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No. 95442-9

SUPREME COURT OF THE STATE OF WASHINGTON

MACMILLAN PIPER, INC.,

Petitioner,

v.

WASHINGTON STATE EMPLOYMENT SECURITY DEPARTMENT,

Respondent.

RESPONDENT'S ANSWER TO PETITION FOR REVIEW

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I. INTRODUCTION

This case involves a straightforward application of the Employment Security Act's independent contractor test, RCW 50.04.140, to the employment relationship between the Petitioner freight carrier and its truck drivers who own their trucks ("owner-operators"). The Court of Appeals affirmed the Commissioner of the Employment Security Department's ruling that MacMillan-Piper, Inc., did not prove all parts of the test. The Court thus upheld the unemployment tax assessment issued to MacMillan for the wages it paid to its owner-operators. Substantial evidence supports the Commissioner's findings, and the conclusions are free of error.

MacMillan obfuscates this straightforward application of law to facts by raising three arguments that have no legal support. First, it claims that having to treat owner-operators as in covered employment for unemployment insurance purposes will lead to a wholesale "restructuring" of the trucking industry. Therefore, MacMillan argues, federal motor carrier law preempts the tax assessment. The Court of Appeals properly found this "restructuring" claim legally unsupported and the preemption argument off base. *MacMillan-Piper, Inc. v. Emp't Sec. Dep't*, No. 75534-0-I, 2017 WL 6594805 at *4-5 (Wash. Ct. App. Dec. 26, 2017) (unpublished).

Second, MacMillan challenges a long-standing ruling that federally required contractual provisions can be considered when evaluating whether

owner-operators are free from carriers' "control or direction" under one element of the independent contractor test. *See W. Ports Transp., Inc. v. Emp't Sec. Dep't*, 110 Wn. App. 440, 41 P.3d 510 (2002) (Div. I). Division III of the Court of Appeals recently analyzed this question and, upon thorough consideration, agreed with the long-standing decision. *Swanson Hay Co., et al. v. Emp't Sec. Dep't*, 1 Wn. App. 2d 174, 208-12, 404 P.3d 517 (2017). Here, Division I evaluated and agreed with Division III's ruling and its own past precedent. *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *3. A ruling that adheres to established precedent does not warrant review.

And third, MacMillan challenges the conduct of the tax audit as arbitrary or capricious and a violation of its due process rights. MacMillan pursues this counter-factual argument even though it had a de novo appeal of the validity of the tax assessment before a neutral hearing examiner, where it suffered no prejudice in its ability to put on a defense. The Court of Appeals properly rejected these arguments, too. *Id.* at 5-7.

In short, four levels of review—from the administrative law judge, to the Department's Commissioner, to the superior court, and finally to Division I of the Court of Appeals—have rejected all of MacMillan's contentions. And now in related appellate cases, where other trucking carriers are represented by the same counsel and have made the same arguments, Divisions II and III of the Court of Appeals have ruled the same.

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

II. COUNTERSTATEMENT OF THE ISSUES

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

1. Did the Commissioner correctly rule under RCW 50.04.140(1)—the statutory independent contractor test for unemployment insurance—that MacMillan failed to prove its owner-operators were free from its control or direction over the performance of services, when MacMillan: had the right to full possession and control of owner-operators' equipment; imposed daily notice and reporting for duty requirements; could find drivers unqualified for any reason; prohibited driving for others without its written consent; required maintenance and inspection of equipment, submission of records, and installation of communication equipment and decals or placards; and could terminate an owner-operator for refusal to perform a dispatch?

2. Does the Federal Aviation Administration Authorization Act, which preempts state laws that relate to the prices, routes, or services of a motor carrier, preempt applying Washington's Employment Security Act to the services of owner-operators, when the Act applies generally to all Washington employers, poses only a minor cost increase, and affects worker classification only under the Act?

3. Did MacMillan fail to establish arbitrary or capricious or unconstitutional audit conduct when there was room for two positions as to the amount to be assessed based on the records MacMillan provided to the auditor, and MacMillan had a de novo

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

hearing in which it suffered no prejudice in its ability to present a defense?

III. COUNTERSTATEMENT OF THE CASE

MacMillan is involved in drayage—moving freight containers and cargo from point to point, often from the port to a rail yard or another place. Owner-operators own trucking equipment, and MacMillan enters into "lease agreements" with them to have them use their own trucks to perform the drayage services, using MacMillan's operating authority issued by the Federal Motor Carrier Safety Administration and Department of Transportation. Agency Record Vol. 1 (AR1) 216-17 ¶¶ 4.5-4.10, 4.16, 4.22; AR4 1118; AR1 163-75.

MacMillan considers its owner-operators to be independent contractors and thus does not report their wages or pay unemployment taxes on them to the Employment Security Department. The Department audited MacMillan to determine whether that classification was correct under the Employment Security Act. The auditor determined the owner-operators did not meet the independent contractor test, and the Department issued an unemployment tax assessment to MacMillan for the wages it paid to the owner-operators. AR4 1099; AR1 215 ¶ 4.1; AR1 5.

MacMillan appealed the assessment, which was adjudicated at the Office of Administrative Hearings (OAH). MacMillan moved for summary judgment, arguing federal law preempted the assessment. AR1 52-68. The

ALJ denied the motion. AR1 127-33. The Department cross-moved for partial summary judgment, arguing that the undisputed facts established the owner-operators were in MacMillan's "employment" under RCW 50.04.100 and that MacMillan could not as a matter of law prove all elements of the independent contractor exception test under RCW 50.04.140(1).[2] AR1 134-48. The ALJ granted the Department's motion. AR1 218-20 ¶¶ 5.8-5.15; AR1 220-22 ¶¶ 5.16-5.25.

The ALJ ruled that the "lease agreements" provide for MacMillan's control or direction over the owner-operators' performance of services, thereby defeating MacMillan's claim for exception under RCW 50.04.140(1)(a), based on at least the following contractual provisions:

- MacMillan has the "right to full possession and control" of the equipment during the lease term;
- Owner-operators must report for duty daily at 7:30 a.m. with adequate fuel for a full day's work, must notify MacMillan by 7:00 a.m. if they will not be available that day, and must give two weeks' notice if they will not be available for two or more consecutive days;
- An owner-operator's refusal to perform a dispatch is considered a material breach of the agreement;
- Owner-operators may not haul freight for other carriers without MacMillan's written permission;
- Drivers must meet federal and state safety requirements and may be found unqualified by MacMillan "for any reason";
- Owner-operators must submit to MacMillan records of hours on duty, daily inspections, vehicle tonnage, log sheets, and other documents;
- Owner-operators must "immediately" report accidents or citations to MacMillan, maintain the equipment consistent with regulations, perform daily pre-trip inspections, install

[2] At the Court of Appeals, MacMillan abandoned its argument that the owner-operators are not in "employment" under RCW 50.04.100.

communication equipment "at the sole discretion and for the sole benefit of MacMillan-Piper," and display decals or placards on the equipment indicating it is leased to MacMillan.

AR1 216-17 ¶¶ 4.11-4.22 (ALJ findings); contract AR1 163-75 ¶¶ 3, 4, 6, 7, 15, 17, 18, 20, 27, and App. C ¶¶ 1, 2, 5. Some of these provisions are required by federal regulations, but others are not. The ALJ ruled that under *Western Ports Transportation, Inc. v. Employment Security Department*, the trier of fact can consider federally-required controls when applying the independent contractor statute. AR1 220-22 ¶¶ 5.16-5.25.

MacMillan then moved to dismiss the assessment as "void," claiming the Department improperly taxed the total amounts paid to the owner-operators, which included both payments for the equipment lease and for driving services, rather than just for the driving services. *See* AR2 225-49. The ALJ denied the motion, reasoning that the Department properly relied on the wage information MacMillan had provided to it in calculating the assessment because MacMillan had not provided information "with which to separate non-taxable remuneration from taxable remuneration." AR2 680-81 ¶ 4.8.[3]

[3] *See also* AR8 Ex. V, W, X (MacMillan reported all owner-operator payments as "nonemployee compensation" on IRS 1099 forms, instead of reporting any as for "rents"—including for equipment); AR2 400, 404, 592-93 (no records were provided to Department on which a contrary assessment calculation could be made).

Having concluded on summary judgment the owner-operators were in covered employment, the evidentiary hearing then addressed the assessment amount. MacMillan hired a forensic accountant to opine on how to allocate the payments for the leased equipment versus the driving services. AR4 1040, FF 4.23; AR6 9/17/14 Bishop test. 10. The accountant saw no records showing which portions of the payments were for personal services and which were for equipment, nor did he interview any owner-operators. AR4 1040, FF 4.24, 4.26; AR6 9/17/14 Bishop test. 62-63. Rather, he did internet research and talked with other trucking companies to determine that driving services constituted approximately 30 percent of the contract, and equipment-related costs were approximately 70 percent. AR4 1040-41, FF 4.26-4.27; AR6 9/17/14 Bishop test. Relying on that testimony, the ALJ found that only 30 percent of the payments MacMillan made to owner-operators was for driving services and, therefore, taxable. AR4 1039, FF 4.13, 4.16; 1045-46, CL 5.27; AR2 680 ¶ 4.8.

MacMillan and the Department each sought review of the ALJ's decision by the Department's Commissioner. MacMillan raised the same arguments it made at OAH, and the Department argued that the ALJ improperly reduced the assessment amount. AR4 1068-72, 1052-57.

The Commissioner upheld the rulings of the ALJ. AR4 1099-1126. The Commissioner determined MacMillan exerted "extensive controls over

the methods and details of how the driving services are to be performed by the owner-operators." AR4 1116. Concerning the amount of taxable wages, the Commissioner ruled that the Department presented a "prima facie case on the amount of wages subject to assessment," but MacMillan successfully rebutted it. AR4 1121. The Commissioner agreed with the ALJ's "30/70 split between wages and equipment rental." AR4 1121.

MacMillan sought judicial review in King County Superior Court, which affirmed the Commissioner's order. CP 433-42. MacMillan appealed to the Court of Appeals, which again affirmed.

IV. ARGUMENT WHY REVIEW SHOULD BE DENIED

The issues in this case are factually tied to a specific trucking carrier who challenges a tax assessment; there is no reason for review. First, MacMillan failed to show its drivers are independent contractors under the Employment Security Act. That ruling does not involve a conflict with precedent or a question of substantial public interest. RAP 13.4(b)(1), (4). Second, the ruling that federal law does not preempt the assessment is consistent with precedent, and MacMillan shows no reason why this Court should review its flawed arguments. Third, MacMillan's "inflated assessment" theory rings hollow because it had a de novo hearing where it achieved a significant reduction in the assessment amount. The Court and Commissioner correctly found MacMillan failed its heavy burden of

proving arbitrary or capricious or unconstitutional conduct. MacMillan's argument, unmoored from any showing of an erroneous final order, does not merit review.

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

By challenging in all three divisions of the Courts of Appeals the holdings of Division I's 2002 decision in *Western Ports*, several carriers had hoped to create a conflict that would warrant review under RAP 13.4(b)(2). But Division III's *Swanson Hay* court agreed with the *Western Ports* court in all relevant respects, Division I has reaffirmed its holdings, and Division II has agreed, too. *Swanson Hay Co., et al., supra*; *MacMillan-Piper, Inc., supra*; *Gulick Trucking, Inc., supra*. There are now 16 years of uniform decisions rejecting MacMillan's arguments that owner-operators are exempt from the Act, that the Act's independent contractor test should artificially ignore the control carriers exert over their drivers that originates in federal law, and that federal motor carrier law preempts the Act.

Faced with no real conflicts, MacMillan attempts to manufacture a conflict with a 1945 decision of this Court, which interpreted a definition of "employment" in Title 50 RCW that pre-dated the current definition. MacMillan also suggests that review is warranted under RAP 13.4(b)(1) because the Court of Appeals decision conflicts with the decisions of *other*

jurisdictions. This is not grounds for review. Finally, MacMillan mischaracterizes this Court's opinion in *Washington Trucking Associations, et al. v. Employment Security Department, et al.*, 188 Wn.2d 198, 393 P.3d 761 (2017), by claiming that it held that the administrative appeals must provide relief based on carriers' arguments about audit conduct. This Court said no such thing. None of the claimed conflicts exist or warrant review.

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

MacMillan argues the Court of Appeals decision conflicts with a case from 1945: *Seattle Aerie No. 1 of the Fraternal Order of Eagles v. Commissioner of Unemployment Compensation and Placement*, 23 Wn.2d 167, 160 P.2d 614 (1945). Pet. 19. It contends that *Seattle Aerie* requires the Department to rely on the common law definition of "control" when analyzing the first element of the Act's independent contractor test, RCW 50.04.140(1)(a): whether workers are free from an employer's "control or direction" over the performance of services.[4] But, as *Swanson Hay* noted,

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

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

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

Seattle Aerie was decided just days before the Legislature broadened the definition of "employment" to expressly include "personal service . . . *unlimited by the relationship of master and servant as known to the common law or any other legal relationship* . . . ."[5] RCW 50.04.100 (emphasis added); *Swanson Hay Co.*, 1 Wn. App. 2d at 205-06; *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *3 (agreeing with *Swanson Hay*).

Two years after the statute was amended, this Court acknowledged that its decision in *Seattle Aerie*—at least as to the scope of "employment" in the Employment Security Act—was no longer good law:

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

Swanson Hay Co., 1 Wn. App. 2d at 207 (quoting *Skrivanich v. Davis*, 29 Wn.2d 150, 158, 186 P.2d 364 (1947)). As *Swanson Hay* correctly noted, the Washington Legislature "did not use the language [of a draft bill]

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performed outside of all the places of business of the enterprises for which such service is performed; and

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

RCW 50.04.140(1) (emphasis added).

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

incorporating the 'control' that distinguished servants and independent contractors under Washington common law." *Swanson Hay Co.*, 1 Wn. App. 2d at 207. Rather, "the statutory standard [for freedom from control] is independent of and unrelated to common law concepts underlying the independent contractor analysis in other settings." *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *3. Thus, as *Swanson Hay* properly held, "when it comes to applying the 'free[dom] from control or direction over the performance of services' required for exemption under RCW 50.04.140(1), it is cases applying Title 50, not common law cases, that are controlling." *Swanson Hay Co.*, 1 Wn. App. 2d at 208. MacMillan's continued reliance on *Seattle Aerie* and its argument that common law definitions of control in other legal contexts should apply here are misplaced. There is no conflict.[6]

Courts throughout the state—including this Court—have routinely recognized that worker classification under the Employment Security Act "is more likely than any other to be viewed as employment." *Swanson Hay Co.*, 1 Wn. App. 2d at 180; *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *3 ("The inquiry under the statute is not whether owner-operators are

[6] MacMillan suggests in a footnote that the Court of Appeals decision also conflicts with *Kamla v. Space Needle Corporation*, 147 Wn.2d 114, 52 P.3d 472 (2002). Pet. 19 n.25. But that case addressed whether an employer retained the right to direct a contractor's work so as to bring the employer within the "retained control" exception to the general rule of non-liability for injuries of a contractor. *Kamla*, 147 Wn.2d at 119. It is not an unemployment case, and it did not discuss Title 50 RCW.

independent contractors for other purposes but whether they meet all of the prongs of the exemption test contained in the [Act][.]"); *Wash. Trucking Ass'ns*, 188 Wn.2d at 203 ("Persons engaged in 'employment' include independent contractors so long as they perform 'personal services' under a contract and an exemption does not apply."); *W. Ports*, 110 Wn. App. at 458 (Act's definition of "employment" is "exceedingly broad"). Thus Division I properly agreed with the *Swanson Hay* court here: the common law tests for "employment" and "control" do not apply in the employment security context. There is no conflict to review.

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

MacMillan suggests review is warranted because the Court of Appeals decision is inconsistent with *other* jurisdictions' decisions, including a decision from the Oregon Court of Appeals. Pet. 17-18 & nn.22-24. This is not a true conflict warranting review under RAP 13.4(b)(1), which requires a conflict with a decision of *this* Court.

Moreover, many of the cited cases are not unemployment cases, and other state courts have applied their own laws to different facts.[7] The different results MacMillan cites are, therefore, unremarkable.

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[7] *See* Pet. 17 n.22. For example, the contractual relationship in *Hammond v. Department of Employment*, 480 P.2d 912 (Idaho 1971), involved "a series of trip-by-trip contracts with the drivers doing little more than renting trailers from" the carrier, and the drivers were "entirely free from any control whatsoever in the performance of their work."

The *Swanson Hay* court properly rejected these other authorities as both "unhelpful" and "unpersuasive." *Swanson Hay Co.*, 1 Wn. App. 2d at 210-12; *see also MacMillan-Piper, Inc.*, 2017 WL 6594805 at *3 (agreeing with *Swanson Hay* and declining to look beyond the plain language of Washington's statute). The plea to rule differently does not merit review.

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

MacMillan wrongly asserts that this Court's ruling last year in *Washington Trucking Associations* held that "ESD's adjudicative process must provide MP a remedy for ESD's improper means or motive in imposing the assessment." Pet. 25 (citing 188 Wn.2d at 224-25). Rather, this Court held that the state administrative procedure to review and correct an assessment is the only *process* by which the carriers may pursue claims about audit motives and means, but they still must actually prove those claims. *Wash. Trucking Ass'ns*, 188 Wn.2d at 224-26; *see id.* at 226 (stating

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In *Wisconsin Cheese Service, Inc. v. Department of Industry, Labor and Human Relations*, 340 N.W.2d 908 (Wis. Ct. App. 1983), the *only* showing of control was the power to terminate the leases. And in *Hough Transit, Ltd. v. Harig*, 373 N.W.2d 327 (Minn. Ct. App. 1985), Minnesota had a different definition of "employment," and the drivers in question were specifically excluded from the unemployment law. The *Western Ports* court acknowledged that different states have ruled differently concerning owner-operator unemployment coverage. *W. Ports*, 110 Wn. App. at 461-62. Besides, courts in some states have since approved of *Western Ports*. *See C.R. England, Inc. v. Dep't of Emp't Sec.*, 7 N.E. 3d 864, 876-78 (Ill. App. Ct. 2014); *SZL, Inc. v. Indus. Claim Appeals Office*, 254 P.3d 1180, 1188 (Colo. Ct. App. 2011).

that the carriers must "rely exclusively on the procedures set out in Title 50 RCW" to pursue their claims); *see also* RCW 50.32.120; RCW 34.05.570(3), (4). Nothing in this Court's opinion in *Washington Trucking Associations* or the Court of Appeals opinions in *MacMillan-Piper* or *Swanson Hay* affects the standards for proving arbitrary or capricious or unconstitutional action. The Court of Appeals properly ruled that MacMillan did not meet those standards. There is no conflict to review.

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

MacMillan hyperbolically claims that the Department is engaged in an "assault on owner-operators" and aims to "eliminate" them and "restructur[e]" the trucking industry. Pet. 5 and n.6. As a matter of law, MacMillan is wrong. The Court of Appeals ruling is explicitly based on—and limited to—the unique provisions of the Employment Security Act. The Act requires payment of unemployment taxes only; it has no other legal effect. The Court of Appeals correctly rejected MacMillan's argument that the Federal Aviation Administration Authorization Act (FAAAA) preempts applying the Employment Security Act to carriers. It does not present an issue of substantial public interest for this Court's review. RAP 13.4(b)(4).

Further, permitting the consideration of federally required leasing provisions in applying the "control" element in the independent contractor

test, RCW 50.04.140(1)(a), is not an issue of substantial public interest, especially when MacMillan exerted more control than federally required.

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

MacMillan has raised a theory of federal preemption that depends on the false assumption that the tax will result in a "restructuring" of the trucking industry. Therefore, MacMillan argues, the assessment is preempted by the FAAAA, which provides that a "State . . . may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service of any motor carrier . . . with respect to the transportation of property." 49 U.S.C. § 14501(c). The FAAAA preempts state laws that aim directly at transportation, or whose impact on transportation is indirect but *significant*. *See Rowe v. N.H. Motor Transp. Ass'n*, 552 U.S. 364, 371, 128 S. Ct. 989, 169 L. Ed. 2d 933 (2008). The Court of Appeals correctly rejected MacMillan's claim that having to pay unemployment taxes will result in trucking businesses having to treat owner-operators as employees for all other purposes.[8] Importantly, as the

[8] Other courts also have dismissed contentions that imposing an unemployment tax would require motor carriers to change their business models and reclassify their drivers for other purposes. *See Costello v. BeavEx, Inc.*, 810 F.3d 1045, 1056 (7th Cir. 2016) (court rejected carrier's "bare assertion" that complying with the Illinois Wage Payment and Collection Act would require it to classify its drivers as employees for all purposes); *C.R. England, Inc.*, 7 N.E.3d at 880 (noting that applying Illinois' Unemployment Insurance Act to a carrier would not "prohibit motor carriers and drivers from establishing independent contractor relationships outside the context of the Act").

Court of Appeals noted, none of the declarations MacMillan offered in support of summary judgment "stated that the unemployment tax would be a determinative factor affecting its [business] model." *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *5. They instead refer to an alleged need to purchase equipment and bear liability insurance and other expenses. *See* AR1 75-76, 84.

As a matter of law, the Employment Security Act requires employers to pay unemployment taxes only; it does not affect worker classification for any other purpose. This Court stated as much as early as 1945: "The only employment defined by the act is the employment intended to be covered by the act for the purposes of the act and none other." *State Unemp't Comp. & Placement v. Hunt,* 22 Wn.2d 897, 899, 158 P.2d 98 (1945); *see also W. Ports*, 110 Wn. App. at 458 ("an individual may be both an independent contractor for some purposes, and engaged in 'employment' for purposes of the Act"); *Swanson Hay Co.*, 1 Wn. App. 2d at 192 ("chapter 50.04 RCW defines employment and identifies its exemptions solely for unemployment insurance tax purposes"). This question is well settled. There is no need for further review.[9]

[9] Because it is settled as a matter of law that the Employment Security Act affects classification only for the Act's purposes, MacMillan's claim that the Commissioner ignored "*unrebutted* evidence" of the impact on prices, routes, and services based on converting owner-operators to employees, and its rhetoric about a multi-agency task force "bent on eliminating independent contractor relationships," Pet. 13, 14, are red herrings.

Laws that have a "tenuous, remote, or peripheral" relationship to carrier prices, routes, or services are not preempted. *Rowe*, 552 U.S. at 371. The fact that a law is likely to increase a motor carrier's operating costs "alone does not make such law[] 'related to' prices, routes or services." *Dilts v. Penske Logistics, LLC*, 769 F.3d 637, 646 (9th Cir. 2014), *cert. denied*, 135 S. Ct. 2049 (2015). Rather, laws that "do not directly or indirectly mandate, prohibit, or otherwise regulate certain prices routes or services—are not preempted by the FAAAA." *Id.* at 647. The Court of Appeals correctly observed that where "courts have found preemption, the statute established a binding requirement on how the *service* was to be performed." *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *4. The Employment Security Act does not regulate the service of a motor carrier.

The impact of having to pay unemployment taxes for owner-operators is indirect and modest. The *highest* unemployment insurance tax rates are 6–6.5 percent of payroll, and not all wages are taxed. RCW 50.29.025; RCW 50.24.010. The potential for a small increase in taxes is far removed from the nearly 100 percent increase in costs associated with

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Even limited to just the effect under the Act, the Commissioner's ruling does not necessarily result in unemployment coverage of all owner-operators in the industry. Here, the Commissioner excluded two drivers from the assessment because they had not entered into lease agreements with MacMillan; instead, they worked on an invoice arrangement, with verbally agreed-upon terms—limited to where to pick up and transport freight. AR4 1119; AR4 1038, FF 4.3-4.5, 4.9; AR4 1045, CL 5.22. They each had their own motor carrier authority. AR4 1119; AR4 1038, FF 4.6. Hence, they met the independent contractor test under RCW 50.04.140(1). AR4 1119; AR4 1043-44, CL 5.11-5.20.

the wholesale reclassification of independent contractors as employees for purposes of multiple laws, as was the case in the First Circuit decisions the carriers rely on. *See Massachusetts Delivery Ass'n v. Coakley*, 769 F.3d 11, 15 (1st Cir. 2014). As the *Swanson Hay* court recognized, those cases—and the Massachusetts independent contractor law at issue in them—are "inapplicable." *Swanson Hay Co.*, 1 Wn. App. 2d at 196-98; *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *5 (agreeing with *Swanson Hay*).[10]

The unemployment tax is precisely the kind of "generally applicable background regulation[] that [is] several steps removed from prices, routes, or services" that the Ninth Circuit and other courts—including this one—has found to not be preempted.[11] *Dilts*, 769 F.3d at 646 (FAAAA does not preempt California's meal and rest break laws); *Californians for Safe &*

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[10] The Court of Appeals also noted that MacMillan failed to "distinguish the holding of the First Circuit cases that 'motor carriers are not exempt "from state taxes, state lawsuits of many kinds, and perhaps most other state regulation of any consequence."'" *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *5 (quoting *Schwann v. FedEx Ground Package Sys., Inc.*, 813 F.3d 429, 440 (1st Cir. 2016)).

[11] Contrary to MacMillan's assertion that *Hill v. Garda CL Northwest, Inc.*, 198 Wn. App. 326, 394 P.3d 390 (2017), *review granted in part*, 189 Wn.2d 1016 (2017), somehow rejects the "generally applicable background regulation" principle, Pet. 12 n.16, the *Hill* court favorably quotes *Dilts*, stating: "'[G]enerally applicable background regulations that are several steps removed from prices, routes, or services, such as prevailing wage laws or safety regulations, are not preempted, even if employers must factor those provisions into their decisions about the prices that they set, the routes they use, or the services that they provide.'" *Hill*, 198 Wn. App. at 344 (quoting *Dilts*, 769 F.3d at 646). Besides, the *Hill* facts are distinguishable, because the impact of vigilance-free meal and rest breaks on an armored transport company impacts the company's routes and services far more directly and significantly than having to pay unemployment taxes. Even so, any statements in *Hill* about FAAAA preemption of the vigilance-free break requirements are dicta, because the court's holding concerned the company's failure to seek a variance from those requirements. *Hill*, 198 Wn. App. at 348.

Competitive Dump Truck Transp. v. Mendonca, 152 F.3d 1184, 1189 (9th Cir. 1998) (FAAAA did not preempt California's prevailing wage act, despite motor carrier's assertion the act "increases its prices by 25%, causes it to utilize independent owner-operators, and compels it to re-direct and re-route equipment to compensate for lost revenue"); *Bostain v. Food Express, Inc.*, 159 Wn.2d 700, 721 n.9, 153 P.3d 846 (2007) (following reasoning of *Mendonca*, FAAAA does not preempt state overtime requirements for interstate truck drivers); *Filo Foods, LLC v. City of SeaTac*, 183 Wn.2d 770, 357 P.3d 1040 (2015) (SeaTac's $15-per-hour minimum wage law for employees in the hospitality and transportation industries not preempted by nearly identical preemption provision in the Airline Deregulation Act).

MacMillan cites no case holding that the FAAAA or the Airline Deregulation Act on which it is based preempts any tax. The Department is aware of none. To find the unemployment tax preempted would put a cloud over everything from fuel taxes, to business and occupation taxes, to property taxes, because each can be attacked like the unemployment tax.

There is sufficient, uniform judicial guidance concluding that the impact of a state law like Washington's Employment Security Act on motor carriers' prices, routes, and services is too remote and tenuous to invoke FAAAA preemption. Accordingly, this is not an issue of substantial public importance requiring this Court's determination. RAP 13.4(b)(4).

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

MacMillan argues that the Court of Appeals' "reliance on *Western Ports*" to hold that federally mandated controls may be considered when evaluating an employer's control over its workers under the independent contractor test, RCW 50.04.140(1)(a), merits review under RAP 13.4(b)(4). Pet.19. MacMillan is wrong. The Court of Appeals did not blindly rely on *Western Ports*. Rather, the Court reevaluated the question and once again concluded that federally mandated control counts. *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *3. The *Swanson Hay* court also conducted its own extensive analysis and agreed. *Swanson Hay Co.*, 1 Wn. App. 2d at 208-12.

This conclusion is based on the text of the Employment Security Act itself, which must be "liberally construe[d] . . . , viewing with caution any construction that would narrow coverage." *Penick v. Emp't Sec. Dep't*, 82 Wn. App. 30, 36, 917 P.2d 136 (1996); *W. Ports*, 110 Wn. App. at 451 ("[E]xemptions from taxation statutes are strictly construed in favor of applying the tax."). If individuals are in "employment" under RCW 50.04.100, the employer must pay unemployment taxes on their wages, "unless and until it is shown to the satisfaction of the commissioner" that:

> (a) Such individual has been and will continue to be free from control or direction over the performance of

such service, both under his or her contract of service and in fact; and

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

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

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

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

> It would make little sense for the Legislature to have specifically included service in interstate commerce as "employment" only to automatically exempt such service under RCW 50.04.140 based on federal regulations that require a high degree of control over commercial drivers operating motor vehicles in interstate commerce . . . .

Id. at 453-54. The court held alternatively that even if it did not consider the federal controls, it would still find Western Ports did not prove this element because it exerted controls beyond those required by law. *Id.* at 454.[12]

MacMillan asserts that federal regulations, specifically 49 C.F.R. § 376.12, are inconsistent with the Commissioner's and Court of Appeals' decisions. Pet. 18 and n.24. 49 C.F.R. § 376.12(c)(4) provides:

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

49 C.F.R. § 376.12(c)(4) (emphasis added). "[P]aragraph (1)(c) of this section" includes the required leasing provisions. But as the Court of Appeals recognized, the qualifying language in 49 C.F.R. § 376.12(c)(4) "is silent about the other federal leased requirements and safety regulations governing the relationship between motor carriers and owner-operators, which are included in MacMillan's contract."[13] *MacMillan-Piper, Inc.*,

[12] The Commissioner's decision is not an "abrupt turnaround," as MacMillan claims. Pet. 20 n.26 (discussing *Penick*, 82 Wn. App. at 30). The *Penick* court's holding was about company drivers, and the language in *Penick* about owner-operators was dicta. *Penick*, 82 Wn. App. at 41-44. Besides, the *Western Ports* court later decidedly held that an owner-operator was not exempt from coverage under RCW 50.04.140.

[13] Moreover, the Interstate Commerce Commission's guidance says nothing about barring consideration of the numerous federal regulatory requirements under the state law inquiry. Rather, the ICC has stated that it "take[s] no position on the issue of independence of lessors." 8 I.C.C.2d 669, 671 (1992). While the ICC has made clear that the control regulation should not be deemed "prima facie evidence of an employer-employee relationship," it also has sought to "reinforce [its] view of the neutral effect of the control

2017 WL 6594805 at *3. Nothing in the language of 49 C.F.R. § 376.12(c)(4) bars the Department from looking to federally-required contract provisions when assessing employer control.[14]

The Court thus found that "'control' in its plain meaning extends to the right to control, regardless of the source." *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *3. Like Division III in *Swanson Hay*, the Court "decline[d] to look beyond the plain language." *Id.*; *Swanson Hay Co.*, 1 Wn. App. 2d at 212 ("We see no room in the plain language of the 'freedom from control' requirement for excluding federally mandated control exercised by an employer, and we find nothing strained or unrealistic about including that control in the analysis."). This straightforward statutory analysis is sound and does not warrant review.

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

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regulation." *Id.* Thus the ICC is "explicitly agnostic on the issue of the carrier-driver relationship." *Remington v. J.B. Hunt Transport, Inc.*, 2016 WL 4975194 at *5 (D. Mass 2016). Besides, the ICC guidance does not supplant the plain language of the Employment Security Act, which offers no basis for ignoring required control. *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *3; *Swanson Hay Co.*, 1 Wn. App. 2d at 210-12.

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

Legislature may address whether the Department can consider federal controls when applying the independent contractor test.[15] But it is not an issue of substantial public interest for this Court.

Even if this Court granted review to reevaluate whether federal controls may be considered, any conclusion would be immaterial because multiple contract provisions require compliance with MacMillan's policies and procedures beyond those required by federal law.[16] Thus just as in *Western Ports*, MacMillan still would not have established freedom from control or direction because of these additional controls. Accordingly, review should be denied. RAP 13.4(b)(4).[17]

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

[16] These non-federally required examples of control include: the requirement for owner-operators to report daily for duty by 7:30 a.m. with adequate fuel and to notify MacMillan by 7:00 a.m. if they are unavailable that day and two weeks in advance of unavailability for two or more consecutive days (AR1 216 ¶¶ 4.12-4.15; AR4 1117; AR1 174 App. C ¶ 3); treating refusal to perform a dispatch as a material breach (AR1 216 ¶¶ 4.12-4.15; AR4 1117; AR1 174 App. C ¶ 3); requiring owner-operators to install specific communication equipment "at the sole discretion and for the sole benefit of MacMillan-Piper" (AR1 217 ¶ 4.21; AR4 1116; AR1 169 ¶ 27); requiring owner-operators to follow MacMillan's safety rules in addition to those of federal, state, and local authorities (AR4 1117; AR1 175 App. C ¶ 6); and more.

[17] MacMillan also argues that it established the second and third elements of RCW 50.04.140(1), but it does not tie its arguments to the RAP 13.4 criteria. Pet. 21-24. The Commissioner and courts below did not reach the second and third elements. AR4 1118; *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *4. Accordingly, if this Court accepts review and determines that MacMillan somehow met its burden of demonstrating owner-operators' freedom from control or direction over the performance of services, then the Court should remand for further proceedings on the remaining two elements. *See* RCW 34.05.570; RCW 34.05.574(1) (courts should not exercise discretion assigned to agency); RCW 34.05.534 (requiring exhaustion of administrative remedies).

3. MacMillan did not prove that the assessment is arbitrary or capricious or a violation of MacMillan's rights

There is no reason for this Court to grant review or relief based on MacMillan's audit conduct arguments. First, as to the claim that the Department issued a deliberately inflated assessment, the Commissioner and Court of Appeals found that MacMillan had failed to provide the Department any records on which a contrary assessment calculation could be made.[18] *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *5; Further, MacMillan cannot establish the audit process violated its procedural due process rights when it had a de novo hearing to try to prove the assessment was incorrect, where it "d[id] not establish it was prejudiced in its ability to prepare or present its challenge to the assessment," and where it in fact achieved a significant reduction in the assessment amount. *MacMillan-*

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[18] The Department calculated its assessment based on the total remuneration MacMillan reported on the IRS 1099 forms as "nonemployee compensation." AR4 1112-13; AR4 1041, FF 4.29-4.31. MacMillan had the responsibility during the audit to provide records showing which portions of payments to owner-operators were "wages," as required by RCW 50.12.070 and WAC 192-310-050, but never did; the Department did not act unlawfully in using the information it had. AR4 1112-13; AR2 680-81 ¶ 4.8; AR2 400, 404; AR2 592-93. And the Department's action was not taken for settlement leverage, as MacMillan contends. Pet. 24. The record reflects that the Department's original calculation of the assessment was based on the records—or lack thereof—provided during the audit showing the wage amounts for provision of personal services. *See* AR2 404; AR4 1113.

The claims that MacMillan labels as arbitrary or capricious action are really requests to reweigh evidence. As shown, the Commissioner found that the Department did not act with improper motive or otherwise act arbitrarily or capriciously, and the Commissioner's findings are supported by substantial evidence. It is not this Court's role to make new or contrary findings, as MacMillan's claims would require. *See* Pet. 24-25.

Piper, Inc., 2017 WL 6594805 at *6; *Motley-Motley, Inc. v. State*, 127 Wn. App. 62, 81, 110 P.3d 812 (2005).

And, as the Court of Appeals noted, a substantive due process claim requires deprivation of life or a protected liberty or property interest. *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *6; *Swanson Hay Co.*, 1 Wn. App. 2d at 223. MacMillan's petition does not show how "those same fundamental rights attach to an audit, or that a de novo hearing and two stages of judicial review did not ameliorate those concerns." *MacMillan-Piper, Inc.*, 2017 WL 6594805 at *6. In any event, contrary to MacMillan's bare claim that it was improperly "targeted" for an audit that did not follow the Department's standards, Pet. 24-25, the record shows that MacMillan was selected for audit at random among companies with more than 100 employees. AR2 579. Further, employers are not legally entitled to particular audit processes, and internal standards are not the law. *Swanson Hay Co.*, 1 Wn. App. 2d at 222; *Joyce v. Dep't of Corr.*, 155 Wn.2d 306, 323, 119 P.3d 825 (2005). MacMillan shows no reason for further review.

V. CONCLUSION

The Department respectfully asks the Court to deny review.

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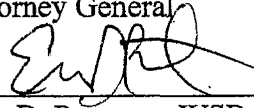
RESPECTFULLY SUBMITTED this 2nd day of March, 2018.

ROBERT W. FERGUSON
Attorney General



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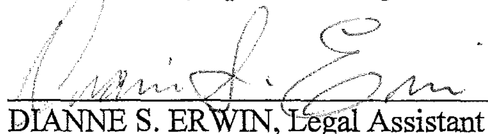

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