliot v. Paul Arpin Van Lines, Inc.*, 292 F.Supp.2d 374, 383 (D. Conn. 2003)); *Ruiz v. Affinity Logistics Corp.*, 887 F.Supp.2d 1034, 1041 n. 7 (S.D. Cal. 2012) ("fact that a putative employer incorporates into its regulations controls required by a government agency does not establish an employer-employee relationship") (citing *Sida of Hawaii, Inc. v. NLRB*, 512 F.2d 354, 359 (9th Cir. 1975)).

by himself to supervise the work for the purpose of merely determining whether it is being done in conformity to the contract does not affect the independence of the relationship." *Id.*

The test is akin to the traditional common-law test for control. Because the Legislature did not define the term "control or direction" in RCW 50.04.140(1)(a), it is presumed to have meant the term to conform to its common-law meaning. *Caplan v. Sullivan*, 37 Wn. App. 289, 292, 679 P.2d 949 (1984) (citing *In re Marriage of Gimlett,* 95 Wn.2d 699, 701, 629 P.2d 450 (1981)).

Our Supreme Court has identified certain types of terms, described as "general contractual rights," which do not establish control at common law. *Kamla v. Space Needle Corp.*, 147 Wn.2d 114, 121, 52 P.3d 472 (2002). Such "general contractual rights as the right to order the work stopped or to control the order of the work or the right to inspect the progress of the work do not mean that the general contractor controls the method of the contractor's work." *Id.* (quoting *Bozung v. Condo. Builders, Inc.*, 42 Wn. App. 442, 445-56, 711 P.2d 1090 (1985)). "The retention of the right to inspect and supervise to insure the proper completion of the contract does not vitiate the independent contractor

relationship." *Id.* at 120-21 (quoting *Hennig v. Crosby Group, Inc.*, 116 Wn.2d 131, 134, 802 P.2d 790 (1991)).

Many of the terms highlighted by the CRO, as showing control, are precisely the "general contractual rights" that the Supreme Court has held do ***not*** show control. These include the right to require reports and the rights to inspect and supervise and ensure contract compliance. *See* CR2 at 1129–30. To the extent ESD cites Court of Appeals decisions that are inconsistent with *Kamla* and *Seattle Aerie No. 1* as support for the CRO's reliance on such terms, those cases are not valid authority.

The Oregon Court of Appeals recently reached a similar conclusion with respect to owner-operators in *CEVA Freight*. The court noted that "a person who is compensated for performing services virtually always will be subject to *some* level of oversight by the entity or individual for whom the work is performed." *CEVA Freight*, 379 P.3d at 782 (quoting *AGAT Transp., Inc. v. Employment Dep't*, 256 Or. App. 294, 305 P.3d 122, 127 (2013)). The court noted that "the owner-operators provided the fundamental means of carrying out the services: their vehicles, drivers and other labor, maintenance, liability and workers' compensation insurance, and fuel." *Id.* Because the owner-operators "provided and operated their own trucks and could hire their own drivers,

establish their own work schedules, routes, and delivery schedules, and load their vehicles according to their preferences," the carrier established freedom from control. *Id.* The same result is required here.

iii. Control over leased equipment is not control over the worker.

A significant flaw in the CRO's analysis is its failure to comprehend that the contracts at issue were *equipment*-lease agreements. As such, many of the terms highlighted by the CRO merely set out the conditions under which owner-operators agree to lease their equipment to Gulick. For example, the contract provides that owner-operators will place Gulick's identification on the equipment; that Gulick can take possession of the equipment to complete a shipment if the owner-operator fails to do so; that owner-operators will inspect the equipment regularly and keep it properly maintained; that owner-operators will provide accessories necessary for proper loading and transportation; that owner-operators will install a telecommunications device in the equipment; and that the agreement will terminate if the equipment becomes unavailable for dispatch. CR2 at 1129–30.

If this were merely an equipment lease—i.e., if there were no transportation component to the contract—one would still expect these terms to be present. They ensure that the leased equipment is properly

identified, maintained, and available for the purposes for which Gulick leases it. The fact that the lease also contemplates driving services does not transform these standard lease provisions into control over the owner-operator's performance.

iv. The mere fact that a contract sets out the contractor's obligations does not mean that the contractor is controlled as to the methods and details of the work.

Further, many of the terms highlighted by the CRO merely set out the obligations undertaken by the owner-operator. For example, most of the freight involved here consisted of refrigerated goods. CR2 at 808. It is thus natural that owner-operators agree not only to transport the freight from point A to point B, but also to check the freight's temperature to ensure that it is properly refrigerated. *See* CR2 at 1130.

ESD seems to believe that if the contract sets out with any detail what the contractor agrees to do, this is somehow control. Only an illusory contract would survive ESD's control analysis. *See Lane v. Wahl*, 101 Wn. App. 878, 882, 6 P.3d 621 (2000) (holding that a lease agreement is illusory and unenforceable if it "is so indefinite that it cannot be enforced, or by its terms makes performance optional or entirely discretionary on the part of the promisor"). The CRO erred in finding that

control is established simply because the contracts identify the owner-operators' obligations.

v. Liquidated damages are not evidence of control.

Finally, the CRO stressed that the lease agreement provides a $50 "fine" for certain breaches of contract. CR2 at 1129–30. The CRO offered no authority for the proposition that liquidated damages are evidence of control. To the contrary, liquidated damages are commonly found in commercial contracts. *See, e.g.*, *Forest Mktg. Enterprises, Inc. v. State, Dep't of Natural Res.*, 125 Wn. App. 126, 135-36, 104 P.3d 40 (2005) (upholding liquidated damages clause in state agency's contract with private party).

The breaches subject to liquidated damages include failing to meet scheduled pickup or delivery appointments and failure to notify Gulick of cargo shortage, damage, or temperature discrepancies. CR2 at 1129–30. Unquestionably, these are a breach of an owner-operator's obligations under the lease agreement. Providing in advance for the amount of damages to be paid in the event of such a breach is a commercially reasonable practice. *See Watson v. Ingram*, 124 Wn.2d 845, 850, 881 P.2d 247 (1994) ("Liquidated damages clauses are favored in Washington . . .") (citing *Ashley v. Lance*, 80 Wn.2d 274, 280, 493 P.2d 1242 (1972)).

In short, this Court should reject the CRO's superficial analysis and hold that Gulick established the first element of RCW 50.04.140(1).

b. Owner-operators work over the open road, not at Gulick's places of business.

The evidence also established the second element of the exception test, which applies where services are performed either "outside the usual course of business for which such service is performed," ***or*** "outside of all the places of business of the enterprises for which such service is performed." RCW 50.04.140(1)(b). ESD instructs its auditors that the latter alternative can be met if "the driver's services are performed outside of all places of business of the lessee – except for activities relating to the loading or unloading of freight." CR1 at 545. Gulick's evidence established this latter alternative.

Gulick presented extensive evidence, throughout two days of trial, of a system by which: (a) available loads are offered to owner-operators via a satellite communications system; (b) owner-operators receive and respond to these communications from the cabs of their trucks; (c) if they accept a load they drive over public roads to the customer's place of business to collect the freight; and (d) they then drive over public roads to deliver the freight at a place of business belonging to the customer or another third party. *See* CR2 at 802–03, 839, 891–92, 895, 897–98,

901-02, 904, 923, 928–29, 932, 938, 941. Further, Gulick does not own the locations where loads are picked up and delivered. CR2 at 802. And Gulick established that owner-operators' responsibilities do not require them to perform work at Gulick's offices or ever go to Gulick's offices to collect loads or clock in or out. CR2 at 849–50.

This evidence was undisputed at trial. Nonetheless, the CRO found that Gulick had not met this element, based entirely on three terms in the lease agreement: (1) the leased equipment is "subject to inspection . . . at *Gulick's regular inspection station*"; (2) safety inspections may be done "by *Gulick's contract shop*" or by "another shop"; and (3) Gulick's trailers must be returned to "*Gulick's terminal*." CR2 at 1135. The CRO's analysis overlooked two important details.

First, ESD never raised these terms as defeating the "places of business" element. ESD relied on a legal argument that the federally required lease transformed the truck itself into Gulick's place of business. *See* CR1 at 242–43, 271; CR2 at 960–61, 1104–05. The CRO rejected that argument, but then based its decision on contract terms that were not addressed by any argument or evidence below. *See* CR2 at 1134–35.

Second, the CRO conflated the analysis under element (a) of RCW 50.04.140(1)(a) with the analysis under element (b). The first

element requires the employer to show a lack of control *both* under the "contract of service and in fact." RCW 50.04.140(1)(a). Because of this language, ESD might defeat a showing under the first element based entirely on contract terms, even where the evidence shows that the employer exercises no control "in fact." But the second element does ***not*** have this language. Rather, it refers only to the reality of where "such service ***is*** performed." RCW 50.04.140(1)(b) (emphasis added).

Because Gulick's evidence established that owner-operators perform their services over the open road, with no need to visit Gulick's places of business, the CRO erred in basing its decision entirely on contract terms that were never raised at trial. This Court should hold that Gulick established the second element of RCW 50.04.140(1).

c. Owner-operators are engaged in an independently established trade, occupation, or business.

The final element is met if the workers are "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). Several factors, including the worker's investment in the business and provision of the necessary equipment, the provision of insurance, and the impact on the worker's business if the relationship is terminated, are indicia of being independently established. *Jerome*, 69

Wn. App. at 815. ESD instructs its auditors that owner-operators are independently established if they have ultimate responsibility for the operation of the trucks, maintain a separate set of books, and are responsible for the majority of cost items. CR1 at 545. Relevant cost items include maintenance, insurance, permits, fuel, oil, tires, repairs, ferry charges and tolls, and driver's remuneration. *Id.*

It is beyond dispute that the owner-operators meet this definition. Gulick presented uncontested evidence that the owner-operators have ultimate responsibility for their trucks' operation. *See* CR2 at 847–51. Owner-operator DeJean testified emphatically: "My truck is completely my responsibility." CR2 at 925. Likewise, Matlock insisted: "The whole thing is my responsibility." CR2 at 895.

Moreover, the evidence showed that owner-operators maintain their own separate set of books. Matlock testified, for example, that he keeps a journal of his loads and reports his own taxes. CR2 at 900. DeJean explained that she keeps her own business records and provides them to her private accountant, who is not affiliated with Gulick. CR2 at 930, 932. Carnes testified that he has a home office where he keeps his business records. CR2 at 943.

The evidence was also uncontested that owner-operators are responsible for all cost items. *See* CR2 at 899–900, 925–26, 942–43. Indeed, ESD's counsel objected to questions establishing owner-operators' responsibility for all expenses as cumulative. CR2 at 925. This responsibility includes insurance. CR2 at 900, 925, 937.

Further, owner-operators make an enormous capital investment in their businesses. The truck itself represents an investment of roughly $200,000. CR2 at 798. And they have various trade associations designed to protect their interests as small businesses. CR1 at 103.

Notwithstanding these real-world hallmarks of independence, the CRO found that this element was not met because of an administrative formality. According to the CRO, interstate operating authority (sometimes referred to as an "MC number") is an "*additional paramount factor*." CR2 at 1137. But the notion of an MC number being the linchpin to this element is completely arbitrary.

Adams explained that obtaining an MC number involves filling out a form on the internet and paying a $300 fee. CR2 at 797. It would be pointless, however, for an owner-operator to undertake this expense, because federal regulations require that the equipment be operated under the ***carrier's*** MC number. *See* CR2 at 798; 49 C.F.R. § 390.21(b)(2).

Most small-business owners would balk at the notion that paying for a license they cannot use is somehow the defining characteristic of an independent business.

To be sure, the owner-operators' business model may be different from what ESD ordinarily sees. Rather than marketing their products or services directly to customers, owner-operators make a substantial investment in equipment and then market it to carriers. They lease the equipment to a carrier, thereby gaining access to the carrier's customer base. CR2 at 798. Again, an MC number is unnecessary under this business model. *See* CR2 at 937.

The owner-operator model has been an established trade or occupation in the trucking industry for decades. *See* CR1 at 92, 104; CR2 at 797. The fact that it may seem unconventional from ESD's perspective makes it no less valid.

d. Gulick proved the independent-contractor exception.

In short, Gulick established all three elements under RCW 50.04.140(1). The only way to escape that conclusion is—as ESD will do in its response brief—to advocate an unworkable interpretation of the elements, under which no owner-operator could ever qualify. The

Court should reject that unreasonable and incorrect interpretation and hold that Gulick proved the independent-contractor exception.

3. **Federal law preempts ESD's interference with Gulick's business model.**

On the other hand, if the Court were to adopt ESD's interpretation of RCW 50.04.140(1), then the impossibility of using independent-contractor owner-operators would alter longstanding industry dynamics in a way that is preempted by federal law. Congress has expressly preempted any state action relating to carriers' prices, routes, or services:

> . . . States 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)(1) (emphasis added). As will be explained below, ESD's reclassification scheme has far-reaching effects that relate to carriers' prices, routes, or services, and are therefore preempted.

a. FAAAA preemption is broad.

When Congress deregulated the trucking industry, it sought to remove obstacles to "national and regional carriers attempting to conduct a standard way of doing business." *Cole v. City of Dallas*, 314 F.3d 730, 734 (5th Cir. 2002) (quoting H.R. CONF. REP. No. 103–677, at 87, *reprinted in* 1994 U.S.C.C.A.N. at 1759). Congress's "overarching goal"

was to "ensure transportation rates, routes, and services that reflect 'maximum reliance on competitive market forces,' thereby stimulating 'efficiency, innovation, and low prices,' as well as 'variety' and 'quality.'" *Rowe v. New Hampshire Motor Transport Ass'n*, 552 U.S. 364, 371, 128 S. Ct. 989, 169 L.Ed.2d 933 (2008) (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 378, 112 S. Ct. 2031, 119 L.Ed.2d 157 (1992)). Congress thus sought to leave operational decisions, "where federally unregulated, to the competitive marketplace." *Id.* at 373. It would be inconsistent with this effort to allow "a patchwork of state service-determining laws, rules, and regulations." *Id.*

Accordingly, the U.S. Supreme Court follows Congress's mandate to apply a "***broad preemption interpretation***" to this legislation. *Id.* at 370 (emphasis added) (quoting H.R. Conf. Rep. 103-677, at 83 (1994)). The preemption statute is a "directive to immunize motor carriers from state regulations that threaten to unravel Congress's purposeful deregulation in this area." *Massachusetts Delivery Ass'n v. Coakley*, 769 F.3d 11, 21 (1st Cir. 2014). The Supreme Court has recognized four principles that guide interpretation of 49 U.S.C. § 14501(c)(1):

1) that state "enforcement actions *having a connection with, or reference to*," carrier rates, routes, or services are preempted;

2) that such preemption may occur "even if a state law's effect on rates, routes, or services '***is only indirect***'";

3) that "it makes no difference whether a state law is 'consistent' or 'inconsistent' with federal regulation"; and

4) that preemption occurs "***at least*** where state laws have a 'significant impact' related to Congress' deregulatory and pre-emption-related objectives."

Rowe, 552 U.S. at 370–71 (quoting *Morales*, 504 U.S. at 378, 384, 386-87, 390) (bold italics added, internal quotation marks omitted).

Preemption "might not" apply to "state laws that affect fares in only a 'tenuous, remote, or peripheral . . . manner.'" *Id.* at 371 (quoting *Morales*, 504 U.S. at 390) (alteration in original). As a possible example, the court mentions "state laws forbidding gambling." *Id.* As another example, there was an insufficient connection to a claim arising from the storage and disposal of a car, which occurred long after the towing (the activity subject to federal regulation) had ended. *See Dan's City Used Cars, Inc. v. Pelkey*, 133 S. Ct. 1769, 1779–80, 185 L.Ed.2d 909 (2013).

A state's administration of a tax, however, can have a sufficient connection. *See, e.g.*, *United Parcel Serv., Inc. v. Flores-Galarza*, 318 F.3d 323 (1st Cir. 2003) (Puerto Rico's enforcement of excise tax against airlines was preempted by corollary provision of the Airline Deregulation Act ("ADA")).[9] In evaluating the connection, courts must be mindful that "potential" impacts can trigger preemption, that empirical evidence is not necessary, and that courts can look to "the logical effect that a particular scheme has on the delivery of services or the setting of rates." *Coakley*, 769 F.3d at 21 (quoting *Rowe*, 448 F.3d at 82 n. 14).

b. Preemption arises when a state reclassifies owner-operators as employees.

Multiple courts have held that forcing carriers to reclassify owner-operators as employees is preempted. The Ninth Circuit observed that a provision requiring carriers at the Port of Los Angeles to transition from owner-operators to employee drivers was "highly likely to be shown to be preempted." *Am. Trucking Associations, Inc. v. City of Los Angeles*, 559 F.3d 1046, 1056 (9th Cir. 2009). The district court later enjoined the owner-operator phase-out as preempted under the FAAAA, and the Ninth Circuit affirmed. *Am. Trucking Associations, Inc. v. City of Los Angeles*,

[9] "Congress intended the ADA and FAAAA pre-emption provisions 'to be applied in an identical manner.'" *UPS Store, Inc. v. Hagan*, No. 14CV1210, 2015 WL 9256973, at *3 (S.D. N.Y. Nov. 18, 2015) (quoting *In re EVIC Class Action Litig.*, No. 21md84 et al., 2002 WL 1766554, at *7 (S.D. N.Y. July 31, 2002)).

No. CV 08-4920CASCTX, 2009 WL 1160212, at *7 (C.D. Cal. Apr. 28, 2009), *affirmed in part*, 596 F.3d 602, 604–05 (9th Cir. 2010).

Similarly, in an earlier ruling, a Michigan court struck down as preempted a state regulation mandating that a truck be operated by employees of the carrier. *In re Fed. Preemption of Provisions of the Motor Carrier Act*, 223 Mich. App. 288, 566 N.W.2d 299, 307–08 (1997), *review denied*, 587 N.W.2d 632 (Mich. 1998), *cert. denied,* 525 U.S. 1018 (1998). The court explained that this requirement presented a "barrier to entry for many interstate motor carriers who relied upon independent contractors for drivers." *Id.* at 307.

And the First Circuit twice last year applied FAAAA preemption where the State of Massachusetts attempted to require carriers to provide employee-type benefits to owner-operators. *See Massachusetts Delivery Ass'n v. Healey*, 821 F.3d 187 (1st Cir. 2016); *Schwann v. FedEx Ground Package Sys., Inc.*, 813 F.3d 429 (1st Cir. 2016). These cases construed a Massachusetts statute that is similar to RCW 50.04.140(1), setting out three elements that must be proven for an individual to be considered an independent contractor. *Id.* at 433 (quoting MASS. GEN. LAWS ch. 149, § 148B(a)). Workers not meeting this definition are classified as employees for purposes of two chapters of the Massachusetts code. *Id.* Under those

chapters, carriers would be required to provide four benefits to owner-operators that they had previously given only to employees: days off, parental leave, work-break benefits, and a minimum wage. *Id.*

In *Schwann*, the plaintiffs were owner-operators who provided "first-and-last-mile" pickup and delivery services. *Id.* at 432. The court began by outlining the Supreme Court's history in interpreting FAAAA preemption and explained that, while "there is a limit to the preemptive scope of § 14501(c)(1)," the cases show "that ***one must move quite far afield to confidently reach that limit***." *Id.* at 436 (emphasis added) (citing *DiFiore v. Am. Airlines, Inc.*, 646 F.3d 81, 86–87 (1st Cir. 2011)).

The court then held that regulatory interference in the classification of an individual as an employee or independent contractor is "not peripheral." *Id.* Whether to provide services directly, with one's own employees, or to procure the services of independent contractors "is a significant decision in designing and running a business." *Id.* It "implicates the way in which a company chooses to allocate its resources and incentivize those persons providing the service." *Id.* The state's interference with that decision would pose "a serious potential impediment to the achievement of the FAAAA's objectives because a court, rather

than the market participant, would ultimately determine what services that company provides and how it chooses to provide them." *Id.*

The court explained that this regulatory interference would also logically impact routes. By using independent contractors, FedEx delegated the design of the routes to the contractors, "who assumed the risks and benefits of increased or decreased efficiencies achieved by the selected routes." *Id.* at 439. It would be reasonable, in contrast, "to conclude that employees would have a different array of incentives that could render their selection of routes less efficient, undercutting one of Congress's express goals in crafting an express preemption proviso." *Id.*

In *Healey*, the state attempted to distinguish *Schwann* based on differences in the ways the carrier, Xpressman, structured its relationships with owner-operators. While acknowledging some operational differences, the First Circuit held that the significant common denominator was that both carriers structured their relationships with owner-operators to incentivize them "to keep costs low and to deliver packages efficiently." *Healey*, 821 F.3d at 193. The challenged statute would deprive the carrier "of its choice of method of providing for delivery services and incentivizing the persons providing those services." *Id.* The interference with the carrier's incentive structure was "a restraint on Xpressman's

pursuit of perceived economic efficiencies" and "would ultimately determine what services that company provides and how it chooses to provide them." *Id.* (quoting *Schwann*, 813 F.3d at 438). Likewise, this interference "would logically be expected to have a significant impact on Xpressman's routes." *Id.* The court therefore affirmed the district court's finding of preemption. *Id.*

c. The cases relied upon by ESD are inapposite.

Before discussing its evidence, Gulick will briefly address in this subsection the cases likely to be cited in ESD's response. Primarily, ESD will rely on a vague statement made by Division One, fifteen years ago, declining to find that federal motor-carrier law preempted state unemployment law, in *Western Ports*, 110 Wn. App. at 457. ESD's reliance on *Western Ports* is misplaced for two simple reasons.

First, *Western Ports* never analyzed, and there is no indication that the carrier ever even raised, 49 U.S.C. § 14501(c)(1) as a basis for preemption. Rather, the court considered an implied-preemption argument based on a federal regulation, 49 C.F.R. § 376.12. The court mentioned 49 U.S.C. § 14501(c)(1) only once, and then only to contrast it with the regulations that were actually raised for its consideration. *See Western Ports*, 110 Wn. App. at 456–57 (citing 49 U.S.C. § 14501(c)(1) and 49

U.S.C. § 14502(b) as examples of statutes that, unlike the statutes and regulations brought to the court's attention, clearly stated Congress's intention to prohibit state taxing authorities from burdening interstate commerce). The court never even considered whether the state action related to a price, route, or service. *Western Ports* thus offers no guidance at all on the dispositive question under 49 U.S.C. § 14501(c)(1).

Second, even if *Western Ports*' holding is superimposed onto 49 U.S.C. § 14501(c)(1), its reasoning cannot be reconciled with controlling authority. The only ground it offered for rejecting preemption is that federal motor-carrier law and state unemployment law "have very different policy objectives." *Western Ports*, 110 Wn. App. at 457. Six years later, the U.S. Supreme Court held that preemption under § 14501(c)(1) may occur "even if a state law's effect on rates, routes, or services 'is only indirect'" and that "it makes no difference whether a state law is 'consistent' or 'inconsistent' with federal regulation." *Rowe*, 552 U.S. at 370–71 (quoting *Morales*, 504 U.S. at 386–87).

The U.S. Supreme Court's pronouncements on FAAAA preemption are binding on this Court. *S.S. v. Alexander*, 143 Wn. App. 75, 92, 177 P.3d 724 (2008) (with respect to federal statutes, Washington courts are bound by the construction placed upon them by the U.S.

Supreme Court) (quoting *N. Pac. Ry. Co. v. Longmire*, 104 Wash. 121, 125, 176 P. 150 (1918)). To the extent *Western Ports* intended to reject FAAAA preemption—without analyzing relation to prices, routes, or services, and instead basing its decision entirely on a comparison of legislative purposes—it is irreconcilable with *Rowe*'s holding that a state law is preempted if there is a relation to prices, routes, or services, even if it is consistent with federal regulation. *See Rowe*, 552 U.S. at 370–71.[10]

Aside from *Western Ports*' flawed analysis, ESD will likely rely on several cases that rejected FAAAA preemption under distinguishable circumstances. These cases can be grouped into two categories.

First, ESD will cite several cases that are distinguishable because they did not involve owner-operator reclassification, but instead discussed benefits that carriers must provide to traditional employees. *See Dilts v. Penske Logistics, LLC*, 769 F.3d 637 (9th Cir. 2014) (FAAAA does not preempt employee drivers' claims for violations of California's meal and rest-break laws; *Californians for Safe & Competitive Dump Truck Transp. v. Mendonca*, 152 F.3d 1184 (9th Cir.1998) (FAAAA does not preempt claims based on state prevailing-wage laws brought by employee drivers). *See also Filo Foods, LLC v. City of SeaTac*, 183 Wn.2d 770, 357 P.3d

[10] Another case likely cited by ESD, *SZL, Inc. v. Indus. Claim Appeals Office*, 254 P.3d 1180 (Colo. App. 2011), suffers from the same flaw, i.e. rejecting preemption based purely on the lack of a conflict between policy objectives.

1040 (2015) (ADA does not preclude application of $15/hour minimum wage to restaurant employees at SeaTac airport); *Bostain v. Food Express, Inc.*, 159 Wn.2d 700, 153 P.3d 846 (2007) (in a footnote, disagreeing with amicus curiae's argument that the FAAAA prevents an employee driver's claim for overtime pay). These cases are inapposite here. Gulick does not dispute that the unemployment tax applies to its employee drivers.

Second, ESD will cite cases in which the basis for rejecting preemption was the carrier's failure to present any evidence of how owner-operator reclassification would affect its operations. *See Costello v. BeavEx, Inc.*, 810 F.3d 1045 (7th Cir. 2016) (only purported basis for preemption was the carrier's conclusory assertion that reclassification would increase costs and require reclassification for other purposes); *C.R. England, Inc. v. Dep't of Employment Sec.*, 2014 IL App (1st) 122809, 7 N.E.3d 864 (2014) (only purported basis for preemption was the carrier's conclusory assertion that reclassification precludes it from utilizing independent-contractor drivers). In other words, the carriers in these cases offered *no evidence at all*. The facts thus contrast sharply with the present case where, as explained below, Gulick demonstrated specific, tangible ways in which reclassification for purposes of unemployment taxes affects its prices, routes, and/or services.

d. ESD's reclassification scheme relates to carriers' prices, routes, or services.

As in *Schwann* and *Healey*, ESD's actions in this case—requiring all carriers in the state to treat owner-operators as employees for unemployment purposes—relate to prices, routes, or services and are therefore preempted. This wholesale reclassification interferes with carriers' preferred business models, penalizes carriers for providing certain services through independent contractors, and disrupts the way carriers have provided services to customers for decades. *See Costello*, 810 F.3d at 1054 (noting that laws "that affect the way a carrier interacts with its customers fall squarely within the scope of FAAAA preemption"). As explained in the following subsections, the forbidden relation to prices, routes, or services is manifested in several tangible ways.

i. ESD attempts to restructure the trucking industry by prohibiting the use of independent contractors.

ESD will claim that it is merely applying the Employment Security Act to Gulick's operations, but the undisputed facts expose a more nefarious and broad-sweeping purpose. ESD seeks to restructure the trucking industry through a policy decision that the industry cannot have independent contractors. This is an improper interference by a state agency in a federally protected industry.

ESD has decided that the trucking industry cannot have independent contractors. As noted above, ESD's auditors informed Gulick, before they had even seen any documents, that they were not authorized to treat owner-operators as independent contractors. CR2 at 846–47. As such, this was not an audit at all, but rather an implementation of ESD's policy decision that all carriers in the state must now treat owner-operators as employees.

The statewide nature of ESD's policy decision was exposed by Lim's testimony. He had personally "audited" between fifty and sixty carriers in less than four years. *Id.* at 658. He decided to "audit" Gulick merely because a coworker had identified it as a business with trucks in its yard. *Id.* Further, Lim worked in ESD's Underground Economy Unit, part of an interagency task force, suggesting that the state's attack on the trucking industry goes beyond ESD's reach. *See id.* at 656. In fact, this Court held that the Washington Trucking Associations and six individual carriers stated a valid claim against ESD for its impropriety in targeting the trucking industry for political purposes. *See Washington Trucking Ass'ns v. State, Emp't Sec. Dep't*, 192 Wn. App. 621, 369 P.3d 170 *review granted sub nom.*, 186 Wn.2d 1016, 380 P.3d 522 (2016).

ESD pursues its illicit goal by making it *impossible* for owner-operators to qualify as independent contractors. According to ESD, as explained above, the very terms that the federal government *requires* to be included in carrier/owner-operator contracts preclude application of the independent-contractor exception.[11] It is therefore, in ESD's view, impossible for a carrier to comply with federal law and have the protection of RCW 50.04.140.

ESD's wholesale prohibition on independent contractors is a drastic change to longstanding industry dynamics. Washington law in general, and ESD in particular, has historically recognized that owner-operators are independent contractors. For example, ESD found owner-operators to be independent contractors for purposes of the Employment Security Act in *Penick v. Emp't Sec. Dep't*, 82 Wn. App. 30, 39, 917 P.2d 136 (1996). And ESD issues a Status Manual, which instructs auditors to apply the "Independent Trucker Tests" to distinguish between independent owner-operators and employee truck drivers. CR1 at 545. According to these instructions, true owner-operators are independent contractors. *Id.*

As such, by deciding that owner-operators *cannot* be independent contractors, ESD has changed the law. As the First Circuit explained, this unique interpretation "runs counter to Congress's purpose to avoid 'a

[11] See this brief at §§ D.2.a.i and D.2.c, *supra*.

patchwork of state service-determining laws, rules, and regulations' that it determined were better left to the competitive marketplace." *Schwann*, 813 F.3d at 438 (quoting *Rowe*, 552 U.S. at 373). And its novelty "cuts against" any argument that this "is simply a type of pre-existing and customary manifestation of the state's police power that we might assume Congress intended to leave untouched." *Id.*

Unchallenged expert testimony established that ESD's reclassification scheme will impact the industry. Gulick submitted testimony from several industry experts who explained how ESD's actions impact the trucking industry. Larry Pursley, Executive Vice President of the Washington Trucking Associations, opined that ESD's "effort to strategically target the trucking industry as part of its underground economy initiative is misguided and imperils the structure of Washington's trucking industry." CR1 at 93. He opined further that ESD's assessments "will fundamentally change the business models of both motor carriers and owner/operators throughout Washington because ESD will have effectively eliminated a historical cornerstone of the trucking industry." *Id.* Pursley was aware of at least one carrier that had already been forced out of the state by ESD's tactics. *Id.* at 94.

Joe Rajkovacz, former Director of Regulatory Affairs for the Owner/Operator Independent Drivers Association ("OOIDA"), opined that ESD's attempt to reclassify owner-operators will undoubtedly lead to diminished economic choices and reduced income for owner-operators. CR1 at 106. He also opined that owner-operators located outside Washington who lease equipment to carriers in Washington, will enjoy a competitive edge in the marketplace. *Id.* Carriers will be more likely to prefer non-Washington owner-operators because their work would not be subject to unemployment taxes. *See id.*

Finally, Adams, Gulick's controller, explained that only about 7% of Gulick's mileage is driven in Washington State. CR1 at 99. Being assessed unemployment taxes on owner-operator compensation will place Gulick at a competitive disadvantage with carriers outside Washington, many of whom are headquartered in Oregon, just a few miles from Gulick's Vancouver headquarters. *Id.* To remain competitive, it will be forced to "change customer lanes, drop customers, and downsize to be able to adjust to the new cost structure." *Id.*

ESD has no evidence to refute these expert opinions, which establish a substantial effect on prices, routes, and/or services.

ii. The unemployment tax interferes with Gulick's incentive structure.

In *Schwann* and *Healey*, as explained above, the Massachusetts statute was preempted because it interfered with the carriers' incentive structure. It did so by forcing carriers to provide employee-type benefits to owner-operators who had traditionally been considered independent contractors. *Schwann*, 813 F.3d at 436–39; *Healey*, 821 F.3d at 193.

ESD's reclassification scheme is no different. It forces all carriers in Washington to provide owner-operators with a benefit that has always been reserved for employees: unemployment insurance. Much like the four benefits at issue in *Schwann* and *Healey*, unemployment insurance provides owner-operators a safety net that protects them against loss and skews the traditional incentive structure. Indeed, if carriers are forced to provide such insurance, owner-operators would be entitled to claim benefits anytime their income is reduced by 25% or more. *See* RCW 50.20.050(2)(b)(v).

Unemployment insurance is a business expense. Under the industry's traditional incentive structure, owner-operators are responsible for all business expenses and are guaranteed no income, such that they are motivated to maximize their profits by keeping costs low and transporting freight efficiently. *See Healey*, 821 F.3d at 193. In Gulick's experience

this structure motivates owner-operators to have a greater commitment to their businesses than employee drivers have. CR1 at 98.

If owner-operators wish to obtain unemployment insurance, they can do so by electing self-coverage. *See* RCW 50.24.160. This would be consistent with their contractual responsibility for all operating expenses, including insurance. *See* CR1 at 351–53. But ESD seeks to shift that cost to carriers. Such interference with cost allocation and the incentive structure is preempted. *See Schwann*, 813 F.3d at 436–39.

iii. ESD's punitive tax rate penalizes the use of owner-operators as a flexible supply of equipment.

Forcing carriers to provide unemployment insurance to owner-operators also interferes with industry dynamics by applying the Employment Security Act's punitive tax rate. ESD punishes businesses that use a flexible personnel model with short-term employees to fill temporary surges in demand, by increasing the employer's tax rate whenever an employee files for unemployment compensation. *See* RCW 50.29.021(2), .025; WAC 192-320-005. In this way, ESD incentivizes businesses that favor permanent employees and discourages businesses that seek to use a flexible workforce.

By applying this statutory scheme to owner-operators, ESD will directly affect carriers' operations because the main purpose of using owner-operators is to have a flexible supply of equipment. *See* CR1 at 92, 99. Adams explained that this "situation would break [Gulick's] business model." CR1 at 101. Gulick uses owner-operators heavily. At the time of trial it had four employee drivers on staff and had leases with 152 owner-operators. CR1 at 97. It engages owner-operators with the understanding that the need for their services is short-term and will be followed by a period in which such need will be reduced. *Id.* Under ESD's interpretation, when Gulick uses this traditional practice, ESD will penalize it by raising its tax rate. *See* CR1 at 75. Meanwhile, competitors who rely less heavily on owner-operators would pay a lower rate. This is a direct interference with Gulick's use of a traditional business model.

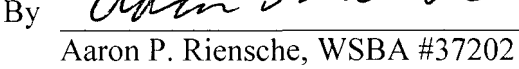
E. CONCLUSION

ESD has targeted the trucking industry in an improper effort to eliminate the use of owner-operators as independent contractors. This Court should reject the unreasonable interpretations of RCW 50.04.140 offered by ESD, which make it impossible for any owner-operator to ever qualify as an independent contractor. To the extent the Court agrees with those interpretations, however, ESD's blatant interference with the

trucking industry is preempted under 49 U.S.C. § 14501(c)(1). Either way, the Court must reverse the CRO's decision with instructions to set ESD's assessment against Gulick aside.

RESPECTFULLY SUBMITTED this 27th day of February, 2017.

OGDEN MURPHY WALLACE, P.L.L.C.

By 

Aaron P. Riensche, WSBA #37202
Attorneys for Appellant

FILED
COURT OF APPEALS
DIVISION II

2017 MAR -1 AM 10: 11

STATE OF WASHINGTON

DEPUTY

DECLARATION OF SERVICE

On said day below I sent a true and accurate copy of the foregoing to the following parties in the manner indicated below:

Eric D. Peterson Leah Harris Assistant Attorney Generals Licensing and Administrative Law Division 800 Fifth Avenue Suite 200 MS TB-14 Seattle, WA 98104-9046 ericp1@atg.wa.gov leahh1@atg.wa.gov lalseaef@atg.wa.gov	☐ FIRST CLASS U.S. MAIL ☐ LEGAL MESSENGER ☒ E-MAIL ☐ FACSIMILE

I declare under penalty of perjury under the laws of the State of Washington and the United States that the foregoing is true and correct.

DATED the 28th day of February, 2017.

Carole Henry

Carole Henry

{APR1542941.DOCX;3/12595.000001/}

APPENDIX

Contract Terms Identified by the Commissioner's Review Office as Showing Gulick Trucking, Inc.'s Alleged Control over Owner-Operators (CR2 at 1129–30)

CRO's Characterization	**Gulick's Comment**
"Gulick has exclusive possession, control, and use of the trucking equipment during the term of the agreement…"	Required by 49 C.F.R. § 376.12(c)(1); shows control over the equipment, not the driver.
"…owner-operators may not transport persons or property for any third party without Gulick's express written consent."	Required by 49 C.F.R. § 376.22.
"The owner-operators must furnish and display identification on the equipment to show such equipment is being operated by Gulick…"	Required by 49 C.F.R. § 376.11(d)(1); condition of equipment lease, not control over driver.
"…upon termination of the agreement, the owner-operators shall immediately remove all identification from the equipment and return any placards to Gulick."	Required by 49 C.F.R. § 376.12(e); condition of equipment lease, not control over driver.
"Gulick will fine an owner-operator $50 each time the owner-operator fails to meet the scheduled pickup or delivery appointments … or each time the owner-operator fails to follow temperature requirements."	Applies to omissions that are clearly a breach of contract; liquidated damages for breach are favored in Washington law.
"If an owner-operator fails to complete the transportation of commodities in transit, abandons a shipment, or otherwise fails to deliver shipment, Gulick retains the right to take physical possession of the equipment and complete the transportation and delivery."	Shows control over the equipment, not over the driver.
"The owner-operators are required	Required by 49 C.F.R. §§ 379 app.

to inspect their trucks prior to operation each day, perform tire checks and visual inspection each 150 miles or three hours of operation … and perform a post-trip inspection upon completion of each day's operation."	A, 390.11, 396.3.
"The owner-operators shall complete, sign, and deliver to Gulick a daily vehicle inspection report as required by federal motor carrier safety regulations."	Required by 49 C.F.R. §§ 379 app. A, 390.11, 396.3; the right to require reports is a "general contractual right."
"Gulick may place any equipment out of service if, in Gulick's opinion, the equipment does not meet the standards set by the government or by Gulick."	Under 49 C.F.R. §§ 376.12(c)(1), 385.5, 390.11, Gulick is responsible for the equipment and for ensuring that owner-operators comply with federal regulations; shows control over the equipment, not the driver.
"The owner-operators are required to furnish all accessories required to properly load and transport the freight, including tire chains, a minimum of three load locks, and temperature recording device."	Merely a condition of the equipment lease; gives responsibility for the necessary tools to the owner-operator, not to Gulick.
"The owner-operators must immediately contact Gulick by telephone in the event of an accident resulting in personal injury or damage to cargo, or in the event of an incident involving hazardous materials."	The right to require reports is a "general contractual right"; this term is commercially reasonable and necessary given that such incidents impact Gulick's safety rating under 49 C.F.R. § 385.5.
"The owner-operators shall check the identity, temperature, condition, and count of all cargo to confirm that the cargo conforms to the bill of lading or loading manifest."	Merely one of the responsibilities that owner-operators undertake in exchange for consideration; does not show control over the method and detail of how owner-operators perform those tasks.
"The owner-operators must immediately notify Gulick of any cargo shortage, damage, or	The right to require reports is a "general contractual right"; liquidated damages for breach are

temperature discrepancies; and failure to do so will result in a $50 fine imposed by Gulick."	favored in Washington law.
"Although Gulick furnishes the telecommunication device such as Qualcomm, it requires the owner-operators to provide mounting brackets and to pay wiring and installation fees as well as a monthly usage fee of $60."	Shows owner-operators' control over the tools needed for the work and responsibility for the costs thereof.
"The owner-operators are expected to cooperate fully with Gulick's dispatch personnel and to transport commodities in a manner that promotes Gulick's goodwill and reputation."	Any principal that engages an independent contractor would expect the contractor's cooperation; 49 C.F.R. § 376.11(c) requires Gulick to identify equipment as being in its service; it would not be commercially reasonable to place Gulick's name on a truck without some assurance that the person driving it would be concerned for Gulick's goodwill and reputation.
"Gulick may terminate the agreement if an owner-operator: (i) substantially violates federal, state, provincial, or Gulick's safety rules and regulations; (ii) is convicted of a felony or traffic crime; (iii) exhibits a continuing pattern of late pickups and deliveries; (iv) becomes unavailable for dispatch; (v) exhibits a continuing pattern of uncivil or impolite communications with Gulick's employees or customers; (vi) does not adequately maintain equipment as defined by Gulick's maintenance guidelines."	All of the enumerated items are acts that would obviously interfere with and undermine Gulick's operations; the CRO offers no authority for the proposition that the ability to end the relationship with a contractor who is harming the principal's business is somehow incompatible with an independent-contractor relationship.