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NO. 34566-1-III

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

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

Appellants,

v.

STATE OF WASHINGTON EMPLOYMENT SECURITY
DEPARTMENT,

Respondent.

BRIEF OF RESPONDENT RE: HATFIELD ENTERPRIZES, INC.

ROBERT W. FERGUSON
Attorney General

ERIC D. PETERSON, WSBA No. 35555
Senior Assistant Attorney General
LEAH E. HARRIS, WSBA No. 40815
Assistant Attorney General
Licensing and Administrative Law Division
800 5th Ave., Ste. 2000; MS TB-14
Seattle, WA 98104-3188
EricP1@atg.wa.gov; LeahH1@atg.wa.gov
OID No. 91020

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I. INTRODUCTION

Hatfield Enterprizes, Inc., a motor carrier, attempts to avoid unemployment compensation taxes for those of its drivers who own and operate their own trucks (owner-operators), claiming they are independent contractors for purposes of a statutory exception from coverage under the Employment Security Act. The Commissioner of the Employment Security Department properly ruled that Hatfield's owner-operators are in its employment for purposes of the Act and that Hatfield failed to prove the exception from the Act's coverage. The Commissioner's findings in this Administrative Procedure Act appeal are supported by substantial evidence, and the conclusions are free of legal error because this case is controlled by *Western Ports Transportation, Inc. v. Employment Security Department*, where the court ruled an owner-operator was in covered employment of a motor carrier for unemployment insurance purposes, and federal law did not preempt the Act. *W. Ports Transp., Inc. v. Emp't Sec. Dep't*, 110 Wn. App. 440, 450-58, 41 P.3d 510 (2002). *Western Ports* has been the law in Washington for over 14 years, is consistent with many other states' decisions, and should not be overruled.

Hatfield, however, raises a theory of federal preemption that depends on the false assumption that the tax will result in a "restructuring"

of the trucking industry. This is empty rhetoric. As a matter of law, the Act obligates employers to pay unemployment taxes for employment covered by the Act, and the assessment or its basis does not affect worker classification for any other legal purpose. Moreover, this tax obligation imposes only a minor cost increase and does not have the significant impact necessary to invoke federal preemption. Hatfield also focuses on the auditor's conduct to claim arbitrary and capricious or unconstitutional action and asks this Court to reweigh evidence, make new findings, and go far beyond the scope of judicial review and relevant precedent. The Court should affirm the Commissioner's order.

II. COUNTERSTATEMENT OF THE ISSUES

- 1) Did the Commissioner correctly rule that Hatfield failed to prove its owner-operators were free from its control or direction over the performance of services under RCW 50.04.140(1) as construed in *Western Ports Transp., Inc. v. Emp't Sec. Dep't*, 110 Wn. App. 440, 41 P.3d 510 (2002)? And, did Hatfield fail to show *Western Ports* is wrong and harmful such that it should be overruled?
- 2) Does the Federal Aviation Administration Authorization Act, which preempts state laws that significantly impact motor carriers' prices, routes, or services, preempt applying Washington's Employment Security Act to the services of owner-operators, when the Act applies generally to all Washington employers, poses only a minor cost increase, and affects owner-operators' classification only for purposes of the Act?
- 3) The Department calculated the original assessment amount based on the records provided by Hatfield, which showed all payments to their owner-operators were for nonemployee compensation for services, with none designated as for equipment rental. Hatfield never produced

other records showing which portion of payments was for equipment rental, even at the evidentiary hearing. Based on these circumstances, did Hatfield fail to establish arbitrary and capricious or unconstitutional conduct when there was room for two positions as to the amount to be assessed, and Hatfield had a de novo hearing in which it suffered no prejudice in its ability to present a defense?

III. STATEMENT OF FACTS

Hatfield engages in interstate trucking and hauls cargo for clients and contracts with "owner-operators" to provide some of those services. Agency Record Hatfield Vol. 1 (ARH1) 210-11 ¶¶ 4.5, 4.9 (findings as a matter of law on partial summary judgment); ARH4 1198 (Commissioner's order, incorporating partial summary judgment order); ARH1 135-43 ("Agreement of Lease and Conduct" between Hatfield and owner-operators);¹ ARH1 35. Hatfield leased tractors or tractor-trailers from individuals (owner-operators) who owned the equipment. ARH1 210 ¶ 4.6; ARH1 135-43. The owner-operators drove the equipment for Hatfield, hauling freight, and Hatfield paid them for these services. ARH1 211 ¶ 4.7; ARH1 135-43. Hatfield operates under authority from the Federal Motor Carrier Safety Administration and the Department of Transportation. ARH1 211 ¶ 4.8; *see* ARH1 135-43. Only one of its owner-operators had his own motor carrier authority; all of Hatfield's other owner-operators lacked such hauling authority independent of Hatfield's authority. ARH1 211 ¶ 4.8; ARH1 122.

¹ A copy of the Agreement of Lease and Conduct is attached as Appendix A.

The owner-operators' contracts with Hatfield contained a number of provisions governing their relationship, including: that Hatfield has "exclusive use" of the equipment 24-hours per day and 365 days per year during the lease; owner-operators must wash and clean the equipment to maintain "good appearance" and "good public image;" they must maintain the equipment in good repair, mechanic condition, running order and appearance; they must mark the equipment with insignia as required by federal, state, and local laws, ordinances, and regulations and maintain the insignia in good order and appearance; they must have safety inspections at least every 90 days at DOT-approved inspection stations; and, they must comply with all rules and regulations of regulatory authorities having jurisdiction, or else Hatfield can immediately terminate the lease contract. ARH1 211-12 ¶¶ 4.13, 4.15, 4.16, 4.17, 4.18, 4.19; ARH1 135-43.

Hatfield did not control the hours the owner-operators worked or require them to work full-time. ARH1 212 ¶ 4.20; *see* ARH1 135-43, 195-96. Owner-operators were not required to accept loads, and they sometimes declined them; when they do accept loads, they decide the route they take. ARH1 212 ¶ 4.21; ARH1 195-96. The owner-operators are responsible for costs and expenses for maintenance, license fees, taxes, fuel, lubricants, cold-weather protection, tie-down gear, and cargo-protection equipment. ARH1 212 ¶ 4.22; *see* ARH1 135-43. And owner-

operators are responsible for any employees, agents, or servants they secure; but if those persons damage, hinder, or injure Hatfield's relations with customers, Hatfield has the right to recommend actions against those persons. ARH1 212 ¶¶ 4.22, 4.23; *see* ARH1 140-41. The owner-operators did not carry their own insurance but were responsible for the costs of cargo and liability insurance borne by Hatfield, and were responsible for their own bobtail and physical damage coverage. ARH1 211 ¶ 4.11; ARH1 135-43.

The Department audited Hatfield to determine whether it properly reported wages and paid unemployment taxes under Title 50 RCW. The Department's auditor determined that 15 owner-operators should be reclassified as in employment instead of as independent contractors under the Employment Security Act. ARH1 210 ¶ 4.4. Hatfield was selected at random for audit from all employers in the State who file 1099 forms, to ensure the classification was done correctly.² ARH3 893.

As a result of the audit, on February 7, 2012, the Department issued an assessment for unpaid taxes, penalties, and interest for quarters

² Because the Department's audit in this case was not pursued by its underground economy unit, Hatfield's reliance on arguments that it incorporates by reference from the brief of System-TWT Transport concerning practices or performance expectations on auditors in that unit lacks any relevance to the record in this case. Those expectations were a basis for the assertions by Hatfield and accountants that it hired that the Department's audit was supposedly predetermined. *See* ARH2 277 (Decl. of Brian Sonntag); ARH2 290-93 (Decl. of Stephen B. Bishop). But those factors do not apply to this auditor or this case (and they are without merit in any regard, for the reasons addressed in briefing in the System appeal).

one, two, and three of 2009; one, two, and four of 2010; and one and two of 2011, in the amount of \$13,616.53, based on the services of owner-operators. ARH4 1140, ¶¶ 4.1, 4.3; ARH1 5. Hatfield timely filed an administrative appeal. ARH4 1140 ¶ 4.2; ARH1 at 1-3.

Hatfield moved for summary judgment, arguing federal preemption. ARH1 8-25. The Administrative Law Judge (ALJ) denied Hatfield's motion. ARH1 76-82.³ The Department cross-moved for partial summary judgment, arguing that undisputed facts established the owner-operators were in Hatfield's employment and Hatfield could not as a matter of law prove all elements of the independent contractor exception statute, as was its burden. ARH1 83-97. The ALJ granted the Department's motion for partial summary judgment, ruling that the owner-operators performed personal services for wages and Hatfield directly benefited from those services, and the owner-operators were thus in Hatfield's employment under RCW 50.04.100. ARH1 213-15 ¶¶ 5.10-5.15.⁴ The ALJ further ruled that Hatfield failed to establish its owner-operators were free from control or direction, as required to prove exception from the Employment Security Act's coverage under RCW 50.04.140. ARH1 215-17 ¶¶ 5.16-5.25.

³ A copy of the ALJ's Order Denying Employers' Motion for Summary Judgment on Federal Preemption is attached as Appendix B.

⁴ A copy of the ALJ's Order Granting Department's Cross-Motion for Partial Summary Judgment is attached as Appendix C.

Hatfield later moved to dismiss the assessment based on claimed audit impropriety, which allegedly affected the amount of the assessment. *See* ARH2 220-71. Hatfield, however, had reported the payments it made to owner-operators on IRS 1099 forms in undifferentiated total amounts. ARH4 1141, ¶¶ 4.4, 4.5; ARH1 135-43; ARH8 Ex. Q, R, X, Y, Z. While parties can separately report payments for “rents” (including for equipment) and for “nonemployee compensation” on 1099 forms, Hatfield reported 100 percent of the payments as “nonemployee compensation” on the 1099 forms. ARH2 at 380-81, 539-48; ARH8 Ex. X, Y, Z. The Department had calculated its assessment based on the total remuneration reported on the 1099 forms as “nonemployee compensation,” and backed out wages that exceeded the maximum taxable wage base, per statute. ARH4 1141-42, ¶¶ 4.9, 4.18; ARH2 378.

In its motion, Hatfield argued the assessment was inflated because the Department taxed payments for the equipment lease, which are not wages, which supposedly rendered the assessment “void.” *See* ARH2 220-71. Its argument was based in part on the fact that the Department had reduced the assessment amounts on such a basis in appeals involving other carriers.⁵ *Id.* But Hatfield never provided the Department any different

⁵ While the Department had in other cases been provided general information in the course of administrative appeals that it decided to accept for purposes of settlement or stipulation, ARH2 395-99, those decisions did not bind the Department in this case.

records on which a contrary calculation of the assessment could be made.⁶

The ALJ denied the motion to dismiss the assessments. ARH2 672-79.⁷

The ALJ reasoned that the Department was entitled to rely on the wage information it had from Hatfield in calculating the assessment because Hatfield was unable to accurately provide information, despite being the entity in the best position to do so:

I am not persuaded that a putative employer should escape tax liability because the putative employer is unable to accurately provide wage information despite being the entity in the best position to do so. Nor is the Department obliged to guess or to seek estimates from the putative employer. . . . I am persuaded . . . that the Department was entitled to rely upon the Carrier information it had – however incomplete – to calculate its assessments.

ARH2 675 ¶ 4.8. The ALJ further noted: “The Carriers have always had the opportunity to provide evidence to re-calibrate the assessments and retain that privilege for the forthcoming evidentiary hearings.” *Id.*

ARH2 408 (audit supervisor describing knowledge that a reduction “was applied, in part of the negotiations on seven previous audits, but was not a standard that was adopted by the agency for these audits or any future audits”).

⁶ An audit supervisor explained: “We had information from 1099 stating an amount that was paid to an individual. How much of that amount was for equipment or gas or other reimbursable expenses, we did not have that information.” ARH2 586-87. And another supervisor said: “I knew that we had no information to figure out how to calculate the factor for equipment.” ARH2 395. The audit supervisor expressed willingness to reconsider the assessment amount during settlement negotiations or if Hatfield produced records showing which portion of payments was for wages. *See* ARH2 399 (“Q: Okay. So it was all to be used, then for settlement. Is that correct? A: [interruptions omitted] Possible settlement or, if MacMillan-Piper had substantial information on the exact amounts for each 1099s, that would be -- also be considered.”) (deposition taken concerning carrier MacMillan-Piper, but questions were also asked concerning Hatfield).

⁷ A copy of the ALJ’s order denying the Motion to Dismiss Void Assessments is attached as Appendix D.

The case then proceeded to a hearing to determine the correctness of the assessment amount.⁸ *See* ARH2 672-79. Hatfield did not offer any of its own records to establish what amount of the payments was for equipment rental and what amount was for driving services. Instead, it hired a forensic accountant to determine the allocation of cost or value between the leased equipment and the driving services. ARH4 1141, ¶ 4.11; ARH6 9/17/14 Bishop test. at 10. The accountant never saw any records that showed which portions of payments to owner-operators was for personal services and which was for equipment rental, nor did he interview any owner-operators or secure any records from them. ARH4 1141, ¶¶ 4.12, 4.14; ARH6 9/17/14 Bishop test. at 62-63. Rather, the accountant did internet research and talked with selected trucking companies and determined driving services constituted approximately 30 percent of the contract, and equipment-related expenses amounted to approximately 70 percent of the contract. ARH4 1141-42, ¶¶ 4.14, 4.15; ARH6 9/17/14 Bishop test.

After the hearing, the ALJ entered an initial order, finding that the payments made to owner-operators were for both equipment rental and

⁸ After Hatfield's motion to dismiss was denied, Hatfield sought to call certain witnesses and introduce related evidence to address these issues in the hearing that was scheduled to determine the correct amount of the assessment. The ALJ denied this request, noting that the matter had been addressed in the ruling on the motion to dismiss, and it would not be revisited in the evidentiary hearing that concerned the proper assessment amount. *See* ARH3 788-795.

driving services. ARH4 1140-47.⁹ The ALJ concluded that 30 percent of the payments Hatfield made to owner-operators was subject to the unemployment tax. ARH4 1142-43, ¶ 5.8 (incorporating the earlier ruling that noted Hatfield had “offered or suggested no information they possess or that the Department possesses or should possess with which to separate non-taxable remuneration from taxable remuneration,” ARH2 674 ¶ 4.8). The ALJ further concluded that Hatfield’s payment of penalties should be waived because it “reasonably, albeit incorrectly, believed at the time [the owner-operators were] independent contractors.” ARH4 1145, ¶ 5.14.

Hatfield and the Department each filed petitions for review to the Department’s Commissioner. ARH4 1150-55, 1166-71. Hatfield argued that the assessment was preempted; that the owner-operators were not in their employment, and even if they were, then the independent contractor exception applied; and that the assessment should be dismissed based on alleged audit impropriety. ARH4 1150-55. The Department argued that the ALJ’s reduction of the assessment and waiver of penalties was improper. ARH4 1166-71.

The Commissioner noted that as a quasi-judicial body within the executive branch, it lacks authority to determine whether the laws it administers are constitutional, but this may be raised on judicial review

⁹ A copy of the ALJ’s Findings of Fact, Conclusions of Law, and Initial Order is attached as Appendix E.

under RCW 34.05.570(3). ARH4 1191.¹⁰ But upon review of the record and to assure the case was properly addressed at the administrative level, the Commissioner addressed the preemption issue and concurred with the ALJ that “Washington’s Employment Security Act as applied to motor carriers . . . is not preempted by the [Federal Aviation Administration Authorization Act] preemption clause.” ARH4 1192 (incorporating ALJ’s order denying Hatfield’s motion for summary judgment, ARH1 76-82).

Concerning Hatfield’s request to dismiss the “void assessment” based on its audit impropriety allegations, including that the assessment amounts were inflated, the Commissioner determined the ALJ properly addressed and resolved the issue. ARH4 1192 (incorporating ALJ’s order denying Hatfield’s motion for dismissal, ARH2 672-79).

The Commissioner ruled that the owner-operators were in Hatfield’s employment under RCW 50.04.100 because their personal services directly benefited Hatfield’s business, and it is “beyond dispute that Hatfield paid wages for the services provided by the owner-operators.” ARH4 1193-94. Regarding the independent contractor exception test, the Commissioner found Hatfield exerts “extensive controls over the methods and details of how the driving services are to be performed by the owner-operators,” referencing multiple provisions in the

¹⁰ A copy of the Decision of Commissioner is attached as Appendix F.

contracts. ARH4 1196-97. Because Hatfield “failed to show that the owner-operators were free from its direction and control under RCW 50.04.140(1)(a) and (2)(a),” the Commissioner did not address the remaining elements of the independent contractor exception test. ARH4 1197. The Commissioner adopted the ALJ’s findings and conclusions in the ALJ’s order granting the Department’s motion for partial summary judgment. ARH4 1198 (incorporating ARH1 209-17).

Concerning the amount of wages subject to assessment, which affected the assessment amount, the Commissioner ruled he was “satisfied that a 30/70 split between wages and equipment rental is an appropriate formula for Hatfield.” ARH4 1198-1201. The Commissioner also adopted the ALJ’s discretionary waiver of penalties. ARH4 1202-03 (incorporating ARH4 1139-47). The Commissioner ordered recalculation of the assessment consistent with the Commissioner’s ruling. ARH4 1204.

Hatfield timely appealed the Commissioner’s order to the Spokane County Superior Court, CP 92-191, which upheld the Commissioner’s decision. CP 301; CP 632-38.

IV. SCOPE AND STANDARD OF REVIEW

The scope and standard of review is identical for this case as in System-TWT Transport (System). The Department incorporates herein by reference Section IV of its Brief of Respondent in that matter.

V. ARGUMENT

Under the Employment Security Act, Title 50 RCW, all Washington employers must contribute to the unemployment compensation fund for the benefit of their employees. RCW 50.01.010; RCW 50.24.010. The Act is intended to “mitigate the negative effects of involuntary unemployment” by applying the “insurance principle of sharing the risks, and by the systematic accumulation of funds during periods of employment.” *Penick v. Emp’t Sec. Dep’t*, 82 Wn. App. 30, 36, 917 P.2d 136 (1996). “To accomplish this goal, courts must liberally construe the statute, viewing with caution any construction that would narrow coverage.” *Id.* at 36; *Shoreline Cmty Coll. Dist. No. 7 v. Emp’t Sec. Dep’t*, 120 Wn.2d 394, 406, 842 P.2d 938 (1992). Therefore, “exemptions from taxation statutes are strictly construed in favor of applying the tax, with the burden of proof on the party who seeks the exemption.” *W. Ports*, 110 Wn. App. at 451.

Persons who perform services for wages for the benefit of an alleged employer are in employment under the Act, RCW 50.04.100, unless the employer can prove all elements of a narrow statutory exception from coverage, RCW 50.04.140. Hatfield does not appeal the Commissioner’s conclusion that the owner-operators are in Hatfield’s employment, and Hatfield failed to prove all necessary elements for

exception because the owner-operators are subject to control or direction concerning their performance of services under RCW 50.04.140(1)(a).

Hatfield attempts to distract from the merits of whether its owner-operators perform services in employment covered by the Act by arguing the Act is preempted based on the false premise that the assessment will “restructure” the trucking industry, and by making incorrect assertions about the Department’s audit conduct and legal standards for those claims. Hatfield’s arguments for preemption or dismissal of the assessment lack merit. The Court should affirm the Commissioner’s order.

A. Hatfield Does Not Appeal the Determination That Owner-Operators Were in Employment Under RCW 50.04.100

The Commissioner properly concluded that the work performed by Hatfield’s owner-operators constitutes “employment” as it is broadly defined under the Employment Security Act. RCW 50.04.100; ARH4 at 1193-94. Like System, Hatfield does not assign error to this conclusion and makes no argument about it. Br. Appellant 2-3. The Department incorporates herein by reference Section V.A of its brief in System. The Commissioner’s conclusion is a verity. Thus, Hatfield could avoid liability for unemployment insurance taxes only if it could establish the owner-operators were independent contractors under RCW 50.04.140. It did not.

B. Hatfield Failed to Meet Its Burden of Proving That Its Owner-Operators are Excepted From Coverage Under the Narrow Test of RCW 50.04.140(1)

The legal principles concerning Hatfield's burden to prove exception from coverage under RCW 50.04.140(1) are the same for Hatfield and System. But because the Hatfield case was decided on summary judgment concerning only the first of the three elements in subsection (1) of the independent contractor statute, the Commissioner did not reach the other two elements.

As to the first element, which concerns Hatfield's control or direction over owner-operators' performance of services, the Department incorporates herein by reference from its System brief the following sections: the introductory analysis of Section V.B (discussing RCW 50.04.140 generally); the introductory analysis of Section V.B.1 and all of Section V.B.1.a (discussing RCW 50.04.140(1)(a)); all of Section V.B.1.c (discussing how *Western Ports* is good law and should not be overruled); and all of Section V.B.1.d (discussing the inapplicability of common law tests for control).

Hatfield fails in its opening brief to meaningfully analyze its contract with owner-operators or to otherwise apply the law concerning RCW 50.04.140 to the facts of this case. *See* Br. Appellant 10-12. Rather, it relies nearly exclusively on the discussion concerning System-TWT

Transport, which had different contractual agreements with its owner-operators. By failing to argue the matter, Hatfield at a minimum has waived any claim that control or direction in its contract above and beyond federal leasing regulation requirements cannot be considered. But to the extent the Court considers this issue, the application of the law concerning the control or direction element in RCW 50.04.140(1)(a) to the facts in this case follows.

1. The Commissioner properly determined that Hatfield failed to show owner-operators are free from control or direction over the performance of services under RCW 50.04.140(1)(a)

The Commissioner properly concluded that Hatfield failed to meet its burden of proving its owner-operators were exempt because the owner-operators were not free from control or direction under RCW 50.04.140(1)(a), as the exception is narrowly construed. As the Commissioner found, many of the same or similar elements identified in *Penick* and *Western Ports* are present here, including:

- Hatfield has the exclusive use of the leased equipment on a 24-hour and 365-day-a-year basis. ARH4 1196-97; ARH1 211, adopted ALJ order, ¶ 4.13; Decl. of Cooper, Exhibit C, ¶ II, ARH1 at 136.
- The owner-operators are required to comply with all applicable federal, state, and local laws, ordinances, and regulations. ARH4 1196-97; ARH1 212, adopted ALJ order, ¶ 4.19; Decl. of Cooper, Exhibit C, ¶ III(d), ARH1 136.

- The owner-operators are required to oil, grease, and inspect the equipment so as to maintain the equipment in good repair, mechanical condition, and running order. ARH4 1196-97; ARH1 211, adopted ALJ order, ¶ 4.16; Decl. of Cooper, Exhibit C, ¶ III(b) & (d), ARH1 136.
- The owner-operators must wash and clean the equipment as reasonably required to keep the equipment in good appearance and to maintain a good public image. ARH4 1196-97; ARH1 211, adopted ALJ order, ¶ 4.15; Decl. of Cooper, Exhibit C, ¶ III(c), ARH1 136.
- The owner-operators are required to mark the equipment with insignia and markings identifying the equipment as required by federal, state, and local laws. ARH4 1196-97; ARH1 211, adopted ALJ order, ¶ 4.17; Decl. of Cooper, Exhibit C, ¶ III(e), ARH1 136.
- Hatfield further requires the owner-operators to furnish all necessary tie-down gear and cargo protection equipment. ARH4 1196-97; Decl. of Cooper, Exhibit C, ¶ III(g), ARH1 137.
- The owner-operators are required to have a safety inspection of the equipment at least once every 90 days. ARH4 1196-97; ARH1 212, adopted ALJ order, ¶ 4.18; Decl. of Cooper, Exhibit C, ¶ III(h), ARH1 at 137.
- Hatfield retains the right to discuss and recommend actions against an owner-operator's employees, agents, or servants when such employees, agents, or servants have damaged, hindered, or injured Hatfield's customer relations through negligent performance of work or other related actions. ARH4 1196-97; Decl. of Cooper, Exhibit C, ¶ XI(b), ARH1 140.
- And, if Hatfield believes that an owner-operator has breached the contract in a manner so as to render Hatfield liable for the shipper, consignee, or any governmental authority, Hatfield can take possession of the owner-operator's equipment and commodities being hauled, and complete the shipment. Ultimately, Hatfield may terminate the contract if an owner-operator has violated the safety rules or regulation of any governmental agencies. ARH4 1196-97; Decl. of Cooper, Exhibit C, ¶ XII, ARH1 141.

The Commissioner ruled that these requirements “are generally inconsistent with freeing the owner-operators from its control and direction; in other words, Hatfield is not just interested in the *end result* of the transportation services performed by the owner-operators, but it also concerns itself as to ‘how’ the transportation services are to be performed by owner-operators.” ARH4 1196-97 (citing *Jerome v. Emp’t Sec. Dep’t*, 69 Wn. App. 810, 817, 850 P.2d 1345 (1993) (a putative employer’s ability to control was evidenced by the fact that it could enforce the control by unilaterally deciding not to give referrals to any food demonstrator)). The concern over how the transportation services are to be performed amounts to control over the “methods and details” of the services. ARH4 1196-97.

Some, but not all, of these factors are federal requirements. And *Western Ports* permits consideration of federally required factors. 110 Wn. App. at 453-54. But even if the federal lease requirements could not be considered, multiple contract provisions required owner-operators to comply with Hatfield’s policies and procedures beyond those required by federal law or pertaining only to the equipment. *See* ARH4 1196-97. For example: to wash and clean the equipment to keep it in good appearance and to maintain a good public image, Decl. of Cooper, Exhibit C, ¶ III(c), ARH1 136; to furnish all necessary tie-down gear and cargo protection

equipment, Decl. of Cooper, Exhibit C, ¶ III(g), ARH1 137; to have the right to discuss and recommend actions against an owner-operator's employees, agents, or servants when such employees, agents, or servants have damaged, hindered, or injured Hatfield's customer relations, Decl. of Cooper, Exhibit C, ¶ XI(b), ARH1 140; and, to permit Hatfield to take possession of the owner-operator's equipment and commodities hauled and complete the shipment if an owner-operator has breached the contract so as to render Hatfield liable to others, Decl. of Cooper, Exhibit C, ¶ XII, ARH1 141. Therefore, while Hatfield's argument that the Court should not consider federally mandated controls is incorrect under Washington case law, it is also immaterial under the facts of this case.

Additionally, because the *right to control* establishes control, Hatfield fails to show freedom from control or direction. *See W. Ports*, 110 Wn. App. at 452. For example, Hatfield's "exclusive use" of the truck on a 24-hour and 365-day-per-year basis, and the ability of Hatfield to "take whatever measures necessary" if the owner-operator or his employees or agents are unable to operate the truck to fulfill Hatfield's obligations to its customers, gives Hatfield the right to control the owner-operators' performance. ARH1 136, ¶ II.

Hatfield argues that a provision in the contract purporting to establish that owner-operators are free to determine the methods and

means to be used in meeting contractual obligations necessarily establishes that this element is satisfied. Br. Appellant 11 (citing ARH1 135). Hatfield is wrong. Just as a contractual provision calling a worker an independent contractor does not establish that the worker is one, *Penick*, 82 Wn. App. at 40, this provision does not establish that owner-operators are free from control or direction over the methods and details of their performance of services. The Court can review the contractual provisions and determine whether there is freedom from control or direction within the meaning of law. General statements of intent in the contract are not dispositive.

In summary, Hatfield failed to prove freedom from control or direction under RCW 50.04.140(1)(a). Because Hatfield fails to meet this element, Hatfield's claim for exception of owner-operators as independent contractors fails.

2. The Commissioner did not consider, and this Court should not reach, the remaining elements of the independent contractor exception test in this case

Hatfield includes argument concerning the second and third elements of the subsection (1) test under RCW 50.04.140. Br. Appellant 10-11 (discussing places of business, and whether owner-operators were engaged in an independent business). The Commissioner did not rule on these issues because the "coverage/liability issue was decided on summary

judgment,” and “the record was not adequately developed on the other two criteria under RCW 50.04.140(1)(b) and (1)(c).” ARH4 1198. The ALJ likewise based his ruling on only the first element, RCW 50.04.140(1)(a). ARH1 216-17. Accordingly, if this Court determines that Hatfield somehow met its burden of demonstrating owner-operators’ freedom from control or direction over the performance of services, then the Court should remand to the Office of Administrative Hearings for further proceedings on the remaining two elements. *See* RCW 34.05.570, .574; RCW 34.05.534 (exhaustion of administrative remedies).

For example, the current record does not address whether the owner-operators performed any services at Hatfield’s principle place of business (which is pertinent to the second element); or whether the owner-operators formed business entities with the Secretary of State, had Department of Revenue accounts, kept their own books, had business cards, advertised their services to the public, actually provided services to other companies,¹¹ and more (which is pertinent to the third element). Further, there are no findings concerning whether the owner-operators possess their own motor carrier authority, which is required for them to independently haul freight for others. *See Stafford Trucking, Inc. v. Dep’t*

¹¹ There is evidence in the record, but no findings, that the owner-operators worked exclusively for Hatfield, ARH6 9/17/14 Bishop test. at 34, which would tend to show absence of independence.

of Indus., Labor & Human Rel., 206 N.W.2d 79, 84 (Wis. Ct. App. 1981).

These matters must be addressed below before they may be considered by this Court. Certainly, Hatfield has not proven exception as a matter of law on this record, as Hatfield seems to claim. *See* Br. Appellant 10-12.

C. Federal Law Does Not Preempt the Assessment

Hatfield raises the same preemption argument as does System. The Department incorporates herein by reference Section V.C from its brief in System. The added discussion in Hatfield's brief, Br. Appellant 10, of the declaration of its president (ARH1 34-38) does not establish entitlement to relief. Like the declarations of the other witnesses concerning the alleged impact of the Department's assessment, the Hatfield declaration describing the impact of added costs rests on the erroneous legal conclusion that the tax assessment results in reclassifying owner-operators for other legal purposes or replacing its workforce with only employees driving company-owned trucks. This will supposedly result in the need to "provide trucking services only through use of employees," "buy expensive trucks," and bear "additional employment-related costs, including state and federal social security taxes," and transfer responsibility for liability insurance, and more. ARH1 37-38. But these are bare assertions, contradicted by Washington law. *W. Ports*, 110 Wn. App. at 458 (the only relationship the Department purports to define is "the

employment intended to be covered by the act for the purpose of the act and none other.” (quoting *Compensation & Placement v. Hunt*, 22 Wn.2d 897, 899, 158 P.2d 98 (1945)); RCW 50.04.100.

D. The Commissioner Properly Declined to Dismiss the Assessment Based on Alleged Audit Conduct

Hatfield’s final argument claims that the audit and assessment should have been dismissed because the Department issued an “inflated” assessment—which was “bad faith,” “arbitrary and capricious,” and amounted to procedural and substantive procedural due process violations, rendering the assessment “void as a matter of law.” Br. Appellant 12-24. The Commissioner properly declined to dismiss the assessment because the audit and assessment were not arbitrary and capricious and did not violate Hatfield’s due process rights. ARH4 1192; ARH2 672-79. There is no basis to set aside the assessment under RCW 34.05.574 or 50.32.050.

1. Hatfield failed its heavy burden of showing the Department’s action is arbitrary and capricious

Hatfield argues the Court should reverse the Commissioner’s decision because the Department’s failure to segregate amounts paid to owner-operators for equipment versus services when it calculated the assessment was “bad faith” and arbitrary and capricious action. First, “bad faith” is not a legal basis to reverse an agency order under RCW 34.05.570(3). Second, the court *may* reverse if an order is arbitrary and

capricious under RCW 34.05.570(3)(i), but to show arbitrary and capricious action, a party must establish that the agency's action was "willful and unreasoning and taken without regard to the attending facts or circumstances." *Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n*, 148 Wn.2d 887, 904, 64 P.3d 606 (2003). An action is not arbitrary and capricious if there is room for two positions, even if one may believe an erroneous conclusion has been reached. *Id.* This is a heavy burden that Hatfield must prove. *Keene v. Bd. of Accountancy*, 77 Wn. App. 849, 859, 894 P.2d 582 (1995). Hatfield nowhere discusses these standards in its opening brief (nor in the brief by System-TWT Transport that it incorporated), and Hatfield failed to meet the required showing.

Here, the Department's assessment was not willful and unreasoning or taken without regard to the attending facts or circumstances, and there was room for two positions. Hatfield provided to the Department the IRS 1099 forms on which it reported the payments it made to its owner-operators. ARH4 1141, ¶¶ 4.4, 4.5; ARH1 135-43; ARH8 Ex. Q, R, X, Y, Z. While parties can separately report payments for "rents" (including for equipment) and for "nonemployee compensation" on 1099 forms, Hatfield reported 100 percent of the payments as "nonemployee compensation" on the forms. ARH2 at 380-81, 539-48; ARH8 Ex. X (1099s for 2009), Y (1099s for 2010), Z (1099s for 2011).

The instructions for IRS Form 1099 explain that Box 1 is used to report “amounts of \$600 or more for all types of rents, such as . . . Machine rentals (for example, renting a bulldozer to level your parking lot). *If the machine rental is part of a contract that includes both the use of the machine and the operator, prorate the rental between the rent of the machine (report that in box 1) and the operator’s charge (report that as nonemployee compensation in box 7).*” ARH2 542 (emphasis added)).

The Department calculated its assessment based on the total remuneration reported on the 1099 forms as “nonemployee compensation,” and backed out wages that exceeded the maximum taxable wage base, per statute. ARH4 1141-42, ¶¶ 4.9, 4.18; ARH2 378. Hatfield never provided the Department with any records, as required by RCW 50.12.070 and WAC 192-310-050, on which a contrary calculation of the assessment could be made. ARH2 674-75 ¶ 4.8. The ALJ reasonably concluded that the Department was entitled to rely on the wage information it had from Hatfield in calculating the assessment because Hatfield was unable to accurately provide information, despite being the entity in the best position to do so. ARH2 675 ¶ 4.8.

Hatfield’s argument that the Department “failed to make any effort to ascertain a proper bifurcation” between equipment and wages, Br. Appellant 14, turns the burden on its head. RCW 50.12.070 requires

employers to keep true and accurate work records, “containing such information as the commissioner may prescribe.” RCW 50.12.070(1)(a). The Commissioner requires employers to keep records of workers’ total gross pay period earnings, the specific sums withheld from the earnings from each worker, and the purpose of each sum withheld to equate to net pay. WAC 192-310-050(1)(g)-(i). Employers are also required to keep payroll and accounting records. WAC 192-310-050(2)(a). Employers must keep these records open to inspection. RCW 50.12.070(1)(a).¹² Thus, the burden is on the *employer* to maintain and provide to the Department accurate records accounting for the wages paid to workers.

When an employer fails to provide necessary payroll or other wage information during an audit, the Department may calculate an assessment based on “information otherwise available to the Department.” WAC 192-340-020 (referencing use of RCW 50.12.080, which authorizes the Department to make what the statute terms an “arbitrary report” on behalf of an employer, based on the knowledge available, when the employer fails to make one). An arbitrary report under the statute and rule is not the same as “arbitrary and capricious” agency action, as it arises in the

¹² Even the federal leasing regulations for owner-operators’ arrangements with carriers provide for the contracting parties, if they choose, to specify which portion of a payment is for equipment lease or provision of driving services. *See* 49 C.F.R. § 376.12(d) (“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.”). Hatfield’s leases with owner-operators did not segregate these amounts. ARH1 143.

circumstance where the Department uses the information available because of the employer's failure to provide required records.

Witness testimony supports the finding that the Department had no records apart from the 1099s on which an assessment could be calculated. ARH2 586-87 ("We had information from 1099 stating an amount that was paid to an individual. How much of that amount was for equipment or gas or other reimbursable expenses, we did not have that information."); ARH2 395 ("I knew that we had no information to figure out how to calculate the factor for equipment."). As such, the Department was not unreasonable in performing its calculations on the only records provided to it during the audit showing payments.¹³

Even at the evidentiary hearing to determine the correct assessment amount, Hatfield never produced records showing which portions of the 1099 payments were for wages versus equipment lease. *See* ARH4 1142-43, ¶ 5.8. Instead, it offered only the testimony of a forensic accountant,

¹³ While the Department had in other cases been provided general information in the course of administrative appeals, which it decided to accept for purposes of settlement or stipulation, ARH2 395-99, those decisions did not bind the Department in this case. ARH2 408 ("Q: Well, by the time that the audits in Swanson Hay, MacMillan-Piper and Hatfield were issued, you were personally aware, at that point, that an issue had arisen in regard to bifurcating out amounts relating to equipment; correct? [objection omitted] A: I was aware that it was applied, in part of the negotiations on seven previous audits, but was not a standard that was adopted by the agency for these audits or any future audits.").

And, while Hatfield suggests that the Department's auditor had sufficient information based on "settlement sheets" to have calculated a reduced assessment that factored out costs for equipment, Br. Appellant 19-20, this is not so. Hatfield's president attested: "There is no allocation for equipment in Hatfield's settlement sheets." ARH1 38.

who never saw any records showing which portion of payments to owner-operators was for personal services and which was for equipment rental, nor did he interview any owner-operators or secure any records from them. ARH4 1141, ¶¶ 4.11, 4.12, 4.14; ARH6 9/17/14 Bishop test. at 10, 62-63. Rather, the accountant did internet research and talked with selected trucking companies and determined driving services constituted approximately 30 percent of the contract, and equipment-related expenses amounted to approximately 70 percent of the contract. ARH4 1141-42, ¶¶ 4.14, 4.15; ARH6 9/17/14 Bishop test. Hatfield “offered or suggested no information they possess or that the Department possesses or should possess with which to separate non-taxable remuneration from taxable remuneration.” ARH2 674 ¶ 4.8.¹⁴

In this context, it was not unreasoning or in disregard of the “attending facts or circumstances” for the Department to treat the payments reported as taxable. *Wash. Indep. Tel. Ass’n*, 148 Wn.2d at 904. Hatfield essentially argues that the Department was obligated to disbelieve

¹⁴ While Hatfield notes that the Department did not put on contrary expert testimony, no such testimony was needed to make the Department’s legal argument, which—though it did not prevail before the Commissioner—was not unreasonable. The expert testimony that Hatfield presented was based on generalized industry information and inferences about the owner-operators’ costs of operation based on the costs of Hatfield operating the trucks it owned. ARH6 9/17/14 Bishop test. at 35, 62-63. The inferences about the owner-operators’ wages were not based on any *owner-operator’s records* nor any conversations with *owner-operators*. ARH6 9/17/14 Bishop test. at 62-63. The Commissioner ultimately ruled these issues go to weight, not admissibility. ARH4 at 1199-1201.

the information Hatfield provided to the Department on the 1099 forms. Instead, RCW 50.12.080 and WAC 192-340-020 authorized use of the information available. And as the auditor testified: "I believe I followed the statute [regarding taxes on wages] . . . [b]y using total nonemployee compensation amounts from the 1099s." ARH2 378. Hence, Hatfield has not shown that it was arbitrary and capricious for the Department to have calculated its assessment as it originally did.

Hatfield asserts that the Department issued inflated assessments for settlement leverage. Br. Appellant 5-6, 13, 25 n.4. This is not so. Hatfield selectively quotes the record from deposition testimony taken concerning another carrier not involved in the appeal before this Court. The Department's original calculation of the assessment was based on the records—or lack thereof—provided by the carriers during the audits showing the wage payment amounts for provision of personal services. *See* ARH2 399 ("Q: Okay. So it was all to be used, then for settlement. Is that correct? A: [interruptions omitted] Possible settlement or, if MacMillan-Piper had substantial information on the exact amounts for each 1099s, that would be -- also be considered.") (deposition taken concerning carrier MacMillan-Piper, but questions were also asked concerning Hatfield). Hatfield had the opportunity and responsibility during the audit to provide records of which portions of payments to

owner-operators were “wages,” and the Department did not act unlawfully in using the information it had.

The Commissioner ultimately determined, based on the accountant’s testimony, that Hatfield presented sufficient evidence to show that 70% of the payments to owner-operators was for equipment rental. ARH4 1143-44 ¶ 5.8; ARH4 1200-01. But that is not to say that the Department was arbitrary and capricious in how it originally calculated the assessment. ARH4 1192; ARH2 674-75 ¶ 4.8. The Department made a legitimate legal argument that—by failing to offer any direct evidence—Hatfield had not met its burden of showing which portions of payments were for wages. That the Commissioner found Hatfield’s expert testimony to satisfy this burden does not establish that the Department’s auditor acted arbitrarily and capriciously.

Hatfield failed to show arbitrary and capricious action because the Department’s actions were not willful and unreasoning, and there was room for two positions under the facts and law. *Wash. Indep. Tel. Ass’n*, 148 Wn.2d at 904; *Keene*, 77 Wn. App. at 859.

2. Hatfield cannot establish a due process violation

Hatfield’s complaints about the audit conduct also fail to show any due process violations. *See Br. Appellant 24-25.*

Procedural due process requires notice and an opportunity to be heard prior to final agency action. *Motley-Motley, Inc. v. State*, 127 Wn. App. 62, 81, 110 P.3d 812 (2005). “To establish a procedural due process violation, the party must establish that he or she has been deprived of notice and opportunity to be heard prior to a final, not tentative, determination.” *Id.*

Hatfield had notice of the assessment and an opportunity to be heard prior to the Department’s final order. An auditor is not a final decision maker, and an assessment is not a final order, unless not appealed within 30 days.

Once the Department issues an assessment, the employer has 30 days to file an appeal. RCW 50.32.030. If no appeal is filed, the assessment becomes final. *Id.* (“If no such petition be filed with the appeal tribunal within thirty days, the assessment shall be conclusively deemed to be just and correct.”). On appeal, the employer may set forth “the reasons why the assessment is objected to and the amount of contributions, if any, which said employer admits to be due.” *Id.* Thus, the Employment Security Act explicitly permits an employer to challenge the amounts, if any, due under a tax assessment. And by filing an appeal, Hatfield stayed the finality of the assessment and had an opportunity to be heard before the Department’s final order. It received due process.

Regarding the allegation that the auditor did not adequately follow the Department's internal manuals, Br. Appellant 20-22, 24-25, "an agency's failure to comply with its own procedures does not establish a procedural due process violation. Instead, to constitute a violation, the party must be prejudiced. Prejudice relates to the inability to prepare or present a defense." *Motley-Motley, Inc.*, 127 Wn. App. at 81 (internal citation omitted).¹⁵ Hatfield can hardly be said to have been prejudiced in its ability to prepare or present its challenge to the assessment when it had a de novo hearing, particularly when it prevailed in getting the assessment amount reduced by precisely the amount it advocated. ARH4 1143-44 ¶ 5.8; ARH4 1201.

Hatfield argues that the recent decision in *Washington Trucking Associations, et al. v. Employment Security Department, et al.*, 192 Wn. App. 621, 647, 369 P.3d 170, review granted, 186 Wn.2d 1016 (2016), supports that assessments can be invalidated if they "resulted from an

¹⁵ The Department's Status Manual and Tax Audit Manual contain guidelines that are for internal use only and, as such, do not represent the official agency interpretation of the Employment Security Act. See *Ass'n of Wash. Bus. v. Dep't of Rev.*, 155 Wn.2d 430, 447, 120 P.3d 46 (2005) (even interpretive statements not binding on public or court "and are afforded no deference other than the power of persuasion."); *Mgmt. Recruiters Int'l, Inc., v. Bloor*, 129 P.3d 851, 856 (6th Cir. 1997) (noting that where an agency has the choice between binding rules and an advisory interpretive statement, the agency's choice to do the latter indicates its interpretation is not binding through judicial deference); see also *Port of Seattle v. Pollution Control Hearings Bd.*, 151 Wn.2d 568, 635 n.32, 90 P.3d 659 (2004) (noting that agency's purported failure to follow a permit writer's manual that was not adopted as a regulation did not justify modification of agency condition in a permit). Here, the Status Manual and Tax Audit Manual do not even rise to the level of an interpretive statement, which itself would be afforded no deference. See *id.*

improper audit process that violated ESD's own standards." Br. Appellant 20, 22. Hatfield mischaracterizes the opinion. Rather, the court stated: "They will be able to invalidate the assessments *if* they can show that . . . imposing the assessments based on ESD's audit procedures violated the constitution." 192 Wn. App. at 647 (emphasis added)). Nothing in the *Washington Trucking Associations* opinion replaces the legal standard in *Motley-Motley, Inc.* and other cases that "an agency's failure to comply with its own procedures does not establish a procedural due process violation." *Motley-Motley, Inc.*, 127 Wn. App. at 81.

Nor has Hatfield established a substantive due process violation. Substantive due process generally asks whether the government abused its power by arbitrarily depriving a person of a protected interest, or by basing the decision on an improper motive. *Nieshe v. Concrete School Dist.*, 129 Wn. App. 632, 640-41, 127 P.3d 713 (2005). As a threshold matter, Hatfield must establish it was deprived of a constitutionally protected liberty or property interest. *Id.* at 641. "[T]he protections of substantive due process have for the most part been accorded to matters relating to marriage, family, procreation, and the right to bodily integrity." *Id.* at 642 (quoting *Nunez v. City of L.A.*, 147 F.3d 867, 871 n.4 (9th Cir. 1998)). Substantive rights can only be created by fundamental interests derived from the Constitution. *Id.* at 642.

Hatfield has not claimed any liberty or property interest is implicated here, because there is none. It merely argues that the audit was “tainted by an improper motive,” citing *Motley-Motley*. Br. Appellant 24. But *Motley-Motley* reached the substantive due process question (holding there was no violation) because that case involved property rights, and the cases it cites were land use decisions. *Motley-Motley, Inc.*, 127 Wn. App. at 82 (analyzing when a *land use decision* violates substantive due process, and citing *Dykstra v. Skagit County*, 97 Wn. App. 670, 673, 985 P.2d 424 (1999) and *Cox v. City of Lynnwood*, 72 Wn. App. 1, 9, 863 P.2d 578 (1993)). Those cases do not apply here. Hatfield has no fundamental right to be audited in a particular way, particularly where a de novo hearing and judicial review are available to challenge the assessment.

Hatfield’s arguments are thus revealed as hollow litigation strategies that ignore its own failure to ever produce records segregating its payments to owner-operators by equipment and services and ignore that that the Department took a position consistent with *Western Ports*—which held an owner-operator was in “non-exempt employment” of a motor carrier under the Employment Security Act, 110 Wn. App. at 459, the same claim made as to Hatfield’s owner-operators. The assessment advances the purposes of the Employment Security Act by taxing services performed in employment to provide funds for the benefit of involuntarily

unemployed workers. This is a legitimate purpose. *See Motley-Motley, Inc.*, 127 Wn. App. at 82. Even separate from Hatfield not having a fundamental interest affected, the ALJ and Commissioner correctly found Hatfield did not prove an improper purpose. *See ARH4 1192; ARH2 672-78.*

3. The Commissioner properly declined to exclude the assessment or declare it “void”

While Hatfield may argue here that the tax assessment is *incorrect*, this does not render it void nor require its dismissal based on alleged impropriety in the Department’s audits. In general, Department orders are void only if there is a defect in personal or subject matter jurisdiction. *See Marley v. Dep’t of Labor & Indus.*, 125 Wn.2d 533, 537-38, 886 P.2d 189 (1994) (orders in industrial insurance cases). There is no defect in personal jurisdiction, as Hatfield operates in Washington and was properly issued the assessment. An agency lacks subject matter jurisdiction only when it does not have authority to adjudicate the “type of controversy” in question. *Marley*, 125 Wn.2d at 539; *Dougherty v. Dep’t of Labor & Indus.*, 150 Wn.2d 310, 317, 76 P.3d 1183 (2003); *Singletary v. Manor Healthcare Corp.*, 166 Wn. App. 774, 782-83, 271 P.3d 356 (2012); *Magee v. Rite Aid*, 167 Wn. App. 60, 27, 277 P.3d 1 (2012). The Department has broad subject matter jurisdiction to issue orders and

notices of assessment for unemployment insurance taxes; this is the “type of controversy” the Department has authority to adjudicate. *See* RCW Title 50; *Marley*, 125 Wn.2d at 542; *Singletary*, 166 Wn. App. at 783.

Despite parties continuing to mistakenly characterize an allegedly erroneous order as “void” or one lacking in “jurisdiction,” the appellate courts have maintained that errors of law and any errors other than hearing the wrong “type of controversy” do not deprive the Department of subject matter jurisdiction. *See Marley*, 125 Wn.2d at 539 (recognizing the confusion between subject matter jurisdiction and a court’s “authority” to enter a given order and stating that all errors other than hearing the wrong type of controversy “go to something other than subject matter jurisdiction”); *Dougherty*, 150 Wn.2d at 315 (by “intertwining procedural requirements with jurisdictional principles,” courts have “blurred” issues of venue and jurisdiction and “transformed” procedural elements into jurisdictional requirements); *Cole v. Harveyland, LLC*, 163 Wn. App. 199, 208, 258 P.3d 70 (2011) (“Despite these cautionary rulings, the terminology of subject matter jurisdiction continues to pop up outside its boundaries like a jurisprudential form of tansy ragwort.”); *see also Sprint Spectrum, LP v. Dep’t of Revenue*, 156 Wn. App. 949, 964, 235 P.3d 849 (2010) (Becker, J., concurring) (noting that the contra authorities are “outdated and harmful”), *review denied*, 170 Wn.2d 1023 (2011).

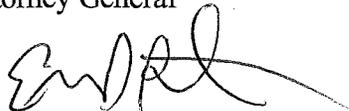
In summary, the allegations about impropriety in the audit lack support and do not demonstrate that the Department's assessment is arbitrary or capricious or violated Hatfield's constitutional rights. The Commissioner properly declined to dismiss the assessment.

VI. CONCLUSION

Hatfield failed to prove that the owner-operators are excepted from unemployment insurance coverage under the Employment Security Act. Hatfield's arguments that the assessment is preempted or must be dismissed due to alleged faulty audits were properly rejected by the Commissioner. The Court should affirm the Commissioner's order.

RESPECTFULLY SUBMITTED this 30th day of January, 2017.

ROBERT W. FERGUSON
Attorney General



ERIC D. PETERSON, WSBA No. 35555

Senior Assistant Attorney General

LEAH HARRIS, WSBA No. 40815

Assistant Attorney General

Attorneys for Washington State

Employment Security Department

OID No. 91020

800 5th Ave., Ste. 2000; MS TB-14

Seattle, WA 98104-3188

Email: EricP1@atg.wa.gov;

LeahH1@atg.wa.gov;

LALSeaEF@atg.wa.gov;

LALolyEF@atg.wa.gov

PROOF OF SERVICE

I, Dianne S. Erwin, declare that I sent a copy of this document, **Brief of Respondent RE: Hatfield Enterprizes, Inc.** for service on all parties or their counsel of record via US Mail Postage Prepaid, and by electronic mail per electronic service agreement on the date below as follows:

Phil Talmadge
Thomas Fitzpatrick
Talmadge/Fitzpatrick/Tribe
2775 Harbor Ave SW, 3rd Fl. Ste C
Seattle, WA 98126-2138

Email: phil@tal-fitzlaw.com
tom@tal-fitzlaw.com

Aaron Riensche
Ogden Murphy Wallace, PLLC
901 Fifth Ave Ste 3500
Seattle, WA 98164-2008

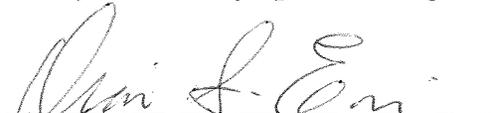
Email: ariensche@omwlaw.com

Ryan R. McNeice
Becki Wheeler
McNeice Wheeler PLLC
P.O. Box 14758
11404 E Sprague Ave
Spokane Valley, WA 99214-0758

Email: ryan@mcneicelaw.com
becki@mcneicelaw.com

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

DATED this 30 day of January 2017 at Olympia, Washington.


DIANNE S. ERWIN, Legal Assistant

HATFIELD ENTERPRIZES, INC.
SPOKANE, WA.

AGREEMENT OF LEASE AND CONDUCT

This agreement made this day 17TH of SEPT, 2008 by and between HATFIELD ENTERPRIZES, INC., having office at E. 16715 Euclid, Spokane, Wa., herein after called (LESSEE), and KEN R NACCARATO herein after called (CONTRACTOR) 15115 E 11ST of VERADALE, WA 99037.

WITNESSETH

WHEREAS, HATFIELD ENTERPRIZES, INC holding Common Carrier Permit Number MC-154881, with the Interstate Commerce Commission, and desires to enter into a lease with the Contractor and his equipment as described in Schedule A attached hereto.

WHEREAS, Lessee desires to hire equipment and/or driver from the Contractor at monies and upon terms and conditions hereinafter set forth.

THE INTENT, of this contract is to affirm the agreement between Lessee and Contractor and while the Lessee and Contractor shall be required to meet obligations assumed hereunder, all parties are entitled to exercise the discretion and judgment of an independent person, business or contractor in determining the methods and means to be used in doing.

NEITHER PARTY shall discriminate against the employees, agents, or servants of the other because of, among others, race, color, sex, religion, origin, or business, social, or other political affiliations.

THE PROVISIONS of this contract, as it is written, intends not to effect the quality of human environment.

NOW, THEREFORE, for and in considerations of the premises and covenants and agreements hereinafter contained set forth the parties hereto covenant and agree as follows:

I. DELIVERY

The Contractor hereby leases to the Lessee, and the Lessee hereby hires from the Contractor the equipment as specified in Schedule A, attached hereto and hereby made part of. Each unit upon commencement of this agreement shall comply with all Federal, State, and Local laws, ordinances, and regulations relating to vehicle specifications and driver requirements and shall be under the directions and dispatch of HATFIELD ENTERPRIZES, INC.

II. TERM OF AGREEMENT

The term of this agreement shall commence on the dates herein and shall only apply to the equipment as described in Schedule A, hereto attached. This agreement shall continue until terminated by either party hereto upon not less than thirty-(30) days prior written notice of such termination to the other party.

During the existence and execution of this Contract, the Contractor agrees that the Motor Vehicles in Schedule A, hereto attached, shall be for the exclusive use of the Lessee on a twenty-four-(24) hour and three hundred sixty-five-(365) days a year basis. Contractor further agrees, shall he or his employees, agents or servants be unable, for one reason or another, to operate said described vehicles, it shall be Lessee's sole right to take whatever measures necessary to fulfill Lessee's obligations to its shippers and receivers.

III. MAINTENANCE, REPAIR AND SUPPLIES

At its sole cost and expense, Contractor shall.

- (a) Pay all costs and expenses incidental to the performance of this agreement, including all operation and maintenance costs for the equipment described in Schedule A and used in said performance, vehicle license fees, mileage taxes, fuel taxes, special permits, gross revenue taxes, third structure taxes, road taxes and tolls, equipment use fees or taxes, and any other tax, fine or fee imposed or assessed against the equipment, cargo, or HATFIELD ENTERPRIZES, INC. by any State. Provincial authority as a result of an action by the Contractor, or by the employees, agents or servants of the Contractor, in performance of this agreement.
- (b) Maintain the equipment in good repair, mechanic condition, running order and appearance.
- (c) Wash and clean the equipment as frequently as reasonably required to maintain the good appearance thereof and a good public image.
- (d) Oil, grease and inspect the equipment as frequently as required to maintain same in good repair, mechanical condition, and running order, and to comply with all applicable Federal, State and Local laws, ordinances and regulations.
- ~~(e) - Mark the equipment with insignia and markings, including markings identifying the equipment as required by or under all applicable Federal, State, and Local laws, ordinances and regulations, and maintain all such insignia, and markings in good order and appearance.~~

- (f) Furnish all fuel, oil, lubricants, and cold weather protections of the equipment.
- (g) Furnish all necessary tie-down gear and cargo protection equipment as reasonably required by the Lessee, and all the safety equipment as required by the Department of Transportation.
- (h) Have a safety inspection made upon his equipment at least once every ninety-(90) days at a D.O.T. approved inspection station.
- (i) Comply with all rules and regulations of the Department of Transportation, Interstate Commerce Commission, State Agencies, and regulatory authorities having jurisdiction over this Lessee' operations. The Contractor shall not allow the equipment described in schedule A, to be operated by himself, or his employees, agents or servants, in violation of the minimum required qualifications of the D.O.T., Interstate Commerce Commission, or any other regulatory agencies which have jurisdiction over this Lessee's operations.

IV. PROCUREMENT of PARTS, SUPPLIES AND REPAIRS

Where reasonably convenient, Contractor may but is not required to procure fuel, oil lubricants, parts, supplies, and repairs for the safe and proper operation of the equipment as described in Schedule A from the Carrier or the Carriers suppliers. Contractor's employees, agents or servants shall reimburse any authorized repairs to Lessee's trailers unless Contractor's negligence, or the negligence causes damage, service or repairs.

V. CONTRACTOR'S SETTLEMENTS

Lessee shall provide the necessary accounting for Contractor and shall make payment for services as follows:

- (a) The Contractor shall be paid as specified in Schedule B, attached hereto and made part of this agreement.
- (b) Lessee shall not be responsible for wages and expenses of Contractor's employees, agents or servants. Contractor shall hold Lessee harmless from any liability arising from the relationship between the Contractor and the Contractor's employees, agents or servants, whether under Industrial Accident laws, Workman's Compensation laws, or any other State, Federal or governmental agency laws applicable to employers and employee.
- (c) Shipments shall be Shipper load and Consignee unload.

- (d) Settlements including the final are to be made fifteen (15) days after receipt of necessary documents for the Carrier to secure payment from the shipper. A clear Bill of Lading, with no exceptions, damage or shortage, logs and other necessary paper work as per Interstate Commerce Commission regulations. The Contractor has the right to examine copies of the tariff and upon request receive copies of rated freight bills.

VI. ADVANCES AGAINST SETTLEMENTS

Contractors may draw up to 40% of revenue each trip after loaded and weight is called in.

OR

COMDATA AND TCH CARD can be used for fuel and not over \$250.00 weekly in advances, except in break down situations.

IF OVER 50% OF INCOME IS DRAWN, ADVANCES MUST BE CLEARED BY MANAGEMENT.

VII. PERMITS AND LICENSING

HATFIELD ENTERPRIZES, INC will make applications for all license and fuel permits, which you will need. Proof of prior year Federal Highway Use Tax is required before this can be done.

Please remember, HATFIELD ENTERPRIZES, INC. is liable for all license fees, road and fuel tax payments and insurance bonds for every state we operate in. All state fees due will be charged to each vehicle owners' account.

All permits and licenses are in the name of HATFIELD ENTERPRIZES, INC. The permits assigned to the owner actually belong to HATFIELD ENTERPRIZES, INC. The registration fees do not grant the vehicle ownership of the permits.

Most of the cab cards and fuel permits have to be updated on a yearly basis. The license Department will update them as required. Watch the license board. However, if you notice that they have expired, contact the office. Don't assume that all your permits are current, check your book regularly.

Failure to return all licenses, permits and other necessary documents will subject Contractor to a two hundred-fifty (\$250.00) dollar penalty to protect Lessee from penalties arising from further audits by any governmental agency. After initial contract, licenses will be ordered November 1, of each year, and the Contractor's equipment will be licensed unless Lessee receives notice in writing that the Contractor does not desire to have his vehicle licensed for the next year. Notice must be received by the Lessee prior to November 1 of each year. Any costs incurred by Lessee due to the failure of the Contractor to give such notice will be charged to the Contractor.

VIII. RESERVE ACCOUNT

A cash deposit of six hundred (\$600.00) dollars is required upon leasing to HATFIELD ENTERPRISES, INC. This deposit is increased at a rate of 5% of your gross revenue until an amount of \$2000.00 is accumulated. This deposit is designed to be used to purchase licensing for the next year, eliminating the burden of large licensing bills during the winter months. Contractors have the right to demand at any time an accounting of any escrow transactions, also an accounting on each settlement statement.

IX. INSURANCE

Lessee shall provide all cargo and liability insurance for the Contractor at the Contractor expense. The Contractor shall be liable for all deductibles and other expenses arising from claims which are not covered by insurance. Lessee is in no way responsible for any damage that may occur to the Contractors' vehicle in the performance of this agreement. Contractor shall be liable for the full amount of any claim for shortage of, loss of, pilferage of, spoilage of, or other damage to the commodities transported by the Contractor's employees, agents or servants and the burden of proof shall be upon the Contractor. The Carrier will provide the Contractor with a written explanation and itemized statement of any deductions for claims, before such deductions are made.

Contractors will be provided a certificate of insurance, and upon demand a copy of each policy purchased by the Carrier.

The Contractor will be responsible for his own bobtail and physical damage coverage

X. TERMINATION

In the event a Contractor decides to terminate his lease agreement, HATFIELD ENTERPRIZES, INC. must receive in writing, thirty (30) day advance notice of his interest.

Upon termination, the Contractor must immediately return to the office in Spokane, Washington with all the permits, cab cards, insurance and license plates, decals, and door signs, copies of operating authority, fuel cards and phone cards.

Reserve funds will be paid forty-five (45) days after receipt of all required items and all other terms of the lease agreements are met. Any licensing refund will be used to cover administrative costs of termination.

XI. PERFORMANCE OF CONTRACTORS

In the review of the requirements of the Interstate Commerce Commission, the Department of Transportation, and of any State or Provincial regulatory agencies having jurisdiction:

- (a) The Contractor shall be solely responsible for the direction and control of the Contractor's employees, agents and servants including hiring, firing, setting wages, performance standards, attendance requirements and working conditions, and paying and adjusting grievances of said employees, agents and servants.
- (b) Lessee shall not request the Contractor to discontinue the use of any particular employee, agent or servant of the Contractor in the performance of Contractors' obligations under this contract except for violations or breaches of applicable laws or governmental rules or regulations. Lessee shall have the right to discuss and recommend actions against a Contractors' employees, agents or servants when such employees, agents or servants have damaged, hindered or injured Lessee's customer relations through negligence of job or other related actions.

XII. WAIVER

If, in the opinion of the Lessee, the Contractors' employees, agents or servants, has breached this contract in such a manner as having subject the Lessee to liability to the shipper, consignee or any governmental authority, Lessee may take possession of the Lessee's equipment and commodities being hauled by the Contractor and complete the shipment. Contractor shall reimburse Lessee for any costs, expenses or damage incurred by Lessee as a result of taking possession of the Lessee's equipment and commodities and completing the shipment, including, but not limited to costs of rehandling and transferring the shipment, transportation expenses and damages paid to the shipper or consignee.

In addition to any other remedies in any other paragraphs of this contract, Lessee may immediately terminate this contract in the event Contractor, or Contractors employees, agents or servants, violates the safety rules or regulations of any Federal, State or Provincial governmental agency, including, but not limited to, the Department of Transportation safety regulations.

XIII. SECTION

All section headings are inserted for convenience only and shall not effect any construction or interpretation of this agreement.

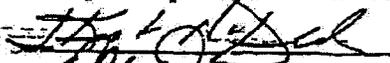
XIV. ENTIRE AGREEMENT

The parties hereto agree that this instrument, together with the Schedule A and B, attached hereto, constitutes the entire agreement between the parties hereto and supercede all prior agreements and understandings of the parties relating to the subject matter hereof and shall be binding upon the respective parties and their respective representatives, successor and assigns.

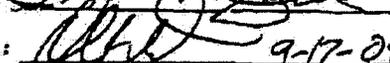
XV. ASSIGNMENT

Neither this agreement nor any interest herein may be assigned or consent of the other party.

IN WITNESS WHEREOF, the parties hereto have caused this agreement to be executed, in duplicate originals, by their duly authorized representatives, as of the day and year first above written.

HATFIELD ENTERPRISES, INC. By: 

CONTRACTOR

By:  9-17-08

KEN NACARRATO

HATFIELD ENTERPRIZES, INC

SCHEDULE A-1

Dated this 17TH day of SEPT, 2008, in conformance to terms of the contract as agreed.

VEHICLE: TRACTOR

TYPE: TRACTOR CONVENTIONAL

MAKE: PETERBILT

YEAR: 1993

SERIAL NUMBER: 1XP5DB9X5FD328859

STATE OF REGISTRATION: WASHINGTON

NAME OF OWNER OF VEHICLE. KEN NACARRATO

VEHICLE: TRAILER FLATBED

MAKE: REINKE

YEAR: 1998

SERIAL NUMBER: 4C6FC4828W1030483

COMMENTS:

OWNERS SIGNATURE
09/17/2008

 9-17-08

HATFIELD ENTERPRIZES, INC

SCHEDULE B

Hatfield Enterprizes, Inc., will pay 82 of the gross revenue on all freight hauled.

Hatfield Enterprizes, Inc.

BY: [Signature]

Contractor

BY: [Signature] 09-17-08

KEN NACCARATO

Name: _____

Address: 15115 E 11TH ST

City, State, Zip: VERADALE, WA 99037

**STATE OF WASHINGTON
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE EMPLOYMENT SECURITY DEPARTMENT**

In The Matter Of:

**MACMILLAN-PIPER, INC.,
HATFIELD ENTERPRISES, INC., and
SWANSON HAY COMPANY,**

Employer-Petitioners.

OAH Docket Nos.

**01-2012-21703T,
01-2012-21704T, and
01-2012-21705T**

**ORDER DENYING EMPLOYERS'
MOTION FOR SUMMARY
JUDGMENT ON FEDERAL
PREEMPTION**

I. ISSUE PRESENTED

Whether to grant the Employers' Motion for Summary Judgment on Federal Preemption.

II. ORDER SUMMARY

The Employers' Motion for Summary Judgment on Federal Preemption is denied.

III. HEARING

3.1 Hearing Date: October 3, 2013

3.2 Administrative Law Judge: Terry A. Schuh

3.3 Employer-Petitioners: MacMillan-Piper, Inc., Hatfield Enterprises, Inc., and Swanson Hay Co.

3.3.1 Representatives: Philip Talmadge and Thomas Fitzpatrick. Talmadge/Fitzpatrick, Attorneys at Law; Aaron Riensche, Ogden Murphy Wallace, P L L C, Attorneys at Law. Suzanne Tilley, Inter-facilities Manager, MacMillan-Piper, Inc. appeared as an observer.

3.4 Agency: Employment Security Department

3.4.1 Representative: Lionel Greaves, IV, Assistant Attorney General; Dionne Padilla Huddleston, Assistant Attorney General. Garrit Eades, Statewide

Audit Coordinator, Employment Security Department, appeared as an observer.

3.5 The record relied upon: Employers' Motion for Summary Judgment on Federal Preemption, Declaration of Larry Pursley in Support of Employers' Motion for Summary Judgment; Declaration of Joe Rajkovic in Support of Employers' Motion for Summary Judgment; Declaration of Steve Stivala; Declaration of Kent Hatfield in Support of Employers' Motion for Summary Judgment; Department's Response to Employer's [sic] Motion for Summary Judgment on Federal Preemption; Reply on Carriers' Motion for Summary Judgment on Federal Preemption, with attachments; the audit reports and Orders and Notices of Assessment produced in these matters, and oral argument heard on October 3, 2013.

IV. ANALYSIS

Summary Judgment

4.1 "Summary judgment is appropriate 'if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.' CR 56(c)." *American Legion Post #149 v. Washington State Dept. of Health*, 164 Wn.2d 570, 584, 192 P.3d 306 (2008).

4.2 "The facts and reasonable inferences therefrom are construed most favorably to the nonmoving party." *Korslund v. Dycorp Tri-Cities Services, Inc.*, 156 Wn.2d 168, 177, 125 P.3d 119 (2005) (citations omitted).

4.3 "Summary judgment should be granted if reasonable persons could reach but one conclusion from the evidence presented." *Korslund*, 156 Wn.2d at 177.

4.4 "The burden is on the moving party to demonstrate there is no issue as to a material fact, and the moving party is held to a strict standard." *Cowiche Canyon Conservancy v. Bosley*, 118 Wn.2d 801, 811, 828 P.2d 549 (1992) (citation omitted).

4.5 If the moving party meets this initial showing and does not have the burden of proof at the forthcoming evidentiary hearing on the merits, then the nonmoving party must set forth specific facts that remain at issue to establish that there is a genuine issue to be resolved at the forthcoming hearing. *Young v. Key Pharmaceuticals, Inc.*, 112 Wn.2d 216, 225-226, 770 P.2d 182 (1989) (citations omitted).

4.6 Here, there are facts material to the cases overall at issue, namely, if remuneration paid by the employer-petitioners ("the Carriers") to the owner-

operators includes taxable wages, what part of that remuneration is taxable? However, it is possible to consider the issue of federal preemption without resolving that factual dispute. Accordingly, that factual dispute is not material in regards to federal preemption, at least not in this instance. However, because I deny the motion as a matter of law, I decline to find facts as a matter of law. Nevertheless, the discussion to follow will necessarily include factual references.

4.7 I further note that the Employment Security Department ("the Department") correctly observed that at least some of the persons characterized by the Department as employees for the purposes of taxation are not owner-operators and not a part of the federal preemption issue as plead by the Carriers. Therefore, if this motion had been granted, that decision would not have fully resolved all three cases.

The effect of the Department's proposed taxation is to increase the cost of doing business

4.8 In considering federal preemption, I first determine the nature of that which the Carriers would preempt.

4.9 The Carriers argued that the Department is converting all owner-operators to the status of employees. That is not what the Department's conduct does. Rather, the Department characterizes the owner-operators as employees for the purposes of unemployment insurance taxation – nothing more, nothing less.

4.10 Nevertheless, the Carriers insist that they will be forced to treat the owner-operators as employees in all ways, that the Carriers will be required to purchase rather than lease tractors and trailers, that the Carriers will no longer be able to rely on the flexibility of independent contractors, and so on. On the other hand, the Carriers insist that the historical arrangement between carriers and owner-operators is essential, even critical, to the industry. I am persuaded by the declarants that the independent-contractor arrangement with owner-operator is pervasive and I am persuaded that this pervasiveness exists because the arrangement is economic and effective, if not critical. However, I am not persuaded by the declarants that the increased cost of doing business implicit, if not explicit, in the Department's proposed taxation will cause them and their competitors to flee from such an otherwise vital and successful arrangement.

4.11 At this juncture, without a precise evidentiary record, the cost of taxation is unclear. The amounts recited in each Order and Notice of Assessment include penalties and interest that will not re-arise if the Carriers timely comply with future quarterly tax payments, which obligations will exist should the Carriers lose their appeals. Moreover, the Department and the Carriers agree that the taxes recited in each Order and Notice of Assessment are based in part on remuneration not

properly adjusted to reflect payment for services only. The Carriers suggest that based on previous settlements, that which constitutes payment for services may be only 30% of the total remuneration packages. Further, the tax itself is a percentage of payment for services. The audit reports that appear in the Department's proposed exhibits for the postponed evidentiary hearings recite quarterly tax rates that range widely. The highest quarterly rate attributed to MacMillan-Piper was 2.43%; the highest quarterly rate attributed to Swanson Hay was 4.99%; the highest quarterly rate attributed to Hatfield was 1.14%. So, likely only a fraction of the monies sought in each Order and Notice of Assessment will become an ongoing cost of doing business should the carriers lose their appeals. Undoubtedly, that cost is worth to the Carriers a fight to avoid it. Any profit-seeking enterprise wishes to limit costs. I expect the Carriers to wish to limit costs. I am simply not persuaded that the costs ultimately at issue here will cause the Carriers to abandon their historical use of owner-operators because I am persuaded that the costs of abandonment likely exceed the costs of acquiescence. Or more correctly, the declarants have not persuaded me that the cost of taxation will render the historical owner-operator arrangements no longer economically viable. If those arrangements are as critical as proposed, then a comparatively small increase in the cost of using those arrangements will not cause the industry to abort them.

4.12 In sum, I will not analyze federal preemption from the catastrophic perspective proposed by the Carriers but rather from the perspective that the costs of doing business will increase by a percentage impossible to presently compute.

Western Ports remains good law

4.13 *Western Ports* flowed from a claim for unemployment benefits by a former owner-operator and independent contractor. That court said that "[the] federal statutory and regulatory scheme does not preempt state employment security law by which a person who might be an independent contractor under federal transportation or common-law principles may nevertheless be entitled to [unemployment insurance] compensation." *Western Ports Transp., Inc. v. Employment Sec. Dept. of the State of Wash.*, 100 Wn.App. 440, 445, 41 P.3d 510 (2002).

4.14 That court "reject[ed] [the] contention that federal transportation law permitting [independent contractor arrangements] preempts state employment security law." *Id.* at 454. The court observed that "[f]ederal transportation law promotes public safety and provides for the easy flow of goods in interstate commerce" where as state unemployment law provides assistance to the unemployed. *Id.* at 457.

4.15 *Western Ports* clearly held that, for the purposes of employment security law, treating owner-operators as employees was not preempted by the federal transportation law that governed independent contractor arrangements. Moreover, that court did so specifically mindful that Congress prohibited the states from enacting or enforcing laws or regulations related to price, route or service. See *id.* at 456.

4.16 The Department essentially challenged the Carriers to demonstrate that *Western Ports* has been overturned. The Carriers did not do so. Instead, the Carriers argued that *Western Ports* is out-of-step with more recent decisions by the U.S. Supreme Court and that other jurisdictions have favored federal preemption over employment security law.

4.17 For example, the Court found a Maine law that regulated the shipping of tobacco products interfered with the federal government's authority over the services that carriers provide and so federal law preempted. *Rowe v. New Hampshire Motor Transp. Ass'n*, 552 S.S. 364, 371-372, 128 S.Ct 989, 169 L.Ed.2d 933 (2008). Here, Washington's employment security law, and especially that the laws at issue, do not affect what services carriers provide. The Carriers insist that taxing the wages attributed to owner-operators will cause them to alter the services they provide, thus affecting services. But, that is not the circumstance at issue in *Rowe*. Moreover, as I discussed already, I am not persuaded that the taxation contemplated by the Department will cause the Carriers to respond as dramatically as they suggest.

4.18 In another case, the Court found that regulations regarding placards on the vehicles and parking restrictions had the force and effect of law. *American Trucking Associations, Inc. v. City of Los Angeles*, ___ U.S. ___, 133 S.Ct. 2906, 2102-2103. But the court expressly did *not* decide whether those provisions related to price, route, or service because the parties did not dispute that issue. *Id.* at 2102. Therefore, the Court did not address the issue disputed herein.

4.19 Regarding the same case, the 9th Circuit held that the elimination of independent contractors in favor of employees was preempted. See 596 F.3d 602 (9th Cir. 2010). However, there, the provisions specifically and directly required the use of employees instead of independent contractors. Here, the Department has no such requirement. The Department does not pretend to alter the relationship between the Carriers and the owner-operators; it simply asserts a tax on certain of the remuneration paid by the Carriers to the owner-operators.

4.20 In similar fashion, *In re Federal Preemption of Provisions of the Motor Carrier Act*, 566 N.W.2d 299 (Mich.App. 1997), *review denied*, 587 N.W.2d 632 (Mich. 1998), *cert. denied* 525 U.S. 1018 (1998), and *Sanchez v. Lasership, Inc.*,

___ F.Supp2d ___, 2013 WL 1395573 (E.D. Va. 2013) the courts addressed law that required the use of employees instead of independent contractors. The Department makes no demand except as to taxation. Again, the Department does not pretend to alter the relationship between the Carriers and the owner-operators.

4.21 However, the Carriers also argued that by increasing the cost of doing business, the affect of the proposed taxation will be an increase in prices. Notwithstanding that price is typically a function of supply and demand and not of cost, if state action that resulted in increased business costs was sufficient to imply federal preemption, than states would have no authority, for example, to increase fuel taxes. I am not aware of any such preclusion, much less a preclusion tied to federal preemption. Point in fact, the *Dilts* court, addressing regulations regarding employee meal and rest breaks, was concerned not about any additional implied costs but rather about the impact on routes, services, schedules, etc. *Dilts v. Penske Logistics, LLC*, 810 F.Supp.2d 1109, 1122, (S.D. Cal. 2011). Here, any increased cost will affect all routes, services, and schedules equally.

4.22 Accordingly, I hold that *Western Ports* remains good law and that unemployment insurance taxation, including characterizing owner-operators as employees for the purposes of such taxation, is not subject to federal preemption.

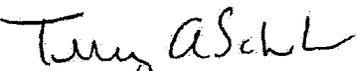
4.23 Therefore, the Carriers' motion for summary judgment predicated upon federal preemption should be denied.

ORDER

IT IS HEREBY ORDERED THAT:

The Employers' Motion for Summary Judgment on Federal Preemption is DENIED.

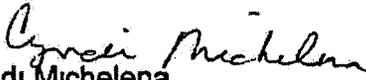
Signed and Issued at Tacoma, Washington, on the date of mailing.



Terry A. Schuh
Lead Administrative Law Judge
Office of Administrative Hearings

Certificate of Service

I certify that I mailed copy of this order to the within-named parties at their respective addresses postage prepaid on the 29th day of January 2014, at Tacoma, Washington.


Cyndi Michelena
Legal Secretary

Philip A. Talmadge
Thomas M. Fitzpatrick
Emmelyn Hart
Talmadge/Fitzpatrick
18010 Southcenter Parkway
Tukwila, WA 98188-4630

Aaron Riensche
Ogden Murphy Wallace, PLLC
901 Fifth Avenue, Suite 3500
Seattle, WA 98164-2008

Scott Michael
Legal Appeals Manager
ESD UI Tax and Wage Admin.
PO Box 9046
Olympia, WA 98507-9046

Karen Mussman
PO Box 9046
Olympia, WA 98507-9046

Lionel Greaves, IV
Assistant Attorney General
Attorney General of Washington
Pacific Plaza, Suite 105
MS: WT-31
1250 Pacific Avenue
PO Box 2317
Tacoma, WA 98401-2317

STATE OF WASHINGTON
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE EMPLOYMENT SECURITY DEPARTMENT

In The Matter Of:

HATFIELD ENTERPRISES, INC.,

Employer-Petitioner

OAH Docket No. 02-2012-21704T

ORDER GRANTING
DEPARTMENT'S CROSS-MOTION
FOR PARTIAL SUMMARY
JUDGMENT

I. ISSUE PRESENTED

Whether to grant the Department's cross-motion for partial summary judgment whether the owner-operators were employees for the purposes of unemployment insurance taxation

II. ORDER SUMMARY

The owner-operators were employees for the purposes of unemployment insurance taxation Accordingly, the Department's cross-motion for partial summary judgment is granted

III. HEARING

3 1 **Hearing Date:** October 3, 2013

3 2 **Administrative Law Judge:** Terry A Schuh

3 3 **Employer-Petitioner:** Hatfield Enterprises, Inc

3 3 1 **Representatives:** Philip Talmadge and Thomas Fitzpatrick, Talmadge/Fitzpatrick, Attorneys at Law, Aaron Riensche, Ogden Murphy Wallace, P L L C , Attorneys at Law Suzanne Tilley, Inter-facilities Manager, MacMillan-Piper, Inc , appeared as an observer

3 4 **Agency:** Employment Security Department

3 4 1 **Representative:** Lionel Greaves, IV, Assistant Attorney General, Dionne Padilla Huddleston, Assistant Attorney General Garrit Eades, Statewide Audit Coordinator, Employment Security Department, appeared as an observer

3 5 The record relied upon: Department's Cross-Motion for Partial Summary Judgment, Employer's Opposition to Department's Cross-Motion for Summary Judgment, Supplemental Declaration of Thomas M Fitzpatrick, with attachments, Supplemental Declaration of Kent Hatfield, Department's Reply to Employer's Response to Department's Motion for Partial Summary Judgment, and oral argument heard on October 3, 2013

IV. FACTS AS A MATTER OF LAW

I find the following facts based on the uncontested pleadings, party admissions, and all reasonable inferences in favor of the non-moving party

Jurisdiction

4 1 On February 7, 2012, the Employment Security Department ("the Department") issued to and served on Hatfield Enterprises, Inc ("Hatfield") an Order and Notice of Assessment asserting taxes, penalties, and interest of \$13,616 53 for the period including the first three quarters of 2009, the first, second, and fourth quarters of 2010, and the first two quarters of 2011 Decl of Cooper, Ex A

4 2 On February 7, 2012, Hatfield wrote that it would appeal *Id* It did so on February 13, 2012

At issue are the owner-operators who leased and drove equipment

4 3 Predicate to the Order and Notice of Assessment was the audit conducted by Gary Cooper Decl of Cooper, paras 2-3, Decl of Cooper, Ex B

4 4 Mr Cooper reclassified 15 individuals as employees instead of independent contractors, all of them truck drivers Decl of Cooper, para 4

4 5 Hatfield "engages in an interstate trucking business and provides contract hauling with authority from the Federal Motor Carrier Safety Administration and the Department of transportation, that [Hatfield's] transportation services involve loading/unloading and transportation of cargo from one point to another including such related activities that are customary within the trucking industry, and that the Carrier contracts with clients for transportation services and contracts with its driver to provide those services " *Id* at para 5

4 6 Hatfield leased tractors or tractor-trailers ("equipment") from individuals ("owner-operators") who owned the equipment and drove the equipment lease to Hatfield *Id* at paras 5-6, *Id* at Ex C

Characteristics of the owner-operators

4 7 The owner-operators drive equipment for Hatfield, hauling freight, and Hatfield pay the owner-operators for these services *Id* at paras 4-6

4 8 Hatfield operates under authority from the Federal Motor Carrier Safety Administration and the Department of Transportation Only one owner-operator possessed such authority independently, all of the other owner-operators lacked authority independent of Hatfield's authority *Id* at paras 5-7

4 9 Hatfield contracts with clients for transportation services and contracts with the owner-operators to provide those transportation services *Id* at para 5 Supp Decl of Hatfield, para 3

4 10 All of the owner-operators are subject to a standard contract Decl of Cooper, para 6, *Id* at Ex C

4 11 None of the owner-operators carry their own insurance Decl of Cooper, para 8 However, the owner-operators are responsible for the cost of cargo and liability insurance borne by Hatfield Decl of Cooper, Ex C, sect IX Moreover, the owner-operators are responsible for their own bobtail and physical damage coverage *Id*

4 12 All licenses and fuel permits are assigned to and owned by Hatfield *Id* at Ex C, sect VII

4 13 The owner-operators lease their equipment to Hatfield, and under the lease Hatfield has "exclusive use" of the equipment, 24 hours a day, 365 days a year *Id* at sect II

4 14 Hatfield paid the owner-operators 82% of the gross revenue for all freight hauled Decl of Cooper, Ex C, sect V(a), Decl of Cooper, Ex C, Schedule B

4 15 The owner-operators must "[w]ash and clean the equipment as frequently as reasonably required to maintain the good appearance thereof, and a good public image " Decl of Cooper, Ex C, sect III(c)

4 16 The owner-operators must "[m]aintain the equipment in good repair, mechanic condition, running order and appearance " *Id* at sect III(b)

4 17 The owner-operators must "[m]ark the equipment with insignia and markings, including marking identifying the equipment as required by or under all applicable Federal, State, and Local laws, ordinances and regulations, and maintain all such insignia, and marking in good order and appearance " *Id* at

sect III(e)

4 18 The owner-operators must "[h]ave a safety inspection upon his equipment at least once every ninety (90) days at a D O T approved inspection station " *Id* at sect III(h)

4 19 The owner-operators must "[c]omply with all rules and regulations of [all] regulatory authorities having jurisdiction over [Hatfield's] operations " *Id* at sect III(i) Hatfield can immediately terminate the lease contract if an owner-operator violates any such rules or regulations " *Id* at sect XII

4 20 "Hatfield does not control the hours that [the] owner-operators work, nor does it require them to work full time " Supp Decl of Hatfield, para 3

4 21 "The owner-operators are not required to accept the loads that Hatfield offers to them Owner-operators can, and sometime do, decline loads Once they accept a load, they decide the route they will take to pick it up and deliver it Owner-operators also have the capability of brokering their own loads for their return trips " *Id* at para 4

4 22 The owner-operators are responsible for costs and expenses, including maintenance, license fees, taxes, fuel, lubricants, cold-weather protection, and tie-down gear and cargo-protection equipment Decl of Cooper, Ex C

4 23 The owner-operators are solely responsible for any employees, agents, or servants they secure unless those employees, agents, or servants breach relevant government regulations or damage, hinder, or injure Hatfield's relations with its customers " *Id* at sect XI

V. CONCLUSIONS OF LAW

Based upon the foregoing Findings of Fact, I make the following Conclusions of Law

Jurisdiction

5 1 I have jurisdiction over the parties and subject matter herein under Title 50 RCW and under Chapters 34 05 and 34 12 RCW

Summary Judgment

5 2 "Summary judgment is appropriate 'if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is

entitled to judgment as a matter of law ' CR 56(c) " *American Legion Post #149 v Washington State Dept of Health*, 164 Wn 2d 570, 584, 192 P 3d 306 (2008)

5 3 "The facts and reasonable inferences therefrom are construed most favorably to the nonmoving party" *Korslund v Dycorp Tri-Cities Services, Inc* , 156 Wn 2d 168, 177, 125 P 3d 119 (2005) (citations omitted)

5 4 "Summary judgment should be granted if reasonable persons could reach but one conclusion from the evidence presented." *Korslund*, 156 Wn 2d at 177

5 5 "The burden is on the moving party to demonstrate there is no issue as to a material fact, and the moving party is held to a strict standard" *Cowiche Canyon Conservancy v Bosley*, 118 Wn 2d 801, 811, 828 P 2d 549 (1992) (citation omitted)

5 6 If the moving party meets this initial showing and does not have the burden of proof at the forthcoming evidentiary hearing on the merits, then the nonmoving party must set forth specific facts that remain at issue to establish that here is a genuine issue to be resolved at the forthcoming hearing *Young v Key Pharmaceuticals, Inc* , 112 Wn 2d 216, 225-226, 770 P 2d 182 (1989) (citations omitted)

5 7 Here, at issue is whether the owner-operators are exempt from unemployment insurance taxation There are no material facts in dispute regarding this issue Rather what is disputed is the whether Hatfield has met its burden to establish that the owner-operators are exempt from taxation To be sure, the record here does not identify specifically who these owner-operators are However, nothing in the record suggests that this is a matter of dispute Therefore, the issue is ripe for summary judgment

The remuneration paid for driving services constituted wages and employment

5 8 Of initial importance is whether the payments made to the owner-operators for driving services, as opposed to equipment rental, constituted wages "Wages" means remuneration paid RCW 50 04 320(1) and (2) "Remuneration" means all compensation paid for personal services " RCW 50 04 320(4)(a)

5 9 Here, Hatfield paid compensation to the owner-operators in part for providing driving services Thus, those payments constituted wages

5 10 Personal services performed for wages constitutes employment RCW 50 04 100 However, to constitute employment, such personal services must be performed for the employer or the employer's benefit *Penick v Employment*

Sec Dep't, 83 Wn App 30, 40, 917 P 2d 136 (1999), see also, *Daily Herald v Employment Security*, 91 Wn 2d 559, 561, 588 P 2d 1157 (1979) In instances where a court found employment, the service that was provided directly benefitted the employer's business, such as drivers driving cabs owned by the employer (*Affordable Cabs, Inc v Employment Sec Dep't*, 124 Wn App 361), droppers delivering the employer's newspapers to carriers for delivery to customers (*Daily Herald, supra*), and truck drivers delivering freight the employer had contracted to deliver (*Penick, supra*) Here, Hatfield paid the owner-operators under the terms of the lease for both equipment rental and driving services for each transport of freight, specifically 82% of gross receipts Thus, Hatfield received the benefit of 18% of the gross receipts as well as maintaining and ongoing relationship with its customers Accordingly, Hatfield benefitted directly from the services provided by the owner-operators Therefore, I hold that the personal services performed by the owner-operators herein for the wages paid by Hatfield constituted employment as contemplated by RCW 50 04 100

5 11 Hatfield argued that *Penick* and *Affordable Cabs* are distinguishable because the employer in *Penick* owned the trucks and the employer in *Affordable Cabs* owned the cabs, whereas Hatfield does not own the equipment However, Hatfield "owns" the equipment in all but title Hatfield has full and complete control of the equipment and the equipment, 24 hours a day and 365 days a year Although Corporate President Kent Hatfield declared that owner-operators are capable of brokering their own loads for return trips, that is inconsistent with the terms of the contract Moreover, Mr Hatfield did not indicate whether Hatfield shares in the profits from that opportunity and how that opportunity impacts the cargo insurance that Hatfield secured at the expense of the owner-operators Thus, I am not persuaded that title to the equipment is an apt distinction here

5 12 Hatfield also argued that the decision in *Cascade Nursing v Employment Sec Dep't*, 71 Wn App 23, 856 P 2d 421 (1993) should persuade me that the owner-operators were not primarily providing personal services However, *Cascade Nursing* was a referral agency, which Hatfield is not, and the decision in *Cascade Nursing*, was subsequently addressed by the legislature when it promulgated RCW 50 04 245 Moreover, key in *Cascade Nursing* was that the referral agency was responsible for paying the nurses only if the medical facility paid If the employer is not responsible for compensation except as a pass-through entity the second element of the threshold test for employment fails *Language Connection LLC v Employment Sec Dep't*, 149 Wn App 575, 581-586, 25 P 3d 924 (2009) Here, Hatfield paid the owner-operators for performance regardless of payment from the clients Accordingly, I am not persuaded by Hatfield's reliance on *Cascade Nursing*

5 13 Hatfield argued that the leases were for equipment, not driving That

assertion clashes with the provision in the lease requiring the owner-operators to assure that the driver complies with all relevant regulations (See sect III(i) in the contract) and the acknowledgment by Corp President Hatfield in his supplementary declaration that the owner-operators were drivers I am not persuaded

5 14 Hatfield also cited to a number of cases that considered the issue of characterizing individuals either as employees or independent contractors for purposes of workers compensation premiums However, the laws regarding workers compensation premiums are not analogous to the laws regarding unemployment insurance taxation and so those courts' analysis is not persuasive

5 15 Thus, the owner-operators were employees whose wages subjected Hatfield to unemployment insurance taxation unless otherwise excepted

The owner-operators are not excepted under RCW 50 04 140

5 16 RCW 50 04 140 provides the two applicable exception tests, one in three elements and the other in six elements If Hatfield satisfies either of those tests, then the wages paid to the owner-operators are excepted from taxation for unemployment insurance The exception must be strictly construed against its application *In re All-State Constr Co v Gordon*, 70 Wn 2d 657, 665, 425 P 2d 16 (1967), *W Ports Transp, Inc v Emp Sec Dep't*, 110 Wn App 440, 451 (2002) The burden of proof is on the party asserting the exception *In re All-State Constr Co, Inc v Gordon*, 70 Wn 2d 657, 665, 425 P 2d 16 (1967), *Penick v Empl Sec Dep't*, 82 Wn App 30, 42, 917 P 2d 136 (1999)

5 17 Hatfield need only satisfy one of the two tests However, each test is conjunctive, meaning that Hatfield must satisfy all of the elements of either the first test or the second

5 18 The first element is the same for each of the two tests That first element is "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 " RCW 50 04 140(1)(a) and (2)(a)

5 19 Critical is not actual control, but, rather, the right to control *Western Ports Transp, Inc v Emp Sec Dep't*, 110 Wn App 440, 452 (2002), *Jerome v Empl Sec Dep't*, 69 Wn App 810, 817, 850 P 2d 1345 (1993)

5 20 One court found the employer to exercise direction and control where the employer required the individual to display the employer's name on his truck, purchase insurance from the employer, submit to drug and alcohol testing, obtain

the employer's permission to carry passengers, notify the employer of accidents, inspections, and citations, keep the truck clean and in repair, call dispatch for assignments, file daily logs, and be subject to termination for violating any employer policy *Western Port*, 110 Wn App at 454 Another court found the employer to exercise direction and control where the employer owned the cab driven by the individual, provided the means by which the individual acquired customers, and set the fares *Affordable Cabs, Inc v Empl Sec Dep't*, 124 Wn App 361, 371 (2004) Another court found the employer to exercise direction and control where the employer trained the individuals, reviewed their performance, and controlled their assignments *Jerome*, 69 Wn App at 817

5 21 Here, the owner-operators, with one exception operated under Hatfield's carrier authority Hatfield provided the primary freight contracts, although the owner-operators were apparently allowed to supplement those freight contracts despite the contractual provision that provided Hatfield with complete control over the leased equipment Although the owner operators bore the cost of insurance, Hatfield selected and purchased the insurance Hatfield owner all licenses and fuel permits Hatfield had exclusive use of equipment The owner-operators were required to maintain the appearance and mechanical integrity of the equipment to the satisfaction of Hatfield The owner-operators were required to mark the equipment with designations associated with Hatfield The owner-operators were required to protect Hatfield's interests by complying with all regulations and complementing Hatfield's relations with its customers Here, Hatfield had the right to exercise direction and control over the owner-operators as to methods and details of providing driving services in substantial and significant degree

5 22 Hatfield observed that the owner-operators are responsible for the costs of operating the equipment and have a substantial investment represented by the ownership of the equipment However, these facts speak to elements other than the element of direction and control Accordingly, they are not persuasive as to the element of direction and control

5 23 Hatfield encouraged me to review and consider the Tax Audit Manual and the Status Manual But neither of those documents is law, never having been adopted in the form of regulations Furthermore, only certain of them address the element of direction and control Arguably, certain content might be persuasive authority but not where, as here, there exist Washington statutes directly on point interpreted and applied by Washington courts Therefore, the Tax Audit Manual and the Status Manual are not useful, much less persuasive, here

5 24 Thus, Hatfield has failed to meet its burden to establish the first element in each of the two conjunctive tests Accordingly, I need not address the remaining

elements in either of the tests. Therefore, Hatfield has failed to establish that the wages paid to the owner-operators should be excepted from unemployment insurance taxation.

5.25 Accordingly, the Department's cross-motion for partial summary judgment should be granted.

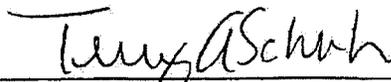
ORDER

IT IS HEREBY ORDERED THAT

The Employment Security Department's cross-motion for partial summary judgment is **GRANTED**.

The owner-operators were employees of Hatfield Enterprises, Inc. for the purposes of unemployment insurance taxation.

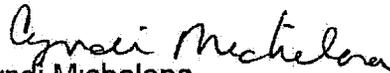
Signed and Issued at Tacoma, Washington, on the date of mailing.



Terry A. Schuh
Lead Administrative Law Judge
Office of Administrative Hearings

Certificate of Service

I certify that I mailed copy of this order to the within-named parties at their respective addresses postage prepaid on the 29th day of January 2014, at Tacoma, Washington.



Cyndi Michelena
Legal Secretary

Philip A. Talmadge
Thomas M. Fitzpatrick
Emmelyn Hart
Talmadge/Fitzpatrick
18010 Southcenter Parkway
Tukwila, WA 98188-4630

Aaron Riensche
Ogden Murphy Wallace, PLLC
901 Fifth Avenue, Suite 3500
Seattle, WA 98164-2008

Scott Michael
Legal Appeals Manager
ESD UI Tax and Wage Admin
PO Box 9046
Olympia, WA 98507-9046

Karen Mussman
PO Box 9046
Olympia, WA 98507-9046

Lionel Greaves, IV
Assistant Attorney General
Attorney General of Washington
Pacific Plaza, Suite 105
MS WT-31
1250 Pacific Avenue
PO Box 2317
Tacoma, WA 98401-2317

STATE OF WASHINGTON
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE EMPLOYMENT SECURITY DEPARTMENT

In The Matter Of:

MACMILLAN-PIPER, INC.,
HATFIELD ENTERPRISES, INC., and
SWANSON HAY COMPANY,

Employer-Petitioners.

OAH Docket Nos.

01-2012-21703T,
01-2012-21704T, and
01-2012-21705T

ORDER DENYING AMENDED
EMPLOYERS' MOTION TO
DISMISS VOID
ASSESSMENTS

I. ISSUE PRESENTED

Whether to grant the Amended Employers' Motion to Dismiss Void Assessments.

II. ORDER SUMMARY

The Amended Employer's Motion to Dismiss Void Assessments is denied.

III. HEARING

3.1 **Hearing Date:** October 3, 2013

3.2 **Administrative Law Judge:** Terry A. Schuh

3.3 **Employer-Petitioners:** MacMillan-Piper, Inc., Hatfield Enterprises, Inc., and Swanson Hay Co.

3.3.1 **Representatives:** Philip Talmadge and Thomas Fitzpatrick. Talmadge/Fitzpatrick, Attorneys at Law; Aaron Riensche, Ogden Murphy Wallace, P.L.L.C, Attorneys at Law. Suzanne Tilley, Inter-facilities Manager, MacMillan-Piper, Inc., appeared as an observer.

3.4 **Agency:** Employment Security Department

3.4.1 **Representatives:** Lionel Greaves, IV, Assistant Attorney General; Dionne Padilla Huddleston, Assistant Attorney General. Garrit Eades, Statewide Audit Coordinator, Employment Security Department, appeared as an observer.

3.5 The record relied upon: Amended Employers' Motion to Dismiss Void Assessments; Declaration of Brian Sonntag; Declaration of Steven B. Bishop, with attachments; Declaration of Thomas M. Fitzpatrick, with attachments; Declaration of Emmelyn Hart in Support of Employers' Motion to Dismiss Void Assessments, with attachments, Department's Response to Employer's Motion to Dismiss (MacMillan-Piper, Inc.); Department's Response to Employer's Motion to Dismiss (Hatfield Enterprises, Inc.); Department's Response to Employer's Motion to Dismiss (Swanson Hay Co., Inc.); Declaration in Support of Department's Responses to Employer's Motion to Dismiss; Employers' Consolidated Reply in Support of Motion to Dismiss Void Assessments; Declaration of Aaron Riensche in Support of Employers' Motion to Dismiss Void Assessments; and oral argument heard on October 3, 2013.

IV. ANALYSIS

4.1 "[T]o prove a departmental order was void, a party must show that the Department lacked either personal or subject matter jurisdiction." *Marley v. Dept. of Labor and Industries*, 125 Wn.2d 533, 537, 886 P.2d 189 (1994).

4.2 "The type of controversy over which an agency or tribunal 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." *Singletary v. Manor Healthcare Corp.*, 166 Wn.App. 774, 782, 271 P.3d 356 (2012) (citation omitted).

4.3 "Obviously the power to decide [a type of controversy] includes the power to decide wrong, and an erroneous decision is as binding as one that is correct." *Id.* at 783 (brackets in original) (citations omitted).

4.4 The above-referenced authority would void the Department's assessments at issue only if the employer-petitioners ("the Carriers") show that the Department lacked personal or subject matter jurisdiction to issue assessments. Issuing tax assessments to Washington employers, putative or otherwise, is precisely within the subject matter delegated to the Department by the Washington state legislature and involves persons and entities subject to that delegation. Accordingly, unless the Carriers demonstrate circumstances that cancel this inherent jurisdiction, the assessments cannot be voided.

4.5 Moreover, Title 50 RCW "shall be liberally construed for the purpose of reducing involuntary unemployment and the suffering caused thereby to the minimum." RCW 50.01.010. The foregoing is legislatively mandated. *Shoreline Community College Dist. No. 7 v. Employment Sec. Dept.*, 120 Wn.2d 394, 406, 842 P.2d 930 (1992).

4.6 The Carriers argued that the Department stepped beyond its jurisdiction because it inflated the assessments by knowingly including equipment rental, which is not subject to taxation, and because it ignored relevant information when it determined the persons at issue to be employees rather than independent contractors.

4.7 "If an employer fails to provide necessary payroll or other wage information during an audit, the department may use RCW 50.12.080 to determine payroll and wage information based on information otherwise available to the department. This may include information from labor market and economic analysis, information provided to other state or local agencies, and the *best information otherwise available to the department.*" WAC 192-340-020 (emphasis added).

4.8 RCW 50.12.080 provides the Department authority to issue an arbitrary report when an employer fails to provide a report. However, the foregoing regulation applies RCW 50.12.080 to audits when an employer fails to provide necessary payroll or wage information. RCW 50.12.080 directs the Department to proceed "upon the basis of such knowledge as may be available" to "arbitrarily" conclude and that this arbitrary conclusion is "deemed to be prima facie correct". The Carriers argued that the Department was obliged as a matter of law to exclude from calculation of remuneration attributed to the drivers at issue ("owner/operators") the cost of leasing the tractor or tractor/trailer. However, other than a 70/30 split, apparently agreed to in settlement of eight cases similar to the ones at bar, the Carriers have offered or suggested no information they possess or that the Department possesses or should possess with which to separate non-taxable remuneration from taxable remuneration. Here, the Department auditors apparently reviewed the 1099 forms the Carriers filed for federal tax purposes as well as other accounting information, none of which distinguished remuneration paid for equipment rental from remuneration paid for driving services. Furthermore, given that eight other entities represented by this same counsel agreed to such a distinction based upon other than direct evidence, i.e. the 70/30 split, suggests that those entities were equally unable to provide a specific breakdown of the remuneration paid. The Department cited to a statute requiring employers to keep such information. But the Department's citation begs the question: The Carriers do not presently and did not during the operative period of time consider themselves to be employers of the individuals in question. That issue is before this tribunal. Accordingly, until if and when this tribunal finds, for the purposes of unemployment insurance taxation, that the individuals in question are employees, the Carriers are not obliged to track wage information in the manner the Department referenced in argument. Regardless, the Carriers are evidently unable to provide better information than already provided to the Department. However, the Carriers imply that the Department cannot assess contributions unless the Department can somehow overcome this

dearth of information. I am not persuaded that a putative employer should escape tax liability because the putative employer is unable to accurately provide wage information despite being the entity in the best position to do so. Nor is the Department obliged to guess or to seek estimates from the putative employer. Here, the Department identified by means of Carrier records remuneration paid to the individuals in question, knowing that this remuneration package included remuneration that was not properly subject to taxation herein. I am persuaded by the authority referenced above that the Department was entitled to rely upon the Carrier information it had – however incomplete – to calculate its assessments. The Carriers have always had the opportunity to provide evidence to re-calibrate the assessments and retain that privilege for the forthcoming evidentiary hearings. Meanwhile, the assessments are not void because they are apparently inflated.

4.9 The Carriers also argued that the assessments should be voided because the Department did not comply with its internal audit standards. However, administrative agency internal standards and directives, unless “promulgated pursuant to legislative delegation . . . do not have the force of law.” *Joyce v. Dept. of Corrections*, 155 Wn.2d 306, 323, 119 P.3d 825 (2005). Regardless, the Carriers argued that the Department is estopped from denying applicability of its internal audit standards and directives and, if not estopped, the Department’s only alternative position is that there are no audit standards, meaning that the Department’s audits were arbitrary and capricious.

4.10 A tribunal’s “determination of whether to apply the judicial estoppel doctrine is guided by three core factors: (1) whether the party’s later position is clearly inconsistent with its earlier position, (2) whether acceptance of the later inconsistent position would create the perception that either the first or the second court was misled, and (3) whether the assertion of the inconsistent position would create an unfair advantage for the asserting party or an unfair detriment to the opposing party.” *Anfinson v. FedEx Ground Package System, Inc.*, 174 Wn.2d 851, 861, 281 P.3d 289(2012)(internal quotation marks omitted)(citations omitted). “Clearly, to give rise to an estoppel, the positions must be not merely different, but so inconsistent that one necessarily excludes the other.” *Markley v. Markley*, 31 Wn 2d 605, 615, 198 P.2d 486 (1948). “The positions taken must be diametrically opposed to one another.” *Kellar v. Estate of Kellar*, 172 Wn.App. 562, ___, 291 P.3d 906, 916 (2012). Here, apparently in a superior court proceeding, evidence was presented that an auditor for the Department defended her audit with the statement that the Department would not have accepted it had she failed to follow internal standards and directives. The Carriers argued that the Department never denied the auditor’s statement and so cannot deny its validity in these proceedings. The auditor was not a Department spokesperson; she spoke based only on her understanding and did not represent the Department’s view. The auditor’s reliance in a prior proceeding on internal

standards and directions is clearly inconsistent with the *Department's* insistence here that they need not be relied upon. However, the Department is not itself inconsistent. Therefore, I am not persuaded that either the first court or the present tribunal has been or is being misled. Finally, the only detriment alleged by the Carriers is that its reliance upon the presumptively first position prejudiced the Carriers' discovery strategy. Nevertheless, the Carriers have ascertained the Department's position well in advance of the evidentiary hearing. Thus, I am not persuaded.

4.11 Lastly, the Carriers argued that the Department auditors operated without standards or direction or otherwise operated arbitrarily and capriciously. In particular, the Carriers argued that the auditors focused on limited evidence regarding the characterization of the individuals at issue as employees or as independent contractors.

4.12 "[A]gency action is arbitrary and capricious if it is willful and unreasoning and taken without regard to the attending facts or circumstances. Where 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." *Washington Independent Telephone Ass'n v. Washington Utilities and Transp. Com'n*, 184 Wn2d 887, 904, 64 P.3d 606 (2003). (internal quotation marks omitted)(citations omitted).

4.13 "Courts cannot, and should not, undertake a probe of the mental processes utilized by an administrative officer in performing his function of decision. Likewise, courts must, in the absence of evidence to the contrary, presume public officers perform their duties properly, legally, and in compliance with controlling statutory provisions." *Ledgering v. State*, 63 Wn.2d 94, 101, 385 P.2d 522 (1963).

4.14 "[T]he scope of review of an order alleged to be arbitrary and capricious is narrow, and the challenger carries a heavy burden. . . . Arbitrary and capricious action has been defined as willful and unreasoning action, without consideration and in disregard of facts and circumstances. Where there is room for two opinions, action is not arbitrary and capricious even though one may believe an erroneous conclusion has been reached." *Keene v. Board of Accountancy*, 77 Wn.App. 849, 859, 894 P.2d 582 (1995)(citations and quotations omitted).

4.15 Here, although apparently operating without specific guidance of internal audit standards and directions, the auditors were still limited and controlled by the statutory tests for characterizing individuals as independent contractors (RCW 50.04.140) and by the statutory definition of remuneration for services. The latter point was addressed in more detail above. Nevertheless, the Carriers argue that the auditors failed to take into consideration other factors expressed in

the standards and directions. In the first place, RCW 50 04.140 and the cases that have applied and interpreted that statute, provide ample guidance. Moreover, many of the factors suggested by the Carriers were rendered moot by the auditor's reliance on the first element, commonly summarized as "free from control or direction". More specifically, to establish exception from taxation, the employer must satisfy all three elements of the first test or all six elements of the second test. The first element of each test is the "freedom from control or direction" element. If the putative employer cannot satisfy the first element, then the employer cannot satisfy either test. Reasonably, the Department auditors first considered the first element and each determined that the Carrier could not satisfy the first element. At that point, there was no need for further analysis and no need to determine if the Carrier could satisfy any of the remaining elements. Therefore, the auditors' failure to address factors regarding the other elements was not arbitrary and capricious. Further, insofar as the Carriers believe that the auditors did not address all relevant factors regarding the first element, that belief merely constitutes a difference of opinion regarding what weight to give to various factors. That the Carriers reasonably disagree with the auditors' conclusions is not sufficient to persuade me that the auditors acted arbitrarily and capriciously. More troubling is the assertion by the Carriers that the auditors were expected to find errors, errors of omitting employees, errors of omitting remuneration, etc. Of course, the goal of an audit should be to determine the accuracy of the material audited, no more, no less. However, an auditing target may be nothing more than assuring that the auditor is thorough. Insisting that the auditors almost always find error may be nothing more than a statistical reality that most employers make errors and so an auditor that finds no errors more than a small percentage of the time is not performing properly. Regardless, either the assessments stand up to the scrutiny of this legal proceeding or they do not and accordingly the Carriers will be found liable for the assessments or not. I am not persuaded that the assessments were created arbitrarily or capriciously. The assessments should not be voided.

4.16 Therefore, the Amended Employers' Motion to Dismiss Void Assessments should be denied.

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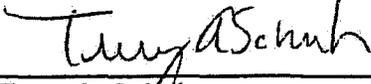
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ORDER

IT IS HEREBY ORDERED THAT:

The Amended Employers' Motion to Dismiss Void Assessment is **DENIED**.

Signed and Issued at Tacoma, Washington, on the date of mailing.



Terry A. Schuh
Lead Administrative Law Judge
Office of Administrative Hearings

Certificate of Service

I certify that I mailed copy of this order to the within-named parties at their respective addresses postage prepaid on the 29th day of January 2014, at Tacoma, Washington.


Cyndi Michelena
Legal Secretary

Philip A. Talmadge
Thomas M. Fitzpatrick
Emmelyn Hart
Talmadge/Fitzpatrick
18010 Southcenter Parkway
Tukwila, WA 98188-4630

Aaron Riensche
Ogden Murphy Wallace, PLLC
901 Fifth Avenue, Suite 3500
Seattle, WA 98164-2008

Scott Michael
Legal Appeals Manager
ESD UI Tax and Wage Admin.
PO Box 9046
Olympia, WA 98507-9046

Karen Mussman
PO Box 9046
Olympia, WA 98507-9046

Lionel Greaves, IV
Assistant Attorney General
Attorney General of Washington
Pacific Plaza, Suite 105
MS: WT-31
1250 Pacific Avenue
PO Box 2317
Tacoma, WA 98401-2317

OAH Docket Nos 01-2012-21703T, 01-2012-21704T, 01-2012-21705T
Order Denying Amended Employers' Motion to Dismiss Void Assessments
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Office of Administrative Hearings
949 Market Street, Suite 500
Tacoma, WA 98402
Tel. (253) 476-6888 • Fax: (253) 593-2200

STATE OF WASHINGTON
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE EMPLOYMENT SECURITY DEPARTMENT

In The Matter Of:

HATFIELD ENTERPRIZES, INC.,

Employer-Petitioner.

OAH Docket No. 01-2012-21704T

TAX CASE:

FINDINGS OF FACT,
CONCLUSIONS OF LAW,
AND
INITIAL ORDER

I. ISSUES PRESENTED

Regarding the Order and Notice of Assessment for \$13,616.53 issued by the Employment Security Department to Hatfield Enterprizes, Inc dated February 7, 2012

1.1 How much, if any, of the remuneration Hatfield Enterprizes, Inc paid to individuals characterized by the Employment Security Department as employees for the purposes of unemployment insurance taxation, constituted wages for the purposes of unemployment insurance taxation?

1.2 What is the correct calculation of contributions, penalties, and interest, if any, owed by Hatfield Enterprizes, Inc to the Employment Security Department for the period of time at issue?

II. ORDER SUMMARY

2.1 Thirty percent of the remuneration Hatfield Enterprizes, Inc paid to the "owner-operators" constituted wages for the purposes of unemployment insurance taxation

2.2 The calculation of contributions, penalties, and interest owed by Hatfield Enterprizes, Inc to the Employment Security Department for the period of time at issue is remanded to the Employment Security Department for calculation consistent with the provisions of this order, subject to further rights of appeal

III. HEARING

3.1 **Hearing Date:** September 16-17, 2014

OAH Docket No 01-2012-21704T
Findings of Fact, Conclusions of Law, and Initial Order
Page 1 of 9

Office of Administrative Hearings
949 Market Street, Suite 500
Tacoma, WA 98402
Tel (253) 476-6888 • Fax (253) 593-2200

3 2 **Administrative Law Judge:** Terry A Schuh

3 3 **Employer-Petitioner:** Hatfield Enterprizes, Inc

3 3 1 **Representatives:** Thomas Fitzpatrick, Talmadge/Fitzpatrick, Attorneys, Aaron P Riensche, Ogden Murphy Wallace PLLC, Attorneys

3 3 2 **Witness:** Steven B Bishop, CAP, CVA, CFF, Bader Martin, P S

3 4 **Agency:** Employment Security Department

3 4 1 **Representative:** Lionel Greaves, IV, Assistant Attorney General

3 4 2 **Witness:** Gary L Cooper, Tax Specialist 4, Emp Sec Dept

3 5 **Exhibits:** Exhibits 1 through 6 and Exhibits G, L through O, Q through DD, FF, and HH were admitted into the record

3 6 **Court Reporter:** Millie Martin, Flygare & Associates, Inc appeared as court reporter. The Office of Administrative Hearings did not order a transcript.

IV. FINDINGS OF FACT

I find the following facts by a preponderance of the evidence

Jurisdiction

4 1 On February 7, 2012, the Employment Security Department ("the Department") issued and served an Order and Notice of Assessment to Hatfield Enterprizes, Inc ("Hatfield") assessing taxes, penalties, and interest for quarters one, two, and three in 2009, one, two, and four in 2010, and one and two in 2011, in the amount of \$13,616 53 Ex 2

4 2 On February 13, 2012, Hatfield filed its appeal Ex 3

The remuneration

4 3 The owner-operators at issue herein were paid by contract. See, exs 4, Q, and R. More specifically, the owner-operators were paid by the terms of a contractor settlement incorporated into the lease contract Ex 4, pp 5-6, section V, and p 11

4 4 Payment under the lease contract was for both equipment rental and

driving services, undifferentiated Exs 4, Q, and R, Testimony of Cooper

4 5 The total amounts, undifferentiated between driving services and equipment rental, paid each year to the individuals were reported on 1099 forms Testimony of Cooper, see exs X, Y, and Z, Testimony of Bishop

Driving services and equipment rental

4 6 Gary Cooper conducted the Hatfield audit Testimony of Cooper

4 7 Mr Cooper did not ask Hatfield for any information with which to bifurcate remuneration between driving services and equipment rental Testimony of Cooper

4 8 Hatfield provided every document that Mr Cooper requested that existed Testimony of Cooper

4 9 The Department calculated its assessment on the total remuneration reported on the 1099 forms Testimony of Cooper

4 10 Hatfield reported the remuneration it paid to the owner-operators on Box 7 of the 1099 forms See Exs X, Y, and Z Box 7 is a "catch-all" box Testimony of Bishop The IRS recognizes that the reporting entity may use Box 7 to report a range of information Testimony of Bishop An entry in Box 7 of a 1099 does not necessarily mean the reporting entity is designating the entry as wages Testimony of Bishop Hatfield's use of Box 7 was not evidence of misrepresentation to the IRS

4 11 Steven Bishop is experienced in forensic accounting and is a certified valuation analyst Testimony of Bishop Hatfield hired Mr Bishop to determine the allocation of cost or value between equipment leased and driving services provided Testimony of Bishop

4 12 During the course of his investigation, Mr Bishop did not see any documents from Hatfield that broke down the remuneration Hatfield paid to the owner-operators into wages and equipment Testimony of Bishop

4 13 The owner-operators could take business deductions on their individual tax returns for their expenses if they wanted to Testimony of Bishop

4 14 Mr Bishop did not interview any owner-operators or secure records from them Testimony of Bishop Instead, Mr Bishop researched the costs of trucking by reviewing articles and websites on the internet and by talking to selected trucking companies Testimony of Bishop Mr Bishop researched and

verified each individual cost associated with trucking, including mileage-related costs, and acknowledging that some costs were fixed and some were variable Testimony of Bishop He also researched how costs might differ between trucking companies whose operations differed significantly Testimony of Bishop Mr Bishop determined that although overall short haul costs typically were less than overall long haul costs, compensation for short haul drivers was typically also less than compensation for long haul drivers, and so, therefore, the percentage of driver costs was reasonably constant Testimony of Bishop His research consistently pointed to the conclusion that driving services constituted approximately 30% of total costs of operating trucking equipment Testimony of Bishop

4.15 The industry rule-of-thumb is that 30% of operating costs are driving services and 70% are equipment-related services Testimony of Bishop Mr Bishop compared this rule-of-thumb to what he knew about Hatfield and concluded that the 30%/70% formula worked for Hatfield as well Testimony of Bishop

4.16 Mr Cooper knew that the Department had bifurcated driving services and equipment in the past Testimony of Cooper He asked his supervisor if he should bifurcate for the Hatfield audit and he was told not to do so Testimony of Cooper

Calculation of the assessment

4.17 The Department relied upon 1099 forms provided by Hatfield to calculate wages and, ultimately, unemployment insurance taxes Testimony of Cooper, see Ex 1, see exhibits X, Y, and Z

4.18 The Department backed out the excess wages – which exceeded the wage base – to calculate taxable wages Testimony of Cooper, see, e g, Ex 1, p 3

4.19 The source of the income reported on the 1099 forms was the settlement forms used by Hatfield and the owner-operators Testimony of Cooper

4.20 Regarding Hatfield, the Department employed an unemployment insurance tax rate of 0.57% in 2009, 1.14% in 2010, and 0.68% in 2011 Ex 1, p 3

V. CONCLUSIONS OF LAW

Based upon the foregoing Findings of Fact, I make the following Conclusions of Law

Jurisdiction

5 1 I have jurisdiction over the parties and subject matter herein under Title 50 RCW and under Chapters 34 05 and 34 12 RCW

Incorporation of Order Granting Department's Motion for Partial Summary Judgment

5 2 The Order Granting Department's Cross-Motion for Partial Summary Judgment ("Order Granting PSJ") issued on January 29, 2014, including the Facts as a Matter of Law and the Conclusions of Law recited therein, is incorporated by this reference into this order

5 3 The Order Granting PSJ held that the owner-operators were employees of Hatfield, for the purposes of unemployment insurance taxation The Order Granting PSJ is not altered by this order

5 4 As decided in the Order on PSJ, the wages paid to the owner-operators was and is taxable. Therefore, I must turn my attention to the calculation of tax, interest, and penalty

30% of the remuneration paid to the owner-operators constituted wages

5 5 As a predicate, there remains the issue of how much of the remuneration paid to the owner-operators constituted wages Part of that undifferentiated remuneration was for leasing equipment and part was for driving services

5 6 "Wages" means remuneration paid by the employer to the individual in the employer's employment RCW 50 04 320(1) "Remuneration" means compensation paid for personal services RCW 50 04 320(4)(a) "Employment" means providing personal services RCW 50 04 100 Only wages are taxable for the purposes of unemployment insurance benefits RCW 50 24 010

5 7 Thus, only the monies Hatfield paid to the owner-operators for driving services constitutes wages and only the monies Hatfield paid to the owner-operators for driving services is taxable

5 8 The parties did not dispute that obvious conclusion Rather, the parties disputed who has the burden of specifically proving how much was paid for equipment and how much for driving services The apparent impetus behind those arguments is an all-or-nothing approach The Department argued that Hatfield must and cannot prove how much was paid for equipment and so is liable for taxation on the entire undifferentiated amount, Hatfield argued that the

Department must and cannot prove how much was paid for driving services and so cannot tax any of the undifferentiated amount. To a certain degree, I addressed this dichotomy in paragraph 4.8 of my Order Denying Amended Employers' Motion to Dismiss Void Assessments, incorporated here by this reference. Further, the legislature provided that Title 50 was enacted "for the compulsory setting aside of unemployment reserves to be used for the benefit of persons unemployed through no fault of their own, and that this title *shall be liberally construed* for the purposes of reducing involuntary unemployment and the suffering caused thereby to a minimum." RCW 50.01.010 (in pertinent part, emphasis added). Neither extreme serves the purpose of Title 50. Therefore, I decline to accept either extreme. Having determined that the owner-operators were paid wages subject to unemployment insurance taxation, I must determine what those wages were. The Department presented no evidence or argument designed to decide that question. By means of the testimony of Steven Bishop, Hatfield did attribute to driving services 30% of the remuneration paid by Hatfield to the owner-operators is consistent with Mr. Bishop's research, with the industry standard, and with prior settlements between trucking companies and the Department. Given the choice of ordering taxation of 100%, 0%, or 30%, I hold that 30% of the remuneration Hatfield paid to the owner-operators is subject to unemployment insurance taxation.

5.9 The tax rates employed by the Department, recited in the Findings of Fact above, were not challenged by Hatfield. They should apply.

Interest

5.10 Interest on delinquent contributions accrues at the rate of 1% per month. RCW 50.24.040.

5.11 Hatfield did not challenge the Department's calculation of interest except to argue that interest should not accrue during the appeal period. As the Department acknowledged, interest does not accrue during the appeal period. RCW 50.32.040. Accordingly, I hold that the Department's manner of calculating interest is correct, mindful that the amount upon which interest is being calculated will change.

Penalties

5.12 Taxes are due on the last day of the month following the quarter for which the taxes are owed. WAC 192-310-020(1), RCW 50.24.010.

5.13 Taxes not paid on the date on which they are due and payable are assessed a penalty of 5%, for the first month delinquent, 10% for the second month, and 20% for the third month. RCW 50.12.220(4).

5 14 Hatfield argued that the penalties should be waived under RCW 50 12 220(6). RCW 50 12.220(6) offers two bases for waiver (1) the department had adequate information and failed to act, (2) the employer's failure to timely pay contributions was not its fault. Hatfield relied upon the first basis. Whether the Department had adequate information and precisely when it got it is debatable. However, the Department had no information regarding the owner-operators until it conducted its audit in 2011. Some of these taxes were due in 2009. The Department could not timely act in 2009, or 2010, or even early 2011, because it lacked information, much less adequate information, regarding the owner-operators. Therefore, I am not persuaded by Hatfield's argument. However, the second basis supports waiver where failure to timely pay was not the employer's fault. Here, Hatfield believed, as apparently did others in the trucking industry, that the owner-operators were not employees. Accordingly, they failed to report them as employees. As a result, Hatfield did not timely pay contributions based on the wages paid to the owner-operators. I conclude that Hatfield cannot be at fault for failing to report, as employees, individuals it reasonably, albeit incorrectly, believed at the time to be independent contractors. Thus, by operation of RCW 50 12 220(6), I hold that the penalties for late payment should be waived.

Remand for calculation of contributions, penalties, and interest consistent with the provisions of this initial order

5 15 This matter is REMANDED to the Department for calculation of contributions, penalties, and interest consistent with the provisions of this order. In sum, that means that the tax rates employed by the Department in calculating the initial assessment should be re-employed, the Department's method of calculating interest was correct and so the calculation of interest will change only in that the amounts to which interest accrues will change, and penalties shall be waived.

INITIAL ORDER

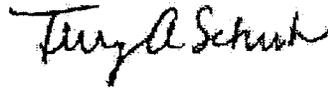
IT IS HEREBY ORDERED THAT

The Order and Notice of Assessment issued under RCW 50 24 070 is ordered **AFFIRMED** in part and **REMANDED** in part.

The Order and Notice of Assessment is **AFFIRMED** in that it correctly holds the Employer-Petitioner liable for unemployment tax contributions and interest in quarters one, two, and three of 2009, one, two, and four of 2010, and one two of 2011.

However, this matter is **REMANDED** to the Employment Security Department for recalculation of the assessment consistent with the terms of this Initial Order, subject to further rights of review only as to the accuracy of that calculation

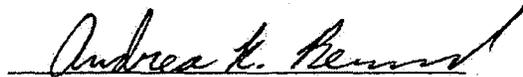
Signed and Issued at Olympia, Washington, on the date of mailing



Terry A. Schuh
Senior Administrative Law Judge
Office of Administrative Hearings

Certificate of Service

I certify that I mailed a copy of this order to the within-named interested parties at their respective addresses, postage prepaid, on the 23 day of December, 2014, at Olympia, Washington



NOTICE OF FURTHER APPEAL RIGHTS

This Tax Initial Order is final unless a Petition for Review is filed, in writing, with the Agency Records Center of the Employment Security Department at PO Box 9046, MS-6000, Olympia, Washington 98507-9046, and postmarked on or before *January 23, 2015*. All argument in support of the Petition for Review must be attached to and submitted with the Petition for Review. The Petition for Review, including attachments, may not exceed five (5) pages. Any pages in excess of five (5) pages will not be considered and will be returned to the petitioner. The docket number from the Initial Order of the Office of Administrative Hearings must be included on the Petition for Review. A Petition for Review need not be filed on an official form, but such form may be obtained from an Unemployment Insurance Office of the Employment Security Department.

TAS tas

Mailed to the following:

Scott Michael
Legal Appeals Manager
ESD UI Tax and Wage Admin
PO Box 9046
Olympia, WA 98507-9046

Karen Mussman
PO Box 9046
Olympia, WA 98507-9046

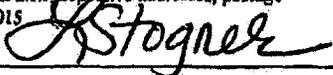
Lionel Greaves, IV
Assistant Attorney General
Attorney General of Washington
Pacific Plaza, Suite 105
MS WT-31
1250 Pacific Avenue
PO Box 2317
Tacoma, WA 98401-2317

Philip A Talmadge
Thomas M Fitzpatrick
Talmadge/Fitzpatrick
18010 Southcenter Parkway
Tukwila, WA 98188-4630

Aaron P Riensche
Ogden Murphy Wallace, PLLC
901 Fifth Avenue, Suite 3500
Seattle, WA 98164-2008

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 August 21, 2015



Representative, Commissioner's Review Office
Employment Security Department

TAX

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

Review No. 2015-0255-CP

In re:

HATFIELD ENTERPRIZES, INC.
Tax ID No. 587660-00-3

Docket No. 01-2012-21704T

DECISION OF COMMISSIONER

This is an unemployment insurance tax dispute between the Employment Security Department ("Department") and the interested employer, Hatfield Enterprizes, Inc. ("Hatfield"). The Department conducted an audit of Hatfield for the period of first, second, and third quarters of 2009; first, second, and fourth quarters of 2010; and first and second quarters of 2011. As a result of the audit, the following 15 individuals hired by Hatfield during the period at issue were reclassified as employees of Hatfield and their wages were deemed reportable to the Department for unemployment insurance tax purposes: Sean Moriarty, Vernon Osterberg, Ronald Dionne, Len Teal, Eldon Kemmerer, Gary Flansburg, Richard Ferguson, Martin Scofield, Andrew Lamoreaux, Thomas Osborne, Juan Martinez, Ronald Dove, Joseph Eisenhower, Kendal Naccarato, and Adcox Robert. See Exhibit 1, pp. 79-80. The Department issued an Order and Notice of Assessment on February 7, 2012, assessing Hatfield contributions, penalties, and interest in the amount of \$13,616.53. See Exhibit 2. Hatfield filed a timely appeal from the Order and Notice of Assessment. See Exhibit 3.

The parties filed extensive motions before the Office of Administrative Hearings ("OAH") prior to the evidentiary hearing held on September 16 and 17, 2014. Specifically, Hatfield filed the following four motions: Motion for Summary Judgment on Federal Preemption, Amended

Motion to Dismiss Void Assessments, Motion to Compel, and Consolidated Motions in Limine.¹ The OAH denied Hatfield's first three motions in their entirety, but granted in part and denied in part Hatfield's Consolidated Motions in Limine. On the other hand, the Department filed a Cross-Motion for Partial Summary Judgment and a Motion to Exclude Witnesses and Strike Exhibits. The OAH granted in part and denied in part the Department's Motion to Exclude Witnesses and Strike Exhibits. The OAH further granted the Department's Cross-Motion for Partial Summary Judgment, holding that the 15 individuals (or owner-operators) were in "employment" of Hatfield pursuant to RCW 50.04.100 and that their personal services were not exempted from coverage pursuant to RCW 50.04.140. Thereafter, the parties proceeded to the evidentiary hearing to determine the correct amount of the contributions, penalties, and interest. After the evidentiary hearing, the OAH issued a Tax Case Initial Order, holding that 30 percent of the remuneration Hatfield paid to the 15 owner-operators constituted wages pursuant to RCW 50.04.320(1) and that the penalties imposed upon Hatfield during the period in question should be waived pursuant to RCW 50.12.220(6).

Hatfield timely petitioned the Commissioner for review of the OAH's rulings in many of the prehearing motions. Specifically, Hatfield challenges: (1) the OAH's Order Granting Department's Cross-Motion for Partial Summary Judgment; (2) the OAH's Order Denying Employers' Motion for Summary Judgment on Federal Preemption; (3) the OAH's Order Denying Amended Employers' Motion to Dismiss Void Assessments; (4) the portions of the OAH's Order Granting Department's Motions to Exclude Witnesses and Strike Exhibits; and (5) the portions of the OAH's Order Denying Carriers' Consolidated Motions in Limine. On the other hand, the Department cross-petitioned the Commissioner for review of the OAH's Tax Case Initial Order. In particular, the Department challenges the OAH's decision to only tax 30 percent of the total remuneration Hatfield paid to the owner-operators as well as the OAH's decision to waive the penalties for the period in question. Pursuant to chapter 192-04 WAC this matter has been delegated by the Commissioner to the Commissioner's Review Office. Having reviewed the entire record (including the audio recording of the various hearings) and having given due regard to the findings of the administrative law judge pursuant to RCW 34.05.464(4), we hereby enter the following.

¹ Hatfield's four motions were filed with and heard by the OAH in conjunction with two other matters: In re Swanson Hay Company, Inc., OAH Docket No. 01-2012-21705T and In re MacMillan-Piper, Inc., OAH Docket No 01-2012-21703T

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.² 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).

² 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.

However, regardless of the length and complexity of the tests developed by IRS to clarify coverage issue 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)³; and a three-prong "independent contractor" or ABC test. *See* Laws of 1937, ch. 162, § 19(g)(5).⁴

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. §

³ 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).

⁴ 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 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).

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 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, Hatfield, 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). Hatfield operates throughout the lower 48 states, and it is based in Spokane Valley, Washington. *See* Declaration of Hatfield in Support of Employers’ Motion for Summary Judgment on Federal Preemption (“Decl. of Hatfield”) ¶ 3. Hatfield is a family-owned business and has been in operation since approximately 1989. *See* Decl. of Hatfield ¶ 2. Hatfield uses two types of drivers to support its business operation: First, it hires approximately 38 *employee* drivers to drive the equipment it owns; second, it leases approximately 10 *trucks with drivers* from third parties commonly known in the trucking industry as owner-operators. *See* Decl. of Hatfield ¶ 4. According to Hatfield, the use of owner-operators is a common and widespread practice within the trucking industry; and it provides operational flexibility that allows Hatfield to meet the fluctuating demand for trucking services without having to make substantial investment in trucking equipment. *See* Decl. of Hatfield ¶ 4.

As discussed above, the Department conducted an audit of Hatfield for various quarters in 2009, 2010, and 2011; and, subsequently, reclassified 15 owner-operators as employees of Hatfield and deemed their wages to be reportable for unemployment insurance tax purposes. Hatfield 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 is preempted by the Federal Aviation Administration Authorization Act of 1994 (“FAAAA”). The crux of Hatfield’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 Ameritrust 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 Ninth Circuit Court of Appeals has on several occasions spoken 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 (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 (2014), *cert. denied*, 135 S. Ct. 2049 (2015) (internal citations omitted).

It is against the backdrop of the U.S. Supreme Court’s decisions in Morales, Rowe, Pelkey as well as the Ninth Circuit’s decisions in Mendonca and Dilts, that we now confront Hatfield’s federal preemption argument. Hatfield 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. Hatfield introduced three declarations in its motion for summary judgment to support its contention: (1) a declaration by Larry Pursley, Executive Vice President of Washington Trucking Association; (2) a declaration by Joe Rajkovicz, Director of Governmental Affairs & Communications for the California Construction Trucking Association; and (3) a declaration by Kent Hatfield, owner of Hatfield Enterprizes, Inc. According to Pursley, 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 eliminate a historical cornerstone of the trucking industry. The effect of this material change will dictate the employment relationship that motor carriers must use in their operations going forward, which will impact their prices, routes, and services. *See Declaration of Pursley in Support of Employers’ Motion for Summary Judgment on Federal Preemption (“Decl. of Pursley”)* ¶ 10. Pursley asserts that the assessments will impact services because the carriers will be forced to provide trucking services only through employees and to purchase expensive trucks and trailers and hire drivers to operate the equipment, which in turn will severely curtail the carriers’ operational flexibility. *See Decl. of Pursley* ¶ 11. The Department’s restructuring of the trucking industry will also require carriers to alter their routes to avoid liability under Washington’s Employment Security Act and will thus prevent carriers from making their own decisions about where to deliver cargo. *See Decl. of Pursley* ¶ 12. Finally, Pursley asserts that the assessments will likely have a significant impact

on prices because of the additional employment-related taxes such as state and federal social security taxes and unemployment insurance taxes, which will undoubtedly have to be recouped by raising prices. *See* Decl. of Pursley ¶ 13. Hatfield reiterates the same assertions in his declaration. *See* Declaration of Pursley in Support of Employers' Motion for Summary Judgment on Federal Preemption ¶¶ 9-12.

Additionally, Hatfield 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. Hatfield 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* Hatfield's Petition for Review at pp. 3-4.

While Hatfield'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 order. *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 Hatfield was allowed to present all evidence (via three declarations in support of its summary judgment motion) it 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 Hatfield 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. Consequently, we will adopt the OAH's analysis in its Order Denying Employers' Motion for Summary Judgment on Federal Preemption issued in this matter on January 29, 2014.

Void Assessment

In its Petition for Review, Hatfield contends that the OAH erred in denying its motion to dismiss void assessment in this case. Hatfield essentially argues that the Department's assessment should be voided because it was issued without statutory authority and was the result of unlawful, arbitrary, or capricious actions. Hatfield relies upon the fact that the Department knowingly included equipment rental (which is not subject to taxation) in the assessment and the fact that the Department did not comply with its own internal audit manuals (i.e. Tax Audit Manual and Status Manual) when conducting the audit. Having carefully reviewed the underlying record, we are satisfied that the various arguments advanced by Hatfield in its Petition for Review have been properly addressed and resolved in the administrative law judge's decision. Accordingly, we will adopt the OAH's analysis in its Order Denying Amended Employers' Motion to Dismiss Void Assessments issued in this matter on January 29, 2014.

Employment

In its Petition for Review, Hatfield further contends that the OAH erred in granting the Department's motion for partial summary judgment, thereby finding that the 15 owner-operators were in "employment" of Hatfield pursuant to RCW 50.04.100 and that their services were not excluded from coverage pursuant to the "independent contractor" exemption under RCW 50.04.140. Hatfield's arguments on these two issues are not persuasive.

Hatfield 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" with Hatfield as defined in RCW 50.04.100. See RCW 50.04.080; RCW 50.24.010. If the owner-operators' employment is not established, Hatfield is not liable for the assessed items. If employment is established, Hatfield 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, Hatfield is engaged in the interstate trucking business; and it provides contract hauling with authority from the U.S. Department of Transportation and the Federal Motor Carrier Safety Administration. Hatfield's business involves loading/unloading and transportation of cargo from one point to another including such related activities that are customary within the trucking industry. See Declaration of Cooper in Support of Department's Cross-Motion for Partial Summary Judgment ("Decl. of Cooper") ¶ 5. Here, the 15 owner-operators performed truck-driving services for Hatfield. As such, the owner-operators' personal services directly benefited Hatfield's business. Moreover, it is beyond dispute that Hatfield paid wages for the services provided by the owner-operators. See Decl. of Cooper, Exhibit C, Appendix B ("Hatfield Enterprises, Inc., will pay 82 [percent] of the gross revenue on all freight hauled."). Consequently, the administrative law judge correctly concluded that the 15 owner-operators were in employment of Hatfield pursuant to RCW 50.04.100. See, e.g., 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 Hatfield 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, 86 Wn.2d at 239.

In this case, the only exception that concerns us is found at RCW 50.04.140(1) and (2). The truck-driving 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 agreements between Hatfield and the owner-operators referred to the owner-operators as contractors. *See Decl. of Cooper, Exhibit C.* This contractual language, however, is not dispositive of the issue of whether the services at issue 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 unemployment insurance tax purposes. 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.

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*, 69 Wn. App. at 816.

In this case, Hatfield entered into nearly-identical contracts 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 the truck-driving services. For example, Hatfield does not control the hours that the owner-operators work, nor does it require them to work fulltime. The owner-operators are not required to accept the loads offered by Hatfield; and they can, and sometimes do, decline loads. Once the owner-operators accept the loads, they decide the route they will take for pick-up and delivery. The owner-operators may also broker their own loads for their return trips. *See Supplemental Declaration of Hatfield in Support of Employer's Opposition to Department's Cross-Motion for Summary Judgment ¶¶ 3 & 4.* The owner-operators are liable for deductibles and other expenses that are not covered by insurances; and such insurances are

provided by Hatfield at the owner-operators' own expense. The owner-operators are also liable for shortage or loss of cargo or for other damage to the commodities transported; and they are responsible for their own bobtail and physical damage coverage. *See* Decl. of Cooper, Exhibit C, ¶ IX.

On the other hand, Hatfield exerts extensive controls over the methods and details of how the driving services are to be performed by the owner-operators. Under the terms of the contracts, Hatfield has the exclusive use of the leased equipment on a 24-hour and 365-day-a-year basis. *See* Decl. of Cooper, Exhibit C, ¶ II. The owner-operators are required to comply with all applicable federal, state, and local laws, ordinances, and regulations. *See* Decl. of Cooper, Exhibit C, ¶ III(d). The owner-operators are also required to oil, grease, and inspect the equipment so as to maintain the equipment in good repair, mechanical condition, and running order. *See* Decl. of Cooper, Exhibit C, ¶¶ III(b) & (d). The owner-operators must wash and clean the equipment as reasonably required to keep the equipment in good appearance and to maintain a good public image. *See* Decl. of Cooper, Exhibit C, ¶ III(c). The owner-operators are required to mark the equipment with insignia and markings identifying the equipment as required by federal, state, and local laws. *See* Decl. of Cooper, Exhibit C, ¶ III(e). Hatfield further requires the owner-operators to furnish all necessary tie-down gear and cargo protection equipment. *See* Decl. of Cooper, Exhibit C, ¶ III(g). The owner-operators are required to have a safety inspection of the equipment at least once every 90 days. *See* Decl. of Cooper, Exhibit C, ¶ III(h). Significantly, Hatfield retains the right to discuss and recommend actions against an owner-operator's employees, agents, or servants when such employees, agents, or servants have damaged, hindered, or injured Hatfield's customer relations through negligent performance of work or other related actions. *See* Decl. of Cooper, Exhibit C, ¶ XI(b). Moreover, if Hatfield believes that an owner-operator has breached the contract in a manner so as to render Hatfield liable for the shipper, consignee, or any governmental authority, Hatfield can take possession of the owner-operator's equipment and commodities being hauled, and complete the shipment. Ultimately, Hatfield may terminate the contract if an owner-operator has violated the safety rules or regulations of any governmental agencies. *See* Decl. of Cooper, Exhibit C, ¶ XII.

The above-referenced requirements imposed by Hatfield are generally inconsistent with freeing the owner-operators from its control and direction; in other words, Hatfield is not just interested in the *end result* of the transportation services performed by the owner-operators, but it

also concerns itself as to “how” the transportation services are to be performed by the owner-operators. See Jerome, 69 Wn. App. at 817 (a putative employer’s ability to control was evidenced by the fact that it could enforce the control by unilaterally deciding not to give referrals to any food demonstrator). In sum, we concur with the administrative law judge that the 15 owner-operators have not met the first criterion – freedom from control or direction – under RCW 50.04.140(1)(a) and (2)(a). Because Hatfield has failed to show that the owner-operators were free from its direction and control under RCW 50.04.140(1)(a) and (2)(a), we do not need to address the remaining criteria of the three-prong test under RCW 50.04.140(1) or the six-prong test under RCW 50.04.140(2). We therefore conclude that the 15 owner-operators’ services for Hatfield constitute non-exempt employment pursuant to RCW 50.04.100.

In its Petition for Review, Hatfield argues that the federally-mandated controls over equipment cannot logically be considered control over the means and methods of operating the equipment. See Hatfield’s Petition for Review at p. 4. 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. As such, 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 Hatfield itself over the owner-operators’ truck-driving services) to conclude that the owner-operators have not met the first criterion under RCW 50.04.140(1)(a) and (2)(a).

Hatfield further contends that the administrative law judge ignored evidence establishing a lack of direction and control when deciding liability on summary judgment. See Hatfield’s Petition for Review at p. 5. This contention, however, is not supported by the record on summary judgment. Indeed, the administrative law judge considered all relevant evidence, including evidence showing

a lack of direction and control (*see* ¶¶ 4.20 & 4.21 in Order Granting Department's Cross-Motion for Partial Summary Judgment), before reaching his conclusion on the liability issue. *See* ¶ 5.21 in Order Granting Department's Cross-Motion for Partial Summary Judgment.

In light of the foregoing, we will adopt the OAH's findings as a matter of law and conclusions of law in the Order Granting Department's Cross-Motion for Partial Summary Judgment issued on January 29, 2014.

In its cross Petition for Review, the Department requests us to enter additional findings with regard to the "usual course and place of business" criterion under RCW 50.04.140(1)(b) and the "independently established business" criterion under RCW 50.04.140(1)(c). *See* Department's Cross Petition for Review at pp. 4-5. As discussed above, the three-prong test under RCW 50.04.14(1) or the six-prong test under RCW 50.04.140(2) is conjunctive; and failure to meet any one prong means failure to meet the entire test. Further, because the coverage/liability issue was decided on summary judgment, the record was not adequately developed on the other two criteria under RCW 50.04.140(1)(b) and (1)(c). Consequently, we will decline the Department's invitation to enter additional findings with regard to the criteria under RCW 50.04.140(1)(b) or (1)(c).

Amount of Wages Subject to Assessment

RCW 50.12.070 requires employers to keep true and accurate work records containing such information as the Commissioner may prescribe. *See* RCW 50.12.070(1)(a). Specifically, the Commissioner requires employers to keep records of the workers' total gross pay period earnings, the specific sums withheld from the earnings from each worker, and the purpose of each sum withheld to equate to net pay. *See* WAC 192-310-050(1)(g) & (1)(h). Employers are also required to keep payroll and accounting records. *See* WAC 192-310-050(2)(a). Pursuant to WAC 192-340-020, if an employer fails to provide necessary payroll or other wage information during an audit, the Department may rely on RCW 50.12.080 to determine payroll and wage information based on information otherwise available to the Department. In particular, RCW 50.12.080 authorizes the Department to arbitrarily make a report on behalf of an employer, based on knowledge available to the Department, if the employer fails to make or file any report; and the report so made shall be deemed to be *prima facie* correct. *Prima facie* evidence means evidence that will establish a fact or sustain a judgment unless contradictory evidence is produced. *See* EVIDENCE, Black's Law Dictionary (10th ed. 2014).

Here, the Department used the amounts reported by Hatfield under “nonemployee compensation” on Form 1099 to calculate the assessment. It is not disputed that the amounts reported under “nonemployee compensation” included both wages paid to the owner-operators for their driving services as well as the costs for equipment rental. Since Hatfield was not able to provide necessary payroll or other wage information *during the audit* so as to separate the wages from equipment rental, the Department was entitled to rely on the amounts reported on Form 1099 to calculate the assessment pursuant to RCW 50.12.080; and the assessment is presumed to be *prima facie correct unless and until Hatfield introduces contradictory evidence*.

Indeed, during the evidentiary hearing below, Hatfield introduced Mr. Steven Bishop’s expert testimony to contradict the Department’s *prima facie* case and to further fine-tune the amount of wages paid to the owner-operators for their driving services. The OAH admitted and relied on Bishop’s expert testimony to conclude that only 30 percent of the total remuneration paid by Hatfield to the owner-operators constituted wages for unemployment insurance tax purposes and that the remaining 70 percent was for equipment rental. In its cross Petition for Review, the Department does not challenge Bishop’s qualification as an expert to testify on the relevant issue; but, instead, it contends that Bishop “did not see any documents from Hatfield that broke down the remuneration,” *see* Finding of Fact 4.12; that Bishop did not interview any owner-operators or secure records from the owner-operators, *see* Finding of Fact 4.14; and that Bishop only relied on “articles and websites on the internet” and conversations with “selected trucking companies.” *See* Finding of Fact 4.14. The Department argues that Bishop’s testimony was not based on evidence or records unique to Hatfield. *See* Department’s Cross Petition for Review at pp. 3-4. The Department’s argument goes to the foundation of Bishop’s expert testimony; and, for reasons set forth below, we reject the Department’s argument in this regard.

Generally speaking, expert testimony is admissible if the expert is qualified, the expert relies on generally accepted theories in the scientific community, and the testimony would be helpful to the trier of fact. *See Johnston-Forbes v. Matsunaga*, 181 Wn.2d 346, 352, 333 P.3d 388 (2014). A trial court has broad discretion in deciding whether to admit expert testimony, and such a decision will not be disturbed absent a showing of an abuse of that discretion. *See Philippides v. Bernard*, 151 Wn.2d 376, 393, 88 P.3d 939 (2004). If the basis for admitting or excluding the expert evidence is “fairly debatable,” the trial court’s exercise of discretion will not be disturbed.

See Group Health Coop. of Puget Sound, Inc. v. Dep't of Revenue, 106 Wn.2d 391, 398, 722 P.2d 787 (1986).

ER 702 generally establishes when expert testimony may be used at trial.⁵ ER 703 allows an expert to base his or her opinion on evidence not admissible in evidence and to base his or her opinion on facts or data perceived by or *made known to* the expert at or before the hearing.⁶ Expert opinions lacking an adequate foundation should be excluded. See Walker v. State, 121 Wn.2d 214, 218, 848 P.2d 721 (1993). But, pursuant to ER 703, an expert is not always required to personally perceive the subject of his or her analysis. That an expert's testimony is not based on a personal evaluation of the subject goes to the weight, not admissibility, of the testimony. See In re Marriage of Katare, 175 Wn.2d 23, 39, 283 P.3d 546 (2012). Before an expert is allowed to render an opinion, the trial court must find that there is an adequate foundation so that the opinion is not mere speculation, conjecture, or misleading. See Johnston-Forbes, 181 Wn.2d at 357.

Here, Bishop did not personally interview any owner-operators or secure any records from the owner-operators; nor did Bishop see any documents from Hatfield breaking down the remuneration. Instead, Bishop conducted research on the internet regarding the trucking industry (i.e. websites of "The Truckers Report" and "American Transportation Research Institute"), reviewed various articles and studies on the relevant issue (i.e. "The Real Costs of Trucking," "Don't Fly by the Seat of Your Pants: Figuring Cost Per Mile," and "An Analysis of the Operational Costs of Trucking"), and talked to selected industry representatives (i.e. CFO Karen Ericson of Oak Harbor Freight Lines and VP Larry Pursley of Washington Trucking Association). Moreover, Bishop also spoke with Kent Hatfield (owner of Hatfield) regarding the nature of his operations and further obtained income tax returns from Hatfield's CPA to analyze the appropriate shares/percentages between wages and equipment rental. The administrative law judge scrutinized Bishop's underlying information and determined that it was sufficient for Bishop to form an opinion on the issue of bifurcating the amounts between wages and equipment rental. See Finding of Fact 4.14. As such, the administrative law judge did not abuse his discretion by admitting

⁵ ER 702 provides that: "If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise."

⁶ ER 703 provides that: "The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence."

Bishop's testimony in this case. Furthermore, regardless of any concession or stipulation that may have been made by the Department in other trucking cases, the fact remains that the Department did not introduce any countervailing evidence *in this case*. Thus, we are left with Bishop's expert testimony only. In short, Hatfield has successfully rebutted the Department's prima facie case on the amount of wages subject to assessment; and we are satisfied that a 30/70 split between wages and equipment rental is an appropriate formula for Hatfield. We will therefore adopt the OAH's findings of fact and conclusions of law in its Initial Order issued on December 23, 2015 with regard to the appropriate amount of wages that should be subject to assessment.

Waiver of Penalties

If the tax contributions are not paid on time, a late payment penalty of 5 percent is assessed for the first month of delinquency, 10 percent for the second month of delinquency, and 20 percent for the third month of delinquency; and no penalty so assessed shall be less than ten dollars. See RCW 50.12.220(4); WAC 192-310-030(5). RCW 50.12.220(6) provides that penalties *shall* be waived if adequate information has been provided to the Department and the Department has failed to act or has advised the employer of no liability, a ground commonly known as "mandatory waiver of penalties." In this case, there is no evidence to show that: (1) prior to the audit, Hatfield provided the Department with any information (adequate or otherwise) on its business operations involving the owner-operators; (2) the Department had failed to act upon any information provided by Hatfield; or (3) the Department had advised Hatfield of no liability based upon any information provided by Hatfield. As such, Hatfield is not eligible for mandatory waiver of penalties pursuant to RCW 50.12.220(6).

Additionally, RCW 50.12.220(6) provides that penalties *may* be waived for "good cause" if the failure to file timely, complete, and correctly formatted reports or pay timely contributions was not due to the employer's fault, a ground commonly known as "discretionary waiver of penalties." WAC 192-310-030(7) sets out the perimeter of the discretion within which waiver of penalties may be granted. WAC 192-310-030(7)(a)(i) – (vii) define the circumstances under which an employer may establish "good cause" to qualify for discretionary waiver of penalties. We note that none of the seven enumerated circumstances under WAC 192-310-030(7)(a) apply to the facts of this case. However, because the seven specific circumstances enumerated under WAC 192-310-030(7)(a) are non-exclusive, we have the discretion to consider additional facts and circumstances in adjudicating an employer's request for discretionary waiver of penalties.

In this case, Hatfield uses leased trucks-with-drivers or owner-operators to support its interstate trucking operation. According to one declaration submitted by Hatfield, 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. The vast majority of interstate truck load transportation businesses in Washington operate to some extent through contractual relationships with owner-operators for operational flexibility: contracting with independent owner-operators enables the carriers to provide on-demand and as-needed deliveries and to address variations in the need to move cargo without having to purchase expensive equipment. See Declaration of Pursley in Support of Employers' Motion for Summary Judgment on Federal Preemption ¶ 7. Hatfield is one of many employers in the trucking industry who have treated the owner-operators as independent contractors for unemployment insurance tax purposes. Although our decision in Penick is not precedential (as it is not published pursuant to RCW 50.32.095), we did hold owner-operators were exempt from coverage under RCW 50.04.140 in that case. See Penick 82 Wn. App. at 39. The validity of our decision in Penick with regard to owner-operators was called into question by the W. Ports decision, where the court decidedly held that an owner-operator was not exempt from coverage under RCW 50.04.140. See W. Ports, 110 Wn. App. at 459. Even in so holding, the W. Ports court acknowledged that other jurisdictions had reached opposite conclusion (that owner-operators were not employees for purposes of unemployment compensation law) in similar cases. *Id.* at 461. Through a series of appeals filed by employers in the trucking industry, Hatfield, along with other employers, appears to be arguing for modification or reversal of the W. Ports decision.

Moreover, we have previously held that the fact that a claimant's theory of the case does not prevail does not in and of itself establish fault. See In re Ostgaard, Empl. Sec. Comm'r Dec.2d 625 (1980); In re Larson, Empl. Sec. Comm'r Dec. 971 (1973). Although these cases deal with waiver of a claimant's overpayment under RCW 50.20.190(2), we are of the view that the rationales are equally applicable to consideration of discretion waiver of penalties under RCW 50.12.220(6). Here, Hatfield has vigorously argued that the owner-operators are not its employees for unemployment insurance tax purposes; and its theory of the case is not entirely frivolous in light of the circumstances described above. As such, we are satisfied that the fact that Hatfield's theory of the case does not ultimately prevail does not establish fault for the purpose of considering

discretionary waiver of penalties pursuant to RCW 50.12.220(6). Consequently, we conclude *on the particular facts of this case* that Hatfield's failure to timely pay contributions on owner-operators' wages is not due to its fault and, thus, Hatfield is entitled to discretionary waiver of penalties pursuant to RCW 50.12.220(6). We will therefore adopt the OAH's findings of fact and conclusions of law in its Initial Order issued on December 23, 2015 granting waiver of penalties during the period in question.

Evidentiary Rulings

Hatfield generally challenges the portions of the OAH's order granting the Department's motions to exclude witnesses and strike exhibits as well as the portions of the OAH's order denying the employers' consolidated motions in limine. In particular, Hatfield contends that the OAH erred by excluding "testimony from any witnesses (including Pursley and Rajkovacz) and any exhibits relating to preemption" and by "excluding any evidence at [evidentiary] hearing that the audit was a sham (testimony of Sonntag, Bishop, and related exhibits excluded including auditor performance requirements) with predetermined results." See Hatfield's Petition for Review at pp. 1-2.

The granting or denial of a motion in limine is addressed to the discretion of the trial court and will be reversed only in the event of abuse of discretion. See Fenimore v. Donald M. Drake Constr. Co., 87 Wn.2d 85, 91, 549 P.2d 483 (1976). A motion in limine should be granted if it describes the evidence objected to with sufficient specificity to enable the trial court to determine that it is clearly inadmissible under the issues as drawn or which may develop during the trial, and if the evidence is so prejudicial that the moving party should be spared the necessity of calling attention to it by objecting when it is offered during the trial. See Douglas v. Freeman, 117 Wn.2d 242, 255, 814 P.2d 1160 (1991) (citing Fenimore, 87 Wn.2d at 91). The trial court abuses its discretion when its decision is manifestly unreasonable, or exercised on untenable grounds, or for untenable reasons. If the trial court relies on unsupported facts or applies the wrong legal standard, its decision is exercised on untenable grounds or for untenable reasons; and if the trial court, despite applying the correct legal standard to the supported facts, adopts a view that no reasonable person would take, its decision is manifestly unreasonable. See Mayer v. Sto Indus., Inc., 156 Wn.2d 677, 684, 132 P.3d 115 (2006). The appellant bears the burden of proving that the trial court abused its discretion. See Childs v. Allen, 125 Wn. App. 50, 58, 105 P.3d 411 (2004).

In this case, the OAH denied Hatfield's motion for summary judgment on federal preemption ground as well as Hatfield's motion to dismiss void assessment. Moreover, the OAH granted the Department's cross motion for partial summary, holding the owner-operators were employees of Hatfield for unemployment insurance tax purposes. As a result of these rulings, the only remaining issues for the evidentiary hearing involved the correct amounts of the contribution, penalties, and interest. Consequently, any testimony and documentary exhibits on federal preemption and void assessment issues would not have been relevant to the issues at the evidentiary hearing. *See* ER 401 (the test of relevancy is whether the evidence has a tendency to make the existence of the fact to be proved more probable or less probable than it would be without the evidence); ER 402 (evidence which is not relevant is not admissible). Here, the OAH did not rely on unsupported facts, apply the wrong legal standard, or adopt a view that no reasonable person would take in deciding to exclude the evidence. Accordingly, the OAH did not abuse its discretion by excluding the testimony of Pursley, Rajkovic, Sonntag, Bishop and related exhibits from the evidentiary hearing. Furthermore, because the parties have not brought any other specific challenges to the remaining evidentiary rulings made by OAH, we will adopt (1) the OAH's analysis in its Order Granting in Part and Denying in Part Department's Motions to Exclude Witnesses and Strike Exhibits issued on January 29, 2014; and (2) the OAH's analysis in its Order Granting in Part and Denying in Part Carriers' Consolidated Motions in Limine issued on January 29, 2014.

Now, therefore,

IT IS HEREBY ORDERED that the December 23, 2014, Tax Case Initial Order issued by the Office of Administrative Hearings is **AFFIRMED**. Hatfield is liable for the contributions and interest assessed pursuant to RCW 50.24.010 regarding the 15 owner-operators for the period of first, second, and third quarters of 2009; first, second, and fourth quarters of 2010; and first and second quarters of 2011. Only 30 percent of the remuneration paid by Hatfield to the owner-operators constitutes wages subject to the assessment pursuant to RCW 50.04.320(1). The penalties assessed for the period in question shall be waived pursuant to RCW 50.12.220(6). The case is **REMANDED** to the Department to re-calculate the total amount of the assessment in accordance with the foregoing.

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Dated at Olympia, Washington, August 21, 2015.*

S. Alexander Liu

Deputy Chief Review Judge
Commissioner's Review Office

*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.

INTERESTED PARTIES

Lionel Greaves, IV
Assistant Attorney General
Attorney General of Washington
Pacific Plaza, Suite 105
MS: WT-31
1250 Pacific Avenue
PO Box 2317
Tacoma, WA 98401-2317

Aaron P. Reinsche, Attorney at Law
Ogden Murphy Wallace, PLLC
901 Fifth Avenue, Ste. 3500
Seattle, WA 98164-2008

Scott Michael, Legal Appeals Unit
Employment Security Department
PO Box 9046
Olympia, WA 98507-9046

Talmage Fitzpatrick Tribe
2775 Harbor Avenue SW
3rd Floor, Ste. C
Seattle, WA 98126

SAL:es