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Division III
State of Washington

No. 34566-1-III

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

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

Appellants,

v.

STATE OF WASHINGTON EMPLOYMENT
SECURITY DEPARTMENT,

Respondent.

BRIEF OF APPELLANT
SYSTEM-TWT TRANSPORT

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A. INTRODUCTION

This case arises out of the effort by the Employment Security Department ("ESD") to target Washington's trucking in hundreds of "audits," in a politically-motivated effort to restructure Washington's trucking industry by eliminating the industry's historical use of "owner/operators" – independent truck owners who lease their equipment to trucking companies ("Carriers"). The outcome of those "audits" was foreordained, conducted by an illegal interagency task force whose purpose was to tax Carriers for owner/operators. Appellant System-TWT Transport ("System") is one of the affected interstate trucking carriers.

The modern American trucking industry has traditionally relied on owner/operators as a flexible supply of equipment in an industry with erratic demand. Federal motor carrier law specifically *authorizes* owner/operators and actually specifies the contents of the carrier-owner/operator equipment leasing agreements. When Congress deregulated interstate trucking in 1980 and intrastate trucking in 1994, it preempted any local or state laws that presumed to affect routes, prices, or services in the industry.

ESD changed its prior interpretation of owner/operators as independent contractors under Title 50 RCW, and assessed unemployment taxes, penalties, and interest against System after rigged audits and

illegally imposed taxes on equipment, knowing that such taxation was illegal. ESD's interpretation of Title 50 RCW made it *impossible* for an owner/operator to exist under that statute. This was but a part of the State's assault on this true independent contractor relationship in the trucking industry.

ESD's action is preempted as federal law as ESD's effective elimination of the owner/operator business model affects System's routes, prices, or services. Alternatively, the owner/operators at issue were not covered under RCW 50.04.100 or were exempt independent contractors under RCW 50.04.140, and ESD's actions were arbitrary or capricious and contrary to law when it instituted illegal, politically-inspired "audits" conducted in bad faith against System and the industry generally.

B. ASSIGNMENTS OF ERROR

(1) Assignments of Error

1. The trial court erred in entering its order on June 23, 2016 as to System.

(2) Issues Pertaining to Assignments of Error

1. The Federal Aviation Administration Authorization Act ("FAAAA") contains an exceedingly broad preemption provision preempting any state action that relates even indirectly to a carrier's prices, routes, or services. ESD's reclassification of owner/operators is a direct interference with an established business model in the trucking industry, with many direct and indirect effects on prices, routes, and services. Is ESD's

reclassification scheme preempted by federal law? (Assignment of Error Number 1)

2. Under RCW 50.04.140, the independent-contractor exception applies if workers are independently established businesses and work free from the carrier's control and outside its places of business. The evidence showed that: (a) owner/operators make an enormous investment in their businesses; (b) System does not control the method and detail by which owner/operators perform transportation services; and (c) owner/operators work on the open road. Did the Commissioner err in finding that owner/operators are not exempt independent contractors? (Assignment of Error Number 1)

3. ESD's so-called "audits" were politically-inspired, conducted in bad faith by an illegal task force, contrary to ESD's own standards for fairness and objective in dealing with taxpayers. Should the assessment against System be set aside? (Assignment of Error Number 1)

C. STATEMENT OF THE CASE

(1) Owner/Operators in the Trucking Industry

Owner/operators have long been important in the trucking industry. ARS3[1] at 93. *See generally,* Douglas C. Grawe, *Have Truck, Will Drive: The Trucking Industry and the Use of Independent Owner-Operators Over Time,* 35 Transp. L.J. 115 (2008). They are used in most, if not all, sectors of the industry, including long-haul trucking, household-goods moving, and intermodal operations. Because demand in the contemporary American trucking industry fluctuates so dramatically, the

[1] The Administrative Record for System is cited herein as "ARS" followed by the volume number.

industry is structured around these independent owner/operators, who provide carriers like System with a flexible supply of trucking equipment. *Id*.

For owner/operators, an independent-contractor relationship is similarly beneficial. Today's shippers are sophisticated and now look for "one stop" shopping for their shipping needs. *Id*. at 95. It would thus be extremely difficult for an individual owning a single truck to compete. By contracting with large carriers, owner/operators can overcome this obstacle and still maintain a small business. *Id*. The carriers give owner/operators access to higher-paying freight than they would have access to if they operated under their own authority and make it easier for owner/operators to obtain insurance. *Id*. at 132.[2]

The federal government requires motor carriers, such as System, to engage owner/operators through a written lease agreement, under 49 C.F.R. § 376. ARS3 at 93; *see also, Owner-Operator Indep. Drivers Ass'n v. Mayflower Transit, Inc.*, 161 F. Supp. 2d 948, 953 n.2 (S.D. Ind. 2001). These regulations not only require a written lease contract, but also

[2] A national organization, the Owner/Operator Independent Drivers Association ("OOIDA") has 153,000 members nationally who value their business independence. ARS3 at 129.

specify certain terms that must be included in the equipment lease agreement. *See, e.g.*, 49 C.F.R. §§ 376.11, 376.12.[3]

(2) System's Operations

System is an interstate motor carrier duly licensed by the U.S. Department of Transportation ("USDOT") and the Federal Motor Carrier Safety Administration ("FMCSA"). ARS3 at 146. It uses primarily flatbed trailers to haul such freight as heavy equipment, steel and aluminum coils, wallboard, lumber, and construction materials. Its operations are widespread; only about 12.25% of its total miles are driven in Washington. *Id*. at 147.

System employs roughly 380 company drivers, who drive equipment owned by System. It also leases more than 250 trucks from owner/operators. Some owner/operators lease only a single truck to System, while others lease multiple trucks. Many owner/operators hire their own employees to drive their trucks. *Id*.[4]

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[3] For example, the regulations *mandate* that owner/operators operate under the carrier's federal operating authority granted by the USDOT and that the owner/operator be insured by the carrier (although the owner/operator must pay for that insurance). These requirements are not surprising as they promote public safety by ensuring that all commercial motor vehicles are covered by adequate insurance and by facilitating the collection of safety data which is used to generate a carrier's safety score. ARS3 at 93–94. As will be discussed *infra*, federal regulations specifically provide that these requirements do not constitute "control" for purpose of state law regulatory schemes.

[4] Owner/operators' compensation is calculated as a percentage of the gross revenue generated from each load. Generally, the payment is 82% or 72%, depending on whether the owner/operator uses System's trailer. Owner/operators also receive 100% of certain items such as fuel surcharges. *Id*. at 28; ARS3 at 148.

The System lease agreement is plainly intended to establish an independent contractor relationship when it specifies that the owner/operators are independent contractors and *not* System employees and gives the owner/operator full responsibility for all aspects of the equipment's operation:

> Contractor hereby assumes full control and responsibility for the selection, training, hiring, setting of grooming and dress standards, disciplining, discharging, setting of hours, wages and grievances, all acts and omissions, and all other matters relating to or arising out of Contractor's employment or use of drivers and laborers, and any and all other employees or agents of Contractor that Contractor may provide or use to perform any aspect of this Agreement.

ARS1 at 26. The owner/operators also remain responsible for "all costs of operation," including insurance, permits, base plates, licenses, taxes, fuel, oil, tires, tolls, fines, and driver wages and payroll taxes. *Id*. at 23. Although System may advance some costs as a courtesy, it ultimately charges those costs back by deducting them from the owner/operator's settlement. *Id*. at 35.

(3) <u>ESD Rigged the System Audit</u>

Without specific legislative authority, ESD joined with the Department of Revenue and the Department of Labor & Industries to form

an "underground economy task force" ("UETF").[5] ESD's own "underground economy unit" was headed by supervisor Lael Byington and overseen by ESD's Deputy Director of Unemployment Insurance Audits and Collections, Bill Ward. ARS3 at 185–86. Instead of pursuing true "underground economy" businesses,[6] however, Byington's unit targeted the trucking industry and its historical use of owner/operators. *Id*. at 191, 223–24.[7]

ESD assigned UETF auditor Joy Stewart ("Stewart") to audit System. Stewart was not an impartial auditor; her objectivity was compromised by her ESD job performance quota requiring her to conduct a minimum number of audits, to discover a certain amount of taxes, and to

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[5] http://www.lni.wa.gov/Main/AboutLNI/Legislature/PDFs/Reports/2015/UndergroundEconomyBenchmarkReport.pdf (last visited November 2, 2016). Ch. 432, Laws of 2009, § 13 required DOR, DOLI, and ESD to "coordinate" their efforts and report annually to the Legislature. Apart from that direction to "coordinate," the Legislature, by statute, and ESD, by rulemaking, have never defined the organization, mission, or authority of the UTEF.

[6] The original impetus for the agencies' "underground economy" efforts was to address contractors in the building industries that refused to follow state law for their workers. In 2007, the Legislature created the Joint Legislative Task Force on the Underground Economy in the Construction Industry. *See* Final Bill Report HB 1555 (2009). Trucking companies are rigorously regulated under federal law and their relationship with owner-operators is also regulated. Trucks operate openly on Washington's roads. They are hardly "underground" in any sense.

[7] ESD notes from a meeting of its officials, including Ward, indicate that in the preceding eighteen months, ESD had audited 284 trucking companies. Those notes also state that ESD "targeted trucking." ARS8, Ex. K. Although Ward claimed at his deposition that he did not recall this particular meeting, he testified that it was likely in connection with a "series of inquiries" relating to "questions from the governor's office" about ESD's audits of the trucking industry. ARS2 at 409-10.

find a certain number of new employees. *Id*. at 248–52, 577, 579. She even had the audacity to ask then Governor Gregoire in an email to pay her a bonus based on revenues she generated for the State. *Id.* at 584.

Stewart ignored ESD's own standards dictating how its audits must be conducted including its Tax Audit Manual ("TAM") that provided factors for an auditor to assess to determine if work is performed by an independent contractor. *Id*. at 539.[8] ESD also provided its auditors a Status Manual ("SM") that directly addressed "truck drivers," telling an auditor how to distinguish an employee from an owner/operator. *Id*. at 570. Finally, ESD generally required that all audits be conducted according to Generally Accepted Auditing Standards ("GAAS"), which mandate auditor objectivity.[9]

Stewart disregarded the TAM/SM standards and instead employed criteria she found on a Canadian website. *Id*. at 571–76. Stewart presumed System's liability and assessed taxes, penalties, and interest accordingly, making no attempt to analyze System's actual operations or

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[8] Those factors include whether the person can hire his or her own employees, whether the person can set his or her own hours, whether the person pays his or her own expenses, whether the person will make a profit or loss on the enterprise and, most importantly, whether the person furnishes equipment and has a significant investment in facilities or equipment. *Id*. at 557–63.

[9] Stewart admitted that ESD's auditors were required to follow the TAM/SM standards. ARS3 at 220–22, 294, 531. In subsequent cases such as *Hatfield Enterprizes*, however, ESD shifted course and took the position that compliance with the manuals is optional and that ESD thus has no standards for conducting audits at all.

the mechanics of its work with owner/operators. *See, e.g.*, *id*. at 387.[10] Ultimately, based on Stewart's faulty audit, ESD issued a notice of assessment on May 4, 2010 to System for taxes, penalties, and interest in the amount of $264,057.40, that included taxes not only on driver time but on equipment payments made to the owner-operators. *Id*. at 600. System appealed that assessment to the Office of Administrative Hearings ("OAH").

(4) Procedural History

System's appeal, along with those of a number of other trucking carriers, was assigned to Administrative Law Judge Todd Gay. Because all of the cases had common questions of law and the same counsel, the ALJ consolidated them for various pretrial matters, with System as the lead case.[11]

As its case proceeded toward hearing, System filed a motion *in limine* to exclude Stewart's testimony and audit findings. Although the

[10] Stewart made admittedly untrue statements in her System audit, including her claim that System failed to maintain requested records and that owner/operators participated in one carrier's 401K plan. *See id*. at 606, 318–20, 462–63. Stewart also admitted that she ignored key information the SM required her to consider, such as whether owner/operators had employees or provided expensive equipment. *See id*. at 336–38, 386, 452–53, 470, 509. She further ignored any evidence that would limit the amount she could assess, such as whether the remuneration in question was paid to corporate entities or to out-of-state owner/operators with no connection to Washington, or whether it included payments for equipment, which is non-taxable. *See id*. at 229, 385–87.

[11] However, when System filed a consolidated motion for summary judgment with three other carriers, the ALJ denied it. ARS1 at 401.

ALJ did not reject the contention that the audits had been improperly conducted, he ruled that he had no authority address any such impropriety. *Id*. at 411. He did, however, conclude that the amounts ESD had imposed in taxes on System and the others were wrong and remanded the case to ESD to reconsider the assessments and issue new ones. *Id*. at 397.[12]

It took a year for ESD to issue new assessments, even though System provided it with information as to owner/operator corporate status, UBI numbers, miles driven in Washington, the cost of operating a tractor/trailer relative to the amounts earned on a mileage basis, and other information necessary for the task. ESD did nothing with that information, forcing the ALJ to schedule a status conference. App. A at 1813. ESD eventually stipulated that 70% of owner/operators' remuneration should be allocated to equipment rental. *Id*. at 1589. ESD delayed issuing new assessments.[13] On September 7, 2012, ESD reduced

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[12] The April 5, 2011 remand order required ESD to exclude owner/operators that were corporations, *id*. at 397–98; owner/operators who were out of state and had no connection to Washington were to be excluded because they were not covered by Washington unemployment pursuant to RCW 50.04.110, *id*. at 398; and amounts attributable to the equipment provided by the owner/operator were to be excluded as well. *Id*. at 399. The order further provided that *after* ESD had completed its work and issued new assessments in conformance with the remand order, the parties were to engage in settlement discussions to either resolve the cases entirely or narrow the issues for hearing. *Id*.

[13] In April 2012, ESD issued new assessments, but it did not provide documentation to support such assessments. ESD's counsel admitted there were calculation errors that required ESD to recalculate the assessments for several of the

System's assessment without explanation to $83,955.75, *id*. at 1562, 1592, but again it could not fully document its revision.[14]

System filed a motion to compel production of ESD's documentation supporting the amount of each Carrier's amended assessment on September 14, 2012, to confirm ESD's calculations and to prepare for hearing, *id*. at 1385–91, 1562–63, but the ALJ delayed consideration of the motion to allow the parties to focus their efforts on a potential resolution of the issues remaining in the administrative process. *Id*. at 1563.

On September 26, 2012, ESD made an offer to System to resolve the issues in the administrative process, *id*. at 1563, 1595–96, that System accepted. *Id*. at 1564, 1598–1600.[15] Then, on November 16, 2012, ESD reneged on its own offer, *id*. at 1565, 1630,[16] forcing System to litigate the

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carriers. That took several months. *Id*. at 1562. ESD could not document its July 2012 adjustment. *Id*. at 1392-94, 1562, 1587.

[14] The September 2012 adjustment was the first time ESD performed the situs adjustment that the ALJ had ordered in April 2011. *Id*.

[15] The agreement resolved any issues pertaining to the amounts assessed and preserved System's right to appeal the ALJ's legal rulings on liability. *Id*. at 1595, 1599.

[16] System advised ESD in writing on November 19, 2012 that its attempt to change the agreement so late in the proceedings constituted bad faith. *Id*. at 1565, 1632–33.

enforcement of the settlement.[17] At the same time, the parties prepared for hearing.[18]

Ultimately, System's appeal returned to the administrative process, and the System appeal was assigned to ALJ Greg Weber for hearing. The parties agreed to stipulated facts and to a trial based on the administrative record. ARS1 at 2. The ALJ affirmed the assessment in the stipulated

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[17] System moved to enforce the agreed resolution of all the carriers' appeals, but the ALJ ruled he lacked authority to enforce the agreement. *Id*. at 1638–39. With the System hearing looming, the Carriers filed a motion for order to show cause in the Pierce County Superior Court on February 1, 2013. The court enforced the parties' agreement. Division II reversed, holding that the show-cause procedure was an incorrect means to initiate an action. The court did not address the substantive determination that ESD had breached a binding settlement agreement. *Eagle Systems, Inc. v. State Employment Sec. Dep't*, 181 Wn. App. 455, 326 P.3d 764 (2014). System did not seek Supreme Court review of the Court of Appeals' decision because that would have caused more delay and expense. When the cases were remanded to the administrative process, ESD agreed to a stipulated amount and trial by oral argument on stipulated facts, essentially the same posture the case would have been in if ESD had not breached the settlement agreement.

[18] The ALJ set System for hearing on February 20-21, 2013. *Id*. at 1200. He did not allow discovery and did not require ESD to submit its witness or exhibit lists in the System hearing until February 6, the same date upon which he ordered ESD to provide the information detailing how it calculated the revised assessment. *Id*. at 1200, 1556–58.

The ALJ ordered ESD's new counsel to meet with the System's counsel in an effort to resolve any outstanding issues related to documentation for ESD's assessments. *Id*. at 1644. During the meeting, ESD informed the Carriers that its documentation could not be relied upon because the figures provided did not verify the revised assessment. ESD then reneged on its earlier agreement to exclude owner/operators with a valid UBI number and/or corporate form from any assessment. *Id*.

ESD's counsel related on January 11, 2013 that ESD had never performed an *official* "revised assessment," even though it issued a revised assessment for System and the other carriers on April 16, 2012 that contained errors. *Id*. at 1644, 1647. ESD's counsel insisted that the documentation for the assessments was created for settlement purposes only and contended that it could not be the basis for a motion to compel. *Id*. at 1647. ESD's counsel also admitted that System's assessment still contained errors. *Id*. at 1645, 1651–53. On January 22, 2013, the ALJ granted the carriers' motion to compel, requiring ESD to produce extensive, detailed information in System. *Id*. at 1636–38.

amount of more than $58,300. ARS2 at 324.[19] System petitioned for review by the ESD Commissioner's Review Office ("CRO"). *Id*. at 337.[20] The CRO likewise affirmed the assessment (*id*. at 380), and System timely sought review in the Spokane County Superior Court. CP 312–57.

(5) The Trial Court's Decision

The trial court, the Honorable Harold Clarke III, heard the System appeal in conjunction with that of Hatfield Enterprizes and Swanson Hay Company. The court considered the record, heard argument, and ruled in favor of ESD. CP 639. The court felt bound by a Division I decision in *Western Ports Transp., Inc. v. Employment Sec. Dep't*, 110 Wn. App. 440, 41 P.3d 510 (2002), a case long predating the development of FAAAA jurisprudence and that dealt not with express preemption, but implied preemption. The court concluded the FAAAA did not preempt ESD's actions. CP 636. It did not find ESD's rigged audits to be consequential. CP 635. In its most interesting point, the court indicated that but for *Western Ports*, it would have concluded that the Carriers had no obligation

[19] ESD never issued a revised assessment in compliance with the ALJ's remand order. The parties negotiated, however, a stipulated assessment amount of $58,300.99—roughly 22% of the original assessment amount—to be applied if the owner/operator reclassification was upheld. *Id*. at 5.

[20] Under RCW 50.32.070, any decisions of an OAH ALJ on ESD issues is subject to further review by ESD's Commissioner, who may change findings of fact (without having heard any evidence) and alter conclusions of law and is the final agency action. RCW 50.32.080-.090. The Commissioner has assigned this role to the CRO.

to pay unemployment compensation taxes because the owner/operators were exempt independent contractors under RCW 50.04.140. CP 638. The court issued orders denying all three Carriers' appeal, CP 82 (Swanson), CP 301 (Hatfield), CP 639 (System). System timely appealed to this Court. CP 640.

D. SUMMARY OF ARGUMENT

ESD's interpretation of RCW 50.04.140 effectively means that there can *never* be an owner/operator as that concept is understood in federal law for purposes of unemployment compensation taxation, thereby effectively eliminating the use of the owner/operator business model in Washington's trucking industry, a business model in place since the early Twentieth Century. As part of its politically-motivated effort to end owner/operators in Washington's trucking industry, ESD's actions affect System's routes, prices, and services and are preempted under the FAAAA.

The CRO erred in concluding that System was obligated to pay taxes for its owners/operators, who were exempt from taxation under RCW 50.04.140(1), as the trial court concluded. In specific, the CRO erred in concluding that System failed to establish elements one and three of the statutory test, particularly where ESD violated federal law in using

federally-mandated requirements in the lease agreements to establish control.

ESD used its taxing and auditing power in bad faith to rig audits and impose illegal tax assessments through its UETF auditors, who had to invariably find employment status for owners/operators, and who knowingly imposed illegal taxes at the direction of their ESD superiors. Such arbitrary or capricious conduct should have foreclosed the assessments here.

E. ARGUMENT[21]

(1) ESD's Attack on the Owner/Operator Business Model Is Federally Preempted

The CRO and the trial court determined that ESD's interpretation of law that would eliminate owner/operators in the trucking industry was not federally preempted under the FAAAA. CP 636. In doing so, the CRO committed an error of law in failing to apply the FAAAA to ESD's

[21] In reviewing the CRO's decisions, the courts apply the provisions of RCW 34.05.570. System bears the burden of demonstrating the CRO erred, RCW 34.05.570(1)(a), and a court must grant relief if System demonstrates that one or more of the statutory bases for relief set forth in RCW 34.05.570(3) are met. *Edelman v. State*, 160 Wn. App. 294, 304, 248 P.3d 581 (2011). Upon appellate review, notwithstanding any decision by the trial court here, this Court sits in the same position as did the trial court, and it applies the APA to the administrative record. *Cornelius v. Wash. Dep't of Ecology*, 182 Wn.2d 574, 585, 344 P.3d 199 (2015).

conduct. RCW 34.05.570(3)(d).[22] Such a decision is reviewed *de novo* by this Court. *Cornelius*, 182 Wn.2d at 585.[23]

When Congress de-regulated interstate trucking in 1980 and intrastate trucking in 1994, it enacted express preemption statutes to make sure market forces would prevail and that local jurisdictions would not re-regulate the trucking industry. *Rowe v. New Hampshire Motor Transp. Ass'n*, 552 U.S. 364, 367-68, 370-71, 128 S. Ct. 989, 169 L. Ed. 2d 933 (2008). The preemptive language of the FAAAA prohibits states from "enacting or enforcing a law, regulation, or other provision . . . *related to a price, route, or service*" of any carrier with respect to the transportation of

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[22] The *only evidence* in this record concerning the impact of ESD's assessments on System came from Larry Pursley, Joe Rajkovacz, and Ted Rehwald. ARS3 at 91–95, 129–32, 146–49. *All* of those witnesses testified that ESD's taxation of owners/operators affected routes, prices, or services in the trucking industry. *ESD offered no contrary evidence whatsoever*.

[23] Ultimately, this is an issue of statutory interpretation. The primary goal of statutory interpretation is to carry out legislative intent. *Cockle v. Dep't of Labor & Indus.*, 142 Wn.2d 801, 807, 16 P.3d 583 (2001). In Washington, this analysis begins by looking at the words of the statute. "If a statute is plain and unambiguous, its meaning must be primarily derived from the language itself." *Id*. Courts look to the statute as a whole, giving effect to all of its language. *Dot Foods, Inc. v. Wash. Dep't of Revenue*, 166 Wn.2d 912, 919, 215 P.3d 185 (2009). Courts must look to what the Legislature said in the statute and related statutes to determine if the Legislature's intent is plain. *Dep't of Ecology v. Campbell & Gwinn, L.L.C.*, 146 Wn.2d 1, 9-10, 43 P.3d 4 (2002). If the language is plain, that ends the courts' role. *Cerillo v. Esparza*, 158 Wn.2d 194, 205-06, 142 P.3d 155 (2006). If, however, the language of the statute is ambiguous, courts must then construe the statutory language. A statute is ambiguous if it is subject to two or more reasonable interpretations. *State v. McGee*, 122 Wn.2d 783, 864 P.2d 912 (1993). Merely because two interpretations of a statute are conceivable, that does not render a statute ambiguous. *Tesoro Refining & Marketing Co. v. State, Dep't of Revenue*, 164 Wn.2d 310, 318, 190 P.3d 28 (2008). Courts do not read language into a statute even if they believe the Legislature might have intended it. *Kilian v. Atkinson*, 147 Wn.2d 16, 20, 50 P.3d 638 (2002).

property. 49 U.S.C. § 14501(c)(1) (emphasis added). Under the Supremacy Clause, United States Const. art. VI, ct. 2, this Court must apply the express preemption statute Congress enacted. *Grogan v. Seattle Bank*, 195 Wn. App. 500, 379 P.3d 158 (2016).

The United States Supreme Court has mandated that FAAAA preemption must be construed *broadly*, consistent with its broad interpretation of similar preemptive language enacted by Congress in connection with airline deregulation, language on which the FAAAA preemption provision is modeled. *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 383-84, 112 S. Ct. 2031, 119 L. Ed. 2d 157 (1992); *Rowe*, 552 U.S. at 370-71 (Congress adopted FAAAA preemptive language knowing of broad construction of same language in *Morales*). That broad construction imperative is *mandatory* for Washington courts.[24]

Given this broad federal preemption and the importance of owner/operators to the trucking industry, every time a state or local government has attempted to *directly* ban owner/operators in the industry, courts have held such efforts to be FAAAA-preempted.[25]

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[24] On matters of federal law, United States Supreme Court decisions are controlling. *W.G. Clark Constr. Co. v. Pac. NW Regional Council of Carpenters*, 180 Wn.2d 54, 62, 322 P.3d 1207 (2014) (with respect to federal statutes, Washington courts are bound by the construction placed upon them by the U.S. Supreme Court and decisions of the circuit courts are persuasive authority only).

[25] *E.g.*, *American Trucking Ass'ns, Inc. v. City of Los Angeles*, 596 F.3d 602, 604-05 (9th Cir. 2010) (local regulation developed in the guise of promoting port

The more difficult question for preemption is where the governmental action aimed at the use of owner/operators involves a law of "general applicability" whose application to the carrier-owner/operator relationship may only indirectly affect trucking carrier routes, prices, or services. Again, decisions of the United States Supreme Court are right on point. In *Rowe*, the Court made clear that even laws that *indirectly* impact prices, routes, or services are preempted, provided they have a significant impact. Moreover, even if a law can be characterized as "generally applicable," it is preempted if its effect intrudes upon trucking carrier routes, prices, and services.[26]

Some courts have mistakenly suggested that "general" state laws are not subject to the FAAAA's broad preemption, but these courts have created an exception found nowhere in the FAAAA's actual statutory language, and have either predated *Rowe* or failed to faithfully apply the Supreme Court's requisite analysis of the law's impact on routes, prices,

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environmental policies prohibiting use of independent contractor drivers at port was preempted); *In re Federal Preemption of Provisions of the Motor Carrier Act*, 566 N.W.2d 299, 308–09 (Mich. App. 1997), *review denied*, 587 N.W.2d 632 (Mich. 1998), *cert. denied*, 525 U.S. 1018 (1998) (striking down as preempted a regulation mandating that a truck be operated only by persons who were employees of the trucking carrier).

[26] *E.g.*, *American Airlines v. Wolens*, 513 U.S. 219, 115 S. Ct. 817, 130 L. Ed. 2d 715 (1995) (preempting Illinois consumer protection statute, a statute of general applicability); *Nw., Inc. v. Ginsberg*, ___ U.S. ___, 134 S. Ct. 1422, 188 L. Ed. 2d 538 (2014) (preempting general common-law claim for breach of the implied covenant of good faith and fair dealing, principles of general applicability).

and services.[27] The United States Supreme Court has expressly rejected attempts to imply exceptions to the broad scope of the FAAAA preemptive language not found in the FAAAA itself. *Rowe*, 552 U.S. at 374 (rejecting public health exception to FAAAA preemption – "The Act says nothing about a public health exception.").

Other courts have properly rejected such any interpretation of the FAAAA disconnected from the FAAAA's express language. Perhaps most emblematic of this analysis is the courts' treatment of Massachusetts' attempt to statutorily distinguish between employees and independent contractors for a variety of its labor laws. That statute adopted what amounts to the same standard for independent contractors that ESD has used to interpret RCW 50.04.140.[28]

Courts interpreting that statute have repeatedly held that it is FAAAA-preempted as it relates to the trucking industry because it affects routes, prices, and services by effectively eliminating a particular employment or business model in the trucking industry and creating a

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[27] *E.g.*, *Californians for Safe & Competitive Dump Truck Transp. v. Mendonca*, 152 F.3d 1184 (9th Cir. 1998), *cert. denied*, 526 U.S. 1060 (1999) (FAAAA does not preempt employee drivers' claims for violations of prevailing wage laws); *Dilts v. Penske Logistics, LLC*, 769 F.3d 637 (9th Cir. 2014), *cert. denied*, 135 S. Ct. 2049 (2015) (FAAAA does not preempt employee drivers' claims for violations of meal and rest-break laws); *Costello v. BeavEx Corp.*, 810 F.3d 105 (7th Cir. 2016).

[28] The Massachusetts statute sets out three elements that must be proven for an individual to be considered an independent contractor. *See* Appendix. It is a statute of *general applicability*, applying to various Massachusetts employment statutes.

patchwork of state laws, contrary to the deregulation policy of Congress. *Sanchez v. Lasership, Inc.*, 937 F. Supp. 2d 730 (E.D. Va. 2013); *Massachusetts Delivery Ass'n v. Coakley*, 769 F.3d 11, 17 (1st Cir. 2014); *Schwann v. FedEx Ground Package Sys., Inc.*, 813 F.3d 429 (1st Cir. 2016); *Mass. Delivery Ass'n v. Healey*, 821 F.3d 187 (1st Cir. 2016).

Recently, in *Remington v. J.B. Hunt Transport, Inc.*, 2016 WL 4975194 (D. Mass. 2016), the court held that the FAAAA preempted any effort by class action owner/operator plaintiffs claiming a violation of Massachusetts' independent contractor statute to assert that the deduction of expenses for repairs, cargo losses, insurance, or administrative fees from owner/operator compensation constituted "control" under that statute where the owner/operator regulations of 49 C.F.R. Part 376 *authorized* such deductions. As the court succinctly observed: "What is explicitly permitted by federal regulations cannot be forbidden by state law." *Id.* at *4. *See also, Rodriguez v. RWA Trucking Co.*, 219 Cal. App. 4th 692, 710 (Cal. App. 2013) (California insurance law could not prohibit charge back to truck drivers of insurance costs in light of federal law).

In this litigation, the CRO, ARS2 at 363–64, and the trial court, CP 636, have erroneously concluded that Division I's *Western Ports* decision controls on the interpretation of the FAAAA. They are wrong. Division I decided *Western Ports years* before the United States Supreme Court

made crystal clear in *Rowe* that the FAAAA must be broadly interpreted and that even a law *indirectly* affecting routes, prices, and services in trucking was preempted.[29] That decision never addressed express preemption under the FAAAA.[30] *Western Ports* is simply inapplicable to the express preemption analysis at issue here, or it must be treated as overruled because it cannot be reconciled with *Rowe*.[31]

Ultimately, at its most basic, ESD's interpretation of RCW 50.04.140 is preempted because it re-regulates (and makes illegal) what federal law specifically has determined is legal in the trucking industry (the owner/operator business model). *Hillman v. Maretta*, __ U.S. __, 133 S. Ct. 1943, 1949, 186 L. Ed. 2d 43 (2013) (a conflict is present "when

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[29] Division I's only ground for rejecting preemption was that there was no conflict between state unemployment law and federal motor carrier law. *See Western Ports*, 110 Wn. App. at 456–57. But the United States Supreme Court subsequently held that a law is preempted even if its effects are "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 (quoting *Morales*, 504 U.S. at 386-87).

[30] Division I did not address 49 U.S.C. § 14501(c), the statute at issue here. Rather, *Western Ports* considered only whether ESD's actions were *impliedly* preempted under 49 C.F.R. § 376.12(c)(4), a federal *regulation* which provides that federal leasing requirements are not intended to affect whether an owner/operator is an independent contractor or an employee. *Nowhere* did *Western Ports* ever analyze whether ESD's actions related to the carrier's prices, routes, or services. It mentioned 49 U.S.C. § 14501(c) only once, and then only to *contrast* it with the regulation actually under consideration. *See Western Ports*, 110 Wn. App. at 456–57 (calling attention to 49 U.S.C. §§ 14501(c) and 14502(b) as examples of statutes which, unlike the regulation at issue, involved Congress's express, clear, and understandable statement of preemption).

[31] *See Miller v. Gammie*, 335 F.3d 889, 893 (9th Cir. 2003) (holding that where an appellate court's reasoning is irreconcilable with the reasoning of intervening higher authority, "a lower court should consider itself bound by the later and controlling authority, and should reject the prior circuit opinion as having been effectively overruled").

compliance with both federal and state regulations is impossible."). Stated another way, preemption is required if the state law is an obstacle to the accomplishment of the purposes and objectives of Congress. *Id.* at 1950. Under the proper analysis mandated in *Rowe*, ESD's interpretation of RCW 50.04.140, designed to reclassify all owner/operators as employees, is preempted by the FAAAA.

(a) ESD's Interpretation of RCW 50.04.140 Ends the Owner/Operator Business Model in Trucking

ESD's interpretation of RCW 50.04.140 makes it *impossible* for *any* owner/operator to *ever* qualify as an exempted independent contractor. Indeed, ESD never disputed this fact below. CP 609. In this way, ESD deprives an entire industry of the right to use the owner/operator business model without facing explicit taxation by ESD and reregulation by other state agencies involved in the UETF. The State's action here is no different than the outright ban of owner/operators by the Ports of Los Angeles/Long Beach or the Michigan Legislature. For example, in finding that the control element of RCW 50.04.140 cannot be met, ESD has emphasized the fact that owner/operators must operate under a trucking carrier's federal authority or permit.[32] But federal regulations *require* that

[32] Stewart testified that "freedom from direction or control" cannot be shown if an owner/operator uses a trucking carrier's USDOT authority. ARS3 at 194.

leased equipment be operated under the carrier's USDOT authority.[33] This fact *alone* makes it impossible for an owner/operator ever to meet the test of RCW 50.04.140. The CRO also ruled that other federally-mandated terms preclude a showing of freedom from direction or control. *See* ARS1 at 372–73.[34] All of these terms are required by federal regulations for an owner/operator to have a valid contract with a trucking carrier; a carrier complying with federal law will *never* meet the test of RCW 50.04.140.

(b) ESD's Interpretation of RCW 50.04.140 Affects Trucking Services and Routes

[33] *See* 49 C.F.R. § 390.21(b)(2) (requiring all commercial motor vehicles to bear the carrier's FMCSA identification number preceded by the letters "USDOT"); *see also*, 49 C.F.R. § 376.11(c)(1) (requiring carrier during lease period to identify equipment in accordance with 49 C.F.R. part 390).

[34] 49 C.F.R. §§ 376.11(c)(1) (requiring proper identification), 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), 382.601 (requiring carriers to institute drug and alcohol testing policy applicable to all "drivers"), 382.107 (defining "driver" as including "independent owner-operator contractors"), 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 ("FMCSR")), 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). It would be impossible for a carrier to comply with these regulations without having the contract terms that the CRO interprets as showing direction and control.

Although the CRO noted System's argument that ESD's interpretation of RCW 50.04.140 affects industry services and routes was "appealing," it simply adhered to *Western Ports*. ARS2 at 363–64. ESD presented *no evidence* to contradict the Carriers' testimony that ESD's conduct affected routes, prices, and services.

Larry Pursley, Executive Vice President of the Washington Trucking Associations, Washington's principal trade organization for trucking firms, who has 33 years of experience in the trucking industry, opined that "ESD's assessments imperil the structure of Washington's trucking industry." ARS3 at 94. He explained that owner/operators provide a flexible supply of equipment in an industry with volatile demand. To meet this demand with employees, carriers would need to maintain higher equipment and personnel levels than the market calls for normally. *Id*. The added costs—not just of the equipment and the personnel, but also of the associated expenses—would necessarily be passed on to customers in the form of higher prices. *Id*. at 94–95. Joe Rajkovacz, formerly OOIDA's Director of Regulatory Affairs, testified that ESD's attempt to reclassify owner/operators will undoubtedly lead to diminished economic choices and reduced income for owner/operators. *Id*. at 132. He also testified that owner/operators located outside

Washington who lease equipment to carriers in Washington will enjoy a competitive edge in the marketplace. *Id*.

System's Vice President of Finance & Administration, Ted Rehwald, echoed this concern, explaining that the owner/operator model provides operational flexibility. *Id*. at 147. It allows System to meet fluctuating demand for its services without purchasing expensive equipment that would sit idle during periods of reduced demand. *Id*.; *see also*, ARS at 88-89, 138-40, 142-43.

Nevertheless, the CRO adopted ESD's argument that it is only addressing unemployment compensation taxes, and not altering the industry's structure. ARS2 at 363–64. ESD argued to the CRO that trucking carriers could restructure their businesses to treat owner/operators as employees in some contexts and independent contractors in others. ARS2 at 344. But that argument is unrealistic,[35] and impractical as the

[35] The claim is belied by the fact that ESD was part of the illegal UETF whose thrust was to subject carriers to state regulation for a variety of other agency purposes. UETF, a joint effort by ESD, the Department of Revenue, and the Department of Labor & Industries, developed a "Cross-Agency Referral Committee." *See* http://www.lni.wa.gov/Main/Docs/UEBenchmarkFY2011.pdf at p. 3 (last visited March 23, 2016). Also, the Obama Administration announced a new misclassification initiative. *See* http://www.dol.gov/whd/Highlights/archived.htm#Jul15_2015 (last visited Aug. 10, 2015). The U.S. Department of Labor boasts partnerships with 23 states, including Washington, "to work together on this issue in a variety of ways – through, for example, information sharing and coordinated enforcement." *See* http://www.dol.gov/whd/workers/Misclassification/index.htm#stateDetails (last visited Aug. 10, 2015). Other agencies will use ESD's determination against trucking carriers. As made clear in the 2015 report to the Legislature, n.5 *supra* at 3: "The multi-agency effort to dismantle the underground economy will continue to be a critical mission for DOR, L&I, and ESD."

district court in *Healey* noted in rejecting a similar argument. *Mass. Delivery Ass'n v. Healey*, 117 F. Supp. 3d 86, 95 (D. Mass), *aff'd*, 821 F.3d 187 (1st Cir. 2016), that such an approach was a "significant burden," that could be found *nowhere* in actual practice.

Moreover, the CRO erred in addressing this issue because any effort to supplant the owner/operator business model for trucking companies with a model of the government's choosing necessarily constitutes an effort by ESD to supplant market forces with State regulation, something the FAAAA was specifically designed to forestall.[36]

In sum, ESD's actions affected System's services and routes profoundly by effectively barring the owner/operator business model approved in federal law and essential to those carriers in addressing fluctuating service demands.

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[36] As the First Circuit noted in *Schwann*, whether to provide services through employees or through independent contractors is a significant business decision which "implicates the way in which a company chooses to allocate its resources and incentivize those persons providing the service." *Schwann*, 813 F.3d at 438. The state's interference with this decision in the trucking industry 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*.

This interference would also have a logical effect on routes. As *Schwann* explained, independent contractors assume "the risks and benefits of increased or decreased efficiencies achieved by the selected routes," while employees would likely "have a different array of incentives that could render their selection of routes less efficient." *Id*. at 439. Therefore, forcing a carrier to treat owner/operators as employees relates to routes, in addition to prices and services.

(c) ESD's Interpretation of RCW 50.04.140 Impacts Costs and Prices

For the time periods in question, ESD ultimately assessed more than $58,000 against System. ARS1 at 5. System will also have this tax obligation well into the future, if it uses the owner/operator business model. Plainly, this past and future taxation imposes an additional direct cost burden on trucking firms. The assessment of unemployment compensation taxes is not the end of the financial impact, though. Trucking companies will face added expenses under wage and hour laws, and for benefits for drivers as employees. If trucking carriers cannot use owner/operators they may need to purchase equipment, equipment is not cheap and may often sit idle as cargo needs fluctuate. These are *real* costs.

The district court in *Healey* explained that the "potential logical, if indirect, effect of Section 148B is to increase [the carrier's] prices by increasing its costs." *Healey*, *supra* at 93. The court ruled that the logical relation to prices could not be averted simply by claiming that cost increases were slight. *Id*. Likewise, here, ESD must concede that unemployment taxes increase carriers' costs now and in the future, even if it disputes the extent of that increase.

Because FAAAA preemption is intended to prevent states from substituting their "own governmental commands for 'competitive market forces' in determining (to a significant degree) the services that motor carriers will provide," *Rowe*, 552 U.S. at 372 (quoting *Morales*, 504 U.S. at 378), *any* substantial impact by ESD on the owner/operator service model in the trucking industry is preempted. As the district court in *Healey* explained, if a carrier wishes to fulfill on-demand requests for unscheduled deliveries with employee drivers, it necessarily must have on-call employees available. "Retaining on-call employees forces [the carrier] to incur costs that translate into increased prices. . . . Conversely, if [the carrier] endeavors to maintain its current prices, then the practical effect of [the statute] is to force it to abandon a service now demanded by the competitive marketplace." *Id*. at 93. These are precisely the concerns explained in System's expert declarations. *See* ARS3 at 88–89, 94–95, 132, 138–40, 142–43, 147.

To remain competitive, carriers who rely on owner/operators as a flexible supply of equipment will have to change how they do business, adopting some combination of: (a) reducing their capacity to respond to fluctuating demand for transportation services; (b) increasing their operating costs by adding new employees and equipment, which would sit idle during leaner times; or (c) raising prices to account for increased costs

and/or taxes. Indeed, ESD even imposes a higher tax rate on businesses using a flexible personnel model.[37] All of these changes from the owner/operator business model constitute a direct interference with carriers' services and/or prices. *See* ARS3 at 88–89, 138–40, 142–43, 147.[38]

In sum, ESD's interpretation of RCW 50.04.140 effectively bring owner/operators is preempted by the FAAAA. 49 U.S.C. § 14501(c).

(2) Owner/Operators Are Independent Contractors Under RCW 50.04.140(1)

RCW 50.04.140(1) establishes a three-part test exempting principals from paying unemployment compensation taxes for independent contractors. *See* Appendix.[39] The CRO agreed with

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[37] ESD punishes businesses using a flexible personnel model with short-term employees to fill temporary surges in demand, by increasing their tax rate whenever their employees file for unemployment compensation. *See* RCW 50.29.021(2), .025; WAC 192-320-005. Indeed, a trucking carrier would be at risk of an unemployment claim, and corresponding tax increase, any time an owner/operator's income is reduced by 25% or more. *See* RCW 50.20.050(2)(b)(v). ESD incentivizes businesses that favor permanent employees and discourages businesses that seek to use a flexible workforce.

[38] ESD could pursue the goal of coverage without interfering with the owner/operator business model by offering unemployment insurance to owner/operators. Owner/operators may be employers and are responsible for their employee drivers. ARS1 at 25. Owner/operators can provide such coverage for themselves by electing self-coverage. *See* RCW 50.24.160. Trucking carriers report owner/operators to ESD on Form 1099, so ESD could easily identify them and contact them to explain this option. But ESD's real goal is not to ensure unemployment coverage, but rather to shift the costs of that insurance from owner/operators to trucking carriers for politically-inspired reasons.

[39] A worker is exempted from coverage under the ESA if the employer can prove 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.

System/Hatfield that they established the second element of the statutory test. ARS2 at 378.[40] ESD has not sought review on that determination, *conceding* it.

The CRO erred specifically in concluding that the first and third elements of RCW 50.04.140(1) were not established here.[41] Indeed, the CRO's decision is entirely inconsistent with decisions of numerous other jurisdictions holding that trucking carriers are exempt from paying unemployment compensation taxes on owner/operators. *See, e.g.*, *Hammond v. Dep't of Employment*, 480 P.2d 912 (Ida. 1971); *A Nu Transfer, Inc. v. Dep't of Labor & Employment Sec. Div. of Employment*

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[40] That second element requires the contractor to provide services outside the usual course of business or outside of all the places of business of the employer. The CRO correctly determined that owner/operators performed their services outside all places of the System place of business, thus satisfying the second element of RCW 50.04.140(1). ARS1 at 378. The CRO rejected ESD's argument that the federally-mandated lease requirements could transform the owner/operator's equipment into System's place of business. *Id*. at 376–78. The CRO noted that ESD's interpretation would "effectively preclude a carrier from ever being able to satisfy the second alternative." ARS1 at 377.

[41] The trial court, however, believed that the CRO was wrong:

> Given this manner of weighing the various factors, this Court would hold the carriers are controlling the end result of the work, not the performance of the work, and the decision of the Commissioner should be reversed. However, this Court believes it is constrained to follow the holding in Western Ports, where on facts very similar to those at hand, the court held the owner-operator to be an employee for the purposes of the Unemployment Compensation Act. Accordingly the appeals are denied.

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Security, 427 So.2d 305 (Fla. App. 1983); *Wisconsin Cheese Service, Inc. v. Dep't of Industry, Labor & Human Relations*, 340 N.W.2d 908 (Wisc. 1983); *Hough Transit, Ltd. v. Harig*, 373 N.W.2d 327 (Minn. App. 1985).[42]

With regard to Washington law specifically, owner/operators are not subject to minimum wage laws, state and federal, precisely because they are true independent contractors and not subject to control. In *Moba v. Total Transportation Services, Inc.*, 16 F. Supp.3d 1257 (W.D. Wash. 2014), the court held that a motor carrier was not subject to the federal Fair Labor Standards Act or Washington's minimum wage law because its owner/operators were exempt independent contractors. The court specifically examined the terms of what were traditional owner/operator agreements in the dryage industry and concluded that the carrier did not exert control over the manner the work was performed, the owner/operators had the opportunity for profit and loss, they invested heavily in their own equipment and could hire others to operate it, they had special skills, the relationship was of a limited duration, and the

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[42] With the decisions of the Idaho Supreme Court and Oregon Court of Appeals on the implications of federally-mandated contract provisions for carrier control over owner-operators, this Court is confronted with an obvious case of a patchwork quilt of state regulations for trucking carriers post-federal deregulation. This is exactly what FAAAA preemption was intended to prevent.

owner/operators set their own schedule and could decide whether to accept a load. *Id.* at 1264-67. It is *no different* for System's owner/operators.

The Oregon Court of Appeals addressed the question of owner/operators in the trucking industry comprehensively in four decisions. *Delta Logistics, Inc. v. Employment Dep't Tax Section*, 379 P.3d 783 (Or. App. 2016); *Market Transport, Ltd. v. Employment Dep't*, 379 P.3d 608 (Or. App. 2016); *May Trucking Co. v. Employment Dep't*, 379 P.3d 602 (Or. App. 2016); and *Ceva Freight, LLC v. Employment Dep't*, 379 P.3d 776 (Or. App. 2016). That court concluded that carriers were exempt from paying unemployment compensation taxes for owner-operators.

The CRO erred in its determination, wrongly applying the law to the facts here. RCW 34.05.570(3)(d).

(a) System Does Not Control the Owner/Operators

RCW 50.04.140(1)(a) required System to document that the owner/operators have been "and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact." The System leasing agreements, mandated by 49 C.F.R. Part 376, created an independent contractor relationship with the owner/operators. ARS1 at 23.

But the CRO adopted ESD's contention that federally-mandated contractual provisions established "control" *by System*, and that such contractual requirements, not any actual control by those trucking carriers over how the owner/operators perform trucking services, constitute "control" under RCW 50.04.140. ARS2 at 372–73. That is a fundamental misstatement of law in two very key respects.

(i) Carrier Compliance With Mandatory Federal Contract Requirements Is Not "Control" by the Carriers over the Owner/Operators

System did not exercise control over the owner/operators merely because they complied with federal law that expressly mandated the contents of an equipment lease between a carrier and an owner/operator. 49 C.F.R. Part 376.[43] *Western Ports* was wrong as to this issue, as the *Remington* court recently noted.

Those regulations require a carrier to "assume complete responsibility" for the operation of the leased equipment and further obligate the carrier to maintain "*exclusive possession, control, and use of the equipment for the duration of the lease*." 49 C.F.R. § 376.12(c)(1)

[43] 49 U.S.C. § 14102(a) provides for federal regulation of a carrier's lease of motor vehicle equipment. This regulation is necessary for the efficient management of the motor carrier industry. Jessica Goldstein, *The Lease and Interchange of Vehicles in the Motor Carrier Industry*, 32 Transp. L.J. 131 (Spring 2005). *See also*, ARS3 at 94–95. Regulations in 49 C.F.R. § 376.11 *et seq.* dictate the specific terms and conditions by which a carrier may perform authorized transportation in equipment it does not own.

(emphasis added). In the interest of public safety, the regulations also mandate that trucking carriers provide liability insurance and ensure that drivers have undergone mandatory drug testing. 49 C.F.R. §§ 382.601, .107. Anticipating that states would attempt to do exactly what ESD has done here, the federal government also expressly provided in the same regulation that "[n]othing" in the "exclusive use" requirement "is intended to affect whether the lessor or driver provided by the lessor is an independent contractor or an employee of the authorized carrier lessee." 49 C.F.R. § 376.12(c)(4). The CRO should have applied this provision because it carries preemptive effect, as the *Remington* court ruled.

With regard to specific matters addressed in 49 C.F.R. Part 376 that federal regulations mandate for inclusion in a carrier-owner/operator equipment lease agreement, the federal government, not the carrier, imposes the lease requirements. Thus, any "control" exercised is that of the federal government, not the carrier, and it is exercised over both parties. Ensuring compliance with federal regulatory and safety requirements is not evidence of the right to control. *See, e.g.*, *Reed v. Indus. Comm'n*, 534 P.2d 1090 (Ariz. App. 1975) (government regulations

imposed on carriers and, in turn, applied to owner/operators do not indicate control).[44]

Recognizing that state authorities were confused about the impact of federally-mandated requirements on state law control issues, before the full federal deregulation of trucking, the Interstate Commerce Commission promulgated the predecessor to 49 C.F.R. § 376.12, and issued an explanation for that regulation, emphasizing that "exclusive possession, control, and use" of an owner/operators equipment was to have no impact on state law determinations of control over owner/operators. 1992 WL 17965. That agency reinforced that position in a subsequent 1994 declaratory order. 1994 WL 70557.

In *Western Ports*, Division I determined that ESD could properly consider such federally-mandated controls in applying the statutory test for exemption. *Western Ports* is wrong in light of the specific language of 49 C.F.R. § 376.12, and the ICC's intent for it. It is contrary to extensive

[44] *Sida of Hawaii, Inc. v. NLRB*, 512 F.2d 354, 359 (9th Cir. 1975) ("fact that a putative employer incorporates into its regulations controls required by a government agency does not establish an employer-employee relationship."); *Pouliot v. Paul Arpin Van Lines, Inc.*, 292 F. Supp. 2d 374, 383 (D. Conn. 2003) (lease regulations have no impact on the type of relationship that exists between the parties to the lease); *Tamez v. S.W. Motor Transp., Inc.*, 155 S.W.2d 564, 573 (Tex. Civ. App. 2004) (existence of lease does not have any impact on relationship between owner/operator and trucking firm); *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); *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).

authority that makes it clear that when the government controls the contract provisions, it is *the government*, not the contracting parties, exercising control. *Western Ports* also missed the point recognized by the *Remington* court that the FAAAA itself preempts its analysis. 2016 WL 4975194 at *5.

The CRO's decision allowing ESD to utilize the federal leasing requirements to find an employment relationship is error.

(ii) Control Means Control over the Owner/Operator's Provision of Trucking Services

The CRO also adopted ESD's contention that effectively *any* contractual requirement in an equipment lease agreement like System's resulted in "control" by System over its owner/operators. ARS2 at 372–73. Such an interpretation also reads an independent contract out of existence. Obviously, a principal will "control" the cargo, and when and where it is to be delivered as part of that contract. But that is *not* control over the means of providing the service, the core of decisional law on this issue.

As long ago as 1945, our Supreme Court rejected such an analysis. *Seattle Aerie No. 1 of Fraternal Order of Eagles v. Commissioner of Unemployment Comp. and Placement*, 23 Wn.2d 167, 160 P.2d 614 (1945). There, our Supreme Court held that the Eagles were not obligated

to pay unemployment compensation for musicians in orchestras 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.* at 172. The Court also stated that "A reservation by the employer of the right 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.* Washington courts have adhered to this standard in the unemployment compensation setting since that time. *E.g.*, *Jerome v. State, Emp't Sec. Dep't*, 69 Wn. App. 810, 816, 850 P.3d 1345 (1993) (RCW 50.04.140(1)(a) requires proof of control over the "methods and details of doing the work.").

The test articulated in *Aerie No. 1* and *Jerome* is akin to the traditional common law test of control.[45] Because the Legislature did not define the term "control or direction" in RCW 50.04.140(1)(a), in the

[45] The common law meaning of "control" is well-established in cases like *Kamla v. Space Needle Corp.*, 147 Wn.2d 114, 119, 52 P.3d 472 (2002) where our Supreme Court noted that the retention of the right to inspect and supervise to insure the proper completion of the contract does not preclude the independent contractor relationship, *id*. at 120–21, and a principal may retain the contractual right to order the work stopped or to control the order of the work or the right to inspect the progress of the work without creating an employment relationship.

absence of a definition, the Legislature is presumed to 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)).

As explained above, the CRO identified several contract terms that precluded System from establishing RCW 50.04.140's independent contractor exception. Essentially, the CRO parsed the contract terms and determined that the specification of certain terms constituted "control," thereby concluding that these services cannot be performed by independent contractors. The trial court here correctly perceived that "control" meant control by System over the means of delivering service, something System did not do.[46]

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[46] The trial court stated:

> …the question is whether the carriers have the right to control the methods and details of the performance of the work, as opposed to the end result of the work. This Court believes an appropriate test as to the issue of control and direction would be to measure those points of control that affect the core of the work being provided. In other words, the key is to examine whether any particular factor is central to the service being supplied, which in this case is the delivery of freight. The Administrative Law Judges and Commissioner developed a laundry list of items they believed demonstrated the right to control the performance of the work, but this Court is left with the belief that such things as keeping the equipment clean, maintaining correct signage or cooperating in any event of a loss are ancillary to the actual work of hauling, while the issues of maintaining and operating the truck, accepting a load or not, and choosing the route are more central to the question of the moving of freight.

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Again, the vast majority of the terms that showed control, according to the CRO, were required for compliance with federal regulations. These regulations are intended to promote public safety and ensure compensation is available to members of the public injured in trucking accidents. *Tamez*, 155 S.W.3d at 572. Properly insured and safely operated vehicles are a fundamental aspect of the contract between trucking carriers and owner/operators.[47]

Indeed, ESD has engaged in an abrupt turnaround in its own application of RCW 50.04.140 to owner/operators in the trucking industry. Formerly, it applied the principles of *Aerie No. 1* and *Jerome* to conclude that trucking carriers were not subject to taxation for owner/operators. In *Penick v. Emp't Sec. Dep't*, 82 Wn. App. 30, 917 P.2d 136, *review denied*, 130 Wn.2d 1004 (1996), a Division II case, ESD itself distinguished

[47] For example, federal law *mandates* that an owner-operator must use a carrier's federal operating authority, 49 C.F.R. § 390.21(b)(2); 49 C.F.R. § 376.11(c)(1), and that carriers must insure that owner-operators comply with federal alcohol and drug testing regimes for drivers. 49 C.F.R. §§ 382.107, 382.601. Federal law even dictates that carriers must give written authorization for owner/operators to have passengers in a truck. 49 C.F.R. § 392.60. The CRO highlighted the fact that System must provide written authorization for equipment to be leased to other carriers. ARS1 at 372. This is a federal requirement, 49 C.F.R. § 376.22, designed to ensure accountability for the leased equipment. The CRO also highlighted such cargo-protection requirements as owner/operators' responsibility to maintain equipment in good operating condition and supply safety devices. But properly functioning equipment that does not break down en route is important to the safety of the motoring public, ensures that a carrier's contractual purpose is achieved, and avoids liability exposure for the trucking carrier. The CRO noted further that System has the right to take possession of the equipment to complete a shipment if the owner/operator breaches the contract. ARS1 at 373. But completion of contracts is not just related to services—it *is* the service that carriers offer their customers. The CRO is inherently saying that a carrier can offer guaranteed delivery to customers only if it uses employees.

between contract employee drivers and independent owner/operators.[48] This was generally consistent with Washington law on owner/operators in other settings. *E.g.*, *Wash. State Dep't of Labor & Indus. v. Mitchell Bros. Truck Line, Inc.*, 113 Wn. App. 700, 54 P.3d 711 (2002) (Division II concludes trucking carriers not obligated to pay industrial insurance premiums for owner/operators).[49]

Ultimately, if our Supreme Court's precedents on the control element are properly applied, nothing in the System contracts evidenced control over the "methods and details" of how owner/operators perform trucking services.

In fact, the CRO *conceded* that the following facts show "autonomy" in owner/operators' work:

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[48] Penick owned Double Eagle Trucking, a firm engaged in interstate transportation. *Penick*, 82 Wn. App. at 34. He required his employee drivers to sign a contract designating them as independent contractors. But he continued to own the trucks and operate them under Double Eagle's federal authority and to pay for fuel, repairs, maintenance, licensing, and insurance. He paid the contract drivers 20% of the gross revenue generated by the loads they hauled, and assigned the contract drivers to specific trucks. *Id*. These drivers were covered under Title 50 RCW. By contrast, Penick also used the services of owner/operators, to whom he paid 80% of their gross revenues. *Id*. at 35. He leased the trucks from the owner/operators for a specified period of time. Unlike the contract drivers, the owner/operators remained responsible for operating expenses. The leased trucks carried Penick's insignia and were operated under his ICC authority. *Id*. Although ESD determined that the contract drivers were Penick's employees, it found that the owner/operators were independent contractors. *Id*. at 39.

[49] ESD's position in *Penick* on true owner/operators cannot be squared with Division I's treatment of owner/operators in *Western Ports*.

- Owner/operators are responsible for the costs of operating their equipment, including motor fuel, tires, lubricants, maintenance, repairs, taxes, assessments, licenses, permits, tolls, and scale fees." ARS1 at 372.

- Owner/operators "maintain their own liability and property damage insurance while not operating for System, and are responsible for any insurance deductibles." *Id*.

- Owner/operators are "responsible for any other fine or fees imposed against the equipment and cargo." *Id*.

- Owner/operators "are solely responsible for selecting, hiring, training, disciplining, discharging, and setting hours and wages for, its employee drivers and laborers." *Id*.

- Owner/operators "pay their own employees and make such deductions or contributions as may be required by regulatory entities." *Id*.

These factors amply document that System did not exercise control over its owner/operators under RCW 50.04.140, just as the Oregon Court of Appeals concluded in *Ceva Freight*, 379 P.3d at 780-82.[50]

(b) <u>The Owner/Operators Maintained Separate Businesses</u>

[50] The CRO also overlooked un-contradicted testimony of Ted Rehwald that System exercised no direction and control over the operators of the leased equipment and has no control over the selection, supervision, and discharge of the owner/operators' employees except as required to ensure compliance with the federal regulations. ARS3 at 147. Rehwald also stated that "System does not control the manner or prescribe the method of accomplishing the contracted-for services, except to the extent that it is required to ensure compliance with the federal regulations." *Id.* at 148. Because the contracts gave System no control over the "methods and details" of how owner/operators drive the leased equipment, the first element of the exception test is met, and owner/operators therefore qualify as independent contractors under RCW 50.04.140(1). The CRO also did not mention that under the contract's express provision, entitled "Contractor Not Employee Of Carrier," the owner/operator "is an independent contractor for the Equipment and driver services provided pursuant to this Agreement." *Id*. at 26.

The CRO determined that System did not establish the third requirement of RCW 50.04.140(1) pertaining to the existence of a business separate and apart from that of System. ARS2 at 380. In so doing, the CRO ignored *unrebutted* evidence to the contrary.[51]

A number of points of analysis apply to this third element. For example, 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 key indicia of an independently established business. *Jerome*, 69 Wn. App. at 815.

Here, the owner/operators are engaged in an established trade within the trucking industry. ARS3 at 88, 94, 132, 138, 142, 147. They conduct independently established businesses because they own their own trucks and trailers and have the ultimate responsibility for their operation. *Id.*[52] The purchase of a truck or trailer represents a significant investment for an owner/operator where the truck can cost more than $150,000 and

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[51] Owner/operators have historically been treated as independent contractors. ARS3 at 88, 94, 132, 138, 142, 147. The practice of carriers leasing trucks and classifying the drivers as independent contractors dates back to the first half of the twentieth century. *Tamez*, 155 S.W.3d at 572. As noted *supra*, courts around the nation have routinely found owner/operators to be independent contractors, as have Washington courts in cases like *Penick*. The Industrial Insurance Act, for example, expressly exempts owner/ operators from its coverage. RCW 51.08.180. ESD instructs auditors to distinguish between independent owner/operators and employee truck drivers. ARS3 at 570.

[52] Indeed, owner/operators may elect coverage under both Title 50 and 51 for themselves, RCW 50.24.160; RCW 51.12.110, and must pay premiums and taxes for drivers they employ.

the trailer can cost up to $45,000. ARH1 at 35. Moreover, owner/operators, not System, are responsible for all operating costs such as personnel, maintenance, insurance, permits, base plates, licenses, taxes, fuel, oil, and tires. ARS3 at 148. Finally, because the owner/operators own their equipment, the centerpiece of any trucking business, their businesses will survive the termination of the contractual relationships. Simply put, they can always lease that equipment to another trucking carrier or secure their own FMCSA authority.

The CRO came to the contrary conclusion on this element largely because owner/operators do not operate under their own FMCSA permits. ARS2 at 378–80. This fact is unremarkable, given that federal law *requires* owner/operators to operate under a trucking carrier's FMCSA permit. *See* 49 C.F.R. § 376.11(c). Simply put, owner/operators are not owner/operators if they operate under their own federal authority.[53]

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[53] The trial court here agreed that System satisfied this requirement:

> The case of *Jerome v. Employment Security*, 69 Wa. App. 810, 850 P.2d 1345 (1993) supplies us with a test to make a determination under this statute. The Commissioner used this test but went beyond the test to hold that whether the owner-operator had their own operating authority under the Federal Motor Carrier Safety Act (FMCSA) is an *additional paramount* (emphasis added by Commissioner) factor to be considered for the purpose of providing independently established businesses. There is no authority cited for making this an additional factor or a paramount factor.
>
> The evidence given at the hearings established most drivers do not obtain this authority, but rather operate under the authority of the

It is undisputed that owner/operators are an established business model in the trucking industry. Indeed, owner/operators have a national trade association, OOIDA, with nearly 153,000 members who collectively own and/or operate more than 200,000 heavy-duty trucks. ARS3 at 129. OOIDA advocates for the interests of these small businesses, which provide truck drivers greater income opportunities than they would have as employees. *Id*. at 129, 131–32.

The CRO erred in concluding that owner/operators, a key part of the trucking industry since the dawn of the Motor Age, are not engaged in independent trade, occupation, or business.

……..

> carrier they lease their trucks to. The Commissioner equated this decision not to obtain individual operating authority of not taking on "the administrative burdens of running a business." While that could be a conclusion one could reach if supported by some evidence, another equally speculative conclusion would be that a smart business owner would not add an unnecessary overhead expense such as buying a license if there is no need.
>
> The court in *In re: All-State Construction Co.*, 70 Wn.2d 657 (1967) held the most important factor in determining whether an individual is independently engaged is the ability to continue in business if the worker loses a particular customer. Here, the evidence was that drivers could and would operate under the authority of those they entered into leases with. This appears, from the evidence, to be their business model. There was no evidence introduced showing a driver may be out of work for any period longer without operating authority than they would be otherwise. It is simply speculative. The Commissioner's decision on this point was erroneous in interpreting and/or applying the law and should be reversed on this point.

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In sum, the CRO erred in concluding that System failed to demonstrate that RCW 50.04.140(1) applied to owner/operators. RCW 34.05.570(3)(d).

(3) ESD's Improper Audits and Assessments Should Have Been Dismissed Because ESD's Conduct Was Arbitrary or Capricious

Completely disregarding ESD's duty to use its audit power in good faith, the CRO concluded that ESD's "audits" and the assessments based on them were proper so long as ESD's ultimate System assessment was defensible. ARS2 at 367. That was error. RCW 34.05.570(3)(d).

ESD admittedly targeted the trucking industry and utilized auditors, with performance expectations requiring them to find liability in essentially *every* case. The auditors were biased and incompetent, and failed to exercise due professional care. In other words, these were not audits at all, but rather shams with predetermined results.

ESD's failure to conduct audits justly and fairly is at a minimum, arbitrary or capricious conduct, and generally unlawful. *In re Jullin*, 23 Wn.2d 1, 15-16, 158 P.2d 319 (1945) ("[ESD] commissioner must administer the act justly and fairly, for the benefit of all concerned, in accordance with law, and unless his powers are so exercised his acts are of no effect."). ESD must use its considerable taxing and audit power in

good faith.[54] Actions of an agency in excess of its statutory authority are void. *See Arbogast v. Town of Westport*, 18 Wn. App. 4, 7-8, 567 P.2d 244 (1977), *review denied*, 89 Wn.2d 1017 (1978). ESD's assessments are invalid if they result from audits that violate ESD's own standards. *See Washington Trucking Ass'ns v. State*, 192 Wn. App. 621, 647, 369 P.3d 170 (2016), *review granted*, 186 Wn.2d 1016 (2016).

(a) ESD's Unlawful Conduct Required Exclusion of the Audits and Resulting Assessments

ALJ Gay denied System's motion to exclude evidence of ESD's audits and the assessments derived from them, ruling that he was not aware of any "legal authority for dismissing an Order and Notice of Assessment based on a kind of exclusionary rule, even if there were a finding that the audit was improper or inadequate." ARS1 at 411. This ruling was erroneous because RCW 34.05.452 mandates that an administrative tribunal "*shall* exclude evidence that is excludable on constitutional or statutory grounds …." (emphasis added). ESD's misconduct violated System's constitutional rights.[55]

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[54] *Gange Lumber Co. v. Henneford*, 185 Wash. 180, 192, 53 P.2d 743, 748 (1936) (authority of tax commission cannot be exercised arbitrarily or oppressively); *Dep't of Revenue v. March*, 25 Wn. App. 314, 319, 610 P.2d 916 (1979) (same); *United States v. LaSalle Nat'l Bank*, 437 U.S. 298, 313-14, 98 S. Ct. 2357, 57 L. Ed.2d 221 (1978) (IRS must use its summons authority in good faith).

[55] Indeed, Division II held that System and other Carriers stated a cognizable claim for damages for violations of their due process and equal protection rights. *See Washington Trucking Ass'ns*, 192 Wn. App. at 649.

An agency violates substantive due process when its decision: (1) is irrational, arbitrary and capricious; (2) fails to serve a legitimate governmental purpose, or (3) is tainted by improper motive. *Motley-Motley, Inc. v. State*, 127 Wn. App. 62, 82, 110 P.3d 812 (2005), *review denied*, 156 Wn.2d 1004 (2006). ESD's audits were tainted by an improper motive, where Stewart's performance criteria made her job depend on finding liability in every audit. Further, ESD acted arbitrarily and capriciously when it imposed such performance criteria on Stewart that the zest to collect became paramount and its own audit standards were disregarded. ESD imposed taxes, penalties, and interest on System that it knew were incorrect. This was arbitrary and capricious.

ESD also deprived System of procedural due process. ESD's failure to comply with its own TAM/SM establishes a procedural due process violation where System was prejudiced. *Motley-Motley*, 127 Wn. App. at 81.[56]

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[56] The remedy for constitutional violations is the exclusion of the unlawfully obtained evidence. *See Mapp v. Ohio*, 367 U.S. 643, 655, 81 S. Ct. 1684, 6 L.Ed.2d 1081 (1961) (declaring the exclusionary rule binding on the states as a component of the Fourteenth Amendment due process clause); *State v. Miles*, 160 Wn.2d 236, 156 P.3d 864 (2007) (agents of Department of Financial Institutions failed to obtain warrants; testimony inadmissible). The exclusionary rule has also been applied in cases in which the government is seeking to exact a civil penalty. *See, e.g., McDaniel v. City of Seattle*, 65 Wn. App. 360, 828 P.2d 81 (1992), *review denied*, 120 Wn.2d 1020 (1993) (tax assessment on money illegally seized by the government) (citing *Pizzarello v. United States*, 408 F.2d 579, 585-86, *cert. denied.*, 396 U.S. 986 (2nd Cir. 1969)). *See also, Barlindal v. City of Bonney Lake*, 84 Wn. App. 135, 137–38, 925 P.2d 1289 (1996) (evidence suppressed in criminal trial was excluded in subsequent civil forfeiture proceeding).

System was deprived of the ability to prepare or present a defense by ESD's tactics—failing to make any effort to conduct a fair audit in good faith, and instead placing the burden on System to do ESD's audit work for it through extensive litigation on appeal, at a cost that far outpaces the amount of the assessment.

RCW 34.05.452 also compels this result. The evidence generated by ESD in its audits was inadmissible statutorily.

(b) ESD's Audits Were Improper and Violated ESD's Own Standards

The System assessment should be set aside for the additional reason that ESD's improprieties rendered the assessments invalid; Division II held that System and other carriers "have the ability to argue before the ALJ" that "the assessments are invalid because they resulted from an improper audit process that violated ESD's own standards." 192 Wn. App. at 647. Because ESD's audit violated ESD's own standards, the Court should find that the resulting assessment is invalid.

ESD requires that field audits be conducted in conformity with GAAS. ARS3 at 220, 294, 531, 595–98. The GAAS *General Standards* establish fundamental standards for a proper audit and provide:

> 1. The auditor must have adequate technical training and proficiency to perform the audit.

> 2. The auditor must maintain independence in mental attitude in all matters relating to the audit.
>
> 3. The auditor must exercise due professional care in the performance of the audit and the preparation of the report.

Id. at 595. ESD's TAM incorporates the GAAS *General Standards* and contains the same basic requirements. *Id*. at 219-20, 294, 553, 539, 555–56, 558. Stewart's System audit did not comply with any of these three basic standards.

Stewart failed to meet GAAS *General Standard 1*. She had no previous auditing experience and never took an auditing course. *Id*. at 174–77, 294–95. She never graduated from high school, although she later obtained a GED. *Id*. at 174. She attended community college, but never obtained a degree. *Id*. at 174–76. Her only post-secondary qualification is a certificate in word processing. *Id*. at 175.

The totality of Stewart's training was with ESD, which was limited. *Id*. at 181, 188-89. When she was hired, ESD provided her with copies of its TAM/SM, showed her the applicable statutes, and taught her how to use the relevant computer programs. *Id*. at 187. She attended a few audits with other auditors and a few ESD-sponsored courses, which were mostly investigative classes focused on interview techniques. *Id*. In

short, Stewart possessed neither the adequate training nor the proficiency to perform the audits as required by GAAS *General Standard 1*.

Stewart's audit did not meet GAAS *General Standard 2* where it was not conducted with independence and objectivity; an audit is a sham if the results are predetermined.[57] ESD itself destroyed any objectivity before the audits even began by imposing specific quotas on the amount of taxes to be assessed and the number of independent contractors to be reclassified. Stewart was told that all of her audits had to reclassify independent contractors into employees. *Id*. at 248–52. Stewart's supervisor, Lael Byington, gave her "Performance and Development Plan (PDP) Expectations" that required her to find liability in virtually every instance:

> Be a significant contributor in exceeding the Underground Economy unit's overall goals by working on larger more difficult independent contractor cases. The goals are:
>
> - $55,000 in taxes discovered per quarter
> - 7.25 audits per quarter
> - 71 new employees per quarter
> - $1.7 million in new employee wages discovered per quarter
> - Maintain a 98%-100% audits with changes to payroll

[57] TAM Section 400, states: "Each audit must be approached with an objective attitude and in a professional manner." ARS3 at 533.

Id. at 579. Thus, ESD imposed a requirement on Stewart and other UETF auditors that required them to *invariably* find for ESD. *Id*. at 248-49, 252, 258, 296-97. The results were predetermined.[58]

That ESD's quota system impairs auditor objectivity and creates a conflict of interest was supported by former State Auditor Brian Sonntag and accounting expert Steven Bishop, ARS3 at 96–110, 121–28, whose testimony was *unrebutted* by any ESD expert. This conclusion was further reinforced by a CPA from the State Auditor's Office, who testified that auditor objectivity is impermissibly compromised *any time* a government agency sets specific requirements dictating the outcome of an audit. *Id*. at 123.[59]

ESD's audits did not satisfy GAAS, *General Standard 3*; TAM § 400, mandating due professional care. Stewart admitted that while her audits must comply with the GAAS, ARS3 at 220, 294, 531, she had never

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[58] Given ESD's culture, it is perhaps not surprising that Stewart rejected any inkling of objectivity. She even wrote to Governor Gregoire suggesting that she be paid a commission on every dollar assessed. "The motivation here is obvious," she explained. "Money." *Id*. at 584.

[59] This situation violates not just ESD's internal standards, but also the state employees' statutory code of ethics. State employees are prohibited from having *any* interest, financial or otherwise, direct or indirect, that is in conflict with the proper discharge of that employee's official duties. RCW 42.52.020. ESD's quota system, by pinning Stewart's professional progress to taxpayer liability, violated that rule and created the appearance of unfairness. *See City of Hoquiam v. Public Emp't Relations Comm'n*, 97 Wn.2d 481, 488, 646 P.2d 129 (1982) (if a disinterested person, having been apprised of the totality of an official's personal interest in a matter, would be reasonably justified in thinking that partiality may exist, any course of conduct reached thereon is void).

read them, and she did not know whether her audits complied with them. *Id*. at 220-22, 294. The first time she even saw the Standards was when she was deposed, after the assessments were issued. *Id*. at 294.

Stewart ignored the TAM/SM guidelines for analyzing independent contractors in trucking and instead used tests from a Canadian website in making her determinations. *Id*. at 539, 570–76.

System's accounting expert, Steven Bishop, testified that Stewart either failed to obtain evidence on relevant factors or simply ignored evidence of independent contractor status. *Id*. at 105–07. ESD offered no evidence to contradict this conclusion. Instead, its admissions confirmed it. For example, the TAM requires an auditor to weigh *all* facts when analyzing the "employer/employee relationship" in a "careful evaluation" involving "sound judgment and responsible decisions." *Id*. at 558. But ESD admitted that it did not consider who owned the truck being leased, even though a truck represents a significant investment by an owner/operator and forms the core of the independent contractor relationship. *Id*. at 509. Stewart also ignored the fact that owner/operators make a profit or loss, decide their own routes, decide their working hours, pay their expenses such as fuel, insurance, and taxes, hire their own employees, and work on the open road. As Bishop recounts, Stewart "chose to ignore audit evidence that would support owner-operators as

independent contractors or she chose not to pursue similar evidence." *Id*. at 105.

Stewart disregarded any evidence that would limit the assessment amounts. If an owner/operator was a corporation, for example, she simply disregarded the corporate form and reclassified the corporation as an "employee." *Id*. at 336–37. If an owner/operator had a UBI number, she never researched it. *Id*. at 451–52. If huge sums were paid to an owner/operator, it never occurred to her that the owner/operator had employees. *Id*. at 205. Yet all of the contracts she examined allow owner/operators to hire employee drivers.

ESD also requires a proper audit trail and documentation. *Id*. at 98-100. The TAM at §§ 339.10, 502.04, and 705.03 requires a sufficient description so that the taxpayer, and any reviewing court, can understand how the auditor reached his or her audit findings and conclusions. ARS3 at 103, 555, 558. Stewart's audit reports utterly disregarded these requirements.[60]

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[60] Indeed, ESD's own Director of Tax Operations wrote that there was no way to determine from the audit reports how Stewart arrived at her conclusions:

> Larry – I located the audit. The audit summary and post-audit letter are not detailed enough for me to make a judgment on whether this would be a good case to consider as precedent setting. I will need a full write-up of Joy's investigation of how she applied 50.04.140 to this situation. She mentions that the department determined that the owner-operators are employees, but does not describe how the determination was made.

In sum, the flaws in Stewart's audits were manifest. That they were fundamentally in error is pointedly supported by the ALJ's April 5, 2011 remand decision that, in effect, forced ESD to issue what amounted to *entirely new assessments*. ESD's failure to follow its own auditing rules is a further basis to invalidate the assessment. *See Washington Trucking Ass'ns*, 192 Wn. App. at 647; *see also*, *Systems Amusement, Inc. v. State*, 7 Wn. App. 516, 518, 500 P.2d 1253 (1972) (the Due Process Clause is protection against arbitrary and capricious action by the state and any violation thereof may be declared void).

F. CONCLUSION

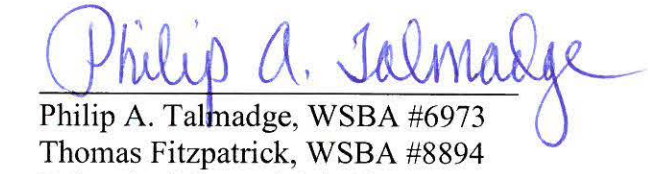
ESD's assessments, designed to eliminate owner/operators in Washington's trucking industry, were preempted by the FAAAA. The owner/operators met the test for exempted independent contractors under RCW 50.04.140, as the trial court concluded. ESD's assessments against System were arbitrary or capricious having ignored any concept of objective audits by a taxing agency using its taxing/audit power in good faith.

Id. at 652. Maureen O'Brien, System's Director of Tax Compliance and a former Alaska state auditor, likewise struggled to understand Stewart's report. For instance, Stewart claimed that she reclassified 921 independent owner/operators as employees. *Id*. at 273, 305, 606. Yet, after being repeatedly queried for information to support this number by O'Brien, Stewart finally admitted it was an error and provided a revised total. *Id*. at 231-33, 305-16. O'Brien never could reconcile the number of reclassified owner/operators from Stewart's records. *Id*. at 134. Needless to say, if ESD's Director of Tax Operations

This Court should reverse the trial court's orders and remand the case to ESD to dismiss the assessments against System. Costs on appeal should be awarded to System.

DATED this 9th day of November, 2016.

Respectfully submitted,



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and a former State Auditor could not decipher Stewart's findings, no taxpayer would be able to do so.

APPENDIX

RCW 34.05.570(3):

Review of agency orders in adjudicative proceedings. The court should grant relief from any agency order in an adjudicative proceeding only if it determines that:

(a) The order, or the statute or rule on which the order is based, is in violation of constitutional provisions on its face or as applied;

(b) The order is outside the statutory authority or jurisdiction of the agency conferred by any provision of law;

(c) The agency has engaged in unlawful procedure or decision-making process, or has failed to follow a prescribed procedure;

(d) The agency has erroneously interpreted or applied the law;

(e) The order is not supported by evidence that is substantial when viewed in light of the whole record before the court, which includes the agency record for judicial review, supplemented by any additional evidence received by the court under this chapter;

(f) The agency has not decided all issues requiring resolution by the agency;

(g) A motion for disqualification under RCW 34.05.425 or 34.12.050 was made and was improperly denied or, if no motion was made, facts are shown to support the grant of such a motion that were not known and were not reasonably discoverable by the challenging party at the appropriate time for making such a motion;

(h) The order is inconsistent with a rule of the agency unless the agency explains the inconsistency by stating facts and reasons to demonstrate a rational basis for inconsistency; or

(i) The order is arbitrary or capricious.

49 U.S.C. § 14102:

(a) GENERAL AUTHORITY OF SECRETARY.—The Secretary may require a motor carrier providing transportation subject to jurisdiction under subchapter I of chapter 135 that uses motor vehicles not owned by it to transport property under an arrangement with another party to—
(1) make the arrangement in writing signed by the parties specifying its duration and the compensation to be paid by the motor carrier;
(2) carry a copy of the arrangement in each motor vehicle to which it applies during the period the arrangement is in effect;
(3) inspect the motor vehicles and obtain liability and cargo insurance on them; and
(4) have control of and be responsible for operating those motor vehicles in compliance with requirements prescribed by the Secretary on safety of operations and equipment, and with other applicable law as if the motor vehicles were owned by the motor carrier.

49 U.S.C. § 14501:

(c) MOTOR CARRIERS OF PROPERTY.—

(1) GENERAL RULE.—
Except as provided in paragraphs (2) and (3), a State, political subdivision of a State, or political authority of 2 or more 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 (other than a carrier affiliated with a direct air carrier covered by section 41713(b)(4)) or any motor private carrier, broker, or freight forwarder with respect to the transportation of property.

49 C.F.R. § 376.11:

Other than through the interchange of equipment as set forth in § 376.31, and under the exemptions set forth in subpart C of these regulations, the authorized carrier may perform authorized transportation in equipment it does not own only under the following conditions:

(a) ***Lease.*** There shall be a written lease granting the use of the equipment and meeting the requirements contained in § 376.12.

(b) ***Receipts for equipment.*** Receipts, specifically identifying the equipment to be leased and stating the date and time of day possession is transferred, shall be given as follows:

(1) When possession of the equipment is taken by the authorized carrier, it shall give the owner of the equipment a receipt. The receipt identified in this section may be transmitted by mail, telegraph, or other similar means of communication.

(2) When possession of the equipment by the authorized carrier ends, a receipt shall be given in accordance with the terms of the lease agreement if the lease agreement requires a receipt.

(3) Authorized representatives of the carrier and the owner may take possession of leased equipment and give and receive the receipts required under this subsection.

(c) ***Identification of equipment.*** The authorized carrier acquiring the use of equipment under this section shall identify the equipment as being in its service as follows:

(1) During the period of the lease, the carrier shall identify the equipment in accordance with the FMCSA's requirements in 49 CFR part 390 of this chapter (Identification of Vehicles).

(2) Unless a copy of the lease is carried on the equipment, the authorized carrier shall keep a statement with the equipment during the period of the lease certifying that the equipment is being operated by it. The statement shall also specify the name of the owner, the date and length of the lease, any restrictions in the lease relative to the commodities to be transported, and the address at which the original lease is kept by the authorized carrier. This statement shall be prepared by the authorized carrier or its authorized representative.

(d) ***Records of equipment.*** The authorized carrier using equipment leased under this section shall keep records of the equipment as follows:

(1) The authorized carrier shall prepare and keep documents covering each trip for which the equipment is used in its service. These documents shall contain the name and address of the owner of the equipment, the point of origin, the time and date of departure, and the point of final destination. Also, the authorized carrier shall carry papers with the leased

during its operation containing this information and identifying the lading and clearly indicating that the transportation is under its responsibility. These papers shall be preserved by the authorized carrier as part of its transportation records. Leases which contain the information required by the provisions in this paragraph may be used and retained instead of such documents or papers. As to lease agreements negotiated under a master lease, this provision is complied with by having a copy of a master lease in the unit of equipment in question and where the balance of documentation called for by this paragraph is included in the freight documents prepared for the specific movement.

(2) [Reserved]

49 C.F.R. § 376.12:

Except as provided in the exemptions set forth in subpart C of this part, the written lease required under § 376.11(a) shall contain the following provisions. The required lease provisions shall be adhered to and performed by the authorized carrier.

(a) ***Parties.*** The lease shall be made between the authorized carrier and the owner of the equipment. The lease shall be signed by these parties or by their authorized representatives.

(b) ***Duration to be specific.*** The lease shall specify the time and date or the circumstances on which the lease begins and ends. These times or circumstances shall coincide with the times for the giving of receipts required by § 376.11(b).

(c) ***Exclusive possession and responsibilities.***

(1) The lease shall provide that the authorized carrier lessee shall have exclusive possession, control, and use of the equipment for the duration of the lease. The lease shall further provide that the authorized carrier lessee shall assume complete responsibility for the operation of the equipment for the duration of the lease.

(2) Provision may be made in the lease for considering the authorized carrier lessee as the owner of the equipment for the purpose of subleasing it under these regulations to other authorized carriers during the lease.

(3) When an authorized carrier of household goods leases equipment for the transportation of household goods, as defined by the Secretary, the parties may provide in the lease that the provisions required by paragraph (c)(1) of this section apply only during the time the equipment is operated by or for the authorized carrier lessee.

(4) Nothing in the provisions required by paragraph (c)(1) of this section is intended to affect whether the lessor or driver provided by 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.

(d) ***Compensation to be specified.*** The amount to be paid by the authorized carrier for equipment and driver's services shall be clearly stated on the face of the lease or in an addendum which is attached to the lease. Such lease or addendum shall be delivered to the lessor prior to the commencement of any trip in the service of the authorized carrier. An authorized representative of the lessor may accept these documents. The amount to be paid may be expressed as a percentage of gross revenue, a flat rate per mile, a variable rate depending on the direction traveled or the type of commodity transported, or by any other method of compensation mutually agreed upon by the parties to the lease. The compensation stated on the lease or in the attached addendum may apply to equipment and driver's services either separately or as a combined amount.

(e) ***Items specified in lease.*** The lease shall clearly specify which party is responsible for removing identification devices from the equipment upon the termination of the lease and when and how these devices, other than those painted directly on the equipment, will be returned to the carrier. The lease shall clearly specify the manner in which a receipt will be given to the authorized carrier by the equipment owner when the latter retakes possession of the equipment upon termination of the lease agreement, if a receipt is required at all by the lease. The lease shall clearly specify the responsibility of each party with respect to the cost of fuel, fuel taxes, empty mileage, permits of all types, tolls, ferries, detention and accessorial services, base plates and licenses, and any unused portions of such items. The lease shall clearly specify who is responsible for loading and unloading the property onto and from the motor vehicle, and the compensation, if any, to be paid for this service. Except when the violation results from the acts or omissions of the lessor, the authorized carrier lessee shall assume the risks and costs of fines for overweight and oversize trailers when the trailers are pre-loaded, sealed, or the load is

containerized, or when the trailer or lading is otherwise outside of the lessor's control, and for improperly permitted overdimension and overweight loads and shall reimburse the lessor for any fines paid by the lessor. If the authorized carrier is authorized to receive a refund or a credit for base plates purchased by the lessor from, and issued in the name of, the authorized carrier, or if the base plates are authorized to be sold by the authorized carrier to another lessor the authorized carrier shall refund to the initial lessor on whose behalf the base plate was first obtained a prorated share of the amount received.

(f) ***Payment period.*** The lease shall specify that payment to the lessor shall be made within 15 days after submission of the necessary delivery documents and other paperwork concerning a trip in the service of the authorized carrier. The paperwork required before the lessor can receive payment is limited to log books required by the Department of Transportation and those documents necessary for the authorized carrier to secure payment from the shipper. In addition, the lease may provide that, upon termination of the lease agreement, as a condition precedent to payment, the lessor shall remove all identification devices of the authorized carrier and, except in the case of identification painted directly on equipment, return them to the carrier. If the identification device has been lost or stolen, a letter certifying its removal will satisfy this requirement. Until this requirement is complied with, the carrier may withhold final payment. The authorized carrier may require the submission of additional documents by the lessor but not as a prerequisite to payment. Payment to the lessor shall not be made contingent upon submission of a bill of lading to which no exceptions have been taken. The authorized carrier shall not set time limits for the submission by the lessor of required delivery documents and other paperwork.

(g) ***Copies of freight bill or other form of freight documentation.*** When a lessor's revenue is based on a percentage of the gross revenue for a shipment, the lease must specify that the authorized carrier will give the lessor, before or at the time of settlement, a copy of the rated freight bill or a computer-generated document containing the same information, or, in the case of contract carriers, any other form of documentation actually used for a shipment containing the same information that would appear on a rated freight bill. When a computer-generated document is provided, the lease will permit lessor to view, during normal business hours, a copy of any actual document underlying the computer-generated document. Regardless of the method of compensation, the lease must permit lessor to

examine copies of the carrier's tariff or, in the case of contract carriers, other documents from which rates and charges are computed, provided that where rates and charges are computed from a contract of a contract carrier, only those portions of the contract containing the same information that would appear on a rated freight bill need be disclosed. The authorized carrier may delete the names of shippers and consignees shown on the freight bill or other form of documentation.

(h) ***Charge-back items.*** The lease shall clearly specify all items that may be initially paid for by the authorized carrier, but ultimately deducted from the lessor's compensation at the time of payment or settlement, together with a recitation as to how the amount of each item is to be computed. The lessor shall be afforded copies of those documents which are necessary to determine the validity of the charge.

(i) ***Products, equipment, or services from authorized carrier.*** The lease shall specify that the lessor is not required to purchase or rent any products, equipment, or services from the authorized carrier as a condition of entering into the lease arrangement. The lease shall specify the terms of any agreement in which the lessor is a party to an equipment purchase or rental contract which gives the authorized carrier the right to make deductions from the lessor's compensation for purchase or rental payments.

(j) ***Insurance.***

(1) The lease shall clearly specify the legal obligation of the authorized carrier to maintain insurance coverage for the protection of the public pursuant to FMCSA regulations under 49 U.S.C. 13906. The lease shall further specify who is responsible for providing any other insurance coverage for the operation of the leased equipment, such as bobtail insurance. If the authorized carrier will make a charge back to the lessor for any of this insurance, the lease shall specify the amount which will be charged-back to the lessor.

(2) If the lessor purchases any insurance coverage for the operation of the leased equipment from or through the authorized carrier, the lease shall specify that the authorized carrier will provide the lessor with a copy of each policy upon the request of the lessor. Also, where the lessor purchases such insurance in this manner, the lease shall specify that the authorized carrier will provide the lessor with a certificate of insurance for each such policy. Each certificate of insurance shall include the name of

the insurer, the policy number, the effective dates of the policy, the amounts and types of coverage, the cost to the lessor for each type of coverage, and the deductible amount for each type of coverage for which the lessor may be liable.

(3) The lease shall clearly specify the conditions under which deductions for cargo or property damage may be made from the lessor's settlements. The lease shall further specify that the authorized carrier must provide the lessor with a written explanation and itemization of any deductions for cargo or property damage made from any compensation of money owed to the lessor. The written explanation and itemization must be delivered to the lessor before any deductions are made.

(k) ***Escrow funds.*** If escrow funds are required, the lease shall specify:

(1) The amount of any escrow fund or performance bond required to be paid by the lessor to the authorized carrier or to a third party.

(2) The specific items to which the escrow fund can be applied.

(3) That while the escrow fund is under the control of the authorized carrier, the authorized carrier shall provide an accounting to the lessor of any transactions involving such fund. The carrier shall perform this accounting in one of the following ways:

(i) By clearly indicating in individual settlement sheets the amount and description of any deduction or addition made to the escrow fund; or

(ii) By providing a separate accounting to the lessor of any transactions involving the escrow fund. This separate accounting shall be done on a monthly basis.

(4) The right of the lessor to demand to have an accounting for transactions involving the escrow fund at any time.

(5) That while the escrow fund is under the control of the carrier, the carrier shall pay interest on the escrow fund on at least a quarterly basis. For purposes of calculating the balance of the escrow fund on which interest must be paid, the carrier may deduct a sum equal to the average advance made to the individual lessor during the period of time for which interest is paid. The interest rate shall be established on the date the interest period begins and shall be at least equal to the average yield or equivalent coupon issue yield on 91-day, 13-week Treasury bills as established in the weekly auction by the Department of Treasury.

(6) The conditions the lessor must fulfill in order to have the escrow fund returned. At the time of the return of the escrow fund, the authorized carrier may deduct monies for those obligations incurred by the lessor which have been previously specified in the lease, and shall provide a final accounting to the lessor of all such final deductions made to the escrow fund. The lease shall further specify that in no event shall the escrow fund be returned later than 45 days from the date of termination.

(l) ***Copies of the lease.*** An original and two copies of each lease shall be signed by the parties. The authorized carrier shall keep the original and shall place a copy of the lease on the equipment during the period of the lease unless a statement as provided for in § 376.11(c)(2) is carried on the equipment instead. The owner of the equipment shall keep the other copy of the lease.

(m) This paragraph applies to owners who are not agents but whose equipment is used by an agent of an authorized carrier in providing transportation on behalf of that authorized carrier. In this situation, the authorized carrier is obligated to ensure that these owners receive all the rights and benefits due an owner under the leasing regulations, especially those set forth in paragraphs (d)-(k) of this section. This is true regardless of whether the lease for the equipment is directly between the authorized carrier and its agent rather than directly between the authorized carrier and each of these owners. The lease between an authorized carrier and its agent shall specify this obligation.

<u>RCW 50.04.140(1):</u>

(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

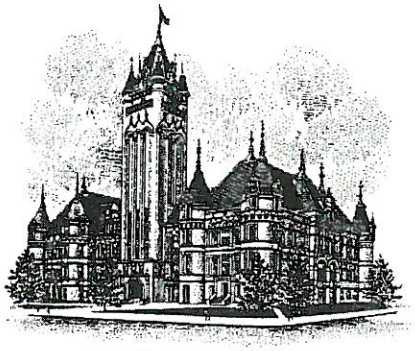
(c) Such individual is customarily engaged in an independently established trade, occupation, profession, or business, of the same nature as that involved in the contract of *service*.

MASS. GEN. LAWS ch. 149, § 148B(a):

(1) the individual is free from control and direction in connection with the performance of the service, both under his contract for the performance of service and in fact; and

(2) the service is performed outside the usual course of the business of the employer; and,

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



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SWANSON HAY COMPANY VS STATE OF WA EMPLOYMENT SECURITY DEPT
HATFIELD ENTERPRIZES INC VS STATE OF WA EMPLOYMENT SECURITY DEPT
SYSTEM-TWT TRANSPORT VS STATE OF WA EMPLOYMENT SECURITY DEPT

Case Numbers: 2015-02-03704-2, 2015-02-03856-1 and 2016-02-00121-6

Dear Counsel:

This matter came before the Court on April 22, 2016 upon the consolidated appeals filed by Petitioners with regard to the decision by the Employment Security Department to assess the Unemployment taxes on a certain group of truck drivers, namely those that own and operate their own equipment and carry freight for Petitioners under a contract. Following argument, the matter was taken under advisement.

The procedural history of this case is long and complex. It will not be recited here except to reference Pages 2 and 3 of Petitioner Swanson's brief; Petitioner Hatfield's brief Pages 9, 10 and 11; Petitioner TWT's brief Pages 6 through 12; Respondent's brief Pages 2 through 5 (Swanson); 2 through 7 (Hatfield) and 2 through 9 (System-TWT) as well as

the Commissioner's decision in each matter. These documents give a good overview of the process that has occurred over the last several years.

The administrative record delivered to the Court consists of thousands of pages from the proceedings in these consolidated matters. The Court requested counsel designate portions of the administrative records that are essential to this proceeding. To that end, the Court has received two e-mails, one from attorney Aaron Riensche, and the other from attorney Eric Peterson, both detailing portions of the record that merit close review. Additionally, Mr. Peterson corrected a portion of the Department's briefing as it pertained to drivers being included or excluded from the Hatfield assessment. The Court notes that correction.

To be precise, System TWT appeals the Commissioner's decision dated December 18, 2015; Swanson Hay appeals the Commissioner's decision dated August 14, 2015; and Hatfield appeals the Commissioner's decision dated August 21, 2015.

The Court is aware there are other pending appeals similar to this across the state. These have not been consolidated in one court for hearing, and as a result there will be various decisions at the Superior Court level that in turn may generate appeals to more than one division of the Court of Appeals. Unfortunately, this is a waste of judicial resources.

The standard of review for this Court is governed by the Administrative Procedure Act (APA). This Court acts in an appellate capacity, and review is limited to the agency record. Generally, for factual findings, the Court's review centers on whether those findings are supported by substantial evidence. Questions of law are reviewed de novo.

These cases raise the interesting issue of how workers may be treated under the law for one purpose, in this case unemployment taxes, as opposed to all purposes or any other purpose.

The Appellants have raised a number of issues, some of which relate to the substantive decision of the Commissioner, some of which relate to the process engaged in by the Department. The Court will address the Swanson appeal first, as its issues pertain mainly to the substantive decision of the Commissioner, and then the process issues raised by System and Hatfield will be addressed.

Swanson Hay: Swanson Hay presents a more limited basis for appeal. The question presented is whether the drivers at issue fall within the Independent Contractor Exemption of RCW 50.04.140. The Court agrees it is the burden of Swanson to prove the drivers fall within the exemption.

RCW 50.04.140 provides, in essence, a three-part test for the determination of whether an owner-operator is an independent contractor. The test includes; a) direction and control; b) outside usual course of business or outside all places of business; c) independently established business.

In this matter the Commissioner found Swanson had met its burden on the second part of the test but not the first or third. The first factor (direction and control) is discussed below under the issues raised by System and Hatfield.

The third factor under RCW 50.04.140(1) is subsection (c) which states "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". As somewhat of an aside, the analysis in all the briefing focuses on the word "business". There was no discussion of the words "trade or occupation". This potentially skews the analysis as to the continuance of a "business" as opposed to an "occupation or trade". While there may be no practical difference, there might be a slightly different approach depending on the category used.

The case of *Jerome v. Employment Security*, 69 Wa. App. 810, 850 P2d 1345 (1993) supplies us with a test to make a determination under this statute. The Commissioner used this test but went beyond the test to hold that whether the owner-operator had their own operating authority under the Federal Motor Carrier Safety Act (FMCSA) is an *additional paramount* (emphasis added by Commissioner) factor to be considered for the purpose of proving independently established business. There is no authority cited for making this an additional factor or a paramount factor.

The evidence given at the hearings established most drivers do not obtain this authority, but rather operate under the authority of the carrier they lease their trucks to. The Commissioner equated this decision not to obtain individual operating authority of not taking on "the administrative burdens of running a business". While that could be a conclusion one could reach if supported by some evidence, another equally speculative conclusion would be that a smart business owner would not add an unnecessary overhead expense such as buying a license if there is no need.

The court in *In re: All-State Construction Co*, 70 Wn.2d 657 (1967) held the most important factor in determining whether an individual is independently engaged is the ability to continue in business if the worker loses a particular customer. Here, the evidence was that drivers could and would operate under the authority of those they entered into leases with. This appears, from the evidence, to be their business model. There was no evidence introduced showing a driver may be out of work for any period longer without operating authority than they would be otherwise. It is simply speculative. The Commissioner's decision on this point was erroneous in interpreting and/or applying the law and should be reversed on this point.

Swanson Hay also asserts the negative impact on the trucking industry from the decision by the Commissioner. The argument is dealt with below.

System TWT / Hatfield Enterprises: System and Hatfield (and Swanson in their briefing) assert that the Department is attempting to fundamentally change the trucking industry in our state by forcing the business model of carriers to change. The evidence demonstrates the trucking industry utilizes independent contractors to meet cyclical demands for

capacity. This allows carriers to remain competitive by being flexible in the number of trucks they utilize over time. There are two problems with this assertion. First, it's unknown whether the assessment of unemployment taxes will cause the carriers to alter their business model, and two, it's unclear to this Court what the remedy would be. It would appear that a legislative resolution might be an appropriate approach to this overall philosophical question of how to treat the trucking industry business model for purposes of unemployment taxes.

System and Hatfield raise a number of other process issues, asking the Court to invalidate, or set aside, the Department's assessment. These relate broadly to: 1) The "targeting" of the trucking industry and its use of independent contractors as an overall pursuit of an "underground economy" and 2) "Rigged" or inadequate audit procedures including improper auditing techniques and 3) An abusive use of the hearings process.

The Court is aware that System, individually and as a part of Washington Trucking Association, has filed suit against the Employment Security Department for claims arising of the audits that form the basis of the assessments before the Court. The trial court dismissed the suit, but the Court of Appeals reversed in part and remanded for further proceedings. The Court left for determination a §1983 claim for attorney's fees and damages unrelated to the challenged assessments. It also left a tortious interference claim intact to the extent it relates to an improper purpose or improper means in making the assessment. The Court also held the administrative process is the place to determine the correctness of the assessment.

Accordingly, as the record reflects, the administrative process is the avenue to challenge the assessment amount, and that was done. A claim for damages has been filed. This Court is not aware of an authority that would allow it to exclude evidence, as one might do in a criminal proceeding if there is a violation of the exclusionary rule under the fourth amendment. Having said that, the Court can overrule an order if the agency has engaged in unlawful procedure or a decision-making process... (RCW 34.05.570). This Court would interpret that to mean an act done in derogation of a statute. Here, the allegation is that the agency acted, generally speaking, in bad faith in the assessment process.

Again, the administrative hearings process is designed to address <u>how</u> the assessment was made, and if the hearing and order are lawful, the challenge is not sustained.

Lastly, this Court would recognize the potential estoppel argument counsel will assert in the damages case if the Court makes any finding here as to the conduct of the agency being "unlawful." Such findings are better made after a full trial on those issues.

System and Hatfield next assert that the Federal Aviation Administration Authorization Act (FAAAA) preempts any state law that have "the force and effect of law related to a price, rate or service of any motor carrier...with respect to the transportation of property" (49 USC § 14501(c)). Appellants posit that the assessment of unemployment taxes will relate to the price, route or service of property transported and thus cannot be imposed.

At a hearing below, declarations of Kent Hatfield and Larry Pursley were introduced as to the question of impact on process, rates and services. These were introduced as a part of the Summary Judgment proceeding. While the declarations talk about a wholesale conversion of independent contractors to employees, they do not discuss analysis of the impact of independent contractors being assessed unemployment taxes. No evidence was taken before the ALJ on this issue. If a court believes the federal law may preempt this type of tax, then a factual determination would have to be made as to the impact and whether it rises to be an impermissible significant impact. That factual determination has not been made, and accordingly, this Court believes that even if preemption is to be considered, a fact finding hearing may have to be held.

Both sides cite to and discuss *Western Ports Transp. Inc. V. Emp. Sec.* 110 Wn App 440 (2002) as it pertains to the preemption questions. That case dealt with the imposition of unemployment taxes on a driver that Western Ports claimed was an independent contractor. The Court of Appeals found the driver to be an employee for the purposes of RCW 50.04, the Employment Security Act. After finding the driver to be covered under the Act, the Court went on to address the preemption argument. At Page 454 the Court stated "We also reject Western Ports' contention that federal transportation law permitting arrangements such as that between Mr. Marshall (the driver at issue) and Western Ports preempts state employment security law." On Page 457 of the opinion the Court states "We decline to infer that Congress, in enacting a federal motor carrier law, intend to preempt state unemployment law. These two types of statutes and regulations have very different policy objectives. Federal transportation law promotes public safety and provides for the easy flow of goods in interstate commerce. State unemployment law provides temporary assistance to workers during periods of involuntary unemployment."

Appellants assert the Federal Courts have rendered decisions that make Western Ports an incorrect statement of the law ("Western Ports was decided years before the core jurisprudence on this issue", Systems' brief, Page 36). The Commissioner in the underlying decision notes the executive branch is not the appropriate place for the determination of the constitutionality of the Department's orders, but does opine that the Employment Security Act is not preempted by FAAAA.

This Court declines to hold Western Ports is not the law in Washington. As the Commissioner notes, the issue has been appropriately preserved and remains so. If a reviewing court holds the law has changed, it can accordingly overrule Western Ports.

Hatfield and System assert the owner-operators do not fall within the definition of employment as that is defined under RCW 50.04.100. Specifically, they challenge the finding that these drivers are delivering "personal service" to the carriers. These two carriers take the position that the owner-operators are suppling equipment (trucks), and that is the central aspect of the relationship. This is a mixed question of law and fact. See *Cascade Nursing Services v. Employment Sec. Dept*, 71 Wn. App. 23 (1993). As with the Swanson matter, the facts as to the relationship between the owner-operators and the carriers are not at issue. The issue is the application of the law to the facts that have been found.

The legal test is whether the services provided are directly for the carriers or for their benefit. Daily Herald Co. v. Dept. of Empl. Sec., 91 Wn. 2d 559 (1997). Here, the acts of the owner-operators clearly were for the benefit of the carriers. This is consistent with the holding of Affordable Cabs v. Employment Sec., 124 Wa. App. 361 (2004). System and Hatfield cite cases from the workers compensation area of law that interpret the phrase "personal labor". This Court does not find these cases to be significantly helpful in determining this issue. The Court holds the owner-operators are delivering personal services under their agreements with the carriers.

The issue of "direction and control," the first factor in the exemption under 50.04.140, was a significant matter of dispute at the administrative level. Again, the parties do not dispute the facts of the relationship to any degree. The owner-operators have a written contract/agreement with the carriers that labels them an independent contractor. While a factor, the contract is not dispositive. Penick v. Employment Sec. Dept., 82 Wn. App. 30 (1996); Jerome, supra. (Note: The contracts in each of the matters before the Court vary somewhat in their terms).

The findings made by the Administrative Law Judge and adopted by the Commissioner are remarkably similar in each case as to the characteristics of the relationship of the carriers and the owner-operators. (See Findings 4.7 through 4.23 of Order Granting Department's Cross-Motion for Partial Summary Judgment on the Hatfield matter dated January 30, 2014 and adopted by the Commissioner on Page 20 of his decision) (See Findings 4.11 through 4.27 of Findings of Fact, Conclusions of Law and initial order on the Swanson matter dated August 14, 2014 and adopted by the Commissioner on Page 2 of his decision) (See Findings 5 through 21 of the initial order on the System-TWT matter dated July 1, 2015 and adopted by the Commissioner on Page 2 of his decision, and the Findings set out on Page 23 and 24 of the Commissioner's decision).

Essentially, the owner-operators in these matters owned their equipment; could operate that equipment themselves or hire others to do that; chose to accept work or not from the carrier; chose the route to move the cargo; are responsible for the maintenance and upkeep of their equipment; pay for fuel; are responsible for insurance or costs thereof for liability and cargo damage; get paid by a percentage of the amount paid by the customer; could transport loads when empty if the load was agreed to by the carrier.

On the other hand the owner-operator had significant reporting and safety compliance requirements both under the agreement and under federal law as it was incorporated under the agreement. Additionally, the carrier had rights to terminate the relationship and to direct when, where and what freight would be moved.

The above is not exhaustive but captures the essence of the relationship. As noted, there are minor differences between the carriers, such as Swanson providing medical and dental coverage.

Regardless, the question is whether the carriers have the right to control the methods and details of the performance of the work, as opposed to the end result of the work. This Court believes an appropriate test as to the issue of control and direction would be to measure those points of control that affect the core of the work being provided. In other words, the key is to examine whether any particular factor is central to the service being supplied, which in this case is the delivery of freight. The Administrative Law Judges and Commissioner developed a laundry list of items they believed demonstrated the right to control the performance of the work, but this Court is left with the belief that such things as keeping the equipment clean, maintaining correct signage or cooperating in the event of a loss are ancillary to the actual work of hauling, while the issues of maintaining and operating the truck, accepting a load or not, and choosing the route are more central to the question of the moving of freight.

Given this manner of weighing the various factors, this Court would hold the carriers are controlling the end result of the work, not the performance of the work, and the decision of the Commissioner should be reversed. However, this Court believes it is constrained to follow the holding in Western Ports, where on facts very similar to those at hand, the court held the owner-operator to be an employee for the purposes of the Unemployment Compensation Act. Accordingly the appeals are denied.

The Court has signed orders and filed the originals. Copies are enclosed for reference.

Sincerely,

Harold D. Clarke, III
Superior Court Judge

HDC/lss
Encl.

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JUN 23 2016
SPOKANE COUNTY CLERK

IN THE SUPERIOR COURT FOR THE STATE OF WASHINGTON
IN AND FOR THE COUNTY OF SPOKANE

SYSTEM-TWT TRANSPORT, a Washington corporation, Petitioner, vs. STATE OF WASHINGTON EMPLOYMENT SECURITY DEPARTMENT, Respondent.	**NO. 2016-02-00121-6** **ORDER RE: APPEAL**

This matter having come before the Court on April 22, 2016 upon the appeal of the Commissioner's decision rendered in this matter, and the Court having considered the pleadings filed, the arguments of counsel and pertinent portions of the administrative record;

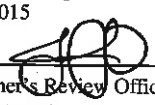
And the Court having prepared a Memorandum Decision filed concurrently with this order, IT IS NOW HEREBY ORDERED:

The appeal submitted in this matter by Petitioner is hereby DENIED.

Dated this 23rd day of June, 2016.

HAROLD D. CLARKE, III
Superior Court Judge

CERTIFICATE OF SERVICE
I certify that I mailed a copy of this decision to the within named interested parties at their respective addresses, postage prepaid, on December 18, 2015



Representative, Commissioner's Review Office
Employment Security Department

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TAX

BEFORE THE COMMISSIONER OF
THE EMPLOYMENT SECURITY DEPARTMENT
OF THE STATE OF WASHINGTON

Review No. 2015-2142

In re:	Docket No. 122014-00336
SYSTEM – TWT TRANSPORT Tax ID No. 575493-00-2	**DECISION OF COMMISSIONER**

This is an unemployment insurance tax dispute between the Employment Security Department ("Department") and the interested employer, System-TWT Transport ("System"). The Department conducted an audit of System for the period of the second quarter of 2007 through the fourth quarter of 2009. As a result of the audit, certain individuals (i.e. owner-operators) hired by System were reclassified as employees of System and their wages were deemed reportable to the Department for unemployment insurance tax purposes. On May 4, 2010, the Department issued an Order and Notice of Assessment, assessing System contributions, penalties, and interest in the amount of $264,057.40. System filed a timely appeal from the Order and Notice of Assessment.

The case then went through an extensive procedural history. Suffice it to say that after several years of litigation before the Office of Administrative Hearings ("OAH"), two state superior courts, and one state appellate court, this case was eventually remanded to the OAH for a hearing on the System's administrative appeal from the Department's tax assessment. *See* Stipulation and Order of Dismissal and Order to Disburse Funds in the Registry of the Court. After the remand, the parties entered into stipulated findings of fact agreeing, among other things, that the correct amount of contributions, penalties, and interest in dispute should be $58,300.99 for the

audit period in question. *See* Stipulated Finding of Fact No. 11. The OAH heard oral argument from the parties on March 23, 2015 and, thereafter, issued an Initial Order on July 1, 2015 ruling in favor of the Department on all issues involved. On July 30, 2015, System timely petitioned the Commissioner for review of the Initial Order. Pursuant to chapter 192-04 WAC this matter has been delegated by the Commissioner to the Commissioner's Review Office. The Commissioner's Review Office acknowledged System's Petition for Review on August 26, 2015; and, on September 10, 2015, the Commissioner's Review Office received a reply filed by the Department. Having reviewed the entire record (including the audio recording of the hearing) and having given due regard to the findings of the administrative law judge pursuant to RCW 34.05.464(4), we adopt the OAH's findings of fact and conclusions of law in the Initial Order, subject to the following additions and modifications.

Preemption

The Social Security Act of 1935 (Public Law 74-271) created the federal-state unemployment compensation program. The program has two main objectives: (1) to provide temporary and partial wage replacement to involuntarily unemployed workers who have been recently employed; and (2) to help stabilize the economy during recessions. The Federal Unemployment Tax Act of 1939 ("FUTA") and Titles III, IX, and XII of the Social Security Act ("SSA") form the basic framework of the unemployment compensation system. The U.S. Department of Labor oversees the system, with each state administering its own program.

Federal law defines certain requirements for the unemployment compensation program. For example, SSA and FUTA set forth broad coverage provisions, some benefit provisions, the federal tax base and rate, and administrative requirements. Each state then designs its own unemployment compensation program within the framework of the federal requirements. The state statute sets forth the benefits structure (e.g., eligibility/disqualification provisions, benefit amount) and the state tax structure (e.g., state taxable wage base and tax rates).

Generally speaking, FUTA applies to employers who employ one or more employees in covered employment in at least 20 weeks in the current or preceding calendar year or who pay wages of $1,500 or more during any calendar quarter of the current or preceding calendar year. *See* 26 U.S.C. § 3306(a)(1). Under FUTA, the term "employee" is defined by reference to section 3121(d) of the Internal Revenue Code. *See* 26 U.S.C. § 3306(i). In turn, 26 U.S.C. § 3121(d)(2) defines "employee" to be any individual who, under the *usual common law rules* applicable in

determining the employer-employee relationship, has the status of an employee. In 1987, the IRS issued Revenue Ruling 87-41, distilling years of case law interpreting "usual common law rules" into a more manageable 20-factor test.[1] While these 20 factors are commonly relied upon, it is not an exhaustive list and other factors may be relevant. Furthermore, some factors may be given more weight than others in a particular case. In 1996, the IRS reorganized the 20 factors into three broad categories: behavioral control, financial control, and relationship of the parties. *See* IRS, Independent Contractor or Employee? Training Materials, Training 3320-102 (October 30, 1996). However, regardless of the length and complexity of the tests developed by the IRS to clarify coverage issues for federal taxation purposes, we have cautioned that FUTA does not purport to fix the scope of coverage of state unemployment compensation laws. *See* In re Coast Aluminum Products, Inc., Empl. Sec. Comm'r Dec. 817 (1970) ("A wide range of judgment is given to the several states as to the particular type of statute to be spread upon their books." (*quoting* Steward Machine Co. v. Davis, 301 U.S. 548, 593 (1937))).

State legislatures tend to cover employers and employment that are subject to the federal taxation. Although the extent of state coverage is greatly influenced by federal statute, each state is free to determine the employers who are liable for contributions and the workers who accrue rights under its own unemployment compensation laws. Here in Washington, the first version of the Employment Security Act (or "Act"), which was then referred to as "Unemployment Compensation Act," was enacted by the state legislature in 1937. *See* Laws of 1937, ch. 162. This first version of the Act contained a definition of "employment," *see* Laws of 1937, ch. 162, § 19(g)(1)[2]; and a three-prong "independent contractor" or ABC test. *See* Laws of 1937, ch. 162, § 19(g)(5).[3]

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[1] The 20 factors are instructions; training; integration; services rendered personally; hiring, supervising, and paying assistants; continuing relationship; set hours of work; full time required; doing work on employer's premises; order or sequence set; oral or written reports; payment by hour, week, month; payment of business and/or traveling expenses; furnishing of tools and materials; significant investment; realization of profit or loss; working for more than one firm at a time; making service available to general public; right to discharge; and right to terminate. *See* Rev. Rul. 87-41, 1987-1 C.B. 296.

[2] In the first version of the Act, "employment" was defined to mean "service, including service in interstate commerce, performed for wages or under any contract of hire, written or oral, express or implied." *See* Laws of 1937, ch. 162, § 19(g)(1).

[3] In the first version of the Act, the "independent contractor" or ABC test read as follows:

> Services performed by an individual for remuneration shall be deemed to be employment subject to this act unless and until it is shown to the satisfaction of

The legislature introduced major revisions to the definition of "employment" in 1945 by adding, among other things, the phrase "*unlimited* by the relationship of *master and servant as known to the common law or any other legal relationship*." *See* Laws of 1945, ch. 35, § 11 (emphasis added). The added language greatly expanded the scope of the employment relationship as covered by the Employment Security Act beyond the scope of the employment relationship as covered by FUTA. *Compare* RCW 50.04.100 *with* 26 U.S.C. § 3306(i) and 26 U.S.C. § 3121(d)(2); *see also* In re All-State Constr. Co., 70 Wn.2d 657, 664, 425 P.2d 16 (1967) (the test to be applied in determining the employment relationship under the Act is a statutory one; and common law distinctions between employees and independent contractors are inapplicable); Skrivanich v. Davis, 29 Wn.2d 150, 158, 186 P.2d 364 (1947) (the 1945 legislature intended and deliberately concluded to extend the coverage of the 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); Unemp't Comp. Dep't v. Hunt, 17 Wn.2d 228, 236, 135 P.2d 89 (1943) (our unemployment compensation act does not confine taxable employment to the relationship of master and servant, but brings within its purview many individuals who would otherwise have been excluded under common law concepts of master and servant, or principal and agent). Since then, the definition of "employment" under the Act has remained largely unchanged. Moreover, the "independent contractor" or ABC test has also remained the same, except that in 1991 the legislature added a separate, six-prong test to the traditional three-prong test. *See* ESSB 5837, ch. 246 § 6, 52nd Leg., Reg. Sess. (Wash. 1991); *compare* RCW 50.04.140(1) *with* RCW 50.04.140(2).

Over the years, the appellate courts in Washington as well as the Commissioner's Review Office (as the final agency decision-maker on behalf of the Department) have grappled with the concept of "employment" under RCW 50.04.100 and applied the "independent contractor" test under RCW 50.04.140 in various factual scenarios, finding any given relationship either within or

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> the director that: (i) Such individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact; and (ii) Such service is either outside the usual course of the 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 (iii) 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.

See Laws of 1937, ch. 162, § 19(g)(5).

outside the intended scope of the Act. *See, e.g.*, State v. Goessman, 13 Wn.2d 598, 126 P.2d 201 (1942) (barbers were held to be in employment of the barber shop; but the legislature later enacted RCW 50.04.225 to exempt barbers from covered employment); Skrivanich, 29 Wn.2d 150 (crew members were in employment of the fishing vessel); All-State Constr. Co., 70 Wn.2d 657 (siding applicators were in employment of the construction company); Miller v. Emp't Sec. Dep't, 3 Wn. App. 503, 476 P.2d 138 (1970) (individuals performing bucking and falling activities were in employment of the logging contractor); Schuffenhauer v. Emp't Sec. Dep't, 86 Wn.2d 233, 543 P.2d 343 (1975) (clam diggers were in employment of the wholesaler of clams); Daily Herald Co. v. Emp't Sec. Dep't, 91 Wn.2d 559, 588 P.2d 1157 (1979) (bundle droppers were in employment of the newspaper publisher); Jerome v. Emp't Sec. Dep't, 69 Wn. App. 810, 850 P.2d 1345 (1993) (food demonstrators were in employment of the food demonstration business); Affordable Cabs, Inc. v. Emp't Sec. Dep't, 124 Wn. App. 361, 101 P.3d 440 (2004) (taxicab drivers were in employment of the taxicab company); *but, see, e.g.*, Cascade Nursing Serv., Ltd. v. Emp't Sec. Dep't, 71 Wn. App. 23, 856 P.2d 421 (1993) (nurses were not in employment of the nurse referral agency); In re Judson Enterprises, Inc., Empl. Sec. Comm'r Dec.2d 982 (2012) (no employment relationship was found because a business entity could not be an employee unless it was shown that the business entity is actually an individual disguised as a business entity).

Two state appellate decisions pertained specifically to the trucking industry. In Penick v. Emp't Sec. Dep't, 82 Wn. App. 30, 917 P.2d 136 (1996), Division Two of the Court of Appeals dealt with the relationship *between* a motor carrier who owned the trucks *and* the drivers who were hired to drive the trucks ("contract drivers"). In that case, the motor carrier owned the trucks and operated them under its authority from the Interstate Commerce Commission. The carrier supplied fuel, repairs and maintenance, license, and insurance; and it also handled state and federal reporting requirements. The contract drivers paid their own federal income tax, social security and medicare taxes, and motel and food expenses; they did not receive sick leave, vacations, or other benefits. The contract drivers could hire a "lumper" if they needed help in loading or unloading. The contracts, which could be terminated by either party at any time, entitled the contract drivers to 20 percent of the gross revenue generated by the loads they hauled. In the event of an accident, the contract drivers were required to pay damages not covered by the $2,500 deductible of the carrier's insurance policy. The contract drivers were also liable for shortage and cargo damage. The drivers often installed a variety of amenities on their assigned trucks to make life on the road more

comfortable. The motor carrier secured the load for the outgoing trip, and the contract drivers occasionally obtained their own loads. Any driver was free to reject an offer to haul a load secured by the carrier and, instead, could choose to haul a load obtained by the driver. The carrier obtained return loads for about half the trips, and the drivers found their own return loads for the other half of the trips. The motor carrier handled the billing and collection and provided bi-weekly draws for trip expenses to the drivers. It also made bi-weekly payments to the drivers for their share of the payment for a particular haul. The carrier required its drivers to clean the inside and outside of the truck, adhere to all federal and state laws and safety regulations, and to call in every day by 10 a.m. while en route. But the motor carrier allowed the drivers to select their own routes and to select their driving hours, so long as the hours complied with legal requirements regarding maximum driving time and rest periods. The carrier also permitted the drivers to take other people with them. *Id.* at 34-35. After examining all relevant facts, the Penick court held that the contract drivers were in employment of the motor carrier pursuant to RCW 50.04.100 and that their driving services were not exempted from coverage under the "independent contractor" test pursuant to RCW 50.04.140. *Id.* at 39-44. However, the Penick court did not address the coverage issue pertaining to the owner-operators (who owned the trucks but leased them to the carrier) because the motor carrier prevailed on that issue before the Commissioner's Review Office and did not appeal. *Id.* at 39. Because the Commissioner's Review Office did not publish the decision in the Penick matter, our holdings in that matter cannot be deemed precedential. *See* RCW 50.32.095 (commissioner may designate certain decisions as precedents by publishing them); *see also* W. Ports Transp., Inc. v. Emp't Sec. Dep't, 110 Wn. App. 440, 459, 41 P.3d 510 (2002) (unpublished decisions of Commissioner have no precedential value).

Six years later, Division One of the Court of Appeals spoke on the coverage issue pertaining to the relationship between a motor carrier and one of its owner-operators. *See* W. Ports Transp., 110 Wn. App. 440. In W. Ports, the motor carrier contracted for the exclusive use of approximately 170 trucks-with-drivers (or owner-operators). The owner-operators either provided and drove their own trucks or hired others to drive them exclusively for the carrier. The standard independent contractor agreement contained various requirements that were dictated by federal regulations governing motor carriers that utilized leased vehicles-with-drivers in interstate commerce; it also contained the carrier's own rules and policies. Pursuant to the independent contractor agreement, the owner-operators were required to operate their trucks exclusively for the

carrier, have the carrier's insignia on the trucks, purchase their insurance through the carrier's fleet insurance coverage, participate in all the company's drug and alcohol testing programs, obtain the carrier's permission before carrying passengers, notify the carrier of accidents, roadside inspections, and citations, keep the trucks clean and in good repair and operating condition in accordance with all governmental regulations, and submit monthly vehicle maintenance reports. The carrier determined the owner-operators' pickup and delivery points and required them to call or come in to its dispatch center to obtain assignments not previously scheduled and to file daily logs of their activities. The owner-operators received flat rate payments for the loads hauled and were paid twice per month. The carrier had broad rights of discharge under the independent contractor agreement, and could terminate the contract or discipline the owner-operators for tardiness, failure to regularly contact the dispatch unit, failure to perform contractual undertakings, theft, dishonest, unsafe operation of the trucks, failure of equipment to comply with federal or state licensing requirements, and failure to abide by any written company policy. The owner-operators, however, did have some autonomy. For example, the owner-operators decided the route to take in making deliveries; they also could have other drivers to operate the trucks in providing services under terms of the independent contractor agreement. The owner-operators paid all of their truck operating expenses and deducted the expenses on their federal income tax returns. *Id.* at 445-47. Based on these facts, the W. Ports court found that the carrier exerted considerable direction and control over the driving services performed by the owner-operator and, accordingly, it failed the first prong of the "independent contractor" test under RCW 50.04.140(1)(a). *Id.* at 452-54. The W. Ports court also considered and rejected the carrier's contention that federal transportation law preempted state employment security law. *Id.* at 454-57.

In this case, the interested employer, System, is an interstate motor carrier duly licensed by the U.S. Department of Transportation and the Federal Motor Carrier Safety Administration (the successor agency to Interstate Commerce Commission). *See* Declaration of Rehwald in Support of Consolidated Motion for Summary Judgment ("Decl. of Rehwald") ¶ 3 at Administrative Record ("AR") 146. System hires approximately 381 company drivers to operate equipment that it owns. In addition, System leases approximately 254 trucks from third parties commonly referred to in the trucking industry as owner-operators. According to Rehwald, the use of owner-operators is common in the industry because of the fluctuating demand for trucking services. System is able to reduce overhead costs and simplify its operations by contracting with owner-operators because

the owner-operators own their equipment and lease it to System via a written equipment lease agreement. *Id.* ¶ 5 at AR 147. System uses two different types of leases to lease motor vehicle equipment from an owner-operator: First, it uses a mileage lease on a very limited and infrequent basis, which only affects a small percentage of the owner-operators leasing equipment to System; second, System uses a percentage lease that compensates an owner-operator based on a percentage of the gross revenue generated by his or her equipment. *Id.* ¶ 6 at AR 148. System's principal office is located in Cheney, Washington; it also has terminals in a number of different states, including California, Arizona, Indiana, Colorado, and Kansas. Both System's company drivers and its owner-operators are dispatched regionally, from regional fleets that serve certain geographic areas. *Id.* ¶ 9 at AR 149. System's load coordinators are responsible for planning and coordinating freight hauling. The load coordinator matches available loads with available trucks and trailers. The loads are hauled by either company drivers or owner-operators. *See* Stipulated Finding of Fact No. 4. System does not dispute that the company drivers are its employees; however, System contends that the owner-operators are not its employees, but independent contractors, for unemployment insurance tax purposes. *See* Stipulated Finding of Fact No. 2.

As discussed above, the Department conducted an audit of System for various quarters in 2007, 2008, and 2009; and, subsequently, reclassified the owner-operators as employees of System and deemed their wages to be reportable for unemployment insurance tax purposes. System moved the OAH for summary judgment on federal preemption ground, essentially arguing that it is entitled to judgment as a matter of law because RCW 50.04.100 and RCW 50.04.140 as applied to motor carriers of the trucking industry in Washington are preempted by the Federal Aviation Administration Authorization Act of 1994 ("FAAAA"). The crux of System's argument is that the Department's efforts in applying RCW 50.04.100 and RCW 50.04.140 to the trucking industry will eliminate the use of owner-operators from the trucking industry and effectively restructure that industry, resulting in a substantial impact on its prices, routes, and services. The Department responded by arguing that the Washington's leading case, W. Port, has rejected the argument that the state employment security law is preempted by federal motor carrier law; and that preemption should not apply because any impact its application of RCW 50.04.100 and RCW 50.04.140 may have on motor carriers is far too tenuous, remote, or peripheral to be preempted.

Federal preemption is based on the United States Constitution's mandate that the "Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be

bound thereby." *See* U.S. CONST., art. VI, cl. 2; *see also* Ameriquest Mortg. Co. v. Washington State Office of Atty. Gen., 170 Wn.2d 418, 439, 241 P.3d 1245 (2010) (federal law may preempt state law by force of the Supremacy Clause of the United States Constitution). A state law that conflicts with federal law is said to be preempted and is "without effect." *See* Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516, 112 S. Ct. 2608 (1992). Federal law may preempt state law in any of the three ways: (1) expressly by the federal law's terms; (2) impliedly by Congress' intent to occupy an entire field of regulation; or (3) by the state law's direct conflict with the federal law. *See* Michigan Canners & Freezers Assoc. v. Agric. Mktg & Bargaining Bd., 467 U.S. 461, 469, 104 S. Ct. 2518 (1984). There are "two cornerstones" of federal preemption jurisprudence: First, the purpose of Congress is the ultimate touchstone in every preemption case; second, where Congress has legislated in a field traditionally occupied by states, there is a presumption against preemption. *See* Wyeth v. Levine, 555 U.S. 555, 565, 129 S. Ct. 1187 (2009). Where Congress has superseded state legislation by statute, the courts' task is to identify the domain expressly preempted. To do so, the courts must first focus on the statutory language, which necessarily contains the best evidence of Congress' preemptive intent. *See* Dan's City Used Cars, Inc. v. Pelkey, 133 S. Ct. 1769, 1778 (2013) (internal citations and quotation marks omitted).

Congress enacted the Airline Deregulation Act ("ADA") in 1978 with the purpose of furthering "efficiency, innovation, and low prices" in the airline industry through "maximum reliance on competitive market forces." *See* 49 U.S.C. §§ 40101(a)(6) & (a)(12)(A). The ADA included a preemption provision that Congress enacted to "ensure that the States would not undo federal deregulation with regulation of their own." *See* Rowe v. New Hampshire Motor Transport Ass'n, 552 U.S. 364, 368, 128 S. Ct. 989 (2008) (*quoting* Morales v. Trans World Airlines, 504 U.S. 374, 378, 112 S. Ct. 2031 (1992)). The provision specifically 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 an air carrier . . . ." *See* 49 U.S.C. § 41713(b)(1).

In 1980, Congress deregulated the trucking industry. *See* Rowe, 552 U.S. at 368 (*citing* Motor Carrier Act of 1980, 94 Stat. 793). Then, a little over a decade later, in 1994, Congress borrowed the preemption language from the ADA to preempt state trucking regulation and thereby ensure that the states would not undo the deregulation of trucking. *Id.* (*citing* FAAAA, 108 Stat. 1569, 1605-06). The FAAAA preemption provision states:

> . . . [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.

See 49 U.S.C. § 14501(c)(1). Consistent with its text and history, the U.S. Supreme Court ("Court") has instructed that, in interpreting the preemption language of the FAAAA, courts should follow decisions interpreting the similar language in the ADA. *See* Rowe, 552 U.S. at 370.

In Morales, the Court first encountered the identical preemption provision under the ADA; and the Court adopted its construction of the term "related to" from its preemption jurisprudence under the Employee Retirement Income Security Act of 1974, defining the term broadly as "having a connection with or reference to airline rates, routes, or services." *See* Morales, 504 U.S. at 384. The Court, however, reserved the question of whether some state actions may affect airline fares in "too tenuous, remote, or peripheral a manner" to trigger preemption, giving as examples state laws prohibiting gambling and prostitution as applied to airlines. *Id.* at 390. Over a decade later, in Rowe, the Court examined whether the FAAAA preempted a state's tobacco delivery regulation, which imposed several requirements on drivers of tobacco products. *See* Rowe, 552 U.S. at 369. In holding that the state's statute was preempted by FAAAA, the Court essentially adopted its reasoning in Morales, because ADA and FAAAA consisted of identical preemption language and further because "when judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its judicial interpretations as well." *Id.* at 370 (*quoting* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 85, 126 S. Ct. 1503 (2006)). In reaffirming Morales, the Court in Rowe explained:

> . . . (1) that "[s]tate enforcement actions having a connection with, or reference to," carrier " 'rates, routes, or services' are pre-empted"; (2) that such pre-emption may occur even if a state law's effect on rates, routes, or services "is only indirect"; (3) that, in respect to pre-emption, it makes no difference whether a state law is "consistent" or "inconsistent" with federal regulation; and (4) that pre-emption occurs at least where state laws have a "significant impact" related to Congress' deregulatory and pre-emption-related objectives.

Id. (internal citations omitted). Subsequently, the Court cautioned that the breath of the words "related to" did not mean the sky was the limit and that the addition of the words "with respect to the transportation of property" massively limited the scope of preemption ordered by the FAAAA.

See Pelkey, 133 S. Ct. at 1778 (FAAAA did not preempt state-law claims for damages against a towing company regarding the company's post-towing disposal of the vehicle) (internal quotation marks omitted). Finally, in Am. Trucking Ass'n, Inc. v. City of Los Angeles, 133 S. Ct. 2096 (2013), the Court addressed another aspect of the FAAAA preemption – the "force and effect of law" language, drawing a distinction between a government's exercise of regulatory authority and its own contract-based participation in the market. The Court held that, when the government employed the "hammer of the criminal law" to achieve its intended goals, it acted with the force and effect of law and thus the concession agreement's placard and parking provisions were preempted by the FAAAA because such provisions had the "force and effect of law." *Id.* at 2102-04.

In the meantime, the lower federal courts do not seem to agree on the FAAAA's preemptive effects on state law. For example, in Californians for Safe & Competitive Dump Truck Transp. v. Mendonca, 152 F.3d 1184, 1189 (9th Cir. 1998), the Ninth Circuit held that California's prevailing wage law, a state law dealing with matters traditionally within a state's police powers, had no more than an indirect, remote, and tenuous effect on and, thus, was not "related to" the motor carriers' prices, routes, and services within the meaning of the FAAAA's preemption clause. Most recently, the Ninth Circuit, in holding that California's meal and rest break laws were not preempted by FAAAA, reasoned that:

> [The meal and break laws] do not set prices, mandate or prohibit certain routes, or tell motor carriers what services they may or may not provide, either directly or indirectly. They are "broad law[s] applying to hundreds of different industries" with no other "forbidden connection with prices[, routes,] and services." They are normal background rules for almost *all* employers doing business in the state of California. And while motor carriers may have to take into account the meal and rest break requirements when allocating resources and scheduling routes – just as they must take into account state wage laws or speed limits and weight restrictions, the laws do not "bind" motor carriers to specific prices, routes, or services. Nor do they "freeze into place" prices, routes, or services or "determin[e] (to a significant degree) the [prices, routes, or] services that motor carriers will provide." Further, applying California's meal and rest break laws to motor carriers would not contribute to an impermissible "patchwork" of state-specific laws, defeating Congress' deregulatory objectives.

See Dilts v. Penske Logistics, LLC, 769 F.3d 637, 647 (9th Cir. 2014), *cert. denied*, 135 S. Ct. 2049 (2015) (internal citations omitted).

In contrast, the Ninth Circuit have held that a complete ban on the use of independent contractors could not survive the FAAAA preemption. *See* Am. Trucking Ass'ns, Inc. v. City of Los Angeles, 559 F.3d 1046, 1056 (9th Cir. 2009) (the independent contractor phase-out provision in Port of Los Angeles' concession agreement was "one highly likely to be shown to be preempted"); *see also* Am. Trucking Ass'ns, Inc. v. City of Los Angeles, 660 F.3d 384, 407-08 (9th Cir. 2011) (the employee-driver provision was preempted by FAAAA as related to rates, routes, and services; and it did not fall under either the safety exception or market participant exception). Furthermore, in considering whether a Massachusetts statute, restricting the second prong (i.e. prong B) of the traditional independent contractor test to only one alternative (i.e. the "outside the usual course of the business" alternative), was preempted by FAAAA, the First Circuit stated that:

> First, a statute's "potential" impact on carriers' prices, routes, and services can be sufficient if it is significant . . . . We have previously . . . allowed courts to "look[ ] to the logical effect that a particular scheme has on the delivery of services or the setting of rates." Second, this logical effect can be sufficient even if indirect . . . . Far from immunizing motor carriers from all state economic regulations, we are following Congress's directive to immunize motor carriers from state regulations that threaten to unravel Congress's purposeful deregulation in this area.

See Mass. Delivery Ass'n v. Coakley, 769 F.3d 11, 21 (1st Cir. 2014) (internal citation omitted). Following a remand from the First Circuit, the lower district court held that prong B of the Massachusetts' independent contractor statute was preempted by the FAAAA. *See* Mass. Delivery Ass'n v. Healey, 2015 WL 4111413 (D. Mass. July 8, 2015).

It is against the backdrop of the U.S. Supreme Court's decisions in Morales, Rowe, and Pelkey as well as a plethora of seemingly conflicting decisions of the lower federal courts, that we now confront System's federal preemption argument. System contends that the FAAAA preempts the Washington's Employment Security Act as applied to the trucking industry because it directly affects and, therefore, is "related to" the prices, routes, and services of its motor carrier business. System introduced two declarations in support of its contention: a declaration by Larry Pursley, Executive Vice President of Washington Trucking Association; and a declaration by Joe

Rajkovacz, Director of Regulatory Affairs for the Owner-Operator Independent Drivers Association.

According to Pursley, the owner-operators have long been an important component of the trucking industry, both nationally and locally. The owner-operators are utilized in most, if not all, sectors of the industry, including long-haul trucking, household goods moving, and intermodal operations. Motor carriers contract with owner-operators to obtain the owner-operators' equipment to haul freight on an as-needed basis. *See* Declaration of Pursley in Support of Consolidated Motion for Summary Judgment ("Decl. of Pursley") ¶ 6 at AR 93. With the economic deregulation of the interstate trucking industry, the vast majority of trucking business are small businesses, and nearly 96 percent of those businesses operate fewer than 20 trucks and nearly 88 percent operate six trucks or less. Consequently, the trucking industry is a highly diverse industry, resulting in intense competition and low profit margins. *Id.* ¶ 5 at AR 92. Pursley asserts that the assessments imposed by the Department on motor carriers will fundamentally change the business models of both motor carriers and owner-operators throughout Washington, because the Department will effectively prohibit carriers from using independent owner-operators. According to Pursley, requiring carriers to use employees rather than independent contractors will force carriers to establish and maintain an employee workforce in order to meet peak demand and to considerably build the related infrastructure such as trucks, administrative staff, and garages. Moreover, requiring carriers to convert independent owner-operators into employees will compel carriers to take on additional employment-related costs, including state and federal social security taxes, unemployment insurance taxes, and medical and retirement costs. As a result, carriers would need to raise their prices in order to defray the additional expenses. *Id.* ¶ 10 at AR 94. Finally, Pursley asserts that the Department's effort will lead to diminished economic choices and reduced income for owner-operators by forcing them to get their own motor carrier authority if they are to maintain their independence. *Id.* ¶ 11 at AR 95.

Additionally, System requests us to depart from our state's appellate decision in W. Ports, which held that federal transportation law did not preempt state employment security law. *See* W. Ports, 110 Wn. App. at 454-57. System argues that W. Ports court never analyzed the FAAAA preemption clause under 49 U.S.C. § 14501(c)(1) and that W. Ports court's two bases for rejecting the preemption argument are no longer valid in light of the subsequent U.S. Supreme Court's decision in Rowe. *See* System's Petition for Review at 3.

While System's arguments are appealing and we are tempted to address the merits of the federal preemption issue, we must be mindful of our limited authority as a quasi-judicial body. As a general proposition, the Commissioner's Review Office, being an office within the executive branch of the state government, lacks the authority or jurisdiction to determine whether the laws it administers are constitutional; only the courts have that power. *See* RCW 50.12.010; RCW 50.12.020; Bare v. Gorton, 84 Wn.2d 380, 383, 526 P.2d 379 (1974); In re Kellas, Empl. Sec. Comm'r Dec.2d 825 (1991) (Commissioner's Review Office is part of an administrative agency in the executive branch of government and is thus without power to rule on constitutionality of a legislation; that function is reserved to judicial branch of government); In re Bremerton Christian Schools, Empl. Sec. Comm'r Dec.2d 809 (1989); In re Ringhofer, Empl. Sec. Comm'r Dec.2d 145 (1975). On the other hand, the superior court, on judicial review of a final agency order issued by the Commissioner's Review Office, may hear arguments and rule on the constitutionality of the Department's orders. *See* RCW 34.05.570(3)(a) (the court shall grant relief from an agency order in an adjudicative proceeding if the order, or the statute or rule on which the order is based, is in violation of constitutional provisions on its face or as applied). Consequently, in keeping with the authority of the highest tribunals of Washington State and federal jurisprudence, we are of the view that, to the extent the Washington's Employment Security Act as applied to motor carriers of the trucking industry implicates the Supremacy Clause of the United States Constitution (on the basis that the Department's enforcement effort is allegedly preempted by the FAAAA), the Commissioner's Review Office, as an executive branch administrative office, is not the appropriate forum to decide such a constitutional issue.

Despite the general prohibition on administrative agencies from deciding constitutional issues, but with an eye toward assuring that the constitutional issue in this case has been properly addressed at the administrative level, we have reviewed the entire record developed by the OAH below and are satisfied that the parties were allowed to present all evidence (via two declarations filed on behalf of System) they deemed relevant to the federal preemption issue. Consequently, we are of the opinion that the OAH and the parties have developed a substantial and sufficient record from which a court can make an informed and equitable decision on the constitutional front.

Finally, the Commissioner's Review Office, as the final decision-maker of an executive agency, is bound by the state appellate court's decisions; and System has not supplied any authorities for us to do otherwise. As such, to the extent that the W. Port court already considered

and rejected the argument that federal transportation laws preempted state employment security law, *see* W. Ports, 110 Wn. App. at 454-57, we concur with the OAH that the Washington's Employment Security Act as applied to motor carriers of trucking industry is not preempted by the FAAAA preemption clause. *See* adopted Conclusions of Law Nos. 11 – 13 in Initial Order.

Void Assessment

In its Petition for Review, System requests that we dismiss the assessment in question as void on various grounds. *See* System's Petition for Review at 5. We consider each of the grounds below and decline to dismiss the assessment as void.

I

First, System contends that the assessment is void because the Department lacked statutory authority to issue the assessment. We disagree. Generally speaking, a Departmental order is void only when the Department lacks either personal or subject matter jurisdiction. *See* Marley v. Dep't of Labor & Indus., 125 Wn.2d 533, 542, 886 P.2d 189 (1994). The type of controversy over which an agency has subject matter jurisdiction refers to the general category of controversies it has authority to decide, and is distinct from the facts of any specific case. *See* Singletary v. Manor Healthcare Corp., 166 Wn. App. 774, 782, 271 P.3d 356 (2012). Obviously, the power to decide a type of controversy includes the power to decide wrong, and an incorrect decision is as binding as a correct one. *See* Marley, 125 Wn.2d at 543. "If the type of controversy is within the subject matter jurisdiction, then all other defects or errors go to something other than subject matter jurisdiction." *Id.* at 539. As such, the assessment in question is void only if System can show that the Department lacked personal or subject matter jurisdiction to issue the assessment. Here, System has not challenged the Department's personal jurisdiction. Moreover, issuing tax assessments to Washington employers, putative or otherwise, for unemployment insurance tax purposes is precisely within the subject matter jurisdiction delegated to the Department by the Washington state legislature. Consequently, we may not void the assessment in question for want of personal or subject matter jurisdiction.

II

System next argues that the assessment is a result of arbitrary or capricious action on the part of the Department. System's argument is not well-taken. In general, courts should not probe the mental processes of administrative officials in making a decision. *See* Nationscapital Mortg. Corp. v. Dep't of Fin. Insts., 133 Wn. App. 723, 762-763, 137 P.3d 78 (2006) (*citing* United States

v. Morgan, 313 U.S. 409, 422 (1941)). In the absence of evidence to the contrary, courts should "presume public officers perform their duties properly, legally, and in compliance with controlling statutory provisions." *Id.* at 763 (*citing* Ledgering v. State, 63 Wn.2d 94, 101, 385 P.2d 522 (1963)). When a court conducts a judicial review of matters of agency discretion, its role is limited to ensuring that the agency has exercised its discretion in accordance with the law and has not abused its discretion. *See* RCW 34.05.574(1); *see also* NW Sportfishing Indus. Ass'n v. Dep't of Ecology, 172 Wn. App. 72, 91, 288 P.3d 677 (2012) (a reviewing court should avoid exercising discretion that our legislature has placed in the agency). An agency abuses its discretion when it exercises its discretion in an arbitrary and capricious manner. *See* Conway v. Dep't of Soc. & Health Servs., 131 Wn. App. 406, 419, 120 P.3d 130 (2005). An agency action is arbitrary and capricious if it is "willful and unreasoning and taken without regard to the attending facts or circumstances." *See* Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n, 148 Wn.2d 887, 905, 64 P.3d 606 (2003). An agency action is not arbitrary and capricious if the decision is exercised honestly and upon due consideration, even where there is room for two opinions. *Id.* ("[W]here there is room for two opinions, an action taken after due consideration is not arbitrary and capricious even though a reviewing court may believe it to be erroneous"); *see also* DeFelice v. State, 187 Wn. App. 779, 787-88, 351 P.3d 197 (2015). The scope of review under an arbitrary and capricious standard is extremely narrow, and the party challenging the agency action carries a heavy burden. *See* Keene v. Bd. Of Accountancy, 77 Wn. App. 849, 859, 894 P.2d 582 (1995); Ass'n of Wash. Spirits & Wine Distrib. v. Wash. State Liquor Control Bd., 182 Wn.2d 342, 359, 340 P.3d 849 (2015).

In the instant case, System asserts that the Department acted arbitrarily and capriciously when it failed to follow its own internal audit standards and manuals, such as Tax Audit Manual, Status Manual, and Generally Accepted Audit Standards. However, internal policies, directives, and standards do not generally create law that binds the agency, unless they are formally promulgated pursuant to legislative delegation. *See* Joyce v. Dep't of Corrections, 155 Wn.2d 306, 323, 119 P.3d 825 (2005). Accordingly, the Department's failure to adhere to its own internal, nonbinding standards or manuals is not an arbitrary and capricious action *per se*.

More troubling is the fact that the Department expected the tax specialist in this case to find errors, errors of omitting employees, and errors of omitting remuneration. System asserts that such performance expectations violated the audit standards of independence, objectivity, and

impartiality, resulting in predetermined liability. We can agree with System this much: The goal of an audit is to determine the accuracy of the material audited, no more and no less. However, an auditing target or quota may be nothing more than assuring that the auditor is conducting the audits thoroughly and adequately. Expecting that the auditors almost always find errors may be nothing more than a statistical reality that most employers make mistakes. Or, as explained by the tax specialist in this case, the pre-audit research by the auditor already established that the employers selected for audit had most likely erred in treating employees as independent contractors. Consequently, performance expectations imposed on an auditor do not in and of themselves make the assessment arbitrary and capricious, unless it can be shown that the auditor intentionally fabricated or manipulated the audit result to meet the performance quota or that the assessment was utterly baseless. In this case, System has not alleged that the tax specialist intentionally fabricated or otherwise manipulated the audit result to meet her performance quota; furthermore, the assessment was certainly not baseless, especially when its result was consistent with the W. Ports decision (finding an owner-operator was in employment of a motor carrier under the Employment Security Act). *See* W. Ports, 110 Wn. App. at 459. Accordingly, we are not persuaded that the Department acted arbitrarily and capriciously in issuing the assessment in question.

System further asserts that the Department deliberately inflated the assessment by including payments for equipment rental, payments to owner-operators with no situs connection to Washington State, and payments to owner-operators with corporate form. This argument fails on its merits. The Department is required to conduct audits with information provided by the employer or with the best information available if the employer fails to provide necessary information. *See* WAC 192-340-020. Employers are under an obligation to provide reports or returns to the Department, and to make payroll and accounting records available to the Department. *See* RCW 50.12.070; WAC 192-310-050(1). The employer records are required to be accurate. *See* RCW 50.12.070(1)(a). When an employer fails to provide sufficient and accurate information to the Department, the Department is authorized to *arbitrarily* make a report on behalf of such employer, and the arbitrary report is deemed *prima facie* correct. *See* RCW 50.12.080. Here, System did not provide all necessary information during the audit for the Department to make an accurate assessment. Instead, System would like us to focus on what the tax specialist could or should have done in reducing the assessment. Based on our review of the record, we are satisfied

that the Department acted within the bounds of its statutory authority, as the Department was only required to make an arbitrary report on the basis of knowledge available to it pursuant to RCW 50.12.080. Because the burden is on System to provide necessary information to the Department, the Department cannot then be faulted for an "inflated" assessment. Regardless, System has now stipulated to the correct amount of the assessment (i.e. $58,300.99), which is less than a quarter of the original assessed amount (i.e. $264,057.40). *See* Stipulated Finding of Fact No. 11. The Department has excluded all items disputed by System in order to reach an agreement with System. *See* Stipulated Findings of Fact Nos. 9, 10. As such, any grounds for System's attack on the validity of the assessment no longer exist, because the amount is no longer "inflated" pursuant to the parties' stipulation.

In any event, any misdeeds on the part of the Department in conducting the audit and issuing the assessment, do not warrant a dismissal or exclusion of the assessment in this case. After all, the statutes (i.e. Title 50 RCW) and regulations (i.e. Title 192 WAC) do not require the Department to follow any particular process or abide by any particular standard in conducting tax audits. To the extent that the Department's audit was inadequate, incomplete, or lack of professional due care, System has the right to appeal the assessment and request a hearing before the OAH, and it did so in this case. *See* RCW 50.32.030; *see, e.g.,* Motley-Motley, Inc. v. State, 127 Wn. App. 62, 78-79, 110 P.3d 812 (2005) (even if Department of Ecology's investigation of Motley's water right was inadequate, incomplete, and secret, Motley still had the opportunity to request a hearing before the Pollution Control Hearings Board; and the proceedings before the Pollution Control Hearings Board were *de novo*, without deference to Department of Ecology's initial/tentative decision). Accordingly, we concur with the OAH that System's request to dismiss or exclude the assessment in question shall be denied. *See* adopted Conclusion of Law No. 14.

III

Additionally, System argues that the Department should be "equitably estopped from changing its longstanding position that owner/operators are independent contractors, as evidenced by the *Penick* case and [its] own manuals." System's argument in this regard is not persuasive. A party asserting equitable estoppel must establish: (1) an admission, statement, or act that is inconsistent with a later claim; (2) a reasonable reliance on the admission, statement, or act; and (3) injury that would result to the relying party if the first party is allowed to contradict or repudiate the prior act, statement, or admission. *See* Robinson v. Seattle, 119 Wn.2d 34, 82, 830 P.2d 318

(1992). Equitable estoppel is based on the principle that a party should be held to a representation made or position assumed where inequitable consequences would otherwise result to another party who has justifiably and in good faith relied thereon. *See* Wilson v. Westinghouse Elec. Corp., 85 Wn.2d 78, 81, 530 P.2d 298 (1975). Equitable estoppel against the government is not favored. *See* Finch v. Matthews, 74 Wn.2d 161, 169, 443 P.2d 833 (1968). Consequently, when a party asserts the doctrine against the government, two additional requirements must be met: equitable estoppel must be necessary to prevent a manifest injustice, and the exercise of governmental functions must not be impaired as a result of the estoppel. *See* Shafer v. State, 83 Wn.2d 618, 622, 521 P.2d 736 (1974). Finally, a party asserting equitable estoppel must prove each element of estoppel by clear, cogent, and convincing evidence. *See* Kramarevcky v. Dep't of Soc. & Health Servs., 122 Wn.2d 738, 744, 863 P.2d 535 (1993).

Without commenting on other elements of equitable estoppel, we conclude that System has failed to prove the second element, in that its reliance on the Commissioner's decision in the Penick case and the Department's own manuals is not reasonable. As discussed above, the Commissioner's Review Office did not publish the Penick decision and, thus, its holding with regard to the owner-operators in that case is not binding. *See* RCW 50.32.095; *see also* W. Ports, 110 Wn. App. at 459. Moreover, System has not pointed out any affirmative statements in the Department's manuals that owner-operators are carrier's independent contractors; and we are aware of none. Even if there were such statements in the internal manuals, those statements are not binding on the Department. *See* Joyce, 155 Wn.2d at 323. Accordingly, System's reliance on the Commissioner's decision in the Penick case and the Department's internal manuals is not reasonable; and such unreasonableness becomes even more palpable in light of a subsequent appellate decision where the court decidedly held that an owner-operator was not an independent contractor, but an employee of the motor carrier, under the Employment Security Act. *See* W. Ports, 110 Wn. App. at 459.

IV

Finally, System contends that the assessment in this case somehow violated its constitutional due process right. System relies on two U.S. Supreme Court cases, United States v. Powell, 379 U.S. 48 (1964) and United States v. LaSalle Nat'l Bank, 437 U.S. 298 (1978), for the general proposition that the IRS must use its summons authority in good faith. Those two cases, however, did not address whether and how the taxpayers' due process rights were violated by the

IRS-issued summons and, thus, they are not helpful to this tribunal in adjudicating System's due process claim. Without any substantive legal arguments that are supported by citations to the record and legal authorities, we obviously cannot conclude the assessment in this case has violated System's due process right, procedural or substantive.

Employment

System is liable for contributions, penalties, and interest as set forth in the Order and Notice of Assessment if, during the period at issue, the owner-operators are in "employment" of System as defined in RCW 50.04.100. *See* RCW 50.04.080; RCW 50.24.010. If the owner-operators' employment is not established, System is not liable for the assessed items. If employment is established, System is liable unless the services in question are exempted from coverage.

We consider the issue of whether an individual is in employment subject to this overarching principle: The purpose of the Employment Security Act, Title 50 RCW, is to mitigate the negative effects of involuntary unemployment. This goal can be achieved only by application of the insurance principle of sharing the risks, and by the systematic accumulation of funds during periods of employment. To accomplish this goal, the Act is to be liberally construed to the end that unemployment benefits are paid to those who are entitled to them. *See* RCW 50.01.010; Warmington v. Emp't Sec. Dep't, 12 Wn. App. 364, 368, 529 P.2d 1142 (1974). This principle has been applied so as to generally find the existence of an employment relationship. *See, e.g.,* All-State Constr. Co., 70 Wn.2d at 665; Penick, 82 Wn. App. at 36.

"Employment," subject only to the other provisions of the Act, means personal service of whatever nature, unlimited by the relationship of master and servant as known to the common law or any other legal relationship, including service in interstate commerce, performed for wages or under any contract calling for the performance of personal services, written or oral, express or implied. RCW 50.04.100. To determine whether a work situation satisfies the definition of "employment" in RCW 50.04.100, we must determine (1) whether the worker performs personal services for the alleged employer; and (2) whether the employer pays wages for those services. *See* Skrivanich, 29 Wn.2d at 157. The test for personal service is whether the services in question were clearly for the entity sought to be taxed or for its benefit. *See* Daily Herald, 91 Wn.2d at 564. In applying this test, we look for a clear and direct connection between the personal services provided and the benefit received by the entity sought to be taxed. *See* Cascade Nursing, 71 Wn. App. at 31.

In this case, System is a common, for-hire motor carrier engaged in the business of transporting various freight in interstate commerce for its customers. *See* Decl. of Rehwald ¶¶ 3, 4 at AR 146-47. System is considered a flatbed company using primarily flatbed, step-deck, and specialty trailers to haul heavy equipment, steel and aluminum coils, wallboard, lumber, and other construction and building materials. *Id.* ¶ 4 at AR 147. The owner-operators performed freight hauling services for System, which consisted of accepting freight onto the truck, covering the freight with tarps as necessary, driving the truck containing the freight to a delivery location, and delivering the freight to System's customer. *See* Stipulated Finding of Fact No. 5. As such, the owner-operators' personal services directly benefited System's business. Moreover, it is beyond dispute that System paid wages for the services provided by the owner-operators. *See* Stipulated Finding of Fact No. 6 (System collects payment from the customers and pays the owner-operators remuneration for hauling the freight); *see also* Independent Contractor Agreement, Appendix "A" at AR 632. Consequently, the administrative law judge correctly concluded that the owner-operators were in employment of System pursuant to RCW 50.04.100. *See* adopted Conclusion of Law No. 4 in Initial Order; *see also* Penick, 82 Wn. App. at 40 (as transportation of goods necessarily required services of truck drivers, it was clear that the carrier directly used and benefited from the drivers' services).

Independent Contractor Exemption

The services performed by the owner-operators are taxable to System unless they can be excluded pursuant to some other provisions of Title 50 RCW. *See* Skrivanich, 29 Wn.2d at 157. The provisions of the Act that exclude certain services from the definition of employment are found at RCW 50.04.140 through RCW 50.04.240, RCW 50.04.255, RCW 50.04.270, and RCW 50.04.275. The burden of proof rests upon the party alleging the exemption. *See* All-State Constr., 70 Wn.2d at 665. Just as RCW 50.04.100 is to be liberally construed to the end that benefits be paid to claimants who are entitled to them, the provisions of Title 50 RCW that exclude certain services from the definition of employment are strictly construed in favor of coverage. *See, e.g.,* In re Fors Farms, Inc., 75 Wn.2d 383, 387, 450 P.2d 973 (1969); All-State Constr., 70 Wn.2d at 665. Because the Act is intended for the benefit of a group that society seeks to aid, any exemption available through the application of these tests must be scrutinized even more closely than an exemption to a tax levied purely for revenue-raising purposes. *See* Schuffenhauer v. Emp't Sec. Dep't, 86 Wn.2d 233, 239, 543 P.2d 343 (1975).

In this case, the only exception that concerns us is found at RCW 50.04.140(1) and (2). The truck-driving and freight-hauling services performed by the owner-operators are excepted from employment only if all of the requirements of either section are met. *See* All-State Constr., 70 Wn.2d at 663. Here, the independent contractor agreements referred to the owner-operators as independent contractors:

> It is expressly understood and agreed that Contractor is an independent contractor for the Equipment and driver services provided pursuant to this Agreement . . . Contractor also agrees to provide necessary documentation and apply for certification of its independent contractor status where mandated by applicable state law . . . Contractor's performance of these responsibilities shall be considered proof of its status as an independent contractor in fact. Proof of such control and responsibility shall be submitted by Contractor to Carrier as required by Carrier . . . .

See Independent Contractor Agreement ¶ 24 at AR 630. This contractual language, however, is not dispositive of the issue of whether the services in question were rendered in employment for purposes of the Act. Instead, we consider all the facts related to the work situation. Penick, 82 Wn. App. at 39.

RCW 50.04.140(1) and (2) provide two alternative tests in determining whether an individual hired by an alleged employer to perform personal services is an "independent contractor" for the purpose of unemployment insurance tax. The first three criteria in each test are essentially identical in all aspects that are relevant to this case. The employer is required to prove that an individual meets all of the criteria in one of the tests in order to qualify that individual for this exemption. Therefore, if an individual fails to meet any single criterion, he or she will not be considered an "independent contractor" and the employer is liable for contributions based on wages paid to the individual pursuant to RCW 50.24.010.

A. Direction and Control.

The first criterion under RCW 50.04.140(1)(a) and (2)(a) is freedom from control or direction. The key issue here is not whether the alleged employer actually controls; rather, the issue is whether the alleged employer has the right to control the *methods and details* of the performance, as opposed to the *end result* of the work. Existence of this right is decisive of the issue as to whether an individual is an employee or independent contractor. *See* Jerome v. Emp't Sec. Dep't, 69 Wn. App. 810, 816, 850 P.2d 1345 (1993).

In this case, System entered into standard independent contractor agreements with the owner-operators governing the relationship between the parties. On the one hand, the owner-operators enjoy some autonomy with regard to the performance of their freight-hauling and truck-driving services. For example, the owner-operators are responsible for the costs of operating their equipment, including motor fuel, tires, lubricants, maintenance, repairs, taxes, assessments, licenses, permits, tolls, and scale fees. The owner-operators maintain their own liability and property damage insurance while not operating for System, and are responsible for any insurance deductibles. The owner-operators are also responsible for any other fine or fees imposed against the equipment and cargo. *See* Independent Contractor Agreement ¶ 4 at AR 627-28. Moreover, the owner-operators are solely responsible for selecting, hiring, training, disciplining, discharging, and setting hours and wages for, its employee drivers and laborers. *See* Independent Contractor Agreement ¶ 24 at AR 630. Finally, the owner-operators pay their own employees and make such deductions or contributions as may be required by regulatory entities. *See* Independent Contractor Agreement ¶ 13 at AR 629.

On the other hand, System exerts extensive controls over the methods and details of how the freight-hauling and truck-driving services are to be performed by the owner-operators. For example, System has exclusive possession, control, and use of the trucking equipment, and assumes complete responsibility for the operation of the equipment during the term of the contract. *See* Independent Contractor Agreement ¶ 2 at AR 627. Additionally, all bills of lading, waybills, freight bills, and manifests shall indicate that the property transported is under the responsibility of System. *See* Independent Contractor Agreement ¶ 23(C) at AR 630. The owner-operators must properly and correctly identify the equipment and, upon termination of the contract, must remove System's identification from the equipment and return to System all permits, plates, decals, door signs, fuel cards, toil cards, load securement equipment, satellite equipment, and copies of operating authorities. *See* Independent Contractor Agreement ¶¶ 1, 2, 19 at AR 627, 629. Although the owner-operators may trip lease their equipment to other motor carriers, they must first obtain written authorization from System. *See* Independent Contractor Agreement ¶ 2 at AR 627. The owner-operators are required to submit to System delivery documents and other paperwork, including copies of fuel purchases, daily vehicle condition reports, mileage sheets, delivery receipts, and monthly maintenance reports. *See* Independent Contractor Agreement ¶ 6 at AR 628. Moreover, the owner-operators must submit to System on a timely basis, all driver

logs, physical examination certificates, accident reports, and any other required data, documents, or reports. *See* Independent Contractor Agreement ¶ 23(B) at AR 630. The owner-operators must maintain their equipment in good operating condition and supply all safety devices as required by System. *See* Independent Contractor Agreement ¶ 17 at AR 629. The owner-operators are required to operate their equipment in a safe and prudent manner at all times and must ensure their drivers comply with System's policies and procedures and any subsequent revisions thereto. *See* Independent Contractor Agreement ¶ 23(E) at AR 630. At no time shall the owner-operators allow a passenger or a driver to occupy or operate the equipment who has not been approved by System. *See* Independent Contractor Agreement ¶ 15 at AR 629. Further, the owner-operators and their drivers must adhere to System's drug and alcohol policy, including participation in System's random drug and alcohol testing program. *See* Independent Contractor Agreement ¶ 23(D) at AR 630. System retains the right to disqualify any driver supplied by the owner-operators if the driver is found to be unsafe or in violation of System's minimum qualification standards or any policies of System's customers. *See* Independent Contractor Agreement ¶ 23(A) at AR 630. The owner-operators are required to immediately notify System of any accident involving the equipment or the cargo transported by the equipment. The owner-operators are expected to cooperate fully with System regarding any legal action, regulatory hearing, or other proceeding arising from the operation of the equipment, the relationship created by the agreement, or the services performed under the agreement. Upon System's request, the owner-operators must, at their own expense, provide written reports or affidavits, attend hearings or trials, and assist in securing evidence or obtaining the attendance of witnesses. The owner-operators are also required to assist in investigation, settlement, or litigation of any accident, claim, or potential claim by or against System. *See* Independent Contractor Agreement ¶ 14 at AR 629. If the owner-operators fail to complete timely transportation of commodities, abandon a shipment, or otherwise subject System to liabilities, System has the right to take possession of the shipment and complete the transportation. *See* Independent Contractor Agreement ¶¶ 20, 22 at AR 629. Finally, System may terminate the agreement with any owner-operator if the owner-operator commits an illegal or other misconduct that is detrimental to System or System's business. *See* Independent Contractor Agreement ¶ 21 at AR 629.

The above-referenced requirements imposed by System are generally incompatible with freeing the owner-operators from its control and direction; in other words, System is not just

interested in the *end result* of the freight-hauling and truck-driving services performed by the owner-operators, but it also concerns itself as to "*how*" those services are to be performed by the owner-operators. In sum, we concur with the administrative law judge that the owner-operators have not met the first criterion – freedom from control or direction – under RCW 50.04.140(1)(a). *See* adopted Conclusion of Law No. 9 in Initial Order.

In its Petition for Review, System argues that the administrative law judge erred in considering federally-mandated controls over the leased equipment to conclude that the owner-operators did not satisfy the "control or direction" criterion of the exemption test. *See* System's Petition for Review at 1-2. This argument, however, has been specifically rejected by the W. Ports court:

> It is true that a number of the controls exerted by Western Ports over the services performed by Mr. Marshall are dictated by federal regulations that govern the use of leased trucks-with-drivers in interstate commerce. Even so, RCW 50.04.100 suggests that the Department properly can consider such federally mandated controls in applying the statutory test for exemption, in that "service in interstate commerce" is specifically included in the statutory definition of "employment." RCW 50.04.100 ("'Employment' . . . means personal service of whatsoever nature, . . . including service in interstate commerce[.]") 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 . . . .

See W. Ports, 110 Wn. App. at 453-54. Consequently, the administrative law judge did not err in considering the federally-mandated controls over leased trucks-with-drivers (in addition to those controls exerted by System itself over the owner-operators' truck-driving and freight-hauling services) to conclude that the owner-operators have not met the first criterion under RCW 50.04.140(1)(a) and (2)(a).

Relying primarily on Kamla v. Space Needle Corp., 147 Wn.2d 114, 52 P.3d 472 (2002), System contends that "control" in the employment context requires a showing of something more than "general contractual rights," *Id.* at 121; and rather it means "control over the manner in which the wor[k] is done," such that the contractor "is controlled as to his methods of work, or as to operative detail" and "is not entirely free to do the work in his own way." *Id.* (*quoting* Restatement

Second of Torts § 414 cmt. c (1965)). *See* System's Petition for Review at 4. Initially, we note that Kamla is a case addressing the issue of 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 nonliability for injuries of a contractor, *Id.* at 119; and it is not a case interpreting the "control or direction" criterion under RCW 50.04.140(1)(a). Accordingly, we do not find the Kamla's reasoning readily applicable to the case at hand. However, even if we were to consider Kamla as persuasive authority for this case, we find nothing said in Kamla is inconsistent with the decisions interpreting the "control or direction" criterion under RCW 50.04.140(1)(a). As correctly noted by System, we must consider the amount of control exercised over the "methods and details" of the work in evaluating the "control or direction" criterion under RCW 50.04.140(1)(a). *See* Jerome, 69 Wn. App. at 816; W. Ports, 110 Wn. App. at 452.

System further argues that the contract terms do not show controls over "methods and details" of how the freight-hauling services are performed, but merely show the general contractual rights of the parties. *See* System's Petition for Review at 4. System's argument is not persuasive. In fact, general contractual rights can be viewed as controls over methods and details of the services rendered. For example, under the terms and conditions of the independent contractor agreement in W. Ports, 110 Wn. App. at 447, the carrier had the right to terminate the contract or discipline the owner-operator for tardiness, failure to regularly contact the dispatch unit, failure to perform contractual undertakings, theft, dishonesty, unsafe operation of the truck, failure of equipment to comply with federal or state licensing requirements, and failure to abide by any written company policy. The W. Ports court specifically considered those contractual rights in evaluating the "control or direction" criterion under RCW 50.04.140(1)(a). *Id.* at 454.

In sum, it is not any single contractual right, or any single control over an equipment (federally mandated or otherwise), or any single detail of the personal services rendered, that will help this tribunal distinguish an independent contractor from an employee; inevitably, it has to be all of those things and more, considered *in aggregate*, that will aid us in deciding whether an individual is an independent contractor or an employee for unemployment insurance tax purposes.

B. Outside Usual Course of Business or Outside All Places of Business.

The second criterion under RCW 50.04.14)(1)(b) is that the service in question either be performed outside the usual course of business for which such service is performed, or that it be performed outside all places of business of the enterprise for which such service is performed.

Regarding the first alternative, System's usual course of business is to transport goods in interstate commerce, and the owner-operators provided truck-driving services to System. As such, the owner-operators' services were performed within, not outside, the usual course of System's business. Accordingly, System fails the first alternative under RCW 50.04.140(1)(b).

Regarding the second alternative under RCW 50.04.140(1)(b), the critical inquiry in this case is whether the trucks owned by the owner-operators but leased to System constitute the places of System's business. W. Ports did not address this issue as the court there disposed of the case on the first criterion of the independent contractor test under RCW 50.04.140(1)(a). *See* W. Ports, 110 Wn. App. at 459. Although the court in Penick held that the trucks were the carrier's places of business, it relied on the fact that the carrier owned the trucks used by the contract drivers. *See* Penick, 82 Wn. App. at 43. Thus, Penick is factually distinguishable because System did not own the trucks at issue here but, instead, leased the trucks owned by the owner-operators. Other appellate decisions seem to suggest that premises leased by a putative employer or otherwise specified by a putative employer for work purposes, could constitute such employer's place of business. *See, e.g.,* Schuffenhauer, 86 Wn.2d at 237 (clam digging on land leased by employer not outside all places of business); Miller v. Emp't Sec. Dep't, 3 Wn. App. 503, 506, 476 P.2d 138 (1970) (timber harvesting on land leased by employer performed at place of business of employer); Affordable Cabs, Inc. v. Emp't Sec. Dep't, 124 Wn. App. 361, 371, 101 P.3d 440 (2004) (taxi driver drove to locations specified by the employer; while these places were not owned by the employer, they were places where the driver was "engaged in work"); however, these appellate decisions did not deal with the type of leasing practices prevalent in interstate trucking industry and, hence, their applicability to the case at hand is rather limited.

Here, we are dealing with a unique contractual relationship between common carriers and owner-operators that effectuates the lease of equipment (i.e. trucks) along with driving services; and such contractual relationship is subject to extensive federal safety regulations designed for the protection of the public and applying to both motor carriers as well as owner-operators. *See, generally,* Federal Motor Carrier Safety Administration ("FMCSA") Regulations, 49 C.F.R. Parts 300 – 399. In order to clarify the role of federal leasing regulations and their impact on independent contractor status, the Interstate Commerce Commission (the predecessor agency to FMCSA) promulgated 49 C.F.R. § 376.12(c)(4), which states:

> Nothing in the provisions required by paragraph (c)(1) of this section is intended to affect whether the lessor or driver provided by 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.

In essence, 49 C.F.R. § 376.12(c)(4) cautions us that an independent contractor relationship may still exist between a motor carrier and an owner-operator, notwithstanding the fact that the motor carrier must comply with 49 U.S.C. § 14102 and 49 C.F.R. Part 376 in general, and 49 C.F.R. § 376.12(c)(1) in particular. 49 C.F.R. § 376.12(c)(1) specifically provides that:

> The lease shall provide that the authorized carrier lessee shall have *exclusive possession, control, and use of the equipment* for the duration of the lease. The lease shall further provide that the authorized carrier lessee shall assume *complete responsibility for the operation of the equipment* for the duration of the lease. (Emphasis added.)

Consequently, pursuant to 49 C.F.R. § 376.12(c)(4), a carrier's "exclusive possession, control, and use of the equipment" and a carrier's "complete responsibility for the operation of the equipment" do not completely negate the possibility of finding an independent contractor relationship between a carrier and an owner-operator.

Consistent with the spirit of 49 C.F.R. § 376.12(c)(4) and in light of the lack of appellate decisions on the issue, we conclude that a mere leasing arrangement where a carrier (i.e. the lessee) assumes possession of and responsibility for the equipment (i.e. truck) owned by an owner-operator (i.e. lessor) does not in and of itself transform the equipment into the carrier's place of business. To conclude otherwise will effectively preclude a carrier from ever being able to satisfy the second alternative under RCW 50.04.140(1)(b). With that being said, a carrier, however, may still fail the second alternative – outside all places of business – under RCW 50.04.140(1)(b), if its owner-operators are to engage themselves in other places of the carrier's business, such as the carrier's office, repair shop, or terminal, in addition to simply driving the trucks leased to the carrier.

In this case, System leased the trucks owned by the owner-operators; and, as required by 49 C.F.R. § 376.12(c)(1), the independent contractor agreements between System and the owner-operators provided that System "shall have exclusive possession, control, and use of the equipment specified in this contract for the during of the contract" and "shall assume complete responsibility

for the operation of said equipment during the term of the contract." *See* Independent Contractor Agreement ¶ 2 at AR 627. As discussed above, the sheer fact that System leased the trucks with driving services does not automatically transform the trucks (leased to System but owned by the owner-operators) into the places of System's business pursuant to 49 C.F.R. § 376.12(c)(4). Moreover, the record does not show that the owner-operators routinely engaged themselves in other places of System's business, such as the office, repair shop, or terminal. Accordingly, we are satisfied that the truck-driving and freight-hauling services performed by the owner-operators were performed outside all places of System's business and, thus, System has satisfied the second alternative under RCW 50.04.140(1)(b).

C. Independently Established Business.

The third criterion under RCW 50.04.140(1)(c) requires a showing that an 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 with the alleged employer. Proof of independently established business requires evidence of an enterprise created and existing separate and apart from the relationship with the alleged employer, an enterprise that will survive the termination of that relationship. The courts have traditionally examined the following factors as indicia of an independently established business: (1) the worker has a separate office or place of business outside of his or her home; (2) the worker has an investment in the business; (3) the worker provides equipment and supplies needed for the job; (4) the alleged employer fails to provide protection from risk of injury or non-payment; (5) the worker works for others and has individual business cards; (6) the worker is registered as an independent business with the state; and (7) the worker is able to continue in business even if the relationship with the alleged employer is terminated. *See* Penick, 82 Wn. App. at 44.

Furthermore, when a business plans to operate as an authorized for-hire motor carrier that transports regulated commodities in interstate commerce in exchange for a fee or other compensation, such business must obtain an interstate operating authority (MC number) through the FMCSA. A business may need to obtain multiple operating authorities to support its planned business operations. *See* Get Authority to Operate (MC Number), Fed. Motor Carrier Safety Admin., http://www.fmcsa.dot.gov/registration/get-mc-number-authority-operate (last visited December 17, 2015). The types of operating authorities include the authority for motor carrier of property (except household goods), the authority for motor carrier of household goods, the

authority for broker of property (except household goods), and the authority for broker of household goods. *See* Types of Operating Authority, Fed. Motor Carrier Safety Admin., http://www.fmcsa.dot.gov/registration/types-operating-authority (last visited December 17, 2015). Consequently, one of the unique characteristics about the trucking industry is the federal requirement that an owner-operator obtain an operating authority (MC number) in order to engage in the business of transporting goods in interstate commerce; otherwise, the owner-operator must operate under another carrier's operating authority. In other words, when it comes to the trucking industry, whether an owner-operator has his or her own operating authority is an *additional paramount* factor for the purpose of proving independently established business under the third criterion of RCW 50.04.140(1)(c). If an owner-operator wishes to sell his or her services, invoice for the services, collect for the services, and maintain safety records as required by federal regulations, all the while continuing to operate his or her truck, maintain the truck, and manage the load, then he or she has the option to obtain the operating authority. And if an owner-operator does not wish to take upon the administrative burdens of running a business, he or she still has the option of leasing onto an authorized motor carrier with operating authority. *See* Douglas C. Grawe, Have Truck, Will Drive: The Trucking Industry and The Use of Independent Owner-Operators Over Time, 35 Transp. L.J. 115, 133 (2008). However, if an owner-operator chooses the latter option, certain legal consequences may flow from that choice, one of which is that such owner-operator may be deemed an employee of the carrier for the purpose of unemployment insurance tax under the appropriate circumstances.

In this case, System did not introduce any evidence, documentary or testimonial, to show that the owner-operators at issue here had independently established enterprises or entities during the audit period. The record is devoid of any business registration, business license, UBI number, and account with the Department of Revenue tending to show the existence of an established business entity. As such, it matters not that the owner-operators owned their trucks and were responsible for the costs of operating those trucks; or that the costs of the trucks or trailers were significant; or that the owner-operators maintained their own financial books reflecting their income and expenses. *See* Appellant's Hearing Brief at 31. The fact remains that the owner-operators had no established business entities that were separate and apart from their own individuals *in the first place*.

Moreover, System did not introduce any evidence to show that the owner-operators had their own operating authorities; instead, the owner-operators had to contract with System in order to operate under System's operating authority. As a result, the owner-operators could not engage in interstate transportation of goods independent of another carrier with such operating authority. Because this additional factor weighs heavily against finding independently established business and further because many of the traditional factors are also not in favor of finding independently established business,[4] we are satisfied that the owner-operators have not met the third criterion of the exemption test under RCW 50.04.140(1)(c). *See accord* Stafford Trucking, Inc. v. Dep't of Indus., Labor & Human Relations, 306 N.W.2d 79, 84 (1981) ("A truly independently established businessman would obtain his own operating authority, equipment, insurance and customers. If the owner-operators were terminated by [the carrier], in all likelihood they would be out of work until they could make similar arrangements with another carrier").

In summary, System has not carried its burden to prove the owner-operators are independent contractors because these owner-operators have failed at least one of the criteria under RCW 50.04.140(1) or (2). All of the disputed owner-operators are in "employment" of System pursuant to RCW 50.04.100 and are not exempted under either RCW 50.04.140(1) or (2), or any other provisions of law. Consequently, System is liable to pay the contributions, penalties, and interest assessed pursuant to RCW 50.24.010 in the amount of $58,300.99 for the period in question.

Now, therefore,

IT IS HEREBY ORDERED that the July 1, 2015, Initial Order issued by the Office of Administrative Hearings is **AFFIRMED**. System is liable for the contributions, penalties, and interest assessed pursuant to RCW 50.24.010 regarding the owner-operators in the amount of $58,300.99 for the period of the second quarter of 2007 through the fourth quarter of 2009.

Dated at Olympia, Washington, December 18, 2015.*

S. Alexander Liu

Deputy Chief Review Judge
Commissioner's Review Office

[4] For example, the owner-operators were not registered as independent businesses with the state during the audit period; the owner-operators did not have individual business cards; and the putative employer here, System, protected the owner-operators from risk of non-payment by the customers. *See* Stipulated Finding of Fact No. 6 (the owner-operators get paid for the freight hauled whether or not the customers pay).

*Copies of this decision were mailed to all
interested parties on this date.

RECONSIDERATION

Pursuant to RCW 34.05.470 and WAC 192-04-190 you have ten (10) days from the mailing and/or delivery date of this decision/order, whichever is earlier, to file a Petition for Reconsideration. No matter will be reconsidered unless it clearly appears from the face of the Petition for Reconsideration and the arguments in support thereof that (a) there is obvious material, clerical error in the decision/order or (b) the petitioner, through no fault of his or her own, has been denied a reasonable opportunity to present argument or respond to argument pursuant to WAC 192-04-170. Any request for reconsideration shall be deemed to be denied if the Commissioner's Review Office takes no action within twenty (20) days from the date the Petition for Reconsideration is filed. A Petition for Reconsideration together with any argument in support thereof should be filed by mailing or delivering it directly to the Commissioner's Review Office, Employment Security Department, 212 Maple Park Drive, Post Office Box 9555, Olympia, WA 98507-9555, and to all other parties of record and their representatives. The filing of a Petition for Reconsideration is not a prerequisite for filing a judicial appeal.

JUDICIAL REVIEW

If you are a party aggrieved by the attached Commissioner's decision/order, your attention is directed to RCW 34.05.510 through RCW 34.05.598, which provide that further appeal may be taken to the Superior Court within thirty (30) days from the date of mailing as shown on the attached decision/order. If no such appeal is filed, the attached decision/order will become final. If you choose to file a judicial appeal, you must both:

Timely file your judicial appeal directly with the Superior Court of the county of your residence or Thurston County. If you are not a Washington state resident, you must file your judicial appeal with the Superior Court of Thurston County. *See* RCW 34.05.514. (The Department does not furnish judicial appeal forms.) AND

Serve a copy of your judicial appeal by mail or personal service within the thirty (30) day judicial appeal period on the Commissioner of the Employment Security Department, the Office of the Attorney General, and all parties of record.

The copy of your judicial appeal you serve on the Commissioner of the Employment Security Department should be served on or mailed to: Commissioner, Employment Security Department, Attention: Agency Records Center Manager, 212 Maple Park Drive, Post Office Box 9046, Olympia, WA 98507-9046. To properly serve by mail, the copy of your judicial appeal must be received by the Employment Security Department on or before the thirtieth (30th) day of the appeal period. See RCW 34.05.542(4) and WAC 192-04-210. The copy of your judicial appeal your serve on the Office of the Attorney General should be served on or mailed to the Office of the Attorney General, Licensing and Administrative Law Division, 1125 Washington Street SE, Post Office Box 40110, Olympia, WA 98504-0110.

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DECLARATION OF SERVICE

On said day below I electronically served a true and accurate copy of the Brief of Appellants System-TWT Transport in Court of Appeals, Division III Cause No. 34566-1-III (consolidated with 34567-0-III and 34568-8-III) to the following parties:

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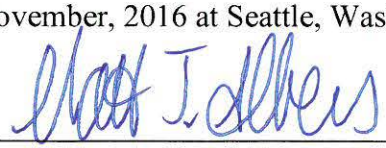
Original E-filed with:
Court of Appeals, Division III
Clerk's Office

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 this 9th day of November, 2016 at Seattle, Washington.



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