NO. 45033-0

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

DEPARTMENT OF LABOR AND INDUSTRIES
OF THE STATE OF WASHINGTON,

Respondent,

v.

LYONS ENTERPRISES, INC.
d/b/a JAN-PRO CLEANING SYSTEMS,

Appellant.

BRIEF OF RESPONDENT DEPARTMENT OF LABOR AND INDUSTRIES

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TABLE OF CONTENTS

I. INTRODUCTION 1

II. ASSIGNMENTS OF ERROR 2

III. COUNTERSTATEMENT OF THE ISSUES 3

1. Does personal labor constitute the essence of the work that Lyons's janitors performed under their contracts, when Lyons contracted with customers for cleaning services, assigned the cleaning services accounts to a janitor, and regularly audited the janitors' work to ensure that it was performed in a manner consistent with Lyons's standards? 3

2. Does RCW 51.08.195 exempt Lyons, when Lyons forbids the janitors from providing cleaning services except through Lyons, when all cleaning contracts are "the property" of Lyons, meaning that Lyons has the right to reassign the contracts to a different janitor at its discretion, and when Lyons regularly supervises its janitors to ensure quality control and when Lyons did nothing to ensure that they qualified for the exemption, aside from checking to see if they had received a unified business identifier (UBI)? 3

3. Does equitable estoppel apply based on the fact that a 2005 audit found only two of Lyons's then-subcontractors to be covered workers, when that audit effectively placed Lyons on notice that its future franchisees would be covered unless they qualified for exemption under RCW 51.08.195? 3

IV. STATEMENT OF THE CASE 3

A. Lyons Contracts For Cleaning Services And Instructs Its Janitors How To Perform Those Services 3

B. The 2005 Audit Did Not Suggest That Lyons Would Never Be Responsible To Pay Industrial Insurance Premiums For Any Of Its Janitors 8

C. The 2010 Audit Found That The Janitors Were Workers 9

D. The Board Found That Some Janitors Were Covered Workers 11

E. The Superior Court Affirmed The Board In Part, Determining That All The Janitors Were Workers 14

V. SUMMARY OF THE ARGUMENT 15

VI. STANDARD OF REVIEW 17

VII. ARGUMENT 19

A. The Essence Of Lyons's Contracts With The Janitors Is The Personal Labor Of The Janitors 19

1. The statutory scheme shows the Legislature's intent to have broad industrial insurance coverage, and narrow exceptions 20

2. The essence of Lyons's contracts with the janitors is their personal labor 23

a. The mere fact that some of the janitors have hired employees of their own does not preclude them from being found to be covered workers 23

b. The essence of Lyons's contract with the janitors is determined based on the work performed under those contracts, not on how Lyons characterizes its relationship with the janitors 27

c. The mere fact that the janitors had the contractual ability to hire their own workers is

insufficient to take them outside of the protection of the Industrial Insurance Act.....31

B. No Authority Supports A Remand Of The Case To The Board For A Further Finding of Fact.....34

C. Lyons Has Failed To Establish That The Janitors Are Exempt Under The Six Factor Test In RCW 51.08.195.....38

D. Lyons Is Not Entitled To Equity Because It Has Failed To Show Justifiable Reliance On Any Department Statement.....42

E. Lyons Is Not Entitled To An Award Of Fees.....48

VIII. CONCLUSION.....50

TABLE OF AUTHORITIES

Cases

Alpine Lakes Protection Soc'y v. Dep't of Natural Res.,
102 Wn. App. 1, 979 P.2d 929 (1999) 49

Cook v. Department of Labor & Industries,
46 Wn.2d 475, 282 P.2d 265 (1955) 32

Cowiche Canyon Conservancy v. Bosley,
118 Wn.2d 801, 828 P.2d 549 (1992) 36

Crall v. Department of Labor & Industries,
45 Wn.2d 497, 275 P.2d 903 (1954) 32

Dana's Housekeeping, Inc. v. Dep't of Labor & Indus.,
76 Wn. App. 600, 886 P.2d 1147 (1995) 23, 28, 29, 31

Davis v. Sill,
55 Wn.2d 477, 348 P.2d 215 (1960) 48

Dennis v. Dep't of Labor & Indus.,
109 Wn.2d 467, 745 P.2d 1295 (1987) 17

Dep't of Labor & Industries v. Tacoma Yellow Cab,
31 Wn. App. 117, 639 P.2d 843 (1982) ..... 14, passim

Gay v. Cornwall,
6 Wn. App. 595, 494 P.2d 1371 (1972) 35

In re Rainbow Int'l,
1990 WL 304362, No. 88 2664 (Wash. Bd. Indus. Ins. Appeals
January 3, 1990) 33, 34

In re Shanley & Wife,
1988 WL 169377, No. 87 0485 (Wash. Bd. Indus. Ins. Appeals
September 8, 1988) 33, 34

Jamison v. Dep't of Labor & Indus.,
65 Wn. App. 125, 827 P.2d 1085 (1992) ..... 14, passim

Johnson v. Dep't of Health,
133 Wn. App. 403, 136 P.3d 760 (2006) 18

Johnson v. Tradewell Stores, Inc.,
95 Wn.2d 739, 630 P.2d 441 (2005) 17

Kramarevcky v. Department of Social & Health Services,
122 Wn.2d 738, 863 P.2d 535 (1993) 42, 43

Macey v. Dep't of Emp't Sec.,
110 Wn.2d 308, 752 P.2d 372 (1988) 18

Malang v. Dep't of Labor & Indus.,
139 Wn. App. 677, 162 P.3d 450 (2007) 21, 23

Massachusetts Mutual Life Insurance Co. v. Department of Labor & Industries,
51 Wn. App. 159, 752 P.2d 381 (1988) 33

Nieman v. Vaughn Cmty. Church,
154 Wn.2d 365, 113 P.3d 463 (2005) 18, 43

Norman v. Dep't of Labor & Indus.,
10 Wn.2d 180, 116 P.2d 360 (1941) 20, 21

R & G Probst v. Dep't of Labor & Indus.,
121 Wn. App. 288, 88 P.3d 413 (2004) 17, 18

Silliman v. Argus Services, Inc.,
105 Wn. App. 232, 19 P.3d 428 (2001) 33

Silverstreak v. Department of Labor & Industries,
159 Wn.2d 868, 154 P.3d 891 (2007) 46, 47, 49, 50

State v. Costich,
152 Wn.2d 463, 98 P.3d 795 (2004) 43

State v. Michielli,
132 Wn.2d 229, 937 P.2d 587 (1997) 43

Univ. of Wash. Med. Ctr. v. Dep't of Health,
164 Wn.2d 95, 187 P.3d 243 (2008) 18

White vs. Dep't of Labor & Indus.,
48 Wn.2d 470, 294 P.2d 650 (1956) ..... 24, passim

Statutes

RCW 34.05.510-.598 17

RCW 34.05.570(1)(a) 17

RCW 34.05.570(3)(e) 17

RCW 51.08.070 ..... 20, 23

RCW 51.08.180 ..... 2, passim

RCW 51.08.195 ..... 3, passim

RCW 51.08.195(1) 38, 39

RCW 51.08.195(3) 39, 41, 44, 45

RCW 51.08.195(4) 45

RCW 51.08.195(5) 45

RCW 51.12.010 ..... 21, 31

RCW 51.12.020 31

RCW 51.14.010 20

RCW 51.32.195 44

RCW 51.48.131 17

RCW 51.52.050 36

Rules

WAC 296-127-0118..... 47

I. INTRODUCTION

This is an appeal from a determination that 110 janitors who provide cleaning services under contracts with Lyons Enterprises, Inc. (Lyons) are covered workers for industrial insurance purposes. The Department of Labor & Industries (Department) found in an audit that 110 janitors were workers for industrial insurance coverage purposes. Individuals classified as workers are covered under the Industrial Insurance Act, and are eligible for compensation benefits in the event they are injured. Here, the janitors performed hard physical labor cleaning offices and other businesses.

Lyons resists coverage, relying on the legal denomination of these janitors as "franchisees." But as the courts have repeatedly recognized, it is not what the individuals are called that matters, it is what work they perform. Under the Industrial Insurance Act, an employer is responsible to provide industrial insurance coverage for its workers, which includes independent contractors when the essence of the contracts is personal labor. The Department determined that the essence of Lyons's contracts with its janitors was personal labor.

Lyons argues that its status as a franchisor distinguishes it from an employer who contracts with independent contractors to perform personal labor, but it fails to demonstrate that the essence of its contracts with the

janitors is anything other than their personal labor. Therefore, this Court should affirm the superior court, which affirmed the Board of Industrial Insurance Appeals (Board) in part.

II. ASSIGNMENTS OF ERROR

Assignment No. 1. The Board erred in entering finding of fact no. 5, which states that the 18 janitors listed on pages one and two of the Department's audit were not workers because they either (1) used specialized equipment, or (2) obviously could not perform their contracts without assistance, or (3) employed others to do all or part of the work under their contracts. CP 31. While substantial evidence supports a finding that these 18 janitors had hired workers of their own, the fact that they had workers is not dispositive because the reality of the situation is that the essence of their contracts was their personal labor.

Assignment No. 2. The Board erred in entering conclusion of law no. 3, which concluded that the 18 janitors listed on pages one and two of the Department's audit are not "workers" under RCW 51.08.180. CP 31. The Board should have concluded that those 18 janitors were workers.

Assignment No. 3. The Board erred in entering conclusion of law no. 7, which reversed the Department's decision and directed the Department to determine that the 18 janitors listed on pages one and two

of the Department's audit were not workers under RCW 51.08.180. CP 31. The Board should have affirmed the Department's decision.

III. COUNTERSTATEMENT OF THE ISSUES

1. Does personal labor constitute the essence of the work that Lyons's janitors performed under their contracts, when Lyons contracted with customers for cleaning services, assigned the cleaning services accounts to a janitor, and regularly audited the janitors' work to ensure that it was performed in a manner consistent with Lyons's standards?

2. Does RCW 51.08.195 exempt Lyons, when Lyons forbids the janitors from providing cleaning services except through Lyons, when all cleaning contracts are "the property" of Lyons, meaning that Lyons has the right to reassign the contracts to a different janitor at its discretion, and when Lyons regularly supervises its janitors to ensure quality control and when Lyons did nothing to ensure that they qualified for the exemption, aside from checking to see if they had received a unified business identifier (UBI)?

3. Does equitable estoppel apply based on the fact that a 2005 audit found only two of Lyons's then-subcontractors to be covered workers, when that audit effectively placed Lyons on notice that its future franchisees would be covered unless they qualified for exemption under RCW 51.08.195?

IV. STATEMENT OF THE CASE

A. Lyons Contracts For Cleaning Services And Instructs Its Janitors How To Perform Those Services

Jan-Pro International provides janitorial services to 32,000 customers in 48 states and 9 countries, using the "Jan-Pro System." CP 1902-03. Lyons is a regional franchisor for Jan-Pro International, operating in western Washington. CP 2132.

Jan-Pro International drafted a unit franchise agreement, which serves as a template for the contract that is used by regional franchisors to create franchisees. CP 1904-05, 1923. Regional franchisors, like Lyons, are free to modify the contract. CP 1923, 2140. Over time, Lyons's contracts have "changed pretty substantially," growing from about 12 pages in 2001 to over 40 pages by 2011. CP 2140.

To become a franchisee, one must purchase a franchise plan: in return for a given investment amount, the franchisor agrees to provide the franchisee with a certain amount of gross billing. CP 1907. For example, a janitor who makes a $2,800 investment is then entitled to receive $5,000 in yearly, gross, billing. CP 1929-30. When a janitor purchases a franchise plan, the regional franchisor (here, Lyons) receives 90 percent of the payment, and Jan-Pro receives the rest. CP 1931.

The janitors perform commercial cleaning services, cleaning offices and other businesses. CP 1902, 1906. Lyons enters into contracts with businesses to provide commercial cleaning services, and offers the account to one of its franchisees, or to a subcontractor. *See* CP 1907-08, 1926, 2155, 2167. The janitor may either accept or reject the offered cleaning contract. CP 1908. If the janitor accepts the assignment, the cleaning contract remains the property of Lyons, and the janitor is not a party to the contract. CP 316, 1908. If the janitor rejects the assignment,

then the regional franchisor is to find another cleaning contract for the janitor, although there may be a delay before a new account can be found. CP 1911.[1]

Lyons can remove a janitor from a cleaning contract. CP 318, 1918. Under the terms of the franchise agreement, if Lyons removes a janitor from a customer account within one year of the date that the janitor began providing cleaning services to that customer, and if Lyons does so for a reason "other than Franchisee Misconduct," Lyons shall "within a reasonable time" find a new account for the janitor. CP 318. "Franchisee misconduct" is defined as "faulty workmanship, untrustworthiness, dishonesty, providing services in a manner unsatisfactory to one or more customers, or otherwise defaulting under this Agreement or its service contract with the Customer." CP 318.

Lyons collects a ten percent royalty fee and a five percent management fee on all of its cleaning contracts. CP 1928. In some cases, Lyons charges a janitor one or more additional fees. CP 1915-16, 1932-33. Lyons must remit three percent of the gross billing amount to Jan-Pro International. CP 1931. After collecting all applicable fees, Lyons then sends the remainder to the janitor. CP 1930.

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[1] The unit franchise agreement states, however, "If Franchisee initially rejects and does not want to service any Customer Accounts that are part of the franchise plan, or discontinues servicing such Customer Accounts, [Lyons] is deemed to have fulfilled its obligations relating to providing Franchisees with such Customer Accounts." CP 318.

Historically, all billing and invoicing had to be done by Lyons, not by a janitor. CP 2158-59. As of the latter half of 2010, Lyons offered janitors the option of doing their own billing and invoicing. CP 2159, 2161. If a janitor did his or her own billing, he or she would be required to remit the applicable fees to Lyons. CP 2190. To date, no janitors have elected to do their own billing. CP 2159.

Under the terms of the franchise agreement, a janitor of Lyons's may only provide commercial cleaning services through Lyons during the life of the franchise agreement, and cannot perform any commercial cleaning services of any kind for a year after the franchise agreement is terminated. CP 1920. A janitor may advertise and seek customers on its own, but, if the janitor convinces a new customer to sign up for cleaning services, the new customer must sign a contract with Lyons and the cleaning contract becomes the property of Lyons. CP 1933. If a janitor wishes to advertise its services, Lyons must approve of the advertising materials. CP 450. Lyons advertises its cleaning services to potential customers through a variety of media, including a website. CP 2178-80, 1654-95.

If a janitor wishes to sell the franchise, Lyons must approve the sale. CP 1942. A janitor may hire and terminate employees without

Lyons's input. CP 328. The contract provides that the janitor shall hire "qualified and competent employees." CP 328.

Lyons may terminate a franchise agreement if, among other things, it concludes that the janitor's actions have tarnished Jan-Pro's reputation. CP 339-42, 2199-2201.

Before a janitor can provide any cleaning services, he or she must complete a 30-hour training course, over a five-week period, regarding the proper methodology for cleaning when using the Jan-Pro System. CP 1912. New franchisees are provided with a 422-page training manual outlining the Jan-Pro System, a roughly 200-page safety manual, and a roughly 100-page policies and procedures manual. CP 1938, 2027-28. The franchise agreements reference those manuals, and provide, among other things, that the franchise agreement may be terminated if the janitor fails to follow the procedures set forth in those manuals. CP 335 (stating that, if Lyons revises a manual, the janitor "shall comply with each new or changed provision"), 340 (stating that a janitor may be found to have defaulted on franchise agreement if he or she "fails or refuses to comply with any mandatory specification, standard or operating procedure [Lyons] prescribes in this Agreement, in the Manuals, or otherwise in writing, relating to safety, sanitation, or environmental concerns . . . .").

Lyons conducts audits of all of its customer accounts to ensure that the janitors are providing appropriate services. CP 2173. It conducts an audit on a monthly basis if the account is for more than $1,000 a month, and on a quarterly basis if the account is for less than $1,000 a month. CP 2173-74. Lyons makes a "customer service account" call in between audits. CP 2174.

B. The 2005 Audit Did Not Suggest That Lyons Would Never Be Responsible To Pay Industrial Insurance Premiums For Any Of Its Janitors

In 2005, the Department conducted a retrospective audit of Lyons because it received a report that there were some discrepancies between what Lyons reported to the Employment Security Department and what it reported to the Department regarding the hours Lyons's employees had worked. CP 875. Lyons provided records to the Department that explained those discrepancies. CP 876.

The auditor also concluded that two of the "subcontractors" Lyons used were covered workers, in that neither had a UBI and thus were not exempt under RCW 51.08.195, and, therefore, Lyons owed premiums for those subcontractors. CP 876.

The audit report contains no discussion of Lyons's status as a franchisor and says nothing about the franchise agreements Lyons had

with its franchisees. *See* CP 875-79. The audit report does not contain words "franchise," "franchisor," or "franchisee". CP 875-79.

C. The 2010 Audit Found That The Janitors Were Workers

In 2010, the Department conducted a second audit of Lyons. CP 1636-47. The field auditor, Kari Hill, reviewed records including the Jan-Pro Cleaning Systems Franchise Disclosure Documents, a copy of a franchise agreement, Lyons's website, and the responses she received to questionnaires she sent to Lyons's janitors. CP 1637. The audit addressed the time period ranging from the second quarter of 2009 to the first quarter of 2010. CP 1636.

Ms. Hill concluded that 18 of Lyons's janitors were exempt from coverage because they employed workers of their own. CP 1636-37. She concluded that the remaining janitors (92) were not exempt, because none of them qualified for all six parts of the exemption contained in RCW 51.08.195. CP 1638-41. She found that the janitors were not "free from direction and control" by Lyons and that several of them failed to meet other aspects of the six-part test found in RCW 51.08.195: eight did not have an account with the Department of Revenue, while 29 did not report income to the Department of Revenue. CP 1638-41.

Lyons requested reconsideration of the audit findings, and provided additional records and documentation to the Department.

CP 2163. Jerold Billings, a litigation specialist working for the Department, considered Lyons's request for reconsideration and concluded that Lyons was responsible for paying premiums for all of its janitors, including the ones who hired workers of their own (and that Lyons was responsible for paying premiums for those workers). CP 1744-46.

Mr. Billings has been a litigation specialist for approximately seven years. CP 2240. Before being a litigation specialist, he worked for the Department as an auditor for nine years. CP 2240.

When asked why the auditor in 2005 concluded that all but two of Lyons's franchisees were exempt from coverage, Mr. Billings concluded that the auditor in 2005 "made a mistake" and "didn't look at the franchise fully." CP 2255-56. Mr. Billings testified that there has not been a change in the Department's approach or philosophy regarding audits of franchisors and franchisees at any time after 2005. CP 2256.

The Department did not assess any penalties against Lyons or order it to pay premiums for the period covered by the 2010 audit because the Department had not previously advised Lyons that its janitors were covered workers for whom it owed premiums. CP 2266-67; *see also* CP 1636, 1641, 1745. Mr. Billings felt that this was necessary as a matter of basic fairness. CP 2266. The Department advised Lyons that it is

responsible to keep records regarding the hours its workers worked, and to pay premiums, effective September 2010. CP 1745.

D. The Board Found That Some Janitors Were Covered Workers

Lyons appealed the Department's decision to the Board. CP 130-32.

Craig Lyons, CEO of Lyons, stated that his company's gross monthly billing was $20,000 per month in the first year, and grew to $340,000 per month as of the current year. CP 2134. Mr. Lyons represented that Lyons's net profit is currently about $125,000 a year. CP 2135. Lyons pays industrial insurance premiums for five workers. CP 2135. Lyons employs an office manager who performs receptionist duties as well as accounting and invoicing, three operations managers who work with the janitors and customers to "make sure that the quality of service is appropriate," and one full-time outside salesperson whose job is to "contact businesses in the community who could potentially use Jan-Pro services." CP 2135-36.

Mr. Lyons testified that the Department had previously audited him in 2005. CP 2136. He claimed that, in reliance on the audit, he entered into several additional franchise agreements, and stated that he would not have entered into any of those franchise agreements had he known that he would be found to be liable for their premiums. CP 2138.

Mr. Lyons acknowledged that he does not check to ensure that his janitors are registered with the Department of Revenue. CP 2165. Rather, he confirms that his janitors have a UBI. CP 2165. It is Mr. Lyons's understanding that, to obtain a UBI, one must have registered with the Department of Revenue. CP 2165.

Mr. Lyons estimated that about 80 percent of his janitors either have employees or receive assistance of some kind, such as from a spouse. CP 2147. Mr. Lyons did not identify which franchisees, in particular, out of that 80 percent estimate, have either an employee or a spouse who provides assistance, nor did he provide an estimate as to how many of his franchisees have an employee as opposed to another form of assistance. *See* CP 2147. The only specific individual that Mr. Lyons identified as having workers of his own was Jung Soo Lee.[2]

The industrial appeals judge assigned to the case issued a proposed decision and order that recommended that the Board find that none of Lyons's janitors were workers for whom Lyons owed industrial insurance premiums. CP 111-28. The Department petitioned the three-member Board for review. CP 83-105. The Board granted review and issued a decision and order that concluded that the janitors who were identified on pages one and two of the audit report, and who employed workers of their

[2] The 2010 audit also found that Mr. Lee had workers of his own. CP 1636-37.

own, were exempt from coverage, but that the remaining janitors, identified on pages three to four of the audit report, were covered workers. CP 22-31.

The Board found that Lyons is "in the business of contracting with businesses for commercial cleaning services (finding of fact no. 2), that the operations of Lyons's janitors "are restricted by [their] individual franchise agreements" (finding of fact no. 3), that the janitors listed on pages three to four of the audit were workers who were "subject to significant . . . control" by Lyons and that their contracts with Lyons "required the use of personal labor" which was to be "performed in a specific manner consistent with the Jen-Pro [sic] program" (finding of fact no. 6) and that the janitors listed on pages three to four of the audit "had not been customarily engaged in an independently established trade, occupation, profession, or business of commercial cleaning; and did not have a principal place of business eligible for a business deduction for federal income tax purposes" (finding of fact no. 7).[3] CP 30.

The Board also found that the 18 janitors listed on pages one and two of the Department's audit were not covered workers because they

[3] Lyons contends that the Board found that it was not in the commercial cleaning business, focusing on language in the Board's narrative discussion of the case. App's Br. at 22 (citing CP 24). However, in its formal findings of fact, the Board plainly *found* that Lyons is in the commercial cleaning business because it contracts with businesses to provide commercial cleaning services. CP 30.

either (1) "owned or supplied machinery or equipment", or (2) "obviously could not perform [their] contract without assistance" or (3) employed others "to do all or part of the work" they had contracted to perform. CP 30. The Board concluded that the 18 janitors listed on pages one and two of the audit were not covered workers, but that the rest were covered workers. CP 31.

Neither Lyons nor the Department claims that these Board findings are unsupported by substantial evidence. *E.g.*, App's Br. at 20.[4]

E. The Superior Court Affirmed The Board In Part, Determining That All The Janitors Were Workers

The Department appealed the decision and order of the Board to the Pierce County Superior Court. CP 1-15. Lyons filed an appeal from the same Board decision with the Thurston County Superior Court, but its appeal was transferred to the Pierce County Superior Court, and it was then consolidated with the Department's appeal. CP 2284-86, 2289-90. The superior court found for the Department, and reversed and remanded the Board's decision and order with directions that the Department's order on reconsideration be upheld. CP 2391-99.

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[4] The Department acknowledges that there is substantial evidence that the janitors listed on pages one and two of its audit had workers of their own, but argues that this fact is not dispositive because the reality of the situation shows that the essence of the work done by all of the janitors is their personal labor. *See Jamison v. Dep't of Labor & Indus.*, 65 Wn. App. 125, 133, 827 P.2d 1085 (1992); *Dep't of Labor & Industries v. Tacoma Yellow Cab*, 31 Wn. App. 117, 123-24, 639 P.2d 843 (1982).

Lyons then appealed to this Court. CP 2400-01.

V. SUMMARY OF THE ARGUMENT

The Department and the superior court properly concluded that the janitors are Lyons's workers because the essence of their contract is their personal labor. The Board found that the janitors who had employees of their own were not covered, but it erred in doing so.

Under RCW 51.08.180, an individual is a "worker" if he or she either is an employee of an employer or is working under an independent contract, "the essence of which is his or her personal labor." In deciding whether the essence of an independent contractor's work is his or her personal labor, a court considers whether the independent contractor was hired for his or her personal labor, whether the independent contractor "obviously" could not perform the contract without assistance, and whether the independent contractor either by necessity or choice employs others to perform the work under the contract.

However, if the "realities of the situation" show that the essence of the contract was the personal labor of the independent contractor, and that the contractor's relationship with the employer is—as a practical matter—more like that of an employee than one pursuing an independent line of work, then the fact that a contractor may have an employee of his or her own is not dispositive, and the contractor is a covered worker.

Here, the reality of the situation is that Lyons contracts with customers to provide cleaning services and it then assigns that work to a janitor. The essence of Lyons's contract with its janitors is the janitor's personal labor. Lyons exercises a level of control over its janitors that is incompatible with the notion that they are independent businesses pursuing their own line of work. Therefore, the Board should not have treated the fact that 18 of Lyons's janitors had workers of their own as dispositive, and it should have concluded that all of them were covered by the Industrial Insurance Act.

Lyons has also failed to establish that its janitors are exempt under RCW 51.08.195. Crucially, the janitors are not "free" from control or direction by Lyons. Furthermore, Lyons has not established that any of its janitors "are customarily engaged in an independent established trade", and it concedes that they do not have primary places of business that would qualify for exemptions under the IRS's regulations.

Therefore, this Court should uphold the superior court's conclusion that all of Lyons's janitors are covered workers for whom Lyons owes premiums. In the alternative, in the event this Court concludes that the fact that a janitor has employees necessarily precludes him or her from being a covered worker, this Court should reinstate the decision of the Board.

VI. STANDARD OF REVIEW

This Court reviews decisions of the Board in a premium assessment case under the judicial review provisions of the Administrative Procedures Act, RCW 34.05.510-.598. RCW 51.48.131; *R & G Probst v. Dep't of Labor & Indus.*, 121 Wn. App. 288, 293, 88 P.3d 413 (2004). The party challenging the Board decision bears the burden of proof on appeal. RCW 51.48.131; RCW 34.05.570(1)(a); *R & G Probst*, 121 Wn. App. at 293.

This case involves the question of whether the janitors were "workers" under the Industrial Insurance Act. This Act is remedial and "a liberal construction is not only appropriate but mandatory." *Johnson v. Tradewell Stores, Inc.*, 95 Wn.2d 739, 743, 630 P.2d 441 (2005); *see also* RCW 51.12.010 (providing that the Industrial Insurance Act "shall be liberally construed"). A court interprets the Industrial Insurance Act liberally "to achieve its purpose of providing compensation to all covered employees injured in their employment, with doubts resolved in favor of the worker." *Dennis v. Dep't of Labor & Indus.*, 109 Wn.2d 467, 470, 745 P.2d 1295 (1987).

This Court reviews the Board's findings of fact for substantial evidence in light of the Board record. RCW 34.05.570(3)(e). Substantial evidence is evidence that is sufficient to persuade a fair-minded person of

the truth or correctness of the matter. *R & G Probst*, 121 Wn. App. at 293. Review under the substantial evidence standard is deferential, "requiring the appellate court to view the evidence and its reasonable inferences in the light most favorable to the prevailing party in the highest forum that exercised fact finding authority." *Johnson v. Dep't of Health*, 133 Wn. App. 403, 411, 136 P.3d 760 (2006). This Court does not reweigh the evidence. *Univ. of Wash. Med. Ctr. v. Dep't of Health*, 164 Wn.2d 95, 103, 187 P.3d 243 (2008).

This Court conducts a de novo review of questions of law that are raised by this appeal. *Macey v. Dep't of Emp't Sec.*, 110 Wn.2d 308, 313, 752 P.2d 372 (1988). However, while this Court is not bound by the Department's interpretation of the Industrial Insurance Act, the Court accords deference to its interpretations of it, as it is the agency that has expertise in enforcing and interpreting those laws. *See id.* at 313.

Finally, this Court conducts a de novo review of the issue of whether a party is entitled to equitable relief. *Nieman v. Vaughn Cmty. Church*, 154 Wn.2d 365, 374, 113 P.3d 463 (2005).

VII. ARGUMENT

A. The Essence Of Lyons's Contracts With The Janitors Is The Personal Labor Of The Janitors

The Industrial Insurance Act provides for broad coverage of individuals working in the State of Washington. Lyons posits that because the janitors involved here were working under a franchise agreement they cannot be considered workers. *See* App's Br. 24. Furthermore, under Lyons's view, anyone working subject to a service franchise agreement is necessarily excluded from coverage under the Industrial Insurance Act because of the nature of franchise agreements. *See* App's Br. 23. It cites franchise law to support its position that what it is doing is the business of selling franchises, not cleaning services. *See* App's Br. 10-13. But the law of franchise does not answer the question of what workers are covered under the Industrial Insurance Act.

This Court should reject Lyons's attempt to carve out a special class of individuals from coverage under the Industrial Insurance Act. The Legislature has mandated that it is not how a worker and employer characterize their relationship with each other that controls, it is the essence of the work under the contract that is dispositive. The fact that janitors here are franchisees does not de facto exclude them, or any other franchisee, from coverage under the Industrial Insurance Act. The janitors

provided their own personal labor in the form of janitorial work. Because of this, under RCW 51.08.180, they are workers entitled to coverage under the Industrial Insurance Act if they are injured at work.

1. The statutory scheme shows the Legislature's intent to have broad industrial insurance coverage, and narrow exceptions

The Industrial Insurance Act, RCW Title 51, requires every "employer" to secure workers' compensation coverage by insuring with the state (through premiums) or by self-insuring. RCW 51.14.010. Although the common law distinguishes "employees" and "independent contractors," the Industrial Insurance Act was amended in 1937 to expressly provide coverage for independent contractors who provide personal labor. RCW 51.08.180; *see Norman v. Dep't of Labor & Indus.*, 10 Wn.2d 180, 183, 116 P.2d 360 (1941).

Thus, the Industrial Insurance Act broadly defines both "worker" and "employer" to include independent contractors and those who hire them. An "employer" is any person or entity "all while engaged in this state in any work covered by the provisions of this title, by way of trade or business, or who contracts with one or more workers, *the essence of which is the personal labor of such worker or workers.*" RCW 51.08.070 (emphasis added). Similarly, the term "worker" covers "every person in this state who is engaged in the employment of or who is working under

an independent contract, *the essence of which is his or her personal labor for an employer*." RCW 51.08.180 (emphasis added).

Thus, the Legislature intended "to broaden the industrial insurance act, and bring under its protection *independent contractors whose personal efforts constitute the main essential in accomplishing the objects of the employment*, and this, regardless of who employed or contracted for the work." *Norman*, 10 Wn.2d at 184 (emphasis added). The Legislature's mandate for broad coverage furthers the important goal, inherent in the Industrial Insurance Act, of liberally construing the Act in order to reduce to a minimum the suffering and economic hardship associated with workplace injuries. RCW 51.12.010.

Where the essence of a contract is the personal labor of the independent contractor, the independent contractor is covered unless the employer proves that all six of the criteria set forth in RCW 51.08.195 apply. RCW 51.08.180; RCW 51.08.195; *Malang v. Dep't of Labor & Indus.*, 139 Wn. App. 677, 688, 162 P.3d 450 (2007).

RCW 51.08.195 provides:

> As an exception to the definition of "employer" under RCW 51.08.070 and the definition of "worker" under RCW 51.08.180, services performed by an individual for remuneration shall not constitute employment subject to this title if it is shown that:

(1) The individual has been and will continue to be free from control or direction over the performance of the service, both under the contract of service and in fact; and

(2) The service is either outside the usual course of business for which the service is performed, or the service is performed outside all of the places of business of the enterprise for which the service is performed, or the individual is responsible, both under the contract and in fact, for the costs of the principal place of business from which the service is performed; and

(3) The individual is customarily engaged in an independently established trade, occupation, profession, or business, of the same nature as that involved in the contract of service, or the individual has a principal place of business for the business the individual is conducting that is eligible for a business deduction for federal income tax purposes; and

(4) On the effective date of the contract of service, the individual is responsible for filing at the next applicable filing period, both under the contract of service and in fact, a schedule of expenses with the internal revenue service for the type of business the individual is conducting; and

(5) On the effective date of the contract of service, or within a reasonable period after the effective date of the contract, the individual has established an account with the department of revenue, and other state agencies as required by the particular case, for the business the individual is conducting for the payment of all state taxes normally paid by employers and businesses and has registered for and received a unified business identifier number from the state of Washington; and

(6) On the effective date of the contract of service, the individual is maintaining a separate set of books or records that reflect all items of income and expenses of the business which the individual is conducting.

This rigorous test shows the Legislature's intent to have broad industrial insurance coverage, and narrow exceptions. Here, Lyons was the employer of the janitors because their personal labor is the essence of their contracts and because Lyons has failed to establish that the janitors meet all six of the criteria set forth in RCW 51.08.195. *See* RCW 51.08.070, .080, .195; *Malang*, 139 Wn. App. at 687-88.

2. **The essence of Lyons's contracts with the janitors is their personal labor**

a. **The mere fact that some of the janitors have hired employees of their own does not preclude them from being found to be covered workers**

In determining whether the essence of an independent contract is personal labor, courts examine "the contract itself, the work to be performed, the parties' situation, and any other relevant circumstances." *Malang*, 139 Wn. App. at 688. In determining what the "essence" of a contract is, the court's focus is on "the essence of the *work* under the independent contract, not the characterization of the parties' relationship." *Dana's Housekeeping, Inc. v. Dep't of Labor & Indus.*, 76 Wn. App. 600, 607, 886 P.2d 1147 (1995) (emphasis in original).

White, infra at 474 established a three part test to determine if the essence of an independent contract is personal labor. *White vs. Dep't of Labor & Indus.*, 48 Wn.2d 470, 474, 294 P.2d 650 (1956). Under that test, an independent contractor is not a covered worker if (1) he or she "must of necessity own or supply machinery or equipment (as distinguished from the usual hand tools)", (2) he or she "obviously could not perform the contract without assistance", or (3) he or she "of necessity or choice employs others to do all or part of the work he [or she] has contracted to perform."[5] *White*, 48 Wn.2d at 474.

The case law has subsequently clarified that, under *White*, the fact that an independent contractor employs some workers to perform some tasks is not "in itself dispositive" of the issue of whether the independent contractor is covered by the Industrial Insurance Act. *See Jamison v. Dep't of Labor & Indus.*, 65 Wn. App. 125, 133, 827 P.2d 1085 (1992); *Dep't of Labor & Industries v. Tacoma Yellow Cab*, 31 Wn. App. 117, 123-24, 639 P.2d 843 (1982) (concluding that taxi cab lessee drivers were covered workers, even though they could hire others to drive the taxi cab, because the essence of their contract with the leasing company was their personal labor as drivers). This is because a court's analysis as to whether

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[5] Lyons offers no argument with regard to the first or second prongs of *White*, and relies only on the third prong regarding a contractor who "of necessity or choice" employs others to do the work under the contract. *See* App's Br. 28. As the Department will explain, the third prong is not met here.

the essence of a contract is personal labor is ultimately grounded in "'the realities of the situation' rather than the technical requirements that the independent contractor could not or did not hire anyone to perform work under the contract." *Jamison*, 65 Wn. App. at 132 (quoting *Tacoma Yellow Cab*, 31 Wn. App. at 124).

In both *Jamison* and *Tacoma Yellow Cab*, the court emphasized that the independent contractors provided little to their putative employers other than their personal labor, and noted that the independent contractors in those cases served essentially the same function as the few employees who provided labor for their employers. *Jamison*, 65 Wn. App. at 133, *Tacoma Yellow Cab*, 31 Wn. App. at 124. Thus, finding the independent contractors to be exempt merely because they received some aid from workers of their own would allow a technicality to overcome the reality of the situation, which was that the independent contractors provided personal labor to their employers for the employer's economic benefit. *Jamison*, 65 Wn. App. at 133; *Tacoma Yellow Cab*, 31 Wn. App. at 124.

Notably, the *White* Court, albeit in dicta, provided for a similar outcome with regard to workers who are subject to extensive control even though they were hired primarily for the special equipment that they owned. *White*, 48 Wn.2d at 477. The *White* Court noted that even in a case where a person was primarily hired because he or she owned special

equipment, and even if the person was paid much more for his or her equipment than he or she received for his or her labor, that person would still be covered by the Industrial Insurance Act if he or she was subject to the direction and control of the employer. *White*, 48 Wn.2d at 477. Although the *White* Court's explanation in dicta was that, in such an instance, the worker would be an employee rather than an independent contractor, the *White* Court's observation is nonetheless consistent with *Jamison* and *Tacoma Yellow Cab's* holdings. *White*, 48 Wn.2d at 477. This is because *Jamison* and *Tacoma Yellow Cab* concluded that the employers in those cases exercised a level of control over their independent contractors that was indistinguishable from the control they exercised over their employees. *Compare White*, 48 Wn.2d at 477, *with Jamison*, 65 Wn. App. at 133; *Tacoma Yellow Cab*, 31 Wn. App. at 124.

Here, as in *Jamison* and *Tacoma Yellow Cab*, the "realities of the situation" dictate that the essence of the contracts is the personal labor of the independent contractors. The janitors are forbidden by the terms of their franchise agreements from providing cleaning services except through Lyons. CP 1920. All cleaning contracts are "the property" of Lyons, and Lyons has the right to reassign any cleaning contract from one janitor to another, and may do so whether or not it finds that a janitor provided inadequate services. CP 316, 318, 1908. Lyons requires that the

cleaning services be performed in a manner consistent with the training and manuals that are provided to the janitors, and if the work is not done in a manner consistent with those standards, the janitor faces economic penalties and sanctions ranging from a one-time fine to the loss of that cleaning account. CP 335, 340, 1938, 2027-28. The reality of the situation is that Lyons makes contracts with customers to provide cleaning services, assigns a janitor to provide the cleaning services, and keeps a percentage of the amount billed on all such contracts. CP 1908. As a practical matter Lyons's franchisees serve a *function* that is indistinguishable from the function that would be served by an employee who is paid by an employer to provide cleaning services to a client. Therefore, even though some of Lyons's janitors have workers of their own, all of them are the workers of Lyons, because the essence of the work under those contracts is their personal labor. *See Jamison*, 65 Wn. App. at 133; *Tacoma Yellow Cab*, 31 Wn. App. at 124.

b. The essence of Lyons's contract with the janitors is determined based on the work performed under those contracts, not on how Lyons characterizes its relationship with the janitors

Lyons argues that the essence of its contracts with its franchisees is the franchisee relationship itself, a bilateral agreement between two businesses, rather than the personal labor of the janitors. App's Br. at 21-

27. Lyons's argument is indistinguishable from arguments that the courts considered and rejected in *Dana's* and *Tacoma Yellow Cab*. *Dana's*, 76 Wn. App. at 607-08; *Tacoma Yellow Cab*, 31 Wn. App. at 123-24. This Court should reject it as well.

In *Dana's*, the putative employer, Dana's Housekeeping (Dana's), entered into contracts with homeowners to provide cleaning services, and assigned one or more housecleaners, who it characterized as independent contractors, to the job. *Dana's*, 76 Wn. App. at 602-03. Customers would pay Dana's for the cleaning services, and Dana's would keep a percentage of the payment and send the rest to the housecleaner. *Id.* Dana's argued that the essence of its contracts with its housecleaners was "an agreement to accept referrals and share a fee" rather than the personal labor of the housecleaners. *Id.* at 607. The court rejected this argument, explaining, "the 'essence' with which the statute is concerned is the essence of the *work* under the independent contract, not the characterization of the parties' relationship." *Id.* (emphasis in original). The court concluded that the essence of the *work* performed under the contracts—house cleaning services—was the personal labor of the housecleaners. *Id.*

Here, the relevant issue is the essence of the *work* performed by Lyons's janitors under their independent contracts, not on how either Lyons or the franchisees characterize their relationship with each other.

See Dana's, 76 Wn. App. at 607. The essence of the *work* performed under their cleaning contracts is the janitors' personal labor. *See Dana's*, 76 Wn. App. at 607.

In *Tacoma Yellow Cab*, the putative employers were companies that leased taxi cabs to the lessees, who were taxi cab operators. *Tacoma Yellow Cab*, 31 Wn. App. at 123-24. The lessees paid "a flat fee for the use of the taxi cabs plus a pre-determined rate per mile of use." *Id.* at 123. Therefore, the lessors argued that "they are merely engaged in the business of leasing vehicles for an agreed fee and should not be required to pay industrial insurance premiums for workers compensation for their lessees." *Id.* at 123-24.

The court responded, "That argument evades the real issue, i.e., whether, when each lessee is engaged in operating the taxi as a taxi for hire, is he [or she], in the words of the statute, 'working under an independent contract, the essence of which is her or her personal labor for an employer.'" *Id.* at 124 (quoting RCW 51.08.180). The court concluded that the essence of those contracts was personal labor, noting that "[T]he realities are simply that the essence of the independent lease contract is to provide a method to place taxis and drivers on the city streets of Tacoma to carry passengers at rates which are established by local ordinance." *Id.*

Here, similarly, the "real issue" is whether, when Lyons's janitors are working under independent contracts, the essence of the contracts is their personal labor. *See Tacoma Yellow Cab*, 31 Wn. App. at 124. The "reality of the situation" is that the franchise agreement provides "a method" by which the janitors provide personal labor—in the form of cleaning services—to customers of Lyons's. *Tacoma Yellow Cab*, 31 Wn. App. at 124. Treating the franchise agreement itself as the "essence" of the contract would "evade[] the real issue" and ignore "the realities of the situation." *Id.*

In support of its argument that the essence of its agreements with the janitors is the franchise relationship itself rather than the work performed by the janitors under their contracts, Lyons emphasizes that franchises play a special role in Washington's economy and notes that they are subject to extensive regulation. App's Br. 10-13, 21-27. Lyons also warns of dire consequences for other franchisors if it is found to be a covered employer, and asserts—without support in the record—that the Department has historically recognized that franchisors should not be covered under the Industrial Insurance Act. App's Br. 26-27.

None of Lyons's arguments provide a valid reason to excuse it from paying premiums for its workers. Lyons fails to support either its assumption that the Department had previously declined to find

franchisors subject to the Industrial Insurance Act or its assertion that franchisors generally would not be able to cover the cost of industrial insurance premiums. Furthermore, nothing in either the Industrial Insurance Act or the Franchise Investment Protection Act purports to provide for either a partial or absolute exemption from industrial insurance coverage for franchisors. RCW 51.12.020 contains an extensive list of exclusions, and franchisees are not one of them, evidencing the Legislature's intent that the Industrial Insurance Act covers them if they are workers. RCW 51.12.010 ("it is the purpose of the title to embrace *all* employments . . . ."). Finally, for the reasons explained above, this Court's inquiry is on the essence of the *work* performed by Lyons's janitors under their contracts, not on how the janitors and Lyons characterize their relationship with each other, and the essence of that *work* is plainly the janitors' personal labor. *Dana's*, 76 Wn. App. at 607-08; *Tacoma Yellow Cab*, 31 Wn. App. at 123-24.

c. The mere fact that the janitors had the contractual ability to hire their own workers is insufficient to take them outside of the protection of the Industrial Insurance Act

Lyons also argues that the mere fact that its contracts with its janitors *allowed* the janitors to hire employees is enough to prevent any of them from being found to be covered under the Industrial Insurance Act,

including the janitors who did not actually employ any workers. App's Br. at 28. However, the *White* Court expressly disapproved of this view of the law. *White*, 48 Wn.2d at 472-74.

In *White*, the Court noted that a prior case, *Crall v. Department of Labor & Industries*, 45 Wn.2d 497, 275 P.2d 903 (1954), had language indicating that, as a matter of law, labor that "can" be done by others is not the "personal labor" of the independent contractor, and, therefore, the personal labor of an independent contractor could never be said to be the "essence" of the contract if the contract gave the independent contractor the option of having another perform those services. *White*, 48 Wn.2d at 472-73. The *White* Court noted that another of the Court's opinions, *Cook v. Department of Labor & Industries*, 46 Wn.2d 475, 282 P.2d 265 (1955), citing *Crall*, took the same view. *White*, 48 Wn.2d at 473.

However, the *White* Court expressly disavowed that language in the Court's earlier opinions, explaining,

> We are now convinced that the language in the *Crall* and *Cook* cases is too broad, and that the legislature in 1937, in adopting the section of the workmen's compensation act with which we are now concerned, had something more in mind than the protection in those extremely rare cases in which the party for whom the work is done requires the personal services of the independent contractor and is unwilling that any part of the work be done by someone else.

Id. at 473-74.

Lyons also seeks support from cases decided after *White*, including *Massachusetts Mutual Life Insurance Co. v. Department of Labor & Industries*, 51 Wn. App. 159, 161-62, 752 P.2d 381 (1988), and *Silliman v. Argus Services, Inc.*, 105 Wn. App. 232, 238, 19 P.3d 428 (2001), as well as two decisions of the Board. App's Br. at 29-34. However, the cited cases do not support Lyons's argument. Neither *Massachusetts Mutual* nor *Silliman* stands for the proposition that the hypothetical ability to use another to perform work under a contract is sufficient to preclude an independent contractor from receiving the protection of the Industrial Insurance Act. *See Silliman*, 105 Wn. App. at 237 (holding that the security company was not a coworker of the individual who worked at a plant, because the security company used others to perform all work under its contract); *Massachusetts Mutual*, 51 Wn. App. at 164-65 (holding that the insurance agents were not covered workers because they "may and do" delegate their duties to others).

Similarly, the Board decisions that Lyons cites do not stand for this proposition. App's Br. at 30-32 (citing *In re Shanley & Wife*, 1988 WL 169377, No. 87 0485 (Wash. Bd. Indus. Ins. Appeals September 8, 1988); *In re Rainbow Int'l*, 1990 WL 304362, No. 88 2664 (Wash. Bd. Indus. Ins. Appeals January 3, 1990)). At no point in either case did the Board state that the mere ability to hire a worker under a contract is

sufficient to take the independent contractor outside of coverage. *Shanley*, 1988 WL 169377; *Rainbow Int'l*, 1990 WL 340362.

In short, Lyons's contention that its janitors cannot be found to be covered workers merely because they had the contractual ability to hire workers fails, as *White* expressly renounced that view, and none of the cases cited by Lyons support it. *White*, 48 Wn.2d at 473-74.

B. No Authority Supports A Remand Of The Case To The Board For A Further Finding of Fact

As the Department explained above, all of Lyons's janitors should be held to be workers who are covered under the Industrial Insurance Act. However, if this Court concludes that a janitor who has workers of his or her own is thereby not covered under *White*, the Court should reinstate the decision of the Board, and not—as Lyons requests—remand the matter to the Board for entering a further finding of fact. App's Br. 34-37.

Lyons contends that the Board failed to make an adequate finding as to how many of its janitors hired workers of their own. App's Br. 36. But the Board's findings of fact numbers five and six explain which of the janitors the Board found were covered and which were not. CP 30. Furthermore, when the Board's findings are read in conjunction with its explanation of its ruling, it is plain that the Board found that the 18 janitors identified on pages one and two of the audit report had workers of

their own, while the janitors identified on pages three and four of the audit report did not. *See* CP 21 (noting that the janitors were not exempt under the first or second prong of *White*, but that the janitors identified on pages one and two of the audit had workers of their own and were therefore exempt); CP 30. *Cf. Gay v. Cornwall*, 6 Wn. App. 595, 599, 494 P.2d 1371 (1972) (explaining that when a trial court has not made express findings of fact, an appellate court may look to an oral opinion to clarify the court's ruling). Therefore, the Board has made adequate findings regarding that issue, and a remand is unnecessary and would be improper.

In any event, finding of fact number six is unambiguous in finding that the janitors identified on pages three and four of the audit did not have specialized equipment or machinery, did not obviously require assistance to perform the work under their contracts, and did not have any employees of their own. CP 30. Thus, the Board plainly found that Lyons did not meet its burden with regard to the janitors identified on pages three and four of the audit. CP 30.

Although Lyons argues that the Board failed to "adequately decide" the issues on appeal, it does not assert that the Board's findings of fact are unsupported by substantial evidence, nor does it present any argument under that standard. *See* App's Br. 36. Indeed, Lyons asserts that the facts are not in dispute, and that the only issue raised by its appeal

is whether its janitors are covered workers *as a matter of law*. *See* App's Br. 20. Therefore, Lyons has waived any argument that the Board's findings are unsupported by substantial evidence.[6] *See Cowiche Canyon Conservancy v. Bosley*, 118 Wn.2d 801, 809, 828 P.2d 549 (1992).

In any event, the Board's findings are supported by substantial evidence, as they are consistent with the Department's findings in its audit report, which were admitted into the record. A reasonable person could agree that the Department's audit findings were correct, particularly given that Lyons bore the burden of proof on appeal, and Lyons failed to present any information that directly contradicted the Department's audit findings. CP 1636-47; RCW 51.52.050.

Lyons argues that the Department's audit methods were flawed and that the Board failed to account for Mr. Lyons's testimony that approximately 80 percent of his franchisees either employ workers or have some form of assistance, such as assistance from a spouse. App's Br. 35-36; CP 2147. However, Mr. Lyons did not testify as to any specific franchisees, by name, that he understood to have employees, other than Jung Soo Lee, and the Department and the Board made the same

[6] The Department also does not contest the Board's findings: the Department agrees there is substantial evidence that 18 of Lyons's janitors had workers and that the rest did not. The Department's contention, however, is that that fact is not dispositive in light of the reality of the situation, which is that Lyons exercised great control over the janitors in the performance of their work.

determination regarding Mr. Lee. CP 30, 1636-37, 2145. As Lyons had a copy of the Department's audit, it could have easily presented evidence—either through Mr. Lyons's testimony or through that of another witness—that established which specific franchisees had employees and which did not. Instead, it chose to rely only on a nonspecific estimate. CP 2147.

Furthermore, it must be noted that the *White* Court did not conclude that the fact that a husband or wife received assistance from a *spouse* was sufficient to take him or her out of coverage. *White*, 48 Wn. 2d at 476-77. In that case, Mr. White and Ms. White jointly undertook an independent contract, and they hired a worker to aid them. *White*, 48 Wn.2d at 476-77. The Court relied on the fact that the Whites employed a worker to help them, not on the fact that Mr. White aided Ms. White. *Id.* It was the fact that the Whites had hired a worker, not the fact that they aided each other, which was dispositive. *Id.*

Here, Mr. Lyons was asked to, and presumptively did, lump together the franchisees who he knew to have employees and the franchisees who he understood to receive assistance from a spouse in arriving at an estimate of how many franchisees received aid of some kind. CP 2147. This renders his estimate immaterial, because, under *White*, receiving aid from a spouse does not take an individual out of the protection of the Industrial Insurance Act. *White*, 48 Wn.2d at 476-77.

C. Lyons Has Failed To Establish That The Janitors Are Exempt Under The Six Factor Test In RCW 51.08.195

Substantial evidence supports the Board's findings that Lyons does not qualify for an exemption under RCW 51.08.195 because Lyon's janitors were not "free" from Lyons's direction or control, they did not have "an independently established" trade, and they did not have a primary place of business that would qualify for an exemption under the IRS's regulations. Under RCW 51.08.195, all six of the factors listed in the statute must be met for an employer to satisfy the exemption. The Board's conclusion that Lyons does not qualify for an exemption under that statute follows from its findings.

Under RCW 51.08.195(1), a contractor must be "free from control or direction over the performance of the service, both under the contract of service and in fact . . . ." The plain language of the statute dictates that an independent contractor meets this criterion only if he or she is *free* from control or direction.

Here, substantial evidence establishes that Lyons's franchisees were not free of its control or direction. The janitors are required to undergo an extensive, five-week training, and are directed by the franchise contract to provide cleaning services in a manner consistent with a 422-page training manual, a 200-page safety manual, and a 100-page policies

and procedures manual. CP 1912, 1938, 2027-28. They are audited on a regular basis, and Lyons uses a checklist to ensure that the work was performed consistent with Lyons's and Jan-Pro's expectations. CP 2173-74. If Lyons finds a janitor's services demonstrates "faulty workmanship," it can remove the janitor from that cleaning account, and it would not be obligated to find another account for the janitor in its place: the janitor effectively forfeits his or her right to a portion of the billing that he or she paid for when he or she purchased a franchise plan. CP 318.

Lyons suggests that the control it exercises over its franchisees should not be viewed as control for the purpose of deciding whether it is exempt from coverage, because it only exercises control over its franchisees to protect the Jan-Pro trademark and reputation. App's Br. 25. However, under the plain language of RCW 51.08.195(1), it does not matter *why* an employer exercises control or direction over an independent contractor. Rather, the fact that control or direction is exercised precludes a finding that the independent contractor is exempt under RCW 51.08.195.

Substantial evidence shows that Lyons also fails to meet the third factor. Under RCW 51.08.195(3), an independent contractor must either "be customarily engaged in an independently established trade, occupation, profession, or business" or have a "principal place of business" that is "eligible for a business deduction for federal income tax

purposes." Here, Lyons concedes that it cannot show that the janitors have a "principal place of business" that would qualify for a deduction, and argues only that the janitors are customarily engaged in an independently established trade. App's Br. at 42.

However, Lyons's janitors are contractually forbidden from performing commercial cleaning services except through Lyons during the life of their ten-year franchise agreement and for an additional year after the franchise is terminated. Thus, there is substantial evidence that they are not pursuing a trade, occupation, profession, or business that is "independent" of Lyons.

Lyons argues that the Board unreasonably focused on the fact that its janitors had little experience in commercial cleaning services before becoming franchisees, arguing that it would lead to what is claimed to be an absurd result if the exemption applied only to independent contractors who have pursued a business for a "long time" or operate it on a full-time basis. App's Br. 42.

This argument lacks merit for two reasons. First, the Board did not conclude that a contractor must have pursued a given business for a "long time" or on a "full-time" basis. Rather, it simply noted that the evidence showed that the franchisees here had little or no history of pursuing such work before becoming franchisees and that they often performed it for

Lyons on a part-time basis, and substantial evidence supports those observations. CP 28. Furthermore, the plain language of the statute indicates that one must be "customarily engaged" in an "independently established" line of work. RCW 51.08.195(3). Thus, the statute plainly requires that a contractor have at least *some* history of having engaged in such work in order for that trade to have been "independently established." *Id.* Lyons fails to propose a workable standard for determining whether a franchisee has an "independently established trade" that would give meaning to that statutory language.

Second, Lyons fails to show that the Board's view would produce an absurd result. RCW 51.08.195(3) allows a contractor to qualify for an exemption *either* by showing that it is customarily engaged in an independently established line of work *or* that it has a place of business that would qualify for an exemption. Therefore, an individual who was new to a given trade or who pursued it part-time could qualify for the exception if he or she had a qualifying place of business.

Nor, for that matter, is it absurd for the Legislature to distinguish between an independent contractor who had a long history of independently pursuing a trade before signing on to a given contract and one who had never pursued that trade before signing that contract.

Lyons's suggestion that RCW 51.08.195's terms are too narrow and too restrictive is an argument best directed to the Legislature.

D. Lyons Is Not Entitled To Equity Because It Has Failed To Show Justifiable Reliance On Any Department Statement

Lyons also argues that it is entitled to relief under the doctrine of equitable estoppel because a 2005 audit found that only two of its franchisees were covered workers. App's Br. 42-46. However, Lyons has failed to show that it *justifiably* relied on any past statement of the Department's in assuming that it would never be found liable for premiums for any new franchisees it took on, and, therefore, it is not entitled to equitable relief.

As *Kramarevcky v. Department of Social & Health Services*, 122 Wn.2d 738, 743-44, 863 P.2d 535 (1993), notes, equitable estoppel against the government is a disfavored remedy, and it is granted only if clear, cogent, and convincing evidence supports the following five conclusions: (1) a party made an admission, statement, or act inconsistent with its later claim, (2) an action was taken by another party in justifiable and good faith reliance on the first party's act, statement, or admission, (3) an injury to the relying party as a result of its reliance, (4) granting equitable estoppel is necessary to prevent a manifest injustice, and (5)

granting equitable estoppel would not impair the exercise of a governmental function.[7]

Here, Lyons did not "justifiably" rely on the findings of the Department's 2005 audit in assuming that none of its franchisees would be found to be covered workers for whom it would be responsible to pay premiums. The 2005 audit contains no discussion of the fact that Lyons is a franchisor who enters into ten-year franchise agreements with franchisees. CP 875-79. Indeed, it does not contain the words franchise, franchisee, or franchisor, let alone offer any legal analysis of the nature of Lyons's franchise agreements with its franchisees or the nature of Lyons's business model. *See* CP 875-79.

Furthermore, the 2005 audit found that two of the workers did not meet the six factor test in RCW 51.08.195. RCW 51.08.195 only comes into play if the essence of a contract is a worker's personal labor: if personal labor is not the essence of a contact, then the independent contractor is not covered regardless of whether he or she meets that six factor test. CP 876. Thus, the 2005 audit effectively put Mr. Lyons on

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[7] Lyons correctly notes that the superior court found that the first two factors of the five factor test set out by *Kramarevcky* were met. App's Br. at 44. *Kramarevcky*, 122 Wn.2d at 743-44. However, this Court conducts a de novo review of a trial court's determination regarding whether equitable relief is appropriate. *Nieman*, 154 Wn.2d at 374. Furthermore, it is well-settled that a superior court's decision can be affirmed on any basis that is supported by the record. *See State v. Costich*, 152 Wn.2d 463, 477, 98 P.3d 795 (2004); *State v. Michielli*, 132 Wn.2d 229, 242, 937 P.2d 587 (1997). Here, the record supports the conclusion that equitable relief is not appropriate.

notice that personal labor was the essence of his contracts with those who he uses to perform cleaning services, and that his independent contractors would be found to be exempt only if they met all six of the elements set forth in RCW 51.32.195. *See* CP 876.

The six elements set forth in RCW 51.32.195 are demanding and highly fact specific, and Mr. Lyons could not *reasonably* assume that if only a few of his contractors were found to be covered in 2005, then none of his contractors would be found to be covered in a future audit, as he had no reason to assume that either his existing franchisees or any new ones he contracted for would start or continue to do all of the things that were necessary for them to be found to be exempt under RCW 51.08.195. This is particularly true given that the record indicates that Mr. Lyons did little to ensure that his franchisees did all of the things that are required to be exempt under that statute.

For example, as noted, RCW 51.08.195(3) requires that an independent contractor either be pursuing an independently established trade or have a principal place of business that qualifies for an income tax deduction. There is no evidence that Mr. Lyons did anything to ensure that his franchisees either had an independently established trade before becoming a Lyons franchisee or that they had a place of business that would qualify for an income tax deduction.

Similarly, RCW 51.08.195(5) requires an independent contractor to have an account with the Department of Revenue established as of the date of the contract and that the contractor has a UBI. Mr. Lyons testified that he does not check to see if his contractors have signed up with the Department of Revenue, but does check to make sure they have a UBI. CP 2165. Mr. Lyons asserts that it is his understanding that one must sign up with the Department of Revenue in order to acquire a UBI. CP 2165. However, the Department's auditor found, and Mr. Lyons presented no evidence contradicting this, that eight of Lyons's franchisees did not have accounts with the Department of Revenue. CP 1638-41. Thus, Mr. Lyons's chosen method of ensuring that his franchisees satisfy the requirements of RCW 51.08.195(3) was not reliable.

Furthermore, RCW 51.08.195(4) requires that one have an account with the Department of Revenue established "on the effective date of the contract of service . . . ." Mr. Lyons's practice of making certain that a franchisee has a UBI would not allow him to determine whether a franchisee continues to have an account in good standing with the Department of Revenue in the future. Since Mr. Lyons apparently does nothing to ensure that this element of the statute is met aside from making certain that the franchisee was issued a UBI, he could not reasonably assume that all of his franchisees met this test. *See* CP 2165.

Finally, it should be noted that Mr. Lyons has modified his contracts with his franchisees over the years, causing the contract to grow from 12 pages to over 40 pages in length. CP 2140. Given that the terms of his contracts substantially changed over time, Mr. Lyons could not reasonably assume that his franchisees would continue to be found to be exempt even as the contracts evolved.

Because Lyons's reliance on the 2005 audit was unreasonable, Lyons has also failed to show that equitable relief is necessary to prevent a manifest injustice.

Finally, granting Lyons equitable relief would impair the exercise of legitimate governmental functions. The Industrial Insurance Act contemplates workers receiving industrial insurance benefits for injuries that are funded by premiums paid by employers. Allowing Lyons to escape responsibility for premiums for a large number of workers that it uses to perform personal labor, over an extended period of time, would undermine the Department's ability to follow the mandate of the Legislature to collect premiums from employers.

Lyons relies on *Silverstreak v. Department of Labor & Industries*, 159 Wn.2d 868, 889-91, 154 P.3d 891 (2007), in arguing that it is entitled to equitable estoppel. App's Br. at 45-47. However, the facts of the two cases are readily distinguishable in ways that plainly point to different

outcomes. In *Silverstreak*, the Department adopted a regulation, WAC 296-127-0118, regarding the Prevailing Wage on Public Works Act (PWA). *Id.* at 901-02. Contemporaneous with its adoption of that rule, it distributed a formal memorandum to several businesses that set forth its understanding of its regulations. *Id.* Among other things, the memorandum indicated that certain types of delivery truck drivers were not subject to the PWA. *Silverstreak*, 159 Wn.2d at 901-02. In reliance on that formal statement, a general contractor submitted a bid on a public works contract, at a price that assumed that its delivery truck drivers that fell within that category would not be paid pursuant to the PWA. *Id.* The general contractor received the assignment and paid its truck drivers a non-prevailing wage. *Id.* A year after the work on that contract was completed, the Department ordered the general contractor to pay its delivery truck drivers at the prevailing wage. *Id.*

The Supreme Court concluded that the contractor was entitled to equitable estoppel because it reasonably relied on an express statement of the Department regarding its interpretation of its own regulations, and because it would be manifestly unjust to allow the public to receive the benefit of receiving a public work at an artificially low rate while penalizing the contractor by ordering it to retroactively pay additional wages to some of its workers. *Silverstreak*, 159 Wn.2d at 902-03.

Here, in contrast, the Department did not make any formal statement to Lyons regarding its interpretation of how RCW 51.08.180 and RCW 51.08.195 apply to franchisors. *See* CP 875-79. Indeed, in the 2005 audit, the Department made no statement of any kind regarding the legal significance of a franchise relationship. CP 875-79. Thus, the Department did not make any statement regarding its understanding of the law on which Lyons could reasonably rely in assuming that none of its franchisees would ever be found to be covered workers.

E. Lyons Is Not Entitled To An Award Of Fees

Finally, Lyons argues that, if it prevails on appeal, it is entitled to an award of attorneys fees under the Equal Access to Justice Act (EAJA) for both the superior court appeal and the current litigation. App's Br. at 46-47. It is not entitled to such an award.

First, Lyons should not prevail on appeal, and, therefore, it should not receive an award of fees on appeal.

Second, Lyons did not request an award of fees under the EAJA when its case was before the superior court, and, therefore, it has waived the right to request such fees with regard to the superior court appeal. *See* CP 2320-51, 2371-88; *Davis v. Sill*, 55 Wn.2d 477, 481, 348 P.2d 215 (1960) (noting that party may not raise new issue on appeal).

Finally, this Court should not grant Lyons an award of fees in any event, because the Department's position in this case is substantially justified. *See Alpine Lakes Protection Soc'y v. Dep't of Natural Res.*, 102 Wn. App. 1, 18-19, 979 P.2d 929 (1999). Where the state's position on appeal is one that "could satisfy a reasonable person," its position is substantially justified, and no fee award is proper, even if a court concludes on appeal that the agency was incorrect. *Alpine Lakes*, 102 Wn. App. at 18-19. Here, the Department has presented arguments as to why Lyons should not prevail on appeal that could satisfy a reasonable person. In particular, *Jamison* and *Tacoma Yellow Cab* support the view that the fact that an independent contractor employs workers of his or her own is not dispositive when the reality of the situation is that the contractor is subject to a level of control that is comparable to that exercised by an employer over an employee; and, here, the control Lyons exercised over its franchisees was extreme.

Lyons relies on *Silverstreak* for the idea that if it receives relief on an equitable basis it should be granted fees under the EAJA. App's Br. at 47 (citing *Silverstreak*, 159 Wn.2d at 891). However, in *Silverstreak*, the Court denied the request for fees even though it found that a manifest injustice would result if the state was allowed to prevail. *Silverstreak*, 159 Wn.2d at 892-93. While *Silverstreak* did not hold that a party who

prevails on an equitable theory would never be entitled to a fee award under the EAJA, it suggests that such a remedy would be appropriate only in an extraordinary case presenting facts that are so one-sided that no reasonable person could deny that the plaintiff was entitled to an equitable remedy. *See Silverstreak*, 159 Wn.2d at 892-93. This is not such a case, as a reasonable person could be satisfied that equitable relief is not due in this case, given that the Department's 2005 audit did not make any statements about the Department's understanding of the law as it related to franchisees.

VIII. CONCLUSION

For the reasons discussed above, the Department asks that this Court affirm the decision of the superior court.

RESPECTFULLY SUBMITTED this 15 day of January, 2014.

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DIVISION II
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NO. 45033-0-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

DEPARTMENT OF LABOR AND INDUSTRIES OF THE STATE OF WASHINGTON,

Respondent,

v.

LYONS ENTERPRISES, INC. d/b/a JAN-PRO CLEANING SYSTEMS,

Appellant.

DECLARATION OF MAILING

DATED at Tumwater, Washington:

The undersigned, under penalty of perjury pursuant to the laws of the State of Washington, declares that on the below date, I mailed the Department's Brief of Respondent and this Declaration of Mailing to all parties on record as follows via ABC Legal Messengers:

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DATED this 15 day of January, 2014.

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