No. 91610-1

No. 45033-0-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

WASHINGTON STATE DEPARTMENT OF LABOR AND INDUSTRIES,

Plaintiff-Respondent,

v.

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

Defendant-Appellant.

ON APPEAL FROM PIERCE COUNTY SUPERIOR COURT
(Hon. Linda CJ Lee)

BRIEF OF APPELLANT

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I. INTRODUCTION

Washington's Industrial Insurance Act requires employers to pay IIA premiums for "workers," which include employees and independent contractors where the "essence" of the contract is "personal labor." RCW 51.08.180. The Act does not apply to valid contractual relationships between separate businesses — and, for this reason, to Lyons' knowledge, the Department of Labor and Industries (the "Department") had never applied the Act to legitimate franchisor-franchisee relationships. Indeed, in 2005, the Department audited Lyons Enterprises, Inc. d/b/a Jan-Pro Cleaning Systems ("Lyons"), and determined that Lyons' franchisees were not its "workers." That all changed in 2010. The Department again audited Lyons and—although neither the law nor the facts had changed—this time it classified nearly all of Lyons' franchisees as "workers."

The Department has taken the position that Lyons' situation is not unique. According to the Department, it intends to apply the Act to any franchisor-franchisee relationship where the franchise involves the sale of services rather than goods. The Department's new approach, if accepted, would have a devastating effect on Lyons' business, and on all service-related franchisors — who, from now on, and contrary to the way they have always done business, would be required to pay IIA premiums for their franchisees. Many franchisors would be unable to absorb this

significant expense; and if franchisors are forced out of business, then so too will many franchisees who depend on the franchise for their own business success. In short, this Court's decision will greatly affect the continued viability of the franchise-model in Washington state.

An IAJ initially rejected the Department's approach, but the Board of Industrial Insurance Appeals ultimately upheld it. That final order is contrary to law and must be reversed. The "essence" of Lyons' franchise agreements is not "personal labor" within the meaning of RCW 51.08.180. The essence is a valid and mutually beneficial franchise relationship between two truly independent businesses; the franchisees work for themselves, not for Lyons. Moreover, under *White v. Dep't of Labor & Indus.*, 48 Wn.2d 470, 294 P.2d 650 (1956), because the franchisees can and do employ others to do the work, their labor cannot be considered "personal." Finally, and in any event, under RCW 51.08.195, the franchisees are exempt from classification as "workers" because, among other things, Lyons has no "control or direction" over their work.

At the very least, if the Court affirms the Board's novel application of RCW 51.08.180 and .195 to franchisor-franchisee relationships, then it must estop the Department from immediately doing so in Lyons' case. Lyons relied on the Department's contrary interpretation in 2005 to build its company and enlist dozens of new franchisees. The Department's

change in position would force Lyons to incur devastating IIA liability that it did not expect when it negotiated the terms of its franchise agreements. For this reason too, the decision below must be reversed.

II. ASSIGNMENTS OF ERROR

1. The Board's findings of fact and conclusions of law, affirmed by the trial court, that Lyons' independent franchisees are covered "workers" under RCW 51.08.180 because the "essence" of the franchise agreement is "personal labor." CP 30-31 (BIIA Finding of Fact ("FOF") 2 & 6; Conclusions of Law ("COL") 4 & 5); CP 2394-2396.

2. The Board's findings of fact and conclusions of law, affirmed by the trial court, that Lyons' independent franchisees are covered "workers" under RCW 51.08.180 if, during the relevant audit period, the franchisees did not actually employ others to do all or part of the work. CP 30-31 (BIIA FOF 5 & 6; COL 4 & 5); CP 2394-2396.

3. The trial court's conclusion, reversing the Board, that Lyons' independent franchisees are covered "workers" under RCW 51.08.180 even if, during the relevant audit period, the franchisees did actually employ others to do all or part of the work. CP 2396.

4. The Board's findings of fact and conclusions of law, affirmed by the trial court, that Lyons' independent franchisees do not

qualify for the exception to "worker" status under RCW 51.08.195. CP 30-31 (BIIA FOF 6; COL 6); CP 2397-98.

5. The trial court's conclusion that the doctrine of equitable estoppel did not preclude the Department from classifying Lyons' existing franchisees as "workers," notwithstanding its prior and inconsistent finding to the contrary five years earlier. CP 2398-99.

III. STATEMENT OF ISSUES

1. Did the Board err in concluding that Lyons' franchisees were "workers" under RCW 51.08.180 when the undisputed facts show that the "essence" of the franchise agreements is not "personal labor," but rather the creation and reciprocal obligations of a franchise relationship?

2. Did the Board err in concluding that Lyons' franchisees were "workers" under RCW 51.08.180 when the undisputed facts showed that the franchisees could and did employ others to do the work, thereby satisfying the third prong of *White v. Dep't of Labor & Indus.*, 48 Wn.2d 470, 294 P.2d 650 (1956)?

3. In the alternative, did the trial court err in reversing the Board and concluding that *White*'s third prong did not apply even to those franchisees who actually employed others to do the work and, if so, is a remand to the Department necessary for further proceedings?

4. Did the Board err in concluding that Lyons' franchisees did not satisfy the elements of RCW 51.08.195's exception to "worker" status when the undisputed facts showed that the franchisees were (a) "free from control or direction" over the work, and (b) "engaged in an independently established trade, occupation, profession, or business"?

5. Did the trial court err in refusing to apply the doctrine of equitable estoppel to preclude the Department from applying its new interpretation of the law, reflected in the 2010 Audit, to those franchisees that Lyons contracted with in reliance on the Department's prior and inconsistent interpretation of the law, reflected in the 2005 audit?

6. Is Lyons entitled to an award of reasonable attorneys' fees under the Equal Access to Justice Act because it prevailed in this judicial review, and the Department's actions were not substantially justified?

IV. STATEMENT OF THE CASE

A. Factual Background

Jan-Pro Franchising International, Inc. ("Jan-Pro") sells regional franchises for the Jan-Pro System of cleaning commercial businesses. CP 23 (BIIA Final Order).[1] The Jan-Pro System includes the Jan-Pro brand,

[1] The Clerk's Papers include the entire Certified Administrative Record ("CAR") in this matter, including the transcript of the administrative hearing and exhibits. *See* CP 16-2281. To avoid confusion, Lyons cites to the Clerk's Papers rather than the CAR.

cleaning procedure and processes, manuals and training aids. CP 1902-03 (9/7/11 Tr. at 12-13). Lyons is Jan-Pro's regional franchise owner for several Puget Sound counties. *Id.*; CP 2177-78 (9/26/11 Tr. at 119-20). Lyons is not in the "cleaning" business; Lyons sells unit franchises and helps its franchisees start and manage a business with a goal of long-term profitability. CP 23, 24 (BIIA Final Order); CP 2168, 2171-72 (9/26/11 Tr. at 110, 113-114). As would be expected of any independent business, the franchisees have their own business licenses and insurance, and pay IIA premiums for their own employees. CP 1937, 1947, 1974 (9/7/11 Tr. at 47, 57, 84); CP 2144, 2165-66 (9/26/11 Tr. at 86, 107-108).

Lyons' franchise agreements have a 10-year term. CP 23 (BIIA Final Order); CP 1906 (9/7/11 Tr. at 16). The franchisees agree to pay various royalties and fees, including an initial fee to acquire the Jan-Pro System franchise. CP 23 (BIIA Final Order). Ownership of a franchise guarantees the franchisee a minimum level of income; the greater the initial fee, the more guaranteed income. *Id.* Beyond that, franchisees pay a royalty for the right to use the Jan-Pro cleaning system and brand. CP 23 (BIIA Final Order); CP 1914-15 (9/7/11 Tr. at 24-25). Franchisees also pay management fees for day-to-day support, including billing and collection services. *Id.* Finally, if the franchisee receives additional business because a customer needs special services or a new account is

added, the franchisee pays Lyons one-time administrative, marketing and negotiation fees. *Id.* Lyons, in turn, pays a portion of these royalties and fees to Jan-Pro each month. CP 24 (BIIA Final Order).

For its part, Lyons markets the Jan-Pro System, locates customers for the franchisees, and enters into cleaning contracts with the customers. CP 23-24 (BIIA Final Order). Once it contracts with a customer, Lyons assigns the contract to the franchisee who, in turn, performs the cleaning services through their business. *Id.* Lyons informs the customer that the franchisee will be solely responsible for the services—a fact expressed in the customer contract itself. CP 2167 (9/26/11 Tr. at 109); CP 1651 (Ex. 24: "This … agreement is obtained by Jan-Pro for the business benefit of a Jan-Pro franchisee"). The franchisee must approve the rate negotiated by Lyons before it accepts the account, and may turn down any contract not to its liking. CP 1926 (9/7/11 Tr. at 36); CP 23 (BIIA Final Order). When that happens, Lyons assigns the contract to another franchisee, and locates a replacement account for the first franchisee to ensure it has sufficient accounts to earn the income guaranteed by the franchise agreement. *Id.*

In return for the management fees, Lyons invoices and collects payment from the franchisees' accounts. *Id.*; CP 1916-17 (9/7/11 Tr. at 26-27); CP 2159-63 (9/26/11 Tr. at 100-103). Indeed, Lyons' obligation to perform these services is an important inducement to some franchisees

because they may lack experience in performing certain administrative functions. CP 1916 (9/7/11 Tr. at 26); CP 2159-60, 2168-69 (9/26/11 Tr. at 101-102, 110-111).[2] After the customer pays, Lyons deducts the various royalties and fees, and remits the balance to the franchisee at month's end, which is typically around 85% of the total amount collected from the customer. CP 23 (BIIA Final Order); CP 1931-32 (9/7/11 Tr. at 41-42). If a customer fails to pay, however, the franchisee does not get paid; and, if Lyons paid the franchisee for a defaulted account, the franchisee is obligated to repay Lyons. CP 1910-11 (9/7/11 Tr. at 20-21); CP 2192 (9/26/11 Tr. at 134); CP 326 (Ex. 1, § 7.4).

To ensure they uphold Jan-Pro's standards and brand, franchisees undergo a training program before they begin servicing their accounts. CP 23-24 (BIIA Final Order); CP 1917 (9/7/11 Tr. at 27). The training consists of several sessions over five weeks, for a total of 30 hours. CP 23 (BIIA Final Order); CP 2152-53, 2193 (9/26/11 Tr. at 94-95, 135). Lyons trains the franchisees on the Jan-Pro System and safety, but also on how to run a business and deal with customers. CP 2152-53 (9/26/11 Tr. at 94-95); CP 1940 (9/7/11 Tr. at 50). Franchisees are also provided manuals on the Jan-Pro System and safety. CP 2204-05 (9/26/11 Tr. at 146-47). If a

[2] Beginning in 2010, Lyons gave the franchisees the option to do their own invoicing and collections—but not a single franchisee elected to utilize this option. CP 2158-59, 2190 (9/26/11 Tr. at 100-101, 132).

franchisee hires employees or assistants, the franchisee—not Lyons—is responsible for training its workers. CP 24 (BIIA Final Order); CP 2153-54 (9/26/11 Tr. at 95-96). Primarily for safety reasons, franchisees are required to use certain types of equipment and cleaning supplies, which they may buy from Lyons or on the open market, whichever is cheaper. CP 23-25 (BIIA Final Order); CP 1936-37 (9/7/11 Tr. at 46-47).

Franchisees make all decisions regarding the day-to-day operation of their businesses, including the hiring of employees, the days and hours they work and how the work is actually performed. CP 24 (BIIA Final Order); CP 1909 (9/7/11 Tr. at 19). Other than after-the-fact inspections, discussed below, Lyons has no oversight of the franchisees' work. CP 25 (BIIA Final Order). As it relates to employees, Lyons' franchisees are free to hire and fire employees as needed. CP 24 (BIIA Final Order); CP 328 (Ex. 1, § 8.2). Lyons has no say over who or how many employees its franchisees hire and, as explained above, no role in training them once they are hired. *Id.*; CP 2148, 2200-01 (9/26/11 Tr. at 90, 141-42). Of course, the franchisees—not Lyons—pay employee salaries. CP 1920 (9/7/11 Tr. at 20). According to Lyons, approximately 80 percent of its franchisees have employees or use assistants to do the work. CP 24 (BIIA Final Order); CP 2147 (9/26/11 Tr. at 89). A franchisees may also sell or transfer its franchise with Lyons' consent. CP 24 (BIIA Final Order).

Lyons conducts audits at the customers' place of business during ordinary business hours—once a month or once a quarter, depending on the size of the account—to ensure the franchisee is complying with the Jan-Pro System. CP 23-24 (BIIA Final Order); CP 2173-74 (9/26/11 Tr. at 115-116). If there are problems, Lyons provides the franchisee with feedback to address the issue. CP 23 (BIIA Final Order). This quality control allows Lyons to protect the integrity and value of the Jan-Pro brand. CP 1909-10, 1917 (9/7/11 Tr. at 19-20, 27). Similarly, to prevent franchisees from exploiting their knowledge of the Jan-Pro System and trade secrets without paying royalties, franchisees agree not to compete against Jan-Pro during the term of the franchise agreement or 12 months thereafter. CP 1020 (9/7/11 Tr. at 30); CP 2201-02 (9/26/11 Tr. at 143-44). Finally, Lyons is not able to terminate a franchise agreement "at-will"; it can only terminate a franchise agreement for specified cause, such as insolvency, bankruptcy, violations of law, failure to comply with the terms of the franchise agreement, etc. *See* CP 339-42 (Ex. 1, § 16).

B. Relevant Franchise Law

Lyons is a franchisor in good standing with the Department of Financial Institutions. CP 2168-70 (9/26/11 Tr. at 110-12); CP 1652 (Ex. 25). The franchise agreements between Lyons and its franchisees contain various provisions required by Washington's Franchise Investment

Protection Act ("FIPA"), RCW 19.100 *et seq.*, and are entirely consistent with most traditional franchise agreements. CP 2106-07 (9/26/11 Tr. at 48-49). At bottom, franchising is a strategy by which the owner of intellectual property rights related to goods or services (the franchisor) can expand its business by selling the right to make or sell those goods or services to independent owners (the franchisee). CP 2090-91 (9/26/11 Tr. at 32-33). Franchises are regulated by both federal and state laws, and FIPA is one of the most comprehensive franchise laws in the country. CP 291-93 (9/26/11 Tr. at 33-35). Because it is stricter than federal law, FIPA governs all aspects of franchising in Washington. *Id.*[3]

Under FIPA, a franchise is created by an agreement in which (i) a franchisee is granted a right to engage in the business of offering, selling or distributing goods or services under a "marketing plan," (ii) the business is substantially associated with a trademark, service mark, trade name, advertising or other commercial symbol owned by the franchisor, and (iii) the franchisee pays a franchise fee. RCW 19.100.010(4)(a). The requisite "marketing plan" is defined as a "plan or system concerning an aspect of conducting business," like "[t]raining regarding the promotion,

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[3] Lyons presented expert testimony regarding franchise law and franchise agreements. The Department moved to exclude the testimony. CP 220-223. The IAJ denied the motion. CP 1899-1900 (9/7/11 Tr. at 9-10). The Department did not appeal that ruling to the Board.

operation, or management of the business" or "[o]perational, managerial, technical, or financial guidelines or assistance." RCW 19.100.010(5)(e) & (f). Put simply, to be a valid franchise, the franchisor must have some control over the franchisee's business. Berry et al., *State Regulation of Franchising: The Washington Experience Revisited*, 32 Seattle U.L.Rev. 811, 838 (2009) ("the key to the existence of a 'marketing plan' is whether overall, there is a certain 'level of control' of the franchisee's operation by the franchisor") (internal quotation and brackets omitted).

The marketing plan does not have to be detailed, but many are. CP 2093-95 (9/26/11 Tr. at 35-37). "Franchisors frequently prescribe in minute detail the manner in which their franchisees shall do business." Chisum, *State Regulation of Franchising; The Washington Experience*, 48 Wash. L. Rev. 291, 376 (1973) (hereafter, "Chisum"). "The reason … for doing so is to ensure 'a substantial uniformity in the quality, type, and standards of products, services and manner of operations' in all the franchisor's outlets. This uniformity is considered essential to the goodwill of the entire franchise and to some extent is required to preserve the validity of the franchisor's trademark." *Id.* (citation omitted). *See, e.g., Mini Maid Servs. Co. v. Maid Brigade Sys., Inc.*, 967 F.2d 1516, 1519 (11th Cir. 1992) (a franchisor is required to maintain some control over a

franchisee's use of its mark, or else the franchisor will be deemed to have abandoned the mark under Lanham Act's abandonment provisions).

From the franchisee's perspective, a franchise allows a business owner to be "in business for himself but not by himself." CP 2095-96 (9/26/11 Tr. at 37-38). "The franchisee ... gains access to an established brand name, tested marketing techniques, advertising and training aids." Chisum at 296. The franchisee gets the benefit of offering goods and services already associated with quality through a recognized brand, as well as training and business support from the franchisor. CP 2095-96 (9/26/11 Tr. at 37-38). In this way, a franchisee can successfully start a business with no experience, and can rely on the franchisor to learn how to operate the business. CP 2101-2104, 2111-12 (9/26/11 Tr. at 43-46, 53-54). "The franchise system method of operation has the advantage ... of enabling numerous groups of individuals with small capital to become entrepreneurs. ... [It] creates a class of independent businessmen; it provides the public with an opportunity to get a uniform product at numerous points of sale from small independent contractors, rather than from employees of a vast chain." Chisum at 296 (citation omitted).[4]

[4] The benefits of the franchise model are reflected by its increasing pervasiveness in the American economy. Lyons' expert testified that, as of 2007, franchising in the State of Washington directly supported 164,000 jobs and indirectly support 232,000 jobs. CP 2101 (9/26/11 Tr. at 43).

C. Procedural Background

Lyons was previously audited by the Department in 2005. CP 2137 (9/26/11 Tr. at 79). The Department expressly found that Lyons' franchisees were not "workers" under RCW 51.08.180 and .195 and, thus, Lyons was not responsible for paying IIA premiums for the franchisees or their workers. CP 2137-38 (9/26/11 Tr. at 79-80); CP 873-79 (Ex. 17). Over the next several years, Lyons relied on the audit, and the fact that it would not owe IIA premiums for its franchisees, as it expanded its business and entered into dozens of additional franchise agreements. 9/26/11 Tr. at 80-81; CP 881-1607 (Ex. 18 (franchise agreements)).

The Audit. In 2010, the Department informed Lyons that it intended to audit Lyons for the period between the second quarter of 2007 and the first quarter of 2010. CP 171; CP 209. On July 26, 2010, the Department issued its audit findings (the "Audit"). CP 191-202. The Audit concluded that 18 identified franchisees and subcontractors were not Lyons' "workers" because they reported having hired their own employees. CP 191-92. Other than those 18, however, the auditor concluded that all of Lyons' franchisees were "workers" because the "essence" of the franchise agreements was "personal labor" under RCW 51.08.180, and they failed to satisfy the exception test set forth in RCW

51.08.195. CP 192-195.[5] The Department stated that it would not assess Lyons for past due premiums and, instead, instructed Lyons to begin reporting all "covered workers" beginning September 1, 2010. CP 196.

The Department's Letter Ruling. Lyons protested the Audit. CP 171; CP 209. By letter dated December 27, 2010 (the "Letter Ruling"), the Department's litigation specialist affirmed the Audit's findings and, going even further, determined that all of Lyons' franchisees (including those originally exempted in the Audit) *and their employees* were Lyons' "workers." CP 146-48. (As discussed below, the Board rejected this position, but the trial court would later restore it.).[6] The Letter Ruling stated that the "department is not making a determination that the franchisees are employees," but, like the Audit, concluded that the franchisees were covered "workers" under RCW 51.08.180 and .195. *Id.*

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[5] The Department's auditor, Ms. Hill, admitted that she did not talk to any of the franchisees; did not ask them for any of their records; and did not ask Lyons to describe the level of training it provided. CP 2229-2230, 2232-35 (10/10/11 Tr. at 23-24, 26-29). Rather, her findings were based on her review of Lyons' website, a franchise disclosure document, and 49 responses to a questionnaire she had mailed to over 100 different franchisees and subcontractors. *Id.*; CP 192 (Audit).

[6] In explaining why the Department abandoned the position it took in 2005 that Lyons' franchisees were not "workers," the Department's litigation specialist, Mr. Billings, disavowed the notion of a Department-wide policy change – testifying implausibly that the prior auditor simply had "made a mistake." CP 2255-56 (10/10/11 Tr. at 49-50). Like Ms. Hill, Mr. Billings reached his conclusion without speaking with any of Lyons' franchisees. CP 2259 (10/10/11 Tr. at 53).

The Letter Ruling did not explain why, contrary to the Audit, franchisees who had their own employees would be also be considered workers. *Id.*

IAJ Initial Decision. Lyons appealed the Department's Letter Ruling and underlying Audit to the Board of Industrial Insurance Appeals (the "Board" or "BIIA"). CP 149-56. The Board assigned the matter to an Industrial Appeals Judge ("IAJ"). CP 158. The parties presented testimony and exhibits over three days of hearing (Sept. 7, Sept. 26, and Oct. 10, 2011).[7] On December 20, 2011, the IAJ ruled in favor of Lyons, issuing a detailed Proposed Decision and Order (the "Initial Decision") reversing the Audit and Letter Ruling. CP 111-28. The IAJ concluded that Lyons had satisfied the six-part exception to "worker" status set forth in RCW 51.08.195 and, in particular, that Lyons did not exercise "control or direction" over the franchisees. *Id.* In particular, the IAJ found that the "relationship between Lyons and its unit franchise owners substantially differs from [that] of an employer and its employees." CP 126.

BIIA Final Order. The Department petitioned the Board to review the Initial Decision, which it did. CP 58. On April 9, 2011, the

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[7] The hearing was originally scheduled to commence on September 7th and 8th. CP 175. After the first day of the hearing, at which seven unit franchisees testified, the IAJ ruled that Lyons would be precluded from calling additional franchisee to testify because their testimony would be cumulative and unduly repetitious. CP 241-42; CP 2053-56 (9/7/11 Tr. at 163-166). The September 8 hearing date was cancelled. *Id.*

Board rejected the Initial Decision and effectively reinstated the original Audit findings (the "Final Order"). CP 22-31. Relying on *White v. Dep't of Labor & Indus.*, 48 Wn.2d 470, 294 P.2d 650 (1956), the Board concluded that all of Lyons' franchisees were covered "workers" within the meaning of RCW 51.08.180, with the exception of those franchisees identified in the Audit who had employees of their own. CP 26. It further concluded that none of Lyons' franchisees could satisfy two aspects of RCW 51.08.195's six-part exception to "worker" status. CP 26-29. The Board did not address Lyons' alternative argument (*see* CP 55-56) that, apart from the merits, the Department should be equitably estopped from changing its prior position that Lyons' franchisees were not "workers."

Trial Court Review. Both parties sought judicial review of the Final Order. Lyons filed a notice of appeal in Thurston County Superior Court to challenge the Board's conclusion that Lyons' franchisees were "workers" under RCW 51.08.180 and .195. Meanwhile, the Department filed a notice of appeal in Pierce County Superior Court to challenge the Board's carve-out for the franchisees who employed others. CP 2-15. Lyons' appeal was transferred and consolidated with the Department's appeal. CP 2284-86, 2289-90. Thereafter, the parties briefed the issues without additional evidence or testimony, CP 2292-2388, and presented oral argument on February 27, 2013. CP 2390. At the hearing, the

Department unequivocally stated its position that the franchisees of any service-related franchise should be considered covered "workers" for which the franchisor must pay IIA premiums. 2/7/13 Hr. at 48-49.

The trial court accepted the Department's position, affirming the Board in part and reversing in part. CP 2391-99. The court affirmed the portion of the Final Order that concluded that Lyons' franchisees were "workers" under RCW 51.08.180, and that they did not satisfy the exception set forth in RCW 51.08.195. CP 2394-96, 2397-98. The court reversed the portion of the Final Order, however, that relied on *White* to exempt those franchisees who employed others do the work. According to the trial court, all of Lyons' franchisees were Lyons' workers. CP 2396. The court also rejected Lyons' argument that the Department should be equitably estopped from treating Lyons' existing franchisees as "workers." CP 2398-99. Lyons filed this timely appeal. CP 2400-24.

V. ARGUMENT

A. Standards of Review.

The Administrative Procedures Act ("APA") governs judicial review of the Board's decision in an assessment case. RCW 51.48.131. Under the APA, Lyons has the burden to show that the Board's Final Order was incorrect. RCW 34.05.570(1)(a). When reviewing the Board's decision, this Court sits in the same position as the trial court, and its

review is limited to the certified agency record. *Xenith Group, Inc. v. Dep't of Labor & Indus.*, 167 Wn. App. 389, 393, 269 P.3d 414 (2012). The APA requires reversal when the agency erroneously interprets or applies the law; the order is not supported by substantial evidence; and/or the order is arbitrary or capricious. RCW 34.05.570(3)(d), (e), (i).

This Court gives an agency's interpretation or application of a statute *de novo* review. *Xenith Group*, 167 Wn. App. at 393-94. When reviewing questions of law, this Court may substitute its determination for that of the agency. *Id.* (*citing Postema v. Pollution Control Hearings Bd.*, 142 Wn.2d 68, 77, 11 P.3d 726 (2000)). This Court reviews the agency's findings of fact under a clearly erroneous standard. *Id.* at 393. However, a "finding of fact" that is actually a mis-labeled conclusion of law is subject to *de novo* review. *Dep't of Labor & Indus. v. Mitchell Bros. Truck Line*, 113 Wn. App. 700, 704-05, 54 P.3d 711 (2002).

Finally, a party asserting equitable estoppel must prove each element with clear, cogent and convincing evidence. *Kramarevcky v. Dep't of Soc. & Health Servs.*, 122 Wn.2d 738, 744, 863 P.2d 535 (1993). A determination that the elements of equitable estoppel have not been met presents a mixed question of fact and law. *Kramarevcky v. Dep't of Soc. & Health Servs.*, 64 Wn. App. 14, 18, 822 P.2d 1227 (1992) (citing *Coble v. Hollister*, 57 Wn. App. 304, 788 P.2d 3 (1990)). Thus, where the facts

are undisputed, as here, refusal to apply the doctrine of equitable estoppel is a question of law this Court reviews *de novo*. *Id.*

B. The Board And Trial Court Erroneously Concluded That Lyons' Franchisees Are "Workers" Under RCW 51.08.180.

Under the Industrial Insurance Act, an employer must report and pay premiums for all its "workers." RCW 51.16.035 *et seq.* The term "workers" is defined broadly to encompass not only traditional employees, but also—in certain limited circumstances—independent contractors. As it relates to independent contractors, the Act defines "workers" as follows:

> "Worker" means … 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 under this title ….

RCW 51.08.180 (emphasis added). The threshold and dispositive issue on appeal, therefore, is whether the "essence" of Lyons' franchise agreements was "personal labor." That is mixed question of fact and law. *Silliman v. Argus Servs., Inc.*, 105 Wn. App. 232, 236, 19 P.3d 428 (2001). "What services [the contractor] provided is a question of fact; whether these services constitute 'personal labor' … is a question of law." *Id.*

The facts are not disputed. Thus, whether Lyons' franchisees are covered "workers" under RCW 51.08.180—as the Board both found and concluded, *see* CP 30-31—is a question of law. *Id.*; *Mitchell Bros.*, 113 Wn. App. at 704 ("finding of fact" that operators were not "workers" was

"actually a conclusion of law"). This Court must reverse, and conclude that Lyons' franchisees are not "workers" because (1) the "essence" of the franchise agreements is a franchise relationship between two independent businesses, not "personal labor," and, in any event, (2) under the third prong of the *White* test, the franchisees are *per se* exempt from "worker" status because the franchisees can and do hire others to do the work. At the very minimum, this Court must reverse the trial court's erroneous conclusion that *White* does not apply to those franchisees who had in fact hired employees to do the work, and remand for further proceedings.

1. The "Essence" Of The Franchise Agreements Is The Creation Of A Traditional Franchise Relationship.

RCW 51.08.180 does not apply to every independent contract that involves labor; "personal labor" must be its "essence." Thus, the issue is: "Was the labor which [the contractor] was to perform personally the gist or substance, the vital *sine qua non*, the very heart and soul of his contract …?" *Haller v. Dep't of Labor & Indus.*, 13 Wn.2d 164, 168, 124 P.2d 559 (1942) (emphasis in original). In answering that question, "the court should look to the contract itself, the work, the parties' situation, and other concomitant circumstances." *Silliman*, 105 Wn. App. at 236-37; *Mass. Mut. Life Ins. Co. v. Dep't of Labor & Indus.*, 51 Wn. App. 159, 752 P.2d 381 (1988). The "realities of the situation" are what matters. *Peter M.*

Black Real Estate Co., Inc. v. Dep't of Labor & Indus., 70 Wn. App. 482, 488, 854 P.2d 46 (1993) (citation omitted). Here, the "realities of the situation"—as revealed by the Board's findings, the undisputed facts and the requirements of franchise law—are that the "very heart and soul" of Lyons' franchise agreements is the creation of, and reciprocal obligations inherent to, a valid franchise relationship, not "personal labor."

The Board properly found that Lyons is not in the "cleaning" business; it is the business of selling franchises. CP 24. By definition, all franchises involve a sale to the franchisee of a "right to engage in the business of offering ... goods or services." RCW 19.100.010(4). Here, the "goods or services" include a cleaning system that obviously involves "labor"; after all, how else can the franchisee deliver the "goods or services" to the customer? In the Department's view, that is both the beginning and end of the analysis: if the franchise involves a "service," as opposed to a "good," then its "essence" is always "personal labor," and the franchisees will always be the franchisor's "worker." *See* 2/7/13 Hr. at 49.[8] The Board agreed without any analysis, other than to glibly note that

[8] Judge Lee: "So is it the Department's position that all franchises that are franchises for personal service [are] covered under this Act?" AAG Germiat: "Yes." Judge Lee: "Regardless of how it's structured, if it's a franchise for personal services, it would be covered? Franchisees would be considered workers?" AAG Germiat: "Yes. The fact that it's a franchise does not change the analysis." 2/7/13 Hr. at 49:2-10.

franchisees are not *per se* excluded from RCW 51.08.180. CP 25. That conclusion ignores the true essence of the franchise agreement and, worse yet, threatens to have widespread and potentially devastating implications on thousands of service-related franchisors throughout the state.

The franchise agreements reflect a bilateral contract between two independent businesses; the franchisees are not employees masquerading as independent contractors. *See White*, 48 Wn.2d at 474. The franchisees are registered and licensed businesses; they purchase their own insurance; they pay their own taxes; they hire, train and pay their own workers; they provide their own equipment and supplies; they deal directly with the customer and work free of supervision. They are not paid if the customer fails to pay. *Cf. Lloyd's of Yakima Floor Ctr. v. Dep't of Labor & Indus.*, 33 Wn. App. 745, 753, 662 P.2d 391 (1982) (essence of contract was personal labor because, in part, employer "assumed the risk of loss"). They cannot be fired at-will. *Cf. Clausen v. Dep't of Labor & Indus.*, 15 Wn.2d 62, 73, 129 P.2d 777 (1942) ("the power of the employer to terminate the employment at any time is incompatible with the free control of the work usually enjoyed by an independent contractor"). In short, the franchise agreement bears no resemblance to an employment contract.

On the contrary, the franchise agreements contain a set of mutual obligations typical of (and less "controlling" than) most franchises, CP

2107-12 (9/26/11 Tr. at 49-54) – few of which relate to the franchisees' "labor." As FIPA requires, Lyons provides franchisees with intellectual property rights, initial training, manuals and business support necessary to start and operate a Jan-Pro franchise. *See* CP 317-365 (Ex. 1); RCW 19.100.010(4)(a)(i) & (ii) (franchisor must provide franchisee right to sell proprietary goods or services under a prescribed marketing plan). In return, as FIPA requires, franchisees pay Lyons royalties and fees for the right to use the Jan-Pro brand and system, and for the business support they receive from Lyons. *Id.*; RCW 19.100.010(4)(a)(iii) (franchisee must pay a franchise fee). Indeed, where the "essence" of an independent contract is truly "personal labor," the employer simply pays the worker. Here, Lyons pays the franchisees nothing; on the contrary, the franchisees pay Lyons because they are buying an independent franchise business and the means by which to run it successfully.

By the same token, the few aspects of "control" Lyons exerts on its franchisees' businesses are found in all franchises. Chisum at 295 ("such control is essential to the validity of the franchisor's trademark since trademarks function in part to guarantee the consistent quality of the product identified by the mark"). For example, a franchisor's "marketing plan" can include "[t]raining regarding the ... operation, or management of the business." RCW 19.100.010(5)(e). Not surprisingly, training is a

key aspect of Lyons' marketing plan because the franchisees usually have little experience, and must learn both proper cleaning techniques and good business practice to best promote Jan-Pro's brand. CP 1912 (9/7/11 Tr. at 22). This is common to most service franchises. CP 2112 (9/26/11 Tr. at 54). In any event, only a small part of Lyons' training can be said to relate to the franchisees' "personal labor." Of the five training sessions that franchisees must attend, only two deal with actual cleaning methods; the rest relate to safety, business management and franchise growth. CP 327 (Ex. 1, § 8.1); CP 2152-53 (9/26/11 Tr. at 94-95).

Likewise, Lyons' periodic audits of the franchisees' accounts do not relate to the franchisees' "personal labor" so much as it relates to ensuring the quality and uniformity of the Jan-Pro brand – another core aspect of franchising. CP 2094-95 (9/26/11 Tr. at 36-37); Chisum at 376 ("uniformity is considered essential to the goodwill of the entire franchise and to some extent is required to preserve the validity of the franchisor's trademark"). That is, if the value of Jan-Pro's brand is diminished, Lyons would find it difficult to find new franchisees for its own business and new accounts for its franchisees' businesses. Regardless, as with training, this kind of once–a-month or once-a-quarter QC is far different from what one would expect if the "essence" of the agreement were truly "personal labor." Lyons does not supervise the franchisees' work; indeed, no one

from Lyons is ever on-site when the franchisees are on the job. CP 24-25 (BIIA Final Order); CP 1909-10 (9/7/11 Tr. at 19-20).

There is a good reason why there are no Washington cases or BIIA decisions finding franchisees to be "workers." It is the same reason why, in 2005, the Department did not find Lyons' franchisees to be "workers." It is because the "essence"—the "very heart and soul"—of a franchise agreement is a reciprocal and multi-faceted contractual relationship between independent businesses, not merely a contract for the franchisees' "labor." At bottom, the franchisees work for themselves, not the franchisor. Yet, the Department's new approach, sanctioned here by the Board, creates the absurd result that franchisees who offer "services" are always "workers," whereas franchisees who offer "goods" are not—even if the franchisor exerts far more "control" over the franchisee's "labor" in the latter case.[9] It simply should not matter whether a customer walks away with a hamburger, a completed tax return, a starched shirt or a clean facility; the essence of a franchise agreement is precisely the same.

Finally, the Board's Final Order, if affirmed, will undermine a critical economic assumption upon which all franchises are built and will

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[9] *See* CP 2093-94, 2108-09 (9/26/11 Tr. at 35-36, 50-51) (Lyons' franchising expert explaining that *McDonald's* regulates virtually all aspects of a franchisee's business); *and* CP 2271 (10/10/11 Tr. at 65) (Department's litigation specialist explaining Department's position that essence of *McDonald's* franchise is the sale of hamburgers, not labor).

have a widespread impact on the viability of the franchise model in Washington. If legitimate franchisees are now treated as *de facto* employees, and franchisors required to pay IIA premiums for dozens or, as in Lyons' case, hundreds of franchisees, many franchisors will have no choice but to exit the franchise business. No doubt, many franchisees likewise will be unable to carry on their business without the benefits of the franchise. Whether that represents sound public or economic policy can be debated, but it must be debated by the legislature or, at a minimum, through rulemaking – not on an audit-by-audit basis. The Board's determination that the "essence" of Lyons' franchise agreements was "personal labor" is erroneous as a matter of law and must be reversed.

2. The Franchisees Are Not Covered "Workers" Under *White v. Dep't of Labor & Industries* Because The Franchisees Can And Do Hire Others To Do The Work.

Even if it could be said in the abstract that the "essence" of the franchise agreements was "personal labor," Lyons' franchisees would still be exempt from being classified as "workers" under well-established case law. In *White v. Dep't of Labor & Indus.*, 48 Wn.2d 470, 294 P.2d 650 (1956), the Washington Supreme Court identified three specific situations where the "essence" of an independent contract cannot be considered "personal labor" as a matter of law. RCW 51.08.180 "was not intended to cover an independent contractor (a) who must of necessity own or supply

machinery or equipment ... to perform the contract, ... or (b) who obviously could not perform the contract without assistance, ... or (c) who of necessity or choice employs others to do all or part of the work he has contracted to perform ...." *Id.* at 474. The third prong is dispositive here.

The Board concluded that the third prong "requires the actual employment of other(s), not the mere freedom to do so." CP 26 (BIIA Final Order). That was error. The law is clear that where the parties contemplate, contractually or otherwise, that the independent contractor can hire employees to do the work, whether the contractor does so or not, the third prong of *White* is satisfied. The Supreme Court's decisions in *Crall* and *Cook*, upon which the *White* court relied to articulate its three-prong test, are unequivocal that the distinguishing factor is not whether the work was done by employees of the independent contractor, but whether it could have been. *Cook v. Dep't of Labor & Indus.*, 46 Wn.2d 475, 477, 282 P.2d 265 (1955) ("Labor that may be done by others under the contract is not *personal*, as the word is used in the statute." (emphasis in original)); *Crall v. Dep't of Labor & Indus.*, 45 Wn.2d 497, 499, 275 P.2d 903 (1954) (same); *Haller*, 13 Wn.2d at 168 ("an independent contractor must be one whose *own personal labor*, that is to say, the work which *he* is to do *personally*, the *essence* of the *contract*" (emphasis in original)).

In short, "[p]ersonal labor means labor personal to the independent contractor." *Silliman*, 105 Wn. App. at 238.

This principle is well-established. In *Massachusetts Mutual*, the insurance company had independent contracts with "general agents" who, in turn, had contracts with "sales agents." 51 Wn. App. at 161-62. It was undisputed that the "[g]eneral agents may and do delegate their duties to others," and, similarly, that the "sales agents may delegate their duties." *Id.* Nevertheless, the Board found that all the agents were "workers" under RCW 51.08.180. The Court of Appeals disagreed and reversed. In examining the origin of *White*'s third prong, the court reasoned:

> [T]he *White* court cited *Crall* as standing for the proposition that the Act does not cover an independent contractor when the contracting parties ***contemplate*** that the labor will be done by others, in whole or in part.

Id. at 164-65 (emphasis added). Because it was clear "the contracting parties contemplated the delegation of duties," the court concluded that "none of the insurance agents … are 'workers' for purposes of the Act." *Id.* at 165. Notably, the court did not scrutinize whether every particular agent had, in fact, delegated his or her duties to others. *Also Silliman*, 105

Wn. App. at 237-38 (security company not a "worker" because it "had discretion to hire whomever it chose to perform the contract").[10]

The Board has recognized this too. In *In re Shanley & Wife*, BIIA No. 870,485 (1988), the Board considered whether an insurance agency's independent sales agents were "workers" under RCW 51.08.180. The Department found that the essence of the agents' independent contracts was personal labor, but the Board reversed. The Board noted, "***[i]n some cases*** the individual insurance agents employ office staff for the purpose of soliciting clients and customers by telephone and other means." *Id.* at *4, 8 (emphasis added). Applying *White*'s third prong, and following the decision in *Massachusetts Mutual*, *supra*, the Board reasoned:

> The full extent to which an agent's office staff assists in the selling of insurance was not fully developed in the record. ... Suffice it to say that it appears that individual agents can and do employ others to employ at least part of the contract to sell insurance. [¶] Thus, in light of the third criterion of *White* as well as the rationale of that decision, it is apparent that the sales agents here, ... are not workers

[10] Conversely, but to the same effect, courts have found *White*'s third prong inapplicable where it was undisputed that the independent contractors ***could not*** hire others to do the work. *Dana's Housekeeping, Inc. v. Dep't of Labor & Indus.*, 76 Wn. App. 600, 608, 886 P.2d 1147 (1995) ("housecleaners ... forbidden to employ others"); *Peter M. Black*, 70 Wn. App. at 489-90 ("agents are prohibited by statute ... from hiring anyone to perform their contractual responsibilities"); *Jamison v. Dep't of Labor & Indus.*, 65 Wn. App. 125, 132, 827 P.2d 1085 (1992) ("Contractors shall not ... subcontract all or any part of the work without consent"); *Kerr v. Olson*, 59 Wn. App. 470, 476-77, 798 P.2d 819 (1990) (doctors do not "have the power to delegate their work to other doctors").

> within the meaning of RCW 51.08.180. The Department's assessment of premiums for these agents must be reversed.

Id. at *6-7. Notably, the Board found *White*'s third prong satisfied even though the insurance agents had employed others to sell the insurance only in "some cases." This is so because the fact that the contracts gave each agent discretion to employ others was sufficient, in and of itself, to show that labor was not "personal" to any specific independent contractor.[11]

The Board's decision in *In re Rainbow Int'l*, BIIA No. 882,664 (1990), confirms this interpretation. In *Rainbow*, the issue was whether "route managers" Rainbow hired to clean carpets were covered "workers" under RCW 51.08.180. The IAJ determined that the route managers were independent contractors and that the "essence" of their contracts was "personal labor." *Id.* at *2. The Board felt compelled to disagree based solely on the undisputed fact that "[s]everal of the route managers would employ 'helpers' to assist in the work." *Id.* at *7.[12] It concluded:

> [B]ecause the route managers frequently hired helpers we cannot conclude that they were independent contractors, the essence of whose contract was their personal labor. *See,*

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[11] While not binding, significant decisions published by the Board are persuasive authority. *O'Keefe v. Dep't of Labor & Indus.*, 126 Wn. App. 760, 766, 109 P.3d 484 (2005). The Board's significant decisions can be accessed at http://www.biia.wa.gov/search-page.htm.

[12] In *Rainbow*, only "[a]bout 50% of the managers had one helper ...." *Id.* at *11. There was far more delegation here. "Approximately 80 percent of the franchisees have employees or assistants, helping them service ... the cleaning contracts." CP 24 (BIIA Final Order).

> *White v. Dep't of Labor & Indus.*, 48 Wn.2d 470, 294 P.2d 650 (1956); *Mass. Mutual Life Ins. Co. v. Dep't of Labor & Indus.*, 51 Wn. App. 159, 752 P.2d 381 (1988).

Id. at *2. The Board's analysis was correct: where the contract permits an independent contractor to hire others to do the work, and the parties contemplate that he or she may do so, *White*'s third prong applies, and the "essence" of the contract is not "personal labor" as a matter of law.[13]

This case is no different. The Board found that "[t]here are no restrictions on [a] franchisee's ability to hire employees," and Lyons "does not control who is hired or fired by its franchisees." CP 24 (BIIA Final Order). That finding is undisputed and supported by substantial evidence. The franchise agreements expressly provide:

> 8.2. Franchisee shall hire and maintain a staff of qualified and competent employees. Franchisee is solely responsible for all hiring decisions . ...

CP 328 (Ex. 1). All the witnesses agreed that franchisees have total

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[13] The Board ultimately concluded that the route managers were "employees" rather than independent contractors, but that outcome does not help the Department here: in its Letter Ruling, the Department specifically disavowed a determination that Lyons' franchisees were "employees." CP 146 ("The department is not making a determination that the franchisees are employees."). Indeed, the "essence" test applied to independent contractors does not apply to determine whether one is an employee. *Daniels v. Seattle Seahawks*, 92 Wn. App. 576, 584, 968 P.2d 883 (1998) ("this 'essence' inquiry is appropriate only with respect to independent contractors"); *Xenith Group*, 167 Wn. App. at 400-01 ("analyzing whether an individual works under an independent contract, the essence of which is that individual's personal labor, involves a different analysis than whether the individual is an employee").

discretion to hire others to do the work, and many do. CP 1908-09, 1947, 1963, 1973-74, 2027, 2040-41 (9/7/11 Tr. at 18-19, 57, 73, 83-84, 137, 150-51); CP 2147 (9/26/11 Tr. at 89). Indeed, the Board found that, "[a]pproximately 80 percent of the franchisees have employees or assistants, helping them service … the cleaning contracts." CP 24 (BIIA Final Order). Just like *Massachusetts Mutual*, *Shanley*, and *Rainbow Int'l*, the franchisees' contractual right to hire others to do the work, and their practice of doing so, triggers *White's* third prong, and precludes a finding that they were "workers" under RCW 51.08.180 as a matter of law.

This makes sense. The legislature defined "workers" to include independent contractors where the "essence" of the contract was "personal labor" because it wanted to create a distinction between individuals who were *de facto* employees (for whom IIA premiums must be paid), and those who were truly independent contractors (for whom no IIA premiums need be paid). *White*, 48 Wn.2d at 474. The third prong of the *White* test identifies that distinction. Where the employer hires an independent contractor with the expectation that he or she ***personally*** will do the work, like an employer hiring a particular employee, the essence of the contract is "personal labor." But where the employer hires an independent contractor who, in turn, has discretion to use anyone they want to do the work, it cannot be said that the essence of the contract is "personal" to

anyone. The first type of independent contractor is a "worker"; the second is not. Lyons' franchisees clearly fall in the second category. The Board's Final Order must be reversed for this reason as well.

3. At A Minimum, This Court Must Reverse And Remand For A Determination Of Which Franchisees Employed Others To Do The Work.

Whereas the Board erroneously construed *White*'s third-prong too narrowly, the trial court ignored it altogether. The trial court reversed the Board and concluded that *all* of Lyons' franchisees were "workers" – even those franchisees that actually hired employees of their own to do the work. CP 2396. If this Court concludes that the "essence" of the franchise agreements is "personal labor" (it is not), and that *White*'s third prong does not apply to all of Lyons' franchisees (it does), then—at the very minimum—it must reverse the trial court's refusal to apply *White* to those franchisees who actually employed others to do the work. In that event, because the record was inadequately developed with respect to which franchisees employed others, the Court must also remand this matter to the Department for further proceedings on that issue.

The trial court stated that, "while there may be evidence that these franchisees employed others to perform the services …, there is no evidence to support a finding that these franchisees could not personally perform all the work …." CP 2396. In so reasoning, it is clear that the

court improperly conflated *White*'s second and third prongs, which are separate bases for exemption. The second prong asks whether, because of the size or nature of the work, the contractor "obviously could not perform the contract without assistance." *White*, 48 Wn.2d at 474. The third prong asks a different question: regardless of whether the contractor could do all the work, could he choose to "employ[] others to do" the work. *Id.* The trial court's finding may foreclose application of the second prong, but not the third. Even under the most conservative reading of *White*—the one adopted by the Board—any franchisee who not only could, but did in fact, hire others to do the work is *per se* exempt from "worker" status.

If the Court reverses the trial court on this basis, however, it cannot simply affirm the Board's conclusion that only those few franchisees specifically identified in the Audit are exempt under *White*. CP 26 (BIIA Final Order). The evidence presented at the hearing proved that the list compiled during the audit was woefully incomplete. The Department did not dispute the testimony of Lyons' president that "about 80 percent" of Lyons' franchisees had employees or assistants, *see* CP 2147 (9/26/11 Tr. at 89), and the Board repeated that fact in its Final Order. CP 24. At the same time, several franchisees not listed in the Audit testified that they used employees or assistants to do the work. CP 1973-74, 2027, 2045

(9/7/11 Tr. at 83-84, 137 & 155).[14] Indeed, the Department's auditor, who compiled the list, admitted that she never spoke to a single franchisee, and that less than half of the franchisees responded to the Department's questionnaire. CP 192 (Audit); CP 2223, 2229 (10/10/11 Tr. at 17, 23).[15]

In sum, no evidence supported the Board's conclusion that the Audit accurately identified all the franchisees who employed others. It plainly didn't. Where an agency erroneously fails to adequately decide an issue, and that issue remains relevant, the appropriate remedy is to remand to the agency for further proceedings. *Suquamish Tribe v. Central Puget Sound Growth Mgmt. Hearings Bd.*, 156 Wn. App. 743, 778-79, 235 P.3d 812 (2010); RCW 34.05.574(1). If this Court agrees with the Board that *White*'s third prong only applies to franchisees who actually used others to

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[14] The Department cannot complain that Lyons failed to call more of its franchisees to testify at the hearing. Lyons intended to call additional franchisees to testify about, among other things, whether "they have employees," but—as noted above (*see* fn. 7)—the IAJ believed that additional franchisee testimony was unnecessary and that "Mr. Lyons is fully competent to discuss his relationship with" the franchisees." CP 2051, 2053 -55(9/7/11 Tr. at 161, 163-65).

[15] The questionnaire itself was highly vague. It asked franchisees: "Do you have workers?" and whether they are "full-time or part-time." CP 579-81. Even putting aside false responses by franchisees who themselves wanted to avoid paying IIA premiums for their own employees, this question would invite a negative response where a franchisee did not currently have employees on the payroll or where a franchisee used workers only on a temporary basis when the need arose. Yet, even under the Board's cramped reading of *White*, both types of circumstances would be sufficient to invoke *White*'s third prong.

do the work (and that RCW 51.08.195's exception does not apply, *see below*), then it must both reverse the trial court on this point and remand this matter to the Department so that it can determine which of Lyons' franchisees had employees or used workers during the relevant period.

C. The Board Erroneously Concluded That Lyons' Franchisees Did Not Satisfy RCW 51.08.195's Exception.

Even if this Court concludes that some or all of Lyons' franchisees are workers because the essence of the franchise agreements is personal labor, it must nevertheless conclude that all the franchisees satisfy the exception to "worker" status set forth in RCW 51.08.195. *See Malang v. Dep't of Labor & Indus.*, 139 Wn. App. 677, 688, 162 P.3d 450 (2007) ("if the essence of the contract is personal labor, the next step is to analyze the business arrangement to determine whether ... RCW 51.08.195 creates an exception to the rule"). Independent contractors are not "workers" if:

> (1) The individual has been and will continue to be free from control or direction over the performance of the service ...; 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, ...; 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 ...; and

> (4) ... 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) ... the individual has established an account with the department of revenue ... 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) ... 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.

RCW 51.08.195. An independent contractor must satisfy all six subparts to be exempted. *Malang*, 139 Wn. App. at 689. The IAJ concluded that Lyons' franchisees satisfied all six subparts. CP 121-28 (Initial Decision). The Board apparently agreed as to four of the six, but concluded that Lyons' franchisees did not satisfy the first and third subparts. CP 27-31 (BIIA Final Order). The trial court affirmed. CP 2397-98. For the reasons explained below, the Board's conclusion that Lyons' franchisees failed RCW 51.08.195(1) and (3) was erroneous and must be reversed.

Control or Direction. Subpart (1) is satisfied if the franchisees are "free from control or direction over the performance of the service." RCW 51.08.195(1). "The crucial issue is not whether the employing unit actually controls, but whether it has the right to control the methods and

details of the worker's performance." *Western Ports Transp., Inc. v. Employ. Sec. Dep't*, 110 Wn. App. 440, 452, 41 P.3d 510 (2002) (interpreting identical provision of RCW 50.04.140(1)(a)). For the same reasons described above, the undisputed facts show that Lyons has no control over the "methods and details" of the franchisees' cleaning work: the franchisees have their own business licenses and are responsible for their own taxes; they choose which accounts to take on and which to reject; they deal directly with the customer to determine when to do the work; they select and purchase their own equipment and supplies; they decide who will do the work; and, perhaps most important, they perform the day-to-day work without any supervision from Lyons whatsoever.

In concluding that Lyons' franchisees failed to satisfy subpart (1), the Board ignored this lack of control, and focused exclusively on the fact that Lyons finds and contracts with the customers, and thereafter bills the customers and collect their payment. CP 27.[16] But these aspects of the franchise agreement have nothing to do with the "performance of the

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[16] The Board also stated that franchisees are "**not** allowed to seek additional customers for their ... cleaning business **without** interference from Lyons Enterprises, Inc." CP 27 (emphasis in original). That is simply wrong as a matter of fact. The testimony was uncontradicted that franchisees can and do expand their franchise business by finding their own customers ***and*** they are free to negotiate directly with the customer – in which case they do not have to pay Lyons any negotiation fees for that additional account. CP 2197-99 (9/26/11 Tr. at 139-41).

service," much less the "methods and details" of how a franchisee cleans a customer's facility. *Western Ports*, 110 Wn. App. at 452. Rather, they are among the business-related services Lyons agrees to perform for the franchisees' benefit, and for which the franchisees pay fees in return; these services ensure that Lyons is able to provide the franchisees the income guaranteed to them in the franchise agreement. There is no authority to support the Department's contention that financial services purchased by one business from another constitute "control or direction." On the contrary, they are critical elements of a successful franchise relationship.

Finally, the Department's interpretation of "control or direction" in Lyons' case confirms its strategy to treat all franchisees as covered "workers." As noted, franchisees must follow the franchisor's "marketing plan," which can govern "equipment," "[s]ales techniques," "advertising," "[t]raining," and/or "[o]perational, managerial, technical, or financial guidelines or assistance." RCW 19.100.010(11). Lyons' franchise expert testified that the procedures in Lyons' marketing plan were the "least control[ling]" of the thousands he has reviewed in 25 years in the industry. CP 2107-09 (9/26/11 Tr. at 49-51). The implication is obvious: if Lyons has "control" over its franchisees, then so does every franchisor in the State. In the Department's view, not only would the "essence" of every service-related franchise be "personal labor" within the meaning of RCW

51.08.180, but no franchisee would ever qualify for the exception set forth in RCW 51.08.195.[17] This Court should reject the Department's *de facto* attempt to radically expand the scope of the Industrial Insurance Act.

Customarily Engaged As An Independent Business. Subpart (3) is satisfied if the franchisees are "customarily engaged in an independently established trade, occupation, profession, or business ...." RCW 51.08.195(3). The IAJ correctly found that the franchisees "are in the janitorial business and they provide janitorial services to businesses." CP 124. The franchise agreement requires each franchisee to be licensed, be insured, maintain its own books, and pay its own taxes (including IIA premiums) as an independent business, *see* CP 329, 331-32, 337, 353 (Ex. 1, §§ 8.6, 10, 15, 21.2), and each of franchisees who testified confirmed that they do so. *See* CP 1946-47, 1958, 1966, 1970, 1974-76, 2003, 2004, 2025, 2038-39 (9/7/11 Tr. at 56-57; 68, 76, 80, 84-86, 113, 124, 135, 148-49). Indeed, the essential purpose of a franchise agreement is to enable franchisees to go into business for themselves – not for Lyons.

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[17] The Department said so expressly in its briefings to the trial court: "[It] is exactly the extreme element of direction and control required by the nature of a franchise operation so that every franchisee provides the same type of service or product to every customer that causes the failure under RCW 51.08.195." CP 2360 (Dep't Reply Brief at p. 9). It said the same thing at oral argument in response to a direct question from the trial court. *See* fn. 8 (quoting 2/7/13 Hr. at 49:2-10).

Once again, the Board ignored the undisputed facts, and concluded that Lyons' franchisees did not satisfy subpart (3) because the franchisees "purchased their [franchise] contracts for extra income, and were not in the commercial cleaning business prior to that purchase." CP 27 (BIIA Final Order).[18] But there is no authority to support the Board's conclusion that subpart (3) only applies if the individual has owned the business for a long time or operates it on a full-time basis. Indeed, such an interpretation would lead to the absurd result that no newly formed or part-time business could ever satisfy this subpart—contrary to the text of and policy of the provision. Many truly "independent" and productive businesses—both franchises and non-franchises alike—are characterized by both features. The Board's Final Order must be reversed for this reason too.

D. The Trial Court Erred When It Refused To Equitably Estop The Department From Applying Its New Interpretation Of "Workers" To Lyons' Existing Franchisees.

Even if this Court affirms the Board's novel application of RCW 51.08.180 and .195 to franchisees, it must reverse the trial court's refusal to equitably estop the Department from applying the Final Order to Lyons'

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[18] Subpart (3) can also be satisfied if "the individual has a principal place of business ... that is eligible for a business deduction for federal income tax purposes." The Board concluded that there was insufficient evidence to show that "any franchisee would qualify for a place of business deduction" under IRS rules. CP 27-28. Lyons did not challenge that conclusion at the trial court, and does not challenge it here.

existing franchisees for the duration of their franchise agreements. Equitable estoppel applies where (1) a party's act or admission is inconsistent with a later assertion, (2) another party acts in reliance on the first party's earlier act or admission, and (3) the party relying on that act or admission would be injured if the first party was not estopped from repudiating its earlier act. *Kramarevcky*, 122 Wn.2d at 743. Because equitable estoppel against the government is not favored, two additional requirements must be met: estoppel must be necessary to prevent a manifest injustice, and the exercise of governmental functions will not be impaired as a result of the estoppel. *Id.* Every element is satisfied here.

The trial court properly concluded that Lyons established the first two elements. CP 2399. In 2005, the Department expressly determined that Lyons' franchisees ***were not*** "workers" within the meaning of RCW 51.08.180 and .195. CP 2137-38 (9/26/11 Tr. at 79-80); CP 873-79 (Ex. 17). In reliance on that determination, and in the absence of any change in the law or contrary statements of agency interpretation or policy, Lyons entered into dozens of 10-year franchise agreements over the next five years, hired additional staff, expanded its offices, and invested in additional territory. CP 2138-39 (9/26/11 Tr. at 80-81). Lyons' justified reliance was shattered in July 2010, when the Department issued an Audit that flatly contradicted its earlier 2005 determination. CP 191-202.

The trial court properly concluded that Lyons satisfied the first two elements of equitable estoppel, but erred when it concluded that Lyons did not prove "injury." CP 2399. Injury is shown if a party reasonably relies on the actions of another and changes position to its detriment as a result. *Kramarevcky*, 122 Wn.2d at 747. The trial court reasoned that "while it is obvious that one effect of the Department's change in positions is that [Lyons] must now pay premiums, there is no evidence of how this requirement … would be detrimental to [Lyons]." CP 2399. Nonsense. Pursuant to the franchise agreements, franchisees pay Lyons according to a fixed royalty and fee structure, typically around 15 percent of their monthly revenue. CP 323-24 (Ex. 1, "Continuing fees"); CP 1931-32 (9/7/11 Tr. at 41-42). A basic assumption of that fee structure is that Lyons would not pay IIA premiums for the franchisees. Lyons' president testified that "we would not have signed [up] any additional franchisees" following the 2005 audit had the Department determined then that the franchisees were actually "workers." CP 2138-39 (9/26/11 Tr. at 80-81).

The economic consequence—the "injury"—to Lyons is obvious. Most of Lyons' franchise agreements were signed *after* the Department's 2005 audit but *before* the 2010 Audit. CP 2139 (9/26/11 Tr. at 81). If Lyons is forced to pay IIA premiums for these franchisees, Lyons will receive far less income from its franchise business than it originally

bargained for and reasonably expected given the Department's prior position. Nothing more is required to prove "injury." *See Silverstreak, Inc. v. Dep't of Labor & Indus.*, 159 Wn.2d 868, 889-90, 154 P.3d 891 (2007) ("injury" shown if party relies on agency statements to enter into contracts with economic terms that are later impaired when agency changes position). To be sure, Lyons cannot—under the terms of the agreements or by law—ask the franchisees to pay IIA premiums for which Lyons is responsible. RCW 51.04.060; RCW 51.16.140(2).

For all the same reasons, there will be a "manifest injustice" if the Department is allowed to apply its novel interpretation of RCW 51.08.180 and .195 to Lyons' existing franchisees. *Silverstreak*, 159 Wn.2d at 890 ("manifest injustice" where agency's change in position deprives parties "of a large portion of the benefit of their bargain").[19] The fact that the Department intends to apply its Audit on a prospective basis only, CP 196, does not lessen the injury or injustice. The franchise agreements have 10-year terms and, thus, Lyons cannot escape the potentially ruinous consequences of the Department's flip-flop for several years to come. If this Court approves the Department's new approach to franchisees, the

[19] The Department's auditor estimated that Lyons' premiums would equal approximately $150,000 for the period between February 2009 and January 2010. CP 196. Lyons' president testified that Lyons' annual profit was approximately $125,000. CP 2135 (9/26/11 Tr. at 77).

only way to mitigate the injury and prevent a prejudice to Lyons is to estop the Department from assessing Lyons IIA premiums for those franchisees who signed a franchise agreement between the 2005 audit and the 2010 Audit, for the remaining term of their franchise agreement.

This limited relief will not impair the Department's governmental functions; it simply holds the Department to its previously expressed policy in Lyons' case and, even then, only to those franchisee agreements signed in reliance of that policy. *Silverstreak*, 159 Wn.2d at 891 (no impairment "to hold the Department to its previously expressed policy ... and not subject them to post hoc policy"). The Department will be free to apply its new interpretation of RCW 51.08.180 and .195 to all other franchisors in the state and to Lyons' unaffected franchisees (and, eventually, to all its franchisees). Lyons was entitled to, and did, rely on the 2005 audit as an affirmative statement of agency policy. Equity demands that the Department be estopped from repudiating that policy for the remaining duration of Lyons' pre-2010 franchise agreements. The trial court erred in refusing to grant Lyons this equitable relief.

E. Lyons Is Entitled To An Award Of Attorneys' Fees And Expenses Under The Equal Access To Justice Act.

Under the Equal Access to Justice Act ("EAJA"), "a court shall award a qualified party that prevails in a judicial review of an agency

action fees and other expenses, including reasonable attorneys' fees, unless the court finds that the agency action was substantially justified or that circumstances make an award unjust." RCW 4.84.350(1). The EAJA can apply even where a court upholds the agency's determination or interpretation, but determines that the agency is equitably estopped from enforcing its order in a particular case. *See Silverstreak*, 159 Wn.2d at 891; *and* RCW 4.84.350(1) ("A qualified party shall be considered to have prevailed if the qualified party obtained relief on a significant issue that achieves some benefit that the qualified party sought.").

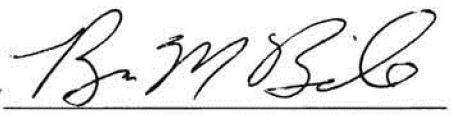
For the reasons explained above, Lyons is a prevailing party in this judicial review because the Department erred in its conclusion that its franchisees are non-exempt "workers" under RCW 51.08.180 and .195, and/or the trial court erred in refusing to equitably estop the Department from applying its new interpretation of those statutes to Lyons. Pursuant to RAP 18.1(a), Lyons asks this Court to award Lyons its expenses and fees incurred at both the trial court and in this Court, to the maximum extent allowed under the EAJA, RCW 4.84.350(2), or to remand the issue to the trial court for that purpose. *See Nor-Pac Enterprises, Inc. v. Dep't of Licensing*, 129 Wn. App. 556, 571-72, 119 P.3d 889 (2005).

VI. CONCLUSION

The decision of the trial court affirming the Board's Final Order must be reversed. Lyons' franchisees are not covered "workers."

RESPECTFULLY SUBMITTED this 18th day of October, 2013.

LANE POWELL PC

By 

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CERTIFICATE OF SERVICE

I, Kathryn Savaria, hereby certify under penalty of perjury of the laws of the State of Washington that on October 18, 2013, I caused to be served a copy of the attached document to the following person(s) in the manner indicated below at the following address(es):

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