No. 18-

IN THE

Supreme Court of the United States

HATFIELD ENTERPRIZES, INC., A WASHINGTON CORPORATION, AND SYSTEM-TWT TRANSPORT, A WASHINGTON CORPORATION,

Petitioners,

v.

STATE OF WASHINGTON EMPLOYMENT SECURITY DEPARTMENT,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF WASHINGTON, DIVISION III

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. The Federal Aviation Administration Authorization Act, 49 U.S.C. § 14501(c)(1), ("FAAAA") broadly preempts any state action that relates even indirectly to a carrier's prices, routes, or services. Washington State's statute defining independent contractors for unemployment compensation taxes, Wash. Rev. Code § 50.04.140, makes it impossible for such federally-authorized independent contractors in the trucking industry (owner/operators) to ever be anything but trucking carriers' employees. Such a reclassification eliminates an established business model in that industry. Is such a reclassification scheme preempted by the FAAAA, given its direct and indirect effects on prices, routes, and services of trucking carriers?

2. 49 C.F.R. § 376.12 regulates the relationship between trucking carriers and owner/operators, specifically providing in C.F.R. § 376.12(c)(4) that compliance with the federal requirement of exclusive carrier possession, control, and use of owner/operator equipment during the duration of the parties' equipment lease may not affect whether an owner/operator is an employee or independent contractor under state law. Are courts barred from considering federally-mandated lease contract provisions in determining carrier control over an owner/operator for purposes of unemployment compensation taxation?

PARTIES TO THE PROCEEDING

Petitioners

HATFIELD ENTERPRIZES, INC., a Washington corporation,

SYSTEM-TWT TRANSPORT, a Washington corporation,

Respondent

STATE OF WASHINGTON EMPLOYMENT SECURITY DEPARTMENT

CORPORATE DISCLOSURE FORM

Pursuant to Supreme Court Rule 29.6, petitioners Hatfield Enterprizes, Inc. and System-TWT Transport provide the following Corporate Disclosure Statement:

1. Petitioner Hatfield Enterprizes, Inc. is a wholly owned subsidiary whose parent company is the privately held company Northwest Truck Leasing. There is no publicly held corporation that owns 10% or more of Northwest Truck Leasing's stock.

2. Trans-System, Inc. is the parent company of petitioner System-TWT Transport. There is no publicly held corporation that owns 10% or more of Trans-System, Inc.'s stock.

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OPINIONS BELOW

Three separate divisions of the Washington Court of Appeals affirmed trial court decisions approving of the Washington State Employment Security Department's ("ESD") assessments of unemployment taxes against trucking carriers for remuneration paid to independent contractor owner/operators. *Swanson Hay Co. v. State of Washington Employment Security Department*, 404 P.3d 517 (Wash. App. 2017); *MacMillan-Piper, Inc. v. State of Washington Employment Security Department*, 2017 WL 6594805 (Wash. App. 2017); *Gulick Trucking Inc. v. State of Washington Employment Security Department*, 2018 WL 509096 (Wash. App. 2018). This case involves System-TWT Transport ("System") and Hatfield Enterprizes, Inc. ("Hatfield"). App. A. The Washington Supreme Court denied review on July 12, 2018. *See* App. G.

STATEMENT OF JURISDICTION

The Court has jurisdiction under 28 U.S.C. § 1257(a) to review federal questions arising from State courts.

STATUTORY PROVISIONS INVOLVED

49 U.S.C. § 14102:

(a) General authority of Secretary.—The Secretary may require a motor carrier providing transportation subject to jurisdiction under subchapter I of chapter 135 that uses motor vehicles not owned by it to transport property under an arrangement with another party to—

(1) make the arrangement in writing signed by the parties specifying its duration and the compensation to be paid by the motor carrier;

(2) carry a copy of the arrangement in each motor vehicle to which it applies during the period the arrangement is in effect;

(3) inspect the motor vehicles and obtain liability and cargo insurance on them; and

(4) have control of and be responsible for operating those motor vehicles in compliance with requirements prescribed by the Secretary on safety of operations and equipment, and with other applicable law as if the motor vehicles were owned by the motor carrier.

49 U.S.C. § 14501:

(c) MOTOR CARRIERS OF PROPERTY.—

(1) GENERAL RULE.—

Except as provided in paragraphs (2) and (3), a State, political subdivision of a State, or political authority of 2 or more States may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service of any motor carrier (other than a carrier affiliated with a direct air carrier covered by section 41713(b)(4)) or any motor private carrier, broker, or freight forwarder with respect to the transportation of property.

49 C.F.R. § 376.11:

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

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

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

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

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

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

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

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

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

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

(1) The authorized carrier shall prepare and keep documents covering each trip for which the equipment is used in its service. These documents shall contain the name and address of the owner of the equipment, the point of origin, the time and date of departure, and the point of final destination. Also, the authorized carrier shall carry papers with the leased equipment during its operation containing this information and identifying the lading and clearly indicating that the transportation is under its responsibility. These papers shall be preserved by the authorized carrier as part of its transportation records. Leases which contain the information required by the provisions in this paragraph may be used and retained instead of such documents or papers. As to

lease agreements negotiated under a master lease, this provision is complied with by having a copy of a master lease in the unit of equipment in question and where the balance of documentation called for by this paragraph is included in the freight documents prepared for the specific movement.

(2) [Reserved]

49 C.F.R. § 376.12:

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

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

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

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

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

shall assume complete responsibility for the operation of the equipment for the duration of the lease.

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

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

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

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

other method of compensation mutually agreed upon by the parties to the lease. The compensation stated on the lease or in the attached addendum may apply to equipment and driver's services either separately or as a combined amount.

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

the authorized carrier, or if the base plates are authorized to be sold by the authorized carrier to another lessor the authorized carrier shall refund to the initial lessor on whose behalf the base plate was first obtained a prorated share of the amount received.

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

(g) ***Copies of freight bill or other form of freight documentation.*** When a lessor's revenue is based on a percentage of the gross revenue for a shipment, the

lease must specify that the authorized carrier will give the lessor, before or at the time of settlement, a copy of the rated freight bill or a computer-generated document containing the same information, or, in the case of contract carriers, any other form of documentation actually used for a shipment containing the same information that would appear on a rated freight bill. When a computer-generated document is provided, the lease will permit lessor to view, during normal business hours, a copy of any actual document underlying the computer-generated document. Regardless of the method of compensation, the lease must permit lessor to examine copies of the carrier's tariff or, in the case of contract carriers, other documents from which rates and charges are computed, provided that where rates and charges are computed from a contract of a contract carrier, only those portions of the contract containing the same information that would appear on a rated freight bill need be disclosed. The authorized carrier may delete the names of shippers and consignees shown on the freight bill or other form of documentation.

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

(i) ***Products, equipment, or services from authorized carrier.*** The lease shall specify that the lessor is not required to purchase or rent any products, equipment, or services from the authorized carrier as a condition

of entering into the lease arrangement. The lease shall specify the terms of any agreement in which the lessor is a party to an equipment purchase or rental contract which gives the authorized carrier the right to make deductions from the lessor's compensation for purchase or rental payments.

(j) ***Insurance.***

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

(2) If the lessor purchases any insurance coverage for the operation of the leased equipment from or through the authorized carrier, the lease shall specify that the authorized carrier will provide the lessor with a copy of each policy upon the request of the lessor. Also, where the lessor purchases such insurance in this manner, the lease shall specify that the authorized carrier will provide the lessor with a certificate of insurance for each such policy. Each certificate of insurance shall include the name of the insurer, the policy number, the effective dates of the policy, the amounts and types of coverage, the cost to the lessor for each type of coverage, and the deductible amount for each type of coverage for which the lessor may be liable.

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

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

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

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

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

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

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

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

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

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

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

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

STATEMENT OF THE CASE

(1) Owner/Operators in the Trucking Industry

Owner/operators have long been important in the trucking industry. *See generally,* Douglas C. Grawe, *Have Truck, Will Drive: The Trucking Industry and the Use of Independent Owner-Operators Over Time,* 35 Transp. L.J. 115 (2008). They are used in most, if not all, sectors of the industry, including long-haul trucking, household-goods moving, and intermodal operations. App. 127a-128a. Because demand in the contemporary American trucking industry fluctuates so dramatically, the industry is structured around these independent owner/operators, who provide carriers with a flexible supply of trucking equipment.

For owner/operators, an independent-contractor relationship is similarly beneficial. In this era of increased shipping demand because of internet shopping, today's

shippers are sophisticated and now look for "one stop" shopping for their shipping needs. It would thus be extremely difficult for an individual owning a single truck to compete. By contracting with large trucking carriers, owner/operators can overcome this obstacle and still maintain a small business. The firms give owner/operators access to higher-paying freight than they would have access to if they operated under their own authority and make it easier for owner/operators to obtain insurance.

The federal government requires all motor carriers to engage owner/operators through a written lease agreement, under 49 C.F.R. § 376, known as the Truth-in-Leasing regulations. *Owner-Operator Indep. Drivers Ass'n v. Mayflower Transit, Inc.*, 161 F. Supp. 2d 948, 953 n.2 (S.D. Ind. 2001). These regulations not only require a written lease contract, but also specify certain terms that must be included in the equipment lease agreement. *See*, *e.g.*, 49 C.F.R. §§ 376.11, 376.12.[1]

(2) Petitioners' Operations

The four petitioning interstate motor carriers share certain common characteristics. Each is licensed by the

1. For example, the regulations *mandate* that owner/operators operate exclusively under a carrier's federal license granted by the USDOT and that the owner/operator be insured by the carrier (although the owner/operator must pay for that insurance). 49 C.F.R. § 376.12(c), (j). These requirements promote public safety by ensuring that all trucks are covered by adequate insurance and by facilitating the collection of safety data for carriers. As will be discussed *infra,* federal regulations specifically provide that these requirements do not constitute "control" for purpose of state law regulatory schemes.

United States Department of Transportation ("USDOT") and the Federal Motor Carrier Safety Administration ("FMCSA"). Each operates in interstate commerce.[2] Each carrier leases trucking equipment from owner/operators. Each carrier, with the exception of Mac-Millan Piper ("MP"), is involved in the long haul of freight and utilizes both company drivers and owner/operators to accomplish such operations.[3]

Central to the existence of owner/operators as independent businesses, is the fact that owner/operators make an enormous capital investment in their businesses. The truck alone represents an investment of roughly $200,000. Owner/operators have a trade association designed to protect their interests as small businesses.[4]

In leasing equipment, each carrier had equipment lease agreements with owner/operators in the form mandated by federal law. 49 U.S.C. § 14102(a); 49 C.F.R.

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2. Underscoring this point is the fact that System TWT Transport ("System") is headquartered in Cheney, Washington, near the Idaho border. App. 119a. It competes with carriers in other jurisdictions in which unemployment taxes are not levied on carriers for the lease of equipment from owner/operators. *See* n.23, *infra*.

3. System had 380 company drivers, driving System-owned equipment, but it also leased 254 trucks. App. 118a. Hatfield Enterprizes ("Hatfield") had 38 company drivers and leased 10 added trucks. App. 72a.

4. A national organization, the Owner/Operator Independent Drivers Association ("OOIDA") has 153,000 members nationally who value their business independence. https://www.ooida.com/WhoWeAre/.

§ 376.11; 49 C.F.R. § 376.12. As was generally determined by ESD in the administrative process, those agreements made clear that the owner/operator had complete control over the selection of drivers or laborers for the trucks, and over the selection of the routes for the delivery of the cargo the carriers asked them to deliver. The owner/operators also determined employee hours, stops/rest breaks, attendance and performance standards, and general working conditions. The owner/operators could reject loads offered to them by the carriers. Critically, although the carriers might advance expenses to the owner/operators as a convenience, as federal regulations permitted, 49 C.F.R. § 376.12(h), the owner/operators were ultimately responsible for the cost of the operation of their equipment including general vehicle maintenance, insurance, permits, base plates, license fees, taxes, fuel, lubricants, cold weather protection, tie-down gear and cargo protection equipment, tires, tolls, fines, and driver wages and payroll taxes.[5] The owner/operators were generally paid a percentage of the fee paid to the carrier by the customer.

(3) The State Targeted Washington's Trucking Industry

Reversing Washington public policy that had long treated owner/operators as independent contractors,[6]

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5. In addition to paying worker compensation premiums and unemployment compensation taxes for their drivers, owner/operators may elect coverage for themselves, Wash. Rev. Code § 50.24.160; Wash. Rev. Code § 51.12.110.

6. Owner/operators are not carrier employees under Washington's worker compensation laws. Wash. Rev. Code

and without specific legislative authority, ESD joined with Washington's Department of Revenue ("DOR") and Department of Labor & Industries ("DOLI") (the agency administering worker compensation) to form an "underground economy task force" ("UETF").[7] The UETF targeted the trucking industry and its historical use of owner/operators.[8] None of the carriers here were "underground" enterprises. All were rigorously regulated under federal law and their relationship with owner-operators is also federally-regulated. The carriers'

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§ 51.08.180; *Wash. State Dep't of Labor & Indus. v. Mitchell Bros. Truck Line, Inc.*, 54 P.3d 711 (Wash. App. 2002). ESD previously treated owner/operators as independent contractors. *Penick v. Emp't Sec. Dep't,* 917 P.2d 136 (Wash. App. 1996), *review denied*, 925 P.2d 989 (Wash. 1996). ESD previously instructed its auditors the distinction between independent owner/operators and employee truck drivers, on the basis of the "Independent Trucker Tests." These tests provide that owner/operators qualify as independent contractors if they: (1) normally have the right to hire and fire any driver of the truck, set wage amounts, select routes, and establish or approve procedures for loading and unloading; (2) perform all services other than loading or unloading freight outside the carrier's places of business; and (3) maintain a separate set of books and are responsible for the majority of cost items. ESD abandoned those tests when it targeted the industry.

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

8. ESD notes from a meeting of its officials indicated that in the preceding eighteen months, ESD had audited 284 trucking companies. Those notes also stated that ESD "targeted trucking."

operations are also regulated for safety purposes under state law. Their trucks operate openly on Washington's roads. They are taxed under state law and were current in the payment of applicable Washington taxes.

As noted *supra,* ESD had standards for conducting its audits including a Tax Audit Manual ("TAM") that provided factors for an auditor to consider in determining if work is performed by an independent contractor. ESD also provided its auditors a Status Manual ("SM") that supplied the Independent Trucker tests. Finally, ESD generally required that all audits be conducted according to Generally Accepted Auditing Standards, which mandate auditor objectivity. It did not follow any of these standards.[9]

Moreover, ESD auditors were compromised by ESD job performance quotas requiring them to assess a certain amount of unpaid taxes, and to reclassify a certain number of independent contractors to employee status. One auditor even had the audacity to ask the governor to pay her a percentage bonus based on revenues she generated for the State. In Hatfield's administrative proceedings, evidence was adduced that ESD leadership even directed auditors to impose taxes on owner/operator equipment *knowing* that such assessments were illegal under Washington law that confined unemployment compensation taxation to

9. Although it initially admitted it had to follow the TAM/SM standards, in later cases, ESD shifted course and took the position that compliance with its manuals was optional. Brian Sonntag, Washington's elected State Auditor for 20 years, observed that ESD created a system of no standards, no supervisory or peer review, no quality control, and institutional interference with auditor objectivity.

wages paid by the taxpayer; ESD wanted to "leverage" settlement by carriers. *See generally*, *Wash. Trucking Ass'ns v. State, Emp't Sec. Dep't.* 369 P.3d 170, 176-77 (Wash. App. 2016) *rev'd*, 393 P.3d 761 (Wash. 2017).

Ultimately, based on these so-called "audits," ESD issued notices of assessment against the carriers (for taxes, penalties, and interest. As to System and Hatfield, ESD assessed taxes on *equipment payments* when state law expressly limited the tax to the wages paid to the covered worker. Wash. Rev. Code § 50.24.010. The carriers filed administrative appeals.

(4) Procedural History

The petitioning carriers were subjected to lengthy administrative proceedings in which ESD ultimately backed down on assessing unemployment taxes on the equipment the owner/operators leased to petitioners. ESD's Commissioner eventually affirmed the assessments, a final agency action for purposes of judicial review, app. B, D, and the carriers sought review in the superior court. Those courts affirmed the assessments. App. C, E, F.

On appeal, the Washington Court of Appeals affirmed the trial court decisions. App. A. Its opinions effectively upheld an interpretation of Wash. Rev. Code § 50.04.140, relating to independent contractors, that makes it impossible for an owner/operator to be anything but a trucking carrier employee. The Washington Supreme Court denied review. App. G.

REASONS FOR GRANTING THE PETITION

Washington State targeted Washington's trucking in hundreds of "audits," as part of a politically-motivated effort to restructure Washington's federally-regulated trucking industry by eliminating the industry's historical use of owner/operators. Indeed, federal motor carrier law specifically *authorizes* owner/operators and specifies the contents of the carrier-owner/operator equipment-leasing agreements.

When Congress deregulated interstate trucking in 1980 and intrastate trucking in 1994, it enacted the FAAAA, 49 U.S.C. § 14501(c)(1), a statute that broadly preempts any local or state laws that affect routes, prices, or services in the trucking industry.

The Washington courts' interpretation of Wash. Rev. Code § 50.04.140, the definition of an independent contractor for purposes of unemployment compensation taxation, makes it *impossible* for an owner/operator to be an independent contractor, just as occurred in Massachusetts by statute and California by judicial decision, as will be discussed *infra*. The Washington courts' decisions condone the effective elimination of the owner/operator business model in the trucking industry for purposes of unemployment compensation taxation. Those courts failed to apply the FAAAA as Congress and this Court's precedents direct. The Washington courts' decisions permit a backdoor attempt by state authorities to disrupt the modern American trucking industry, and create a patchwork of inconsistent state-by-state regulations of interstate trucking, something Congress emphatically rejected.

(1) Washington State's Effective Elimination of the Owner/Operator Business Model Is Federally Preempted

The Washington courts' opinions are consistent in certain key respects. First, they interpret Wash. Rev. Code § 50.04.140, the statute dealing with independent contractor status for unemployment compensation taxes that mirrors the so-called ABC test for independent contractor status, in a fashion that renders it impossible for an owner/operator to *ever* be an independent contractor for unemployment compensation tax purposes. In particular, no owner/operator will ever have an independently established business because such owner/operators function under a carrier's federal operating authority. App. 50a-53a. Second, the opinions all adopt the Ninth Circuit's limitation on FAAAA preemption with regard to statutes of "general applicability." App. 21a-22a. Finally, all three opinions allow federally-mandated equipment leasing contract terms to be used as evidence of control by carriers over owner/operators. App. 38a-44a.

(a) The Washington Courts Failed to Apply This Court's FAAAA Jurisprudence Providing Expansive Federal Preemption of Local Laws Affecting Prices, Routes, or Services in Trucking

The Washington court decisions are but further evidence of a split of authority on the proper interpretation of the FAAAA. Those decisions join the courts who have found what amounts to a nonexistent FAAAA exception for "background laws of general applicability."

When Congress de-regulated interstate trucking in 1980 and intrastate trucking in 1994, it sought to remove obstacles to "national and regional carriers attempting to conduct a standard way of doing business." *Cole v. City of Dallas*, 314 F.3d 730, 734 (5th Cir. 2002) (quoting H. R. Conf. Rep. No. 103-677, at 87, *reprinted in* 1994 U.S.C.C.A.N. at 1759). It enacted the FAAAA's express preemption to make sure market forces would prevail and that local jurisdictions would not re-regulate the trucking industry in a "patchwork of state-service determining laws, rules, and regulations." *Rowe v. New Hampshire Motor Transp. Ass'n*, 552 U.S. 364, 367-68, 370-71, 378 (2008).[10] The FAAAA's preemptive language bars states from "enacting or enforcing a law, regulation, or other provision . . . *related to a price, route, or service*" of any carrier with respect to the transportation of property. 49 U.S.C. § 14501(c)(1) (emphasis added). This Court has mandated that FAAAA preemption must be construed *broadly*, consistent with its broad interpretation of similar preemptive language enacted by Congress for airline deregulation. *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 383-84 (1992); *Rowe*, 552 U.S. at 370-71 (Congress adopted FAAAA preemptive language knowing of broad construction of same language in *Morales*).[11]

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10. Congress also specifically directed USDOT to regulate lease agreements between carriers and owner/operators. 49 U.S.C. § 14102(a). In the interest of public safety, the regulations also mandate that trucking carriers provide liability insurance and ensure that drivers have undergone mandatory drug testing. 49 C.F.R. §§ 376.11, 376.12, 382.601.

11. In *Dan's City Used Cars, Inc. v. Pelkey*, 569 U.S. 251 (2013), this Court held that the FAAAA did not preempt a state law damages claim arising from storage and disposal of towed vehicle because FAAAA preempted only local laws addressing the

Given this broad federal preemption and the importance of owner/operators to the trucking industry, every time a state or local government has attempted to *directly* ban owner/operators in the industry, courts have held such efforts to be FAAAA-preempted.[12]

As noted *supra*, the Washington courts concluded, however, that if the governmental action involves a law of "general applicability," even if carrier routes, prices, or services are affected, the law is not federally-preempted. This holding contradicts this Court's FAAAA preemption decisions. In *Rowe*, the Court made clear that even laws that *indirectly* impact prices, routes, or services are preempted, provided they have a significant impact. Even if a law can be characterized as "generally applicable," it is preempted if its effect intrudes upon trucking carrier routes, prices, and services, as this Court has made clear. *E.g.*, *American Airlines v. Wolens*, 513 U.S. 219 (1995) (preempting Illinois consumer protection statute, a statute of general applicability); *Nw., Inc. v. Ginsberg*,

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transportation of property, but it also re-affirmed the holding in *Rowe* that the FAAAA's preemption is broad, and encompasses even local laws indirectly affecting carrier prices, routes, or services. *Id.* at 260.

12. *E.g.*, *American Trucking Ass'ns, Inc. v. City of Los Angeles*, 596 F.3d 602, 604-05 (9th Cir. 2010) (local regulation developed in the guise of promoting port environmental policies prohibiting use of independent contractor drivers at port was preempted); *In re Federal Preemption of Provisions of the Motor Carrier Act*, 566 N.W.2d 299, 308–09 (Mich. App. 1997), *review denied*, 587 N.W.2d 632 (Mich. 1998), *cert. denied*, 525 U.S. 1018 (1998) (striking down as preempted a regulation mandating that a truck be operated only by persons who were employees of the trucking carrier).

572 U.S. 273 (2014) (preempting general common-law claim for breach of the implied covenant of good faith and fair dealing, principles of general applicability); *United Parcel Serv., Inc. v. Flores-Galarza*, 318 F.3d 323 (1st Cir. 2003) (Puerto Rico's enforcement of excise tax against airlines was ADA-preempted).

The Washington courts' misinterpretation of the FAAAA and this Court's precedents is not isolated. Other courts continue to mistakenly suggest that "general" state laws are not subject to the FAAAA's broad preemption, creating an exception found nowhere in the FAAAA's actual statutory language. Those courts failed to faithfully apply this Court's requisite analysis of the law's impact on carrier prices, routes, or services.[13] This Court has expressly rejected attempts to imply exceptions to the broad scope of the FAAAA preemptive language not found in the FAAAA itself. *Rowe*, 552 U.S. at 374 (rejecting public health exception to FAAAA preemption – "The Act says nothing about a public health exception.").

This Court should grant review to make it clear that there is no "generally applicable statute" exception to the broad sweep of FAAAA preemption. The Washington Supreme Court has joined the Seventh and Ninth Circuits

13. *E.g.*, *Californians for Safe & Competitive Dump Truck Transp. v. Mendonca*, 152 F.3d 1184 (9th Cir. 1998), *cert. denied*, 526 U.S. 1060 (1999) (FAAAA does not preempt employee drivers' claims for violations of prevailing wage laws); *Dilts v. Penske Logistics, LLC*, 769 F.3d 637 (9th Cir. 2014), *cert. denied*, 135 S. Ct. 2049 (2015) (FAAAA does not preempt employee drivers' claims for violations of meal and rest-break laws); *Costello v. BeavEx Corp.*, 810 F.3d 1045 (7th Cir. 2016), *cert denied*, 137 S. Ct. 2289 (2017).

(*Costello*, 810 F.3d at 1055; *Dilts*, 769 F.3d at 650) in an interpretation of the FAAAA that is directly at odds with this Court's expansive interpretation of that express federal preemption statute in *Rowe*. Rule 10(c). Those courts' FAAAA preemption interpretation simply cannot be squared with that of the First Circuit. Rule 10(b). This Court should reaffirm the *Rowe* court's holding that local laws indirectly affecting prices, routes, or services in more than a tenuous fashion are preempted.

(b) Washington State's Effective End to the Owner/Operator Business Model for Unemployment Compensation Tax Purposes Affects Prices, Routes, or Services in the Trucking Industry

The Washington courts' interpretation of Wash. Rev. Code § 50.04.140 makes it *impossible* for *any* owner/operator to *ever* qualify as an exempted independent contractor in the unemployment compensation tax context. Indeed, ESD never disputed this fact below. The Washington courts' decisions make such an outcome crystal clear. In this way, a state has deprived a federally-regulated industry of the right to use the owner/operator business model.[14] As such, the State's actions affect

14. Ultimately, at its most basic, under a conflict preemption type of analysis that is at the core of the FAAAA's express preemptive language, the Washington courts' interpretation of Wash. Rev. Code § 50.04.140 re-regulates (and makes illegal) what federal law specifically has determined is legal in the trucking industry (the owner/operator business model). *Hillman v. Maretta*, 569 U.S. 483, 490 (2013) (a conflict is present "when compliance with both federal and state regulations is impossible."). Stated another way, preemption is required if the state law is an obstacle to the accomplishment of the purposes and objectives of Congress.

prices, routes, and services in the industry. Washington State's action here as to unemployment compensation taxation is no different than the outright ban of owner/operators by the Ports of Los Angeles/Long Beach or the Michigan Legislature. For example, in finding that the control element of Wash. Rev. Code § 50.04.140 cannot be met, as noted *supra*, the Washington courts emphasized the fact that owner/operators must operate under a trucking carrier's federal authority or permit. But federal regulations *require* that leased equipment be operated under the carrier's USDOT authority.[15] This fact *alone* makes it impossible for an owner/operator *ever* to meet the test of Wash. Rev. Code § 50.04.140. The Washington courts also ruled that other federally-mandated terms in

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Id. at 1950. *See also*, *Remington v. J.B. Hunt Transport, Inc.*, 2016 WL 4975194 (D. Mass. 2016) (claim that the deduction of expenses for repairs, cargo losses, insurance, or administrative fees from owner/operator compensation constituted "control" by carriers where the owner/operator regulations of 49 C.F.R. Part 376 *authorized* such deductions was preempted; as the court succinctly observed: "What is explicitly permitted by federal regulations cannot be forbidden by state law." *Id.* at *4.); *Rodriguez v. RWA Trucking Co.*, 219 Cal. App. 4th 692, 710 (Cal. App. 2013) (California insurance law could not prohibit charge back to truck drivers of insurance costs in light of federal law). That there is confusion on the scope of FAAAA preemption is supported by the decision on Truth-in-Lending deductions in *Goyal v. CSX Intermodal Terminals, Inc.*, 2018 WL 4649829 (N.D. Cal. 2018) that arrives at a contradictory result to that of the *Remington* and *Rodriguez* courts.

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

an equipment lease may be evidence of carrier direction or control.[16] As will be established *infra*, that decision is contrary to federal law. All of these lease terms are required by federal regulations for an owner/operator to have a valid contract with a trucking carrier; a carrier complying with federal law will *never* meet the test of Wash. Rev. Code § 50.04.140.

The Washington courts' interpretation of local laws to effectively bar the owner/operator business model in the trucking industry is not an isolated phenomenon. That business model is under attack in numerous states. For example, Massachusetts enacted a statute, Mass. Gen. Laws, ch. 149 § 148B, to distinguish between employees

16. *Compare* App. 45a-48a with 49 C.F.R. §§ 376.11(c)(1) (requiring proper identification), 376.11(d)(1) (documentation must clearly indicate that the transportation is under the carrier's responsibility), 376.12(c)(1) (requiring carrier to take exclusive, use, possession, and control of and full responsibility for the leased equipment), 376.12(e) (requiring the lease to clearly specify which party is responsible for removing identification devices from the equipment upon lease termination), 376.22 (requiring written agreement for a carrier to lease equipment that is under lease to another carrier), 379 app. A (specifying required retention periods for various categories of records and reports, including shipping documents and inspection and repair reports), 382.601 (requiring carriers to institute drug and alcohol testing policy applicable to all "drivers"), 382.107 (defining "driver" as including "independent owner-operator contractors"), 385.5 (unqualified drivers and improperly driven vehicles adversely affect carrier's safety rating), 390.11 (carrier must require drivers to observe all duties imposed by federal motor carrier safety regulations); 392.60 (requiring carrier to give written authorization for any passengers), 396.3 (carriers must systematically inspect or cause to be inspected all vehicles subject to their control and keep inspection and maintenance records).

and independent contractors for a variety of its labor laws that adopted what amounts to the same standard Washington courts have adopted for independent contractors in Wash. Rev. Code § 50.04.140.[17] The California Supreme Court held in *Dynamex Operations West, Inc. v. Superior Court*, 416 P.3d 1 (Cal. 2018) that the so-called ABC test for determining if carrier drivers were independent contractors or carrier employees compelled the conclusion that they were employees. In particular, under category B of the test, because drivers were in the same general business as the carriers, they were employees. *Id.* at 38-39.[18]

In extended litigation over the Massachusetts statute that essentially incorporated the ABC test into the analysis of any labor statute, courts interpreting it have held that it is FAAAA-preempted with regard to its second statutory element as it relates to the trucking industry because it affects prices, routes, or services by effectively

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

18. In *California Trucking Ass'n v. Su*, __ F.3d __, 2018 WL 4288953 (9th Cir. 2018), the Ninth Circuit held that California's common law definition of an independent contractor, applied generally by that State's labor laws, was not FAAAA-preempted, concluding that the FAAAA principally addressed barriers to entry in trucking, tariffs, price regulations, and laws governing the types of commodities carriers could transport. *Id.* at *4. The court consequently reaffirmed *Dilts*, ruling that FAAAA preemption did not extend to generally applicable "background regulation in an area of traditional state power." *Id.* The court determined *Dynamex* to be inapplicable to its analysis. *Id.* at *3 n.4.

eliminating a particular employment or business model in the trucking industry, and creating a patchwork of state laws, contrary to the deregulation intent of Congress. *Sanchez v. Lasership, Inc.*, 937 F. Supp. 2d 730 (E.D. Va. 2013); *Mass. Delivery Ass'n v. Coakley*, 769 F.3d 11, 17 (1st Cir. 2014); *Schwann v. FedEx Ground Package Sys., Inc.*, 813 F.3d 429 (1st Cir. 2016); *Mass. Delivery Ass'n v. Healey*, 821 F.3d 187 (1st Cir. 2016).

Although this case pertains only to the trucking industry's use of the owner/operator business model in the unemployment compensation tax context, there is little doubt that the assault on such a model is more general both in Washington State and other states, requiring this Court to articulate the correct FAAAA test so that state re-regulation of the trucking industry in the guise of applying state wage and hour, worker compensation, or other laws will not continue unabated.[19] Indeed, the Washington court *conceded* that there is advocacy "from some quarters" for applying ESD's analysis of independent contractors elsewhere. App. 19a.

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19. As noted *supra* at n.10, Washington State's effort to deny trucking firms the use of the owner/operator model in wage and hours laws and worker compensation, denominating those firms a part of the "underground economy" persists. *See also*, *e.g.*, *Filo Foods, LLC v. City of Sea-Tac*, 357 P.3d 1040 (Wash. 2015) (local minimum wage ordinance for airport-related hospitality and transportation industries not ADA preempted); *Henry Indus., Inc. v. Dep't of Labor & Indus.*, 381 P.3d 172 (Wash. App. 2016) (courier's owner/operator drivers were carrier employees for worker compensation purposes).

Moreover, the cases cited *supra* document that states like California similarly assault the owner/operator business model outside the narrow setting of unemployment compensation. *See Dynamex*, *Su*, *supra*.

(c) State Unemployment Compensation Laws that Effectively Ban the Use of the Owner/Operator Business Model Affect Carrier Prices, Routes, or Services and Are FAAAA- Preempted

Even if this Court's analysis focuses solely on an effective ban on the owner/operator business model in the unemployment compensation setting alone, those statutes are preempted under the FAAAA and *Rowe*. The Washington courts found insufficient impact on trucking prices, routes, or services, despite *unrebutted* contrary evidence that ESD's conduct affected routes, prices, and services. App. 79a-80a.

Larry Pursley, Executive Vice President of the Washington Trucking Associations, Washington's principal trade organization for trucking firms, who has 33 years of experience in the trucking industry, testified that ESD's assessments would imperil the structure of Washington's trucking industry. He explained that owner/operators provide a flexible supply of equipment in an industry with volatile demand. To meet this demand with employees, carriers would need to maintain higher equipment and personnel levels than the market calls for normally. The added costs—not just of the equipment and the personnel, but also of the associated expenses—would necessarily be passed on to customers in the form of higher prices. App. 127a-128a. Joe Rajkovacz, formerly OOIDA's Director of Regulatory Affairs, testified that ESD's attempt to reclassify owner/operators will undoubtedly lead to diminished economic choices and reduced income for owner/operators. He also testified that owner/operators located outside Washington who lease equipment to carriers in Washington will enjoy a competitive edge in the marketplace.

The reality of ESD's effective ban on the owner/operator model for trucking carriers in the unemployment compensation tax context is that such carriers will be put to a choice. They can restructure their business and make all drivers company employees.[20] If they do so, the impact on prices, routes, or services is manifest. Trucking companies will face the expense of permanent compensation and benefits for drivers as employees, even when there are times when such permanent drivers are unneeded due to the cyclical nature of service demand for such companies. The carriers will be obliged to pay state-mandated unemployment compensation taxes and worker compensation premiums.[21] If trucking carriers cannot use owner/operators, they will need to purchase equipment for company drivers. Such equipment is not cheap and may often sit idle as cargo needs fluctuate. These are *real* costs.

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20. In seeking to uphold ESD's assertion, its counsel argued below that trucking carriers could restructure their businesses to treat owner/operators as employees in some contexts and independent contractors in others. But that argument is unrealistic, and impractical as the district court in *Healey* noted in rejecting a similar argument, that such an approach was a "significant burden," that could be found *nowhere* in actual practice. *Mass. Delivery Ass'n v. Healey*, 117 F. Supp. 3d 86, 95 (D. Mass), *aff'd*, 821 F.3d 187 (1st Cir. 2016). This fact alone makes crystal clear the impact of Washington State's regulation on carrier services.

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

This interference also has a logical effect on routes. As the First Circuit in *Schwann* explained, independent contractors assume "the risks and benefits of increased or decreased efficiencies achieved by the selected routes," while employees would likely "have a different array of incentives that could render their selection of routes less efficient." 813 F.3d at 439. Forcing a carrier to treat owner/operators as employees relates to routes, in addition to prices and services.

Finally, the states' imposition of an unwanted business model – employees rather than owner/operators – on trucking firms impact trucking industry services.[22] FAAAA preemption is intended to prevent states from substituting their "own governmental commands for 'competitive market forces' in determining (to a significant degree) the services that motor carriers will provide." *Rowe*, 552 U.S. at 372 (quoting *Morales*, 504 U.S. at 378). As the district court in *Healey* explained, if a carrier

22. Such a state effort to supplant the owner/operator business model for trucking companies with a model of the government's choosing necessarily constitutes an effort by Washington State to supplant market forces with State regulation, something the FAAAA was specifically designed to forestall. As the First Circuit noted in *Schwann*, whether to provide services through employees or through independent contractors is a significant business decision which "implicates the way in which a company chooses to allocate its resources and incentivize those persons providing the service." *Schwann*, 813 F.3d at 438. Washington State's interference with carriers' decision to lease equipment would pose "a serious potential impediment to the achievement of the FAAAA's objectives because a court, rather than the market participant, would ultimately determine what services that company provides and how it chooses to provide them." *Id.*

wishes to fulfill on-demand requests for unscheduled deliveries with employee drivers, it necessarily must have on-call employees available. "Retaining on-call employees forces [the carrier] to incur costs that translate into increased prices. . . . Conversely, if [the carrier] endeavors to maintain its current prices, then the practical effect of [the statute] is to force it to abandon a service now demanded by the competitive marketplace." 117 F. Supp. 3d at 93.

The other option available to trucking carriers faced with an interpretation of unemployment compensation tax laws like that of the Washington courts is to retain the owner/operator model for unemployment compensation taxation and then risk whether such an admission that owner/operators are carrier employees in that setting will not be used against them in other settings like wage and hours laws or worker compensation. Such an uncertain prospect is a nightmare for carriers.

To remain competitive, trucking firms that rely on owner/operators as a flexible supply of equipment will have to change how they do business, adopting some combination of: (a) reducing their capacity to respond to fluctuating demand for transportation services; (b) increasing their operating costs by adding new employees and equipment, which would sit idle during leaner times; or (c) raising prices to account for increased costs and/or taxes. In fact, further evidencing the adverse impact of ESD's actions, Washington State even imposes a higher tax rate on businesses using a flexible personnel model. ESD punishes businesses using a flexible personnel model with short-term employees to fill temporary surges in demand, by increasing their tax rate whenever their

employees file for unemployment compensation. *See* Wash. Rev. Code § 50.29.021(2), .025; Wash. Admin. Code § 192-320-005. Indeed, a trucking carrier would be at risk of an unemployment claim, and corresponding tax increase, any time an owner/operator's income is reduced by 25% or more. *See* Wash. Rev. Code § 50.20.050(2)(b)(v). ESD incentivizes businesses that favor permanent employees and discourages businesses that seek to use a flexible workforce. All of these changes from the owner/operator business model constitute a direct interference with carriers' services.

In sum, the Washington courts interpretation of state unemployment compensation laws joins an interpretation of such laws by other states that affects carrier prices, routes, or services within the meaning of the FAAAA. This Court should grant review to vindicate the critical federal policy of deregulation in the trucking industry and to avoid the effective state re-regulation of trucking.[23]

(2) Compliance with Federally-Mandated Lease Terms in 49 C.F.R. § 376.12 Is Not Evidence of Carrier Control over Owner/Operators for State Law Purposes

Despite a contrary federal regulation, the Washington courts held that state agencies could treat federally-

23. A patchwork of state laws is not mere rhetoric. Washington's neighboring states, Oregon and Idaho, for example, have held carriers to be exempt from taxation for owner/operators. *See CEVA Freight, LLC v. Employment Dep't*, 279 Or. App. 570, 379 P.3d 776, *review denied*, 360 Or. 751 (2016); *Home Transp., Inc. v. Idaho Dep't of Labor*, 318 P.3d 940 (Ida. 2014). As noted *supra*, System has its headquarters near Idaho.

mandated elements in equipment leases as evidence of carrier direction or control over owner/operators.[24] Such a determination flouts federal law. This Court should grant review to make clear that this is impermissible.

Wash. Rev. Code § 50.04.140(1)(a) required the carriers to document that the owner/operators have been "and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact." The leasing agreements with owner/operators utilized by all of the petitioners contained terms mandated by 49 C.F.R. Part 376.

Those federally-mandated lease terms governing the relationship between carriers and owner/operators are extensive.[25] ESD concluded in each case that federally-

24. The Washington court focused on the fact that owner/operators do not operate under their federal licenses. App. 50a-53a. But federal law *requires* owner/operators to operate under a trucking carrier's FMCSA license. *See* 49 C.F.R. § 376.11(c). Simply put, owner/operators are not owner/operators if they operate under their own federal authority.

25. In addition to the provisions of 49 C.F.R. §§ 376.11 and 376.12 referenced *supra*, federal law even dictates that carriers must give written authorization for owner/operators to have passengers in a truck. 49 C.F.R. § 392.60. ESD used that fact against the carriers. App. 146a. ESD noted that owner/operators had to comply with the drug and alcohol policies. *Id.* That, too, is a federal law mandate. ESD highlighted the fact that the petitioners must provide written authorization for equipment to be leased to other carriers. App. 145a. This is a federal requirement, 49 C.F.R. § 376.22, designed to ensure accountability for the leased equipment. ESD also highlighted such cargo-protection requirements as owner/operators' responsibility to maintain equipment in good operating condition and supply safety devices. App. 146a. But properly functioning equipment that does

mandated lease provisions established "control" by the petitioners, even though those trucking carriers exerted little actual control over how the owner/operators performed the trucking services in question. The owner/operators decided whether to take a load, who would drive the truck, the route the truck would take, and the hours of truck operation, to name a few. ESD's conclusion fundamentally misstates the law in two very key respects.

The carrier petitioners did not exercise control over the owner/operators merely because they complied with federally-mandated equipment lease terms. 49 C.F.R. Part 376.[26] *Western Ports v. Emp't Sec. Dep't*, 41 P.3d 510 (Wash. App. 2002), affirmed by the Washington court decisions here, was wrong as to this issue.

Those mandatory federal equipment lease terms carry out federal motor carrier safety policy. Anticipating that states would attempt to do exactly what ESD has

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not break down en route is important to the safety of the motoring public, ensures that a carrier's contractual purpose is achieved, and avoids liability exposure for the trucking carrier. ESD noted further that the petitioners have the right to take possession of the equipment to complete a shipment if the owner/operator breaches the contract. App. 147a. But completion of contracts is not just related to services––it *is* the service that carriers offer their customers.

26. 49 U.S.C. § 14102(a) provides for federal regulation of a carrier's lease of motor vehicle equipment. This regulation is necessary for the efficient management of the motor carrier industry. Jessica Goldstein, *The Lease and Interchange of Vehicles in the Motor Carrier Industry*, 32 Transp. L.J. 131 (Spring 2005). 49 C.F.R. § 376.11 *et seq.* dictates the specific terms and conditions by which a carrier may perform authorized transportation in equipment it does not own.

done here, the federal government dealt with one of the mandatory lease terms – mandating that the carrier have exclusive control over the leased equipment – by expressly providing that "[n]othing" in the "exclusive use" requirement "is intended to affect whether the lessor or driver provided by the lessor is an independent contractor or an employee of the authorized carrier lessee." 49 C.F.R. § 376.12(c)(4).

Recognizing that state authorities were confused about the impact of federally-mandated exclusivity on state law control issues, before the full federal deregulation of trucking, the Interstate Commerce Commission promulgated the predecessor to 49 C.F.R. § 376.12(c)(4), and issued an explanation for that regulation, emphasizing that "exclusive possession, control, and use" of an owner/operator's equipment was to have no impact on state law determinations of control over owner/operators. 1992 WL 17965. That agency reinforced that position in a subsequent 1994 declaratory order. 1994 WL 70557.[27]

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27. The Washington court asserted that the ICC's ostensible rationale for its rule was incorrect. App. 29a. But that court neglected to reference the 1992 ICC guidance, published when § 376.12(c)(4) was promulgated, which stated that "*most courts have correctly interpreted the appropriate scope of the control regulation and have held that the type of control required by the regulation does not affect 'employment' status....*" *Petition to Amend Lease & Interchange of Vehicle Regulations*, 8 I.C.C.2d 669, 671 (I.C.C. June 29, 1992) (emphasis added). But "some courts and State workers' compensation and *employment agencies*" had improperly used compliance with the leasing regulations as "prima facie evidence of an employer-employee relationship" and had erroneously found that it "evidences the type of control that is indicative of an employer-employee relationship." *Id.* (emphasis added). The intent of this section was not limited to rejecting some

With regard to the other specific lease terms mandated in 49 C.F.R. Part 376 for inclusion in a carrier-owner/operator equipment lease agreement it is no different. The federal government, not the carrier, imposes the lease requirements on both the carrier and owner/operator. Thus, any "control" exercised is that of the federal government, not the carrier, and it is exercised over both parties. Ensuring compliance with federal regulatory and safety requirements is not evidence of a *carrier* right to control the owner/operator.[28]

In *Western Ports*, the Washington court determined that ESD could properly consider all such federally-

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notion of federal vicarious liability. It was to disabuse courts and state administrative agencies of the notion that compliance with the federal requirement was *prima facie* evidence of an employer-employee relationship between carriers and owner/operators.

28. *See*, *e.g.*, *Reed v. Indus. Comm'n*, 534 P.2d 1090 (Ariz. App. 1975) (government regulations imposed on carriers and, in turn, applied to owner/operators do not indicate control); *Sida of Hawaii, Inc. v. NLRB*, 512 F.2d 354, 359 (9th Cir. 1975) ("fact that a putative employer incorporates into its regulations controls required by a government agency does not establish an employer-employee relationship."); *Pouliot v. Paul Arpin Van Lines, Inc.*, 292 F. Supp. 2d 374, 383 (D. Conn. 2003) (lease regulations have no impact on the type of relationship that exists between the parties to the lease); *Tamez v. S.W. Motor Transp., Inc.*, 155 S.W.2d 564, 573 (Tex. Civ. App. 2004) (existence of lease does not have any impact on relationship between owner/operator and trucking firm); *Hernandez v. Triple Ell Transp., Inc.*, 175 P.3d 199, 205 (Idaho 2007) (adherence to federal law" was not evidence of a carrier's control over an owner/operator); *Wilkinson v. Palmetto State Transp. Co.*, 676 S.E.2d 700, 705 (S.C. 2009), *cert. denied*, 130 S. Ct. 741 (2009) (federal regulation "is not intended to affect" the independent contractor determination under state law).

mandated controls in applying the statutory test for exemption. *Western Ports* is wrong in light of the specific language of 49 C.F.R. § 376.12(c)(4) and the reason for the federal mandate of lease terms in 49 C.F.R. Part 376. Plainly, the *carriers* did not mandate such factors. When the government controls the contract provisions, it is *the government*, not the contracting parties, exercising control. *Western Ports* also missed the point recognized by the *Remington* court that the FAAAA itself may also preempt its analysis. 2016 WL 4975194 at *5.

As evidenced by the terms of 49 C.F.R. § 376.12(c)(4) on exclusivity, the case law from numerous jurisdictions opining that compliance with federally-mandated directives is not evidence of control for state law purposes, and *Western Ports*, there is a split of authority on the question of whether compliance with federal law mandates may, in effect, be used against parties under state law. This Court should grant review to vindicate the federal policy and to prevent states from using the federally-required provisions of 49 C.F.R. Part 376 in equipment leases against carriers in determining if they control owner/operators for state law purposes.

CONCLUSION

Lower courts are misapplying this Court's FAAAA precedents, creating an exemption from the broad federal preemption of local laws directed by Congress in that statute for "background laws of general applicability." The FAAAA's language does not authorize such an exception to Congressional policy any more than did "public health" in *Rowe*.

The business model for an entire industry is implicated by the Washington courts' decisions here. That business model drives today's modern trucking industry. Washington, like many other states utilizing a similar definition of an independent contractor, effectively eliminates the use of owner/operators in the unemployment compensation tax setting, adversely affecting carrier prices, routes, and services. Washington's Wash. Rev. Code § 50.04.140 is preempted by the FAAAA, when properly analyzed.

Further, state courts are using trucking carrier compliance with federally-mandated equipment lease provisions to find that carriers "control" independent contractors for state law purposes. This is but an aspect of attempted re-regulation of trucking carriers despite Congressional de-regulation policy.

This Court should grant the System/Hatfield petition and reverse the decision of the Washington court.

DATED this 10th day of October, 2018.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE COURT OF APPEALS OF THE STATE OF WASHINGTON, DIVISION THREE, FILED OCTOBER 31, 2017

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON, DIVISION THREE

No. 34566-1-III (consolidated with
No. 34567-0-III,
No. 34568-8-III)

SWANSON HAY COMPANY,

Appellant,

v.

STATE OF WASHINGTON EMPLOYMENT SECURITY DEPARTMENT,

Respondent.

HATFIELD ENTERPRIZES, INC.,

Appellant,

v.

STATE OF WASHINGTON EMPLOYMENT SECURITY DEPARTMENT,

Respondent.

Appendix A

SYSTEM-TWT TRANSPORT,
A WASHINGTON CORPORATION

Appellant,

v.

STATE OF WASHINGTON EMPLOYMENT
SECURITY DEPARTMENT,

Respondent.

June 13, 2017, Oral Argument
October 31, 2017, Filed

SIDDOWAY, J. — The common law, the Washington Legislature, and the United States Congress have defined whether two parties stand in an employment as opposed to an independent contractor relationship in different ways, depending on the context. This case illustrates that it can be clearer to ask not whether someone is an independent contractor but instead whether the contractor is independent for a given purpose: e.g., for the purpose of the doctrine of respondeat superior, for federal payroll tax purposes, for state workers' compensation, or for other state law purposes. At issue here is employment security—the context in which, in Washington, the relationship is more likely than any other to be viewed as employment.

Appendix A

The three motor carriers in this consolidated appeal challenge assessments of unemployment insurance taxes on amounts they paid for services provided by "owner-operators," meaning individuals who own trucking equipment, lease it to a carrier, and then use that equipment under contract to haul freight for that carrier. The carriers did not meet their burden of demonstrating that the owner-operators' services qualify for the narrow exemption from unemployment insurance tax liability for payments to sufficiently independent enterprises. We find no federal preemption of the tax's application to the owner-operators' services and no basis on which the Employment Security Department's final order was arbitrary or capricious. We affirm.

BACKGROUND

Washington's Employment Security Act

Title IX of the Social Security Act of 1935 for the first time imposed a federal excise tax on employers on wages paid, for the purpose of creating an unemployment benefit fund. Ch. 531, 49 Stat. 620; *Steward Mach. Co. v. Davis*, 301 U.S. 548, 574, 57 S. Ct. 883, 81 L. Ed. 1279 (1937). The tax began with the year 1936 and was payable for the first time on January 31, 1937. 301 U.S. at 574. An employer could claim a 90 percent credit against the tax for contributions paid to an unemployment fund under a state law, provided the state law had been certified to the United States secretary of the treasury as meeting criteria designed in part "to give assurance that the state unemployment compensation law [is] one in substance as

well as name." *Id.* at 575. The tax and largely offsetting credit were described by supporters as "the states and the nation joining in a coöperative endeavor to avert a common evil": the problem of unemployment that the nation had suffered at unprecedented levels during the years 1929 to 1936. *Id.* at 587, 586.

Before Congress considered adoption of the act, most states held back from adopting state unemployment compensation laws despite the ravages of the Great Depression. *Id.* at 588. This was not for "lack of sympathetic interest," but "through alarm lest, in laying such a toll upon their industries, they would place themselves in a position of economic disadvantage as compared with neighbors or competitors." *Id.* "The federal Act, from the nature of its ninety per cent credit device, [was] obviously an invitation to the states to enter the field of unemployment insurance." *Standard Dredging Corp. v. Murphy*, 319 U.S. 306, 310, 63 S. Ct. 1067, 87 L. Ed. 1416 (1943) (citing *Buckstaff Bath House Co. v. McKinley*, 308 U.S. 358, 363, 60 S. Ct. 279, 84 L. Ed. 322 (1939)). Most states accepted the invitation and adopted state unemployment compensation laws. *See* Benjamin S. Asia, *Employment Relation: Common-Law Concept and Legislative Definition*, 55 YALE L.J. 76, 83-85 & nn.24-34 (1945) (discussing laws adopted by 31 states and the District of Columbia).

Criteria by which the federal Social Security Board (now known as the Social Security Administration) would certify state laws were limited to what was "basic and essential" to provide reasonable protection to the unemployed, with "[a] wide range of judgment … given

to the several states as to the particular type of statute to be spread upon their books." *Steward*, 301 U.S. at 593. But to assist state legislatures, the Social Security Board published draft laws in 1936 and 1937 as examples meeting the federal requirements.[1] Following a recommendation by the Committee on Legal Affairs of the Interstate Conference of Unemployment Compensation Agencies that "employment" for purposes of the state laws should be broadly defined, using a pioneering 1935 Wisconsin law as a model, the Social Security Board published a draft bill in January 1937 that tracked Wisconsin's expansive definition of "employment." Asia, *supra*, at 83 n.21. It

1. Introductory language to the draft bills explained:

> These drafts are merely suggestive and are intended to present some of the various alternatives that may be considered in the drafting of State unemployment compensation acts. Therefore, they cannot properly be termed "model" bills or even recommended bills. This is in keeping with the policy of the Social Security Board of recognizing that it is the final responsibility and the right of each State to determine for itself just what type of legislation it desires and how it shall be drafted.

U.S. Soc. Sec. Bd., Draft Bills for State Unemployment Compensation of Pooled Fund and Employer Reserve Account Types (Sept. 1936) (*Draft Bills*, 1936 ed.), https://babel.hathitrust.org/cgi/pt?id=mdp.39015073775531;view=1up;seq=9; *see also* U.S. Soc. Sec. Bd., Draft Bill for State Unemployment Compensation of Pooled Fund Type: January 1937 Edition, with Tentative Revisions (May 1938) (*Draft Bill*, 1937 ed.), https://babel.hathitrust.org/cgi/pt?id=coo.31924002220212;view=1up;seq=9. As to the latter publication, only the version marked for tentative revisions could be located by this author.

broadly defined "employment" to mean "service, including service in interstate commerce, performed for wages or under any contract of hire, written or oral, express or implied… ." *Draft Bill*, 1937 ed., § 2(h)(6)(i)(1) at 7. To narrowly exempt payments to individuals engaged in an independent enterprise, it employed a three-part measure of independence, often referred to as the "ABC" definition, that included a freedom from control ("A") requirement, an independent business character or location ("B") requirement, and an independently established enterprise ("C") requirement. The "C" requirement was described as "at once the most radical departure from common-law criteria and the most relevant of the three tests to the purposes of the unemployment compensation program." Asia, *supra*, at 87.

In March 1937, the Washington Legislature enacted an unemployment compensation act substantially based on the Social Security Board's draft bills, to take effect immediately. LAWS OF 1937, ch. 162, § 24, at 617. Tracking language in the draft bills, its preamble described "economic insecurity due to unemployment" as the "greatest hazard of our economic life." *Id.* § 2, at 574-75, presently codified at RCW 50.01.010. It authorized taxation to create resources from which to provide benefits for persons "unemployed through no fault of their own" by applying "the insurance principle of sharing the risks, and by the systematic accumulation of funds during periods of employment to provide benefits for periods of unemployment." *Id.* at 575.

Section 19(g)(1) of the 1937 Washington legislation tracked Wisconsin's and the Social Security Board's

definition of "employment." *Id.* at 610. Its "ABC" definition of exempt independent enterprises, which was virtually identical to the Social Security Board's 1937 draft bill,[2] provided:

> Services performed by an individual for remuneration shall be deemed to be employment subject to this act unless and until it is shown to the satisfaction of the director that:
>
> (i) Such individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact; and
>
> (ii) Such service is either outside the usual course of the business for which such service is performed, or that such service is performed outside of all the places of business of the enterprises for which such service is performed; and

2. Apart from a few formatting differences, the only changes from the federal draft language in the Washington exemption provision were the substitution of "remuneration" for "wages" in the introductory paragraph and, in the "ABC" paragraphs ((i), (ii), and (iii) in Washington until 1945, when they became (a), (b), and (c)); the substitution of "director" for "commissioner"; and the addition to the "C" requirement of the language that the individual's independently established trade, occupation, profession, or business is "of the same nature as that involved in the contract of service." *Compare* LAWS OF 1937, ch. 162, § 19(g)(5), *with Draft Bill*, 1937 ed., § 2(i)(5), at 8-9.

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

LAWS OF 1937, ch. 162, § 19(g)(5), at 611-12. As later observed by our Supreme Court, because the requirements were stated in the conjunctive, a failure to satisfy any one of them rendered the exemption unavailable. *Penick v. Emp't Sec. Dep't*, 82 Wn. App. 30, 42, 917 P.2d 136 (1996).

In 1945, the Washington Legislature repealed all acts relating to unemployment compensation and enacted a new unemployment compensation act, presently codified as amended in Title 50 RCW. LAWS OF 1945, ch. 35, §§ 1-192, at 76-151. The breadth of "employment" covered by the act was made even clearer by the addition of language describing "personal service, of whatever nature," etc., as "unlimited by the relationship of master and servant as known to the common law or any other legal relationship." *Id.* § 11, at 79.

Appellants and the assessments

In proceedings below, the appellant-carriers, Swanson Hay Co., System-TWT Transport, and Hatfield Enterprizes Inc., appealed unemployment taxes assessed by the Employment Security Department (Department) on the carriers' payments for services to owner-operators. They participated in evidentiary or summary judgment proceedings before an administrative law judge (ALJ) and filed petitions for review of the ALJ's adverse

determinations by the Department's commissioner (Commissioner). The Commissioner entered modified findings and conclusions but affirmed determinations adverse to the carriers.

There are some differences in the three carriers' operations and audit history. System was identified for audit through the work of an "underground economy unit" of the Department and was originally assessed $264,057.40 in taxes for the period beginning in the second quarter of 2007 and including years 2008 and 2009. 1 AR(ST)[3] at 4, ¶ 7; 3 AR(ST) at 185-86, 183, 222-23; 2 AR(ST) at 350. During that time frame, System treated roughly 380 company drivers as employees, reporting and paying unemployment insurance taxes. 2 AR(ST) at 320, ¶ 5; Br. of Appellant System at 5. But it contracted with more than 250 owner-operators that it treated as exempt from operation of the tax. 2 AR(ST) at 320, ¶ 5; Br. of Appellant System at 5. It engaged in several appeals of its assessment, contesting both the amount and liability for the tax, but ultimately stipulated to an assessment value of $58,300.99 should its challenge to liability fail. 1 AR(ST) at 5, ¶ 11; 2 AR(ST) at 350-51.

Swanson and Hatfield are smaller operators. Swanson was originally found by the Department to have misclassified 12 contractors as not in employment and was assessed $36,070.32 for the period 2009, 2010, and the

3. We identify volumes of the administrative record involved by the volume number followed by "AR" and a parenthetical identification of the case—SH, ST, and H for the Swanson, System, and Hatfield appeals, respectively.

first two quarters of 2011. 2 AR(SH) at 235, ¶¶ 4.1, 4.5. On appeal, the Department agreed to modify the assessment to treat only 11 of the contractors as misclassified. 2 AR(SH) at 235, ¶ 4.7. The order and notice of assessment was later remanded to reduce the assessment to account for the contractor treated as exempt. *Id.* at 280.

Hatfield was found by the Department to have misclassified 15 contractors as not in employment and was assessed taxes and penalties of $13,616.53 for eight calendar quarters falling within the period January 2009 through June 2011. 4 AR(H) at 1140, ¶ 4.1. On appeal, the ALJ ordered that the assessment be reduced to 30 percent of that amount to account for the fact that the Department relied on payment amounts of which approximately 70 percent were for equipment rather than driving services. *Id.* at 1144, ¶ 5.8. The reduction was affirmed by the Commissioner. *Id.* at 1201.

Differences in the carriers and their procedural histories are mostly inconsequential on appeal. They are discussed where relevant.

ANALYSIS

Grounds Relied on for Judicial Review and Standards of Review

Judicial review of agency action is governed by the Administrative Procedure Act (APA), chapter 34.05 RCW. *Tapper v. Emp't Sec. Dep't*, 122 Wn.2d 397, 402, 858 P.2d 494 (1993). We apply the standards of the APA directly to

the record before the agency, and in employment security appeals we review the decision of the Commissioner, not the underlying decision of the ALJ or the decision of the superior court. *Id.*; *Verizon Nw., Inc., v. Emp't Sec. Dep't*, 164 Wn.2d 909, 915, 194 P.3d 255 (2008). The Commissioner's decision is deemed prima facie correct, and the burden of demonstrating otherwise is on the party attacking it. RCW 50.32.150.

The APA authorizes courts to grant relief from an agency order in an adjudicative proceeding in nine instances, five of which were relied on in petitions for judicial review filed by one or more of the carriers:

- The order or the statute on which it is based is in violation of constitutional provisions;
- The agency engaged in unlawful procedure or decision-making process, or failed to follow a prescribed procedure;
- The agency erroneously interpreted or applied the law;
- The agency did not decide all issues requiring resolution by the agency; and
- The order is arbitrary or capricious.

RCW 34.05.570(3)(a), (c), (d), (f), (i); Clerk's Papers (CP) at 4, 24, 98, 318.

Errors of law are reviewed de novo. *Inland Empire Distrib. Sys., Inc. v. Wash. Utils. & Transp. Comm'n*, 112 Wn.2d 278, 282, 770 P.2d 624 (1989). An agency's decision is "arbitrary and capricious" if it is "willfully unreasonable, without consideration and in disregard of facts or circumstances." *W. Ports Transp., Inc. v. Emp't Sec. Dep't*, 110 Wn. App. 440, 450, 41 P.3d 510 (2002).

Issue One: Federal Preemption

System makes a threshold argument that even if the Employment Security Act (ESA),[4] Title 50 RCW, would otherwise apply to its payments for the services of owner-operators, the Department's assessments are preempted by federal law. Hatfield joins in all of System's arguments. Br. of Appellant Hatfield at 9. The Department responds that Division One of this court already held that the ESA is not federally preempted in *Western Ports*, 110 Wn. App. at 457.

In its final decisions in the System and Hatfield appeals, the Commissioner, "mindful of [his] limited authority as a quasi-judicial body," discussed case law from other jurisdictions dealing with the federal preemption issue but ultimately concluded that his was not the appropriate forum to decide the constitutional issue, except insofar as he would apply *Western Ports. E.g.*, 4 AR(H) at 1191. He correctly observed that the Commissioner's Review

4. What had formerly been entitled the Unemployment Compensation Act was renamed the Employment Security Act in 1953. LAWS OF 1953, 1st Ex. Sess., ch. 8, § 24.

Office, being an office within the executive branch, lacks the authority or jurisdiction to determine whether the laws it administers are constitutional; only the courts have that power. *Id.* (citing RCW 50.12.010 and .020; *Bare v. Gorton*, 84 Wn.2d 380, 383, 526 P.2d 379 (1974)). At the same time, he recognized that on judicial review, the superior and appellate courts may consider and rule on the constitutionality of an agency order. *Id.* (citing RCW 34.05.570(3)(a)). He found that the record had been adequately developed at the administrative level to enable judicial review. *Id.* at 1192.

To assess the relevance of *Western Ports*, we begin by identifying the preemption arguments that System advances. System first relies on an express preemption provision that it argues was not considered in *Western Ports*. Its second argument relies on language from federal leasing regulations that was considered in *Western Ports* and found not to preempt state law, but System argues we should reject *Western Ports*' conclusion in light of later, persuasive authority.

A. Express Preemption

In 1994, seeking to preempt state trucking regulation, Congress adopted the Federal Aviation Administration Authorization Act of 1994 (FAAAA), Pub. L. No. 103-305, § 601, 108 Stat. 1605-06; *see also* ICC Termination Act of 1995, Pub. L. No. 104-88, § 14501, 109 Stat. 899. Its express rule of preemption, which is subject to exceptions and exclusions not relevant here, provides:

> [A] State, political subdivision of a State, or political authority of 2 or more States may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service of any motor carrier … or any motor private carrier, broker, or freight forwarder with respect to the transportation of property.

49 U.S.C. § 14501(c)(1).

In adopting the preemptive language "related to a price, route, or service," Congress copied language of the preemptive clause of the Airline Deregulation Act of 1978 (ADA), Pub. L. No. 95-504, 92 Stat. 1705, in order to ensure application of the broad interpretation of that preemption provision adopted by the United States Supreme Court in *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 112 S. Ct. 2031, 119 L. Ed. 2d 157 (1992). The Supreme Court held in *Morales* that the "related to" preemption provided by the ADA preempted all "[s]tate enforcement actions having a connection with, or reference to, airline 'rates, routes, or services.'" *Id.* at 384 (quoting former 49 U.S.C. app. § 1305(a)(1) (1984)). It rejected states' arguments that their laws of general applicability were immune from preemption. Pointing to its earlier holding in an ERISA[5] case (ERISA also employs the same preemptive language), the Court held that "'[a] state law may "relate to" a benefit plan, and thereby be pre-empted, even if the law is not

5. Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001-1461.

specifically designed to affect such plans, or the effect is only indirect.'" *Id.* at 386 (alteration in original) (quoting *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 139, 111 S. Ct. 478, 112 L. Ed. 2d 474 (1990)). In a critical limitation on its holding, the Court recognized that "'[s]ome state actions may affect [airline fares] in too tenuous, remote, or peripheral a manner' to have pre-emptive effect." *Id.* at 390 (alterations in original) (quoting *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 100 n.21, 103 S. Ct. 2890, 77 L. Ed. 2d 490 (1983)).

The carriers in this case argue that imposing unemployment insurance taxation on their use of owner-operators has a significant impact rather than a tenuous, remote, or peripheral impact on their prices, routes, and services. They contend that it "effective[ly] eliminat[es] … the owner/operator business model" that has been long relied on for "a flexible supply of equipment in an industry with erratic demand." Br. of Appellant System at 2, 1.

1. *Western Ports* did not address express preemption

With System's first challenge in mind, we turn to *Western Ports*. It arose not from a department audit, but from an application for unemployment benefits by Rick Marshall, an owner-operator whose independent contractor agreement with Western Ports, a trucking firm, had been terminated by the firm. The Department denied Mr. Marshall's application for benefits based on Western Port's contention that he was an independent contractor exempt from coverage under RCW 50.04.140. The principal focus of this court's decision on appeal was

whether Western Ports proved the first, "freedom from control" requirement for the exemption. *W. Ports*, 110 Wn. App. at 452-59.

But Western Ports also argued that federal transportation law preempted state employment security law because it both permitted and heavily regulated owner-operator lease arrangements like Mr. Marshall's. *Id.* at 454. This court analyzed that argument as an issue of implied "field" preemption—one of three ways federal law can be found to preempt state law, the other two being express preemption or where state law would conflict with federal law. *Estate of Becker v. Avco Corp.*, 187 Wn.2d 615, 622, 387 P.3d 1066 (2017). Field preemption can be found from federal regulation so pervasive it supports the inference that Congress left no room for state supplementation, where the federal interest is so dominant it can be assumed to be exclusive, or where the federal objective and regulation reveals the same purpose as the state purpose. *Pac. Gas & Elec. Co. v. State Energy Res. Conserv. & Dev. Comm'n*, 461 U.S. 190, 204, 103 S. Ct. 1713, 75 L. Ed. 2d 752 (1983).

In analyzing the field preemption argument, *Western Ports* considered 49 U.S.C. § 14102, which authorizes the Secretary of the federal Department of Transportation to regulate the leasing of motor vehicles used in interstate commerce, and the detailed federal leasing regulations adopted thereunder. 110 Wn. App. at 454-57, 455 n.2. It "decline[d] to infer" from them that Congress intended to supplant state law, given that "[n]owhere … has Congress even mentioned state employment law" and federal transportation law and state unemployment insurance law "have very different policy objectives." *Id.* at 457. Only

once in *Western Ports* did the court mention the FAAAA's express preemption provision, and that was to point out that when Congress wanted to preempt state law, it did so "expressly, clearly and understandably." *Id.*

Western Ports contains no analysis of whether imposing state unemployment insurance taxes on Western Port's payment for owner-operator services related to its prices, routes, or services. While the decision is relevant and persuasive as to other issues presented in this appeal, it simply did not address the first, express preemption issue that is raised by these carriers.[6]

2. The carriers' express preemption argument proceeds on a theory that Title 50 RCW's broad definition of "employment" will be applied in other contexts, a legal premise we reject

The carriers largely rely on a series of state and federal court decisions that have found a portion of Massachusetts's independent contractor statute to be preempted by the FAAAA as applied to motor carriers' payment for owner-operator services. The carriers' briefs even echo language from one of those decisions, *Sanchez v. Lasership, Inc.*, 937 F. Supp. 2d 730, 736 (E.D. Va.

6. The Department points out that Division Three of the Colorado Court of Appeals read *Western Ports* as rejecting the "argument that the imposition of unemployment tax liability under [Washington's] scheme against a carrier concerning a truck driver was preempted by federal law, *including 49 U.S.C. § 14501(c)(1)*." *SZL, Inc. v. Indus. Claim Appeals Office*, 254 P.3d 1180, 1188 (Colo. App. 2011) (emphasis added). We respectfully disagree with the Colorado court's analysis of the decision.

2013), which characterized the Massachusetts law as "an unprecedented change in independent contractor law that dictates an end to independent contractor carriers in Massachusetts and imposes an anticompetitive, government-driven mandate that motor carriers change their business models to avoid liability under the statute."

The Massachusetts law—chapter 149, section 148B of the Massachusetts General Laws—is different from Washington law in important respects. It mandates "employee" classification for purposes of multiple state laws, more significantly affecting motor carriers. The mandated classification applies at a minimum to chapters 149 and 151 of the Massachusetts General Laws, which deal with workmen's compensation and minimum fair wages. *Schwann v. FedEx Ground Package Sys., Inc.*, 813 F.3d 429, 433 (1st Cir. 2016). Under those laws, an "employer" must provide benefits to employees that include days off, parental leave, work-break benefits, a minimum wage, and reimbursement of all out-of-pocket expenses incurred for the benefit of the employer regardless of what the parties' agreement would otherwise provide. *Id.*

By contrast, chapter 50.04 RCW defines "employment" and identifies its exemptions solely for unemployment insurance tax purposes. As observed in *Western Ports*, "an individual may be both an independent contractor for some purposes, and engaged in 'employment' for purposes of Washington's exceedingly broad definition of covered employment." 110 Wn. App. at 458.

System asks us to reject that conclusion of *Western Ports* and the Department's position that Title 50 RCW's definitions and exemptions apply only to unemployment

insurance taxes, calling them "unrealistic." Br. of Appellant System at 25. It cites to evidence that the Department participated in an underground economy task force "whose thrust was to subject carriers to state regulation for a variety of other agency purposes," and to an Obama administration employee misclassification initiative. Br. of Appellant System at 25 n.35. Our own reading supports the carriers' contention that there is advocacy from some quarters for extending the narrow "ABC" criteria for independent contractor status in the unemployment compensation context to other worker protections. *See, e.g.*, Jennifer Pinsof, *A New Take on an Old Problem: Employee Misclassification in the Modern Gig-Economy*, 22 MICH. TELECOMM. & TECH. L. REV. 341 (2016); Anna Deknatel & Lauren Hoff-Downing, *ABC on the Books and in the Courts: An Analysis of Recent Independent Contractor and Misclassification Statutes*, 18 U. PA. J.L. & SOC. CHANGE 53 (2015). But there is opposition advocacy as well, as evidenced by the participation in this appeal of American Trucking Associations Inc. as amicus curiae in support of System.

The scope of Title 50 RCW's broad definition of "employment" presents an issue of law for this court, not an issue for political speculation. Under the law as it presently stands, the definition and exemptions apply only to the imposition of unemployment insurance taxes.[7]

7. The Washington Minimum Wage Act, chapter 49.46 RCW, applies the nonexhaustive factors developed under the Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201-219, to determine whether the economic reality of the business relationship suggests employee or independent contractor status. *Anfinson v. FedEx Ground Package Sys., Inc.*, 159 Wn. App. 35, 50-51, 52, 244 P.3d 32 (2010), *aff'd*, 174 Wn.2d 851, 281 P.3d 289 (2012).

We reject as legally unsupported the argument that assessment of the tax on carriers' payments for owner-operator services will dictate the end to an historical business model and force carriers to begin purchasing all of their trucking equipment.[8]

To determine employer liability for worker injuries under the Washington Industrial Safety and Health Act of 1973, chapter 49.17 RCW, courts consider whether the employer has retained the right to control the manner in which the work is performed. *Kamla v. Space Needle Corp.*, 147 Wn.2d 114, 52 P.3d 472 (2002).

The Industrial Insurance Act, Title 51 RCW, definition of "worker" was most recently characterized by this court as including common law employees as well as those independent contractors who "'work[ ] under an independent contract, the essence of which is his or her personal labor.'" *Henry Indus., Inc. v. Dep't of Labor & Indus.*, 195 Wn. App. 593, 604, 381 P.3d 172 (2016) (emphasis omitted) (quoting RCW 51.08.180). Notably, the legislature has specifically exempted commercial motor vehicle owner-operators from the definition since 1982, while taking no similar action under the ESA. LAWS OF 1982, ch. 80, § 1, codified at RCW 51.08.180.

And see RCW 49.78.020(4)(a), (b) (defining employee for the purposes of Washington's Family Leave Act, chapter 49.78 RCW, as "a person who has been employed: (i) For at least twelve months by the employer with respect to whom leave is requested under RCW 49.78.220; and (ii) for at least one thousand two hundred fifty hours of service with the employer during the previous twelve-month period" and not as "a person who is employed at a worksite at which the employer as defined in (a) of this subsection employs less than fifty employees if the total number of employees employed by that employer within seventy-five miles of that worksite is less than fifty"). RCW 49.78.010(4)(b)

8. System argues that the Department failed to present evidence to contradict the carriers' testimony that employment insurance taxation affects routes, prices, or services by forcing

3. Federal law does not expressly preempt the assessments

Whether federal law preempts state law fundamentally is a question of congressional intent. *English v. Gen. Elec. Co.*, 496 U.S. 72, 78-79, 110 S. Ct. 2270, 110 L. Ed. 2d 65 (1990). When "federal law is said to bar state action in fields of traditional state regulation, [courts] have worked on the 'assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.'" *N.Y. State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 655, 115 S. Ct. 1671, 131 L. Ed. 2d 695 (1995) (citation omitted) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947)).

Laws of general applicability are usually not preempted merely because they increase a carrier's overall costs. *Dilts v. Penske Logistics, LLC*, 769 F.3d 637,

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carriers to treat owner-operators as employees in all respects and forcing them to purchase all trucking equipment needed for their operations.

Case law holds that empirical evidence of an effect on services or rates is not necessary to demonstrate preemption. Courts may, instead, examine the logical effect that state regulation will have on the delivery of services or setting of rates. *E.g.*, *Mass. Delivery Ass'n v. Healey*, 117 F. Supp. 3d 86, 91 (D. Mass. 2015) (citing *Mass. Delivery Ass'n v. Coakley*, 769 F.3d 11, 21 (1st Cir. 2014)); *Overka v. Am. Airlines, Inc.*, 790 F.3d 36, 40-41 (1st Cir.), *cert. denied*, 136 S. Ct. 372 (2015)). Just as examining the logical effect of state regulation can be sufficient to establish that it *is* preempted, examining its logical effect can be sufficient to establish that it is not.

646 (9th Cir. 2014). "[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 that they use, or the services that they provide." *Id.* Such laws are not preempted "even if they raise the overall cost of doing business or require a carrier to re-direct or reroute some equipment." *Id.* (citing *Californians for Safe & Competitive Dump Truck Transp. v. Mendonca*, 152 F.3d 1184, 1189 (9th Cir. 1998)). Laws of general applicability may be preempted where they have such "acute, albeit indirect, economic effects" that states essentially dictate the prices, routes, or services that the federal law intended the market to control. *Travelers Ins.*, 514 U.S. at 668.

The relevant evidence presented and found by the ALJ is that the ongoing cost of doing business to which Hatfield will be subjected by the application of Title 50 RCW is a quarterly tax rate that has so far not exceeded 1.14 percent. 1 AR(H) at 79. The record does not reveal the agreed tax rate that led to System's stipulated liability of $58,300.99 for owner-operators over an almost three-year period. But the highest unemployment tax rate presently imposed in Washington is 6 to 6.5 percent of payroll, and not all wages are taxed; they are taxed only up to a cap. RCW 50.29.025; RCW 50.24.010.

System and Hatfield fail to demonstrate that assessment of unemployment insurance taxes on their payment for owner-operator services at the rates provided

by Title 50 RCW will have an acute effect that essentially dictates their prices, routes, or services. Instead, they rely unpersuasively on state and federal cases finding the Massachusetts independent contractor act to be preempted. Br. of Appellant System at 19-20 (citing *Sanchez*, 937 F. Supp. 2d 730; *Mass. Delivery Ass'n v. Coakley*, 769 F.3d 11, 17 (1st Cir. 2014); *Schwann*, 813 F.3d 429; and *Mass. Delivery Ass'n v. Healey*, 821 F.3d 187 (1st Cir. 2016)). As already discussed, the Massachusetts law has a greater effect on a carrier's operation because it applies to more laws, imposing additional employer liabilities.

In addition, both the federal First Circuit and the Massachusetts Supreme Judicial Court have found the Massachusetts law to be preempted only in part, and on the basis of a provision that has no parallel in RCW 50.04.140(1). *Schwann*, 813 F.3d at 438; *Chambers v. RDI Logistics, Inc.*, 476 Mass. 95, 102-03, 65 N.E.3d 1 (2016). Similar to RCW 50.04.140(1), the Massachusetts statute has three conjunctive requirements that must be shown to establish that an individual is an independent contractor under the applicable laws. Its "A" and "C" requirements are similar to the Washington exemption's "freedom from control" and "independently established enterprise" requirements. But Massachusetts' "B" requirement—the one found to be federally preempted—is materially different from the "independent business character or location" requirement of RCW 50.04.140(1)(b).

RCW 50.04.140(1)(b), like the "B" prong of the Social Security Board's 1937 draft bill, requires the party

contracting services to show that the "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*." (Emphasis added.) The Commissioner found that System and Hatfield demonstrated that requirement by establishing that the owner-operators perform services using their own trucks, which are outside the carriers' places of business.[9]

By contrast, the second requirement that must be shown under the Massachusetts statute is that "the service is performed outside the usual course of the business of the employer." MASS. GEN. LAWS, ch. 149, § 148B(a)(2). There is no "outside the place of the carrier's business" alternative. An owner-operator performing delivery service in Massachusetts for a carrier will never satisfy the "B" prong of Massachusetts's exemption. The Massachusetts Supreme Judicial Court agreed with the federal First Circuit that "[u]nlike the first and third prongs [of Mass. Gen. Laws ch. 149, § 148B], prong two 'stands as something of an anomaly' amongst State laws regulating the classification of workers." *Chambers*, 476 Mass. at 103 (quoting *Schwann*, 813 F.3d at 438).

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9. Given the carriers' leases, which give them exclusive control of the trucking equipment, the Commissioner did not view this as necessarily a clear call. But he found persuasive a federal neutrality provision, discussed further below, that cautions against assuming that a lessee's federally required exclusive control precludes an independent contractor relationship. *See*, *e.g.*, 2 AR(ST) at 375-78 (citing 49 C.F.R. § 376.12(c)(4)). The Department did not cross appeal that decision.

Preemption is an affirmative defense, so the proponent bears the burden of establishing it. *Hill v. Garda CL Nw., Inc.*, 198 Wn. App. 326, 343, 394 P.3d 390 (2017), *review granted*, No. 94593-4 (Wash. Oct. 24, 2017). System and Hatfield rely on inapplicable case law and present no evidence that the unemployment insurance tax has an acute effect that essentially dictates their prices, routes, or services. They fail to demonstrate express preemption.

B. Field or Conflict Preemption

Alternatively, System argues that field or conflict preemption is required by subsection (4) of 49 C.F.R. § 376.12(c), a provision added to that leasing regulation in 1992 that cautions against its misapplication.

What we refer to as the subsection (4) "neutrality provision" had its genesis in an arguably unintended construction of federal law that sought to "'correct abuses that had arisen under often fly-by-night arrangements'" through which certificated carriers, by leasing equipment from owner-operators, avoided liability for vehicle accidents and left "'thousands of unregulated vehicles on the highways as a menace to safety.'" *Rodriguez v. Ager*, 705 F.2d 1229, 1234 (10th Cir. 1983) (quoting *Simmons v. King*, 478 F.2d 857, 866-67 (5th Cir. 1973)). Congress responded by enacting legislation under which the federal secretary of Transportation could regulate motor carrier leasing arrangements, including by requiring carriers who hold interstate transportation authority to control and be responsible for trucking equipment used in their operations, whether they own it or not. *Edwards v. McElliotts Trucking, LLC*, ___ F. Supp. 3d ___, 2017 WL

3279168, at *7, 2017 U.S. Dist. LEXIS 121293, at *18-19 (S.D. W.Va. Aug. 2, 2017) (citing 49 U.S.C. § 14102(a)(4)).

Among regulations adopted was 49 C.F.R. § 376.12(c)(1), often referred to as the motor carrier "control regulation," which provides:

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

Consistent with this requirement for continuous carrier control during the lease term, federal regulations require that commercial motor vehicles transporting property in interstate commerce legibly display the name of the operating motor carrier and identify the number of the authority under which the vehicle is being operated. 49 C.F.R. § 390.21(b).

Another regulation, in effect until 1986, required that when a carrier terminated a lease and relinquished possession of leased equipment, its relinquishment was not complete until it procured the removal of its name and operating authority identification from the owner-operator's vehicle.[10] Former 49 C.F.R. § 1057.4(d) (1979).

10. As explained in *Thomas v. Johnson Agri-Trucking*, this regulation was repealed in 1986 and replaced with a regulation that requires parties only to specify in their lease which party is

A majority of courts construed these regulations, and later the control regulation standing alone, as creating an irrebuttable presumption of "statutory employment" that trumped state law dealing with the doctrine of respondeat superior in the event an owner-operator negligently caused an accident at a time when the carrier's logo and operating authority number appeared on its vehicle. Even if the facts and circumstances would not support liability of the carrier under state law, the federal regulation was found to dictate liability.

In *Rodriguez*, for example, an owner-operator, David Ager, decided to sell his tractor-trailer to his brother John. David notified the carrier under whose authority he operated of his desire to terminate their lease. 705 F.2d at 1230-31. The carrier sent the necessary paperwork to David, and he signed it. *Id.* He then turned possession of his tractor-trailer over to John, to perform a trip that David had arranged independently, without any involvement or knowledge on the part of the carrier. *Id.* at 1231. Yet the carrier was held liable as a matter of law when John, driving negligently, had a head-on collision with an automobile, killing four members of the Rodriguez family. *Id.* at 1236. At the time of the accident, which occurred within days after David signed the termination paperwork, the carrier's insignia and identifying number had not yet been removed from the sides of David's tractor. *Id.* at 1230. As the Tenth Circuit observed, "[I]t cannot be said that John was driving the truck as an agent of [the carrier]. If … liability exists at all it is by virtue of

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responsible for removing identification devices and how they will be returned to the carrier. 802 F. Supp. 2d 1242, 1246 n.19 (D. Kan. 2011) (citing 49 C.F.R. 376.12(e)).

a regulation of the [Interstate Commerce Commission (ICC)]." *Id.* at 1231.

Beginning in the late 1980s, and at the behest of industry trade groups, the ICC began publishing guidance questioning this interpretation of its regulations as creating a federal basis for liability. *Edwards*, 2017 WL 3279168, at *7, 2017 U.S. Dist. LEXIS 121293, at *19-20. The ICC expressed its view that courts should "decide suits of this nature by applying the ordinary principles of State tort, contract, and agency law. The Commission did not intend that its leasing regulations would supersede otherwise applicable principles of State tort … law and create carrier liability where none would otherwise exist." *Lease & Interchange of Vehicles*, 3 I.C.C.2d 92, 93 (1986). In 1992, the ICC formally amended its regulations by adding the following subsection (4) to the control regulation:

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

49 C.F.R. § 376.12(c)(4). System argues that this provision was intended to explain to "confused" state officials what impact federally mandated requirements had on state law control issues. Br. of Appellant System at 35.

We disagree. Confusion on the part of state officials is not what the ICC was trying to address. It was trying to disabuse courts of the notion that if state common law did not support a carrier's vicarious liability for the negligence of an owner-operator, then ICC's control regulation should be viewed as creating federal-law-based vicarious liability. Nothing in the history of the irrebuttable presumption/statutory employee cases suggests that the ICC believed it should—or could—narrow vicarious liability under state law by dictating to states certain evidence of the relationship between the carrier and the owner-operator that they were required to ignore.

To view 49 C.F.R. § 376.12(c)(4) in this way is to claim that it is preemptive, and System does make that claim. It characterizes the provision as "direct[ing the Department] not to utilize federally-mandated lease requirements to establish that owner/operators are System employees." Reply Br. of Appellant System at 15. System argues that the regulation was held to be preemptive in *Remington v. J.B. Hunt Transport, Inc.*, 2016 WL 4975194, 2016 U.S. Dist. LEXIS 126487 (D. Mass. 2016) (court order).

Remington merely found a narrow conflict-based preemption of the Massachusetts independent contractor act, insofar as that act required a carrier to pay certain owner-operator expenses that federal leasing regulations treated as a matter to be negotiated by the parties. 2016 WL 4975194, at *4-5, 2016 U.S. Dist. LEXIS 126487, at *10-14. As the district court observed, "What is explicitly permitted by federal regulations cannot be forbidden by state law." 2016 WL 4975194, at *4, 2016 U.S. Dist. LEXIS 126487, at *11. It held that the Massachusetts act would

be preempted "to [the] extent" it conflicted with federal regulations that permitted allocation of expenses. 2016 WL 4975194, at *5, 2016 U.S. Dist. LEXIS 126487, at *13.

Remington rejected the carriers' argument that the neutrality provision and other federal leasing regulations created field preemption, pointing out that federal regulations were silent as to a number of matters the carriers argued were preempted. It was in this context that the district court cited the neutrality provision as demonstrating that the regulations are "explicitly agnostic on the issue of the carrier-driver relationship," language that System deems important. 2016 WL 4975194, at *5, 2016 U.S. Dist. LEXIS 126487, at *15. We read that statement as recognizing a "hands off" approach the neutrality provision takes when it comes to deciding matters of state law—not as dictating what states can consider or what they should find.

Courts heeding the neutrality provision in the vehicle accident context from which it arose also do not view it as preempting state law. Where a lease is still in effect and the control regulation is therefore meaningful evidence of the motor carrier's and owner-operator's legal relationship, courts take the carrier's federally required control into account in deciding vicarious liability. *E.g.*, *Edwards*, 2017 WL 3279168, at *6, 2017 U.S. Dist. LEXIS 121293, at *17 (describing the control regulation as "assum[ing] an additive role in the common law analysis, bolstering Edwards' allegations that [the owner-operator] was a [carrier's] employee but not subsuming the common law standard defining a master-servant relationship"); *Thomas v. Johnson Agri-Trucking*, 802 F. Supp. 2d 1242,

1249 (D. Kan. 2011) (viewing the neutrality provision as eliminating the basis for the irrebuttable presumption formerly imposed, but viewing the control regulation as still supporting a rebuttable presumption of agency, which would be analyzed according to state law); *Bays v. Summitt Trucking, LLC*, 691 F. Supp. 2d 725, 731-32 (W.D. Ky. 2010) (since the trucking equipment lease complied with federal regulations and established that a semitractor was under the carrier's exclusive control and possession, there was a rebuttable presumption of agency, with agency and liability to be analyzed according to Kentucky law).

System again has the burden of demonstrating federal preemption. It identifies no authority that has treated the neutrality provision as preempting state law distinctions between employees and independent contractors. We adhere to *Western Ports*' holding: federal leasing regulations have not been shown to preempt application of the unemployment insurance tax to payment for owner-operator services.

Issue Two: Application of the Independent Contractor Exemption

The ESA requires an employer to contribute to the compensation fund for workers in its employment unless the employer establishes that the workers are exempt. *Penick*, 82 Wn. App. at 42. The carriers do not dispute that the owner-operators from whom they lease equipment and contract delivery service are in their "employment" as defined by the ESA. They contend that the exemption for services provided by an independent enterprise applies.

Consistent with the legislature's command that Title 50 RCW "be liberally construed for the purpose of reducing involuntary unemployment and the suffering caused thereby," exemptions must be narrowly construed in favor of applying the tax. RCW 50.01.010; *W. Ports*, 110 Wn. App. at 450. Moreover, where taxes are imposed not for revenue only but to be held in trust for the benefit of a group society is attempting to aid and protect, "courts will scrutinize much more closely … where the taxes to be saved jeopardize the protection such groups were intended to have." *In re Assessment Against Fors Farms, Inc.*, 75 Wn.2d 383, 391, 450 P.2d 973 (1969).

The Commissioner concluded that System and Swanson failed to demonstrate the first, "freedom from control" requirement, and the third, "independently established enterprise" requirement. In the case of Hatfield, the Department was granted summary judgment on the carrier's failure to demonstrate "freedom from control" and the Commissioner found the record to be inadequate to address the two other requirements for exemption.[11]

A. Freedom from Direction or Control

"The first prong of the exemption test requires determination of whether a worker is free from direction

11. We agree with the Commissioner that the summary judgment record in Hatfield's case is inadequate to determine whether the "B" and "C" prongs of RCW 50.04.140(1) are satisfied by that carrier. We will not further address Hatfield's assignments of error to the Commissioner's refusal to rule in its favor on those issues.

or control during his or her performance of services." *W. Ports*, 110 Wn. App. at 452. "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." *Id.* (citing *Risher v. Dep't of Labor & Indus.*, 55 Wn.2d 830, 834, 350 P.2d 645 (1960)).

The parties disagree on two matters fundamental to application of the "freedom from control" requirement: they dispute whether the exemption incorporates the common law test for control, making relevant all precedents dealing with the common law of agency, not just cases decided under Title 50 RCW; and they disagree whether direction and control required by federal regulation should count. We address these matters first.

1. 1945 changes to the ESA make clear that it does not incorporate the common law test of control

Between 1939 and June 1945, justices of our Supreme Court engaged in a tug-of-war over the scope of "employment" for unemployment compensation purposes. In a 1939 decision in *Washington Recorder Publishing Co. v. Ernst*, a majority of the members of Department Two strayed from prior decisions recognizing the uniquely broad definition of "employment" for unemployment compensation purposes and held that "[i]n drafting the statute, the legislators attempted to codify the common law[,] … intend[ing] that the common law test of employment relationship should likewise be the test under the unemployment compensation act." 199 Wash. 176, 195, 91 P.2d 718 (1939).

The Washington Supreme Court appeared to rectify the inconsistency in *Sound Cities Gas & Oil Co. v. Ryan*, in which it identified six decisions of the court that had construed the scope of "employment" under the ESA and the "ABC" requirements for exemption, stating:

> The opinions of this court, just cited, with the exception of *Washington Recorder Pub. Co. v. Ernst*, *supra*, commit this court to the view that our unemployment compensation act, which is similar to those of the majority of the states where this form of social security obtains, does not confine taxable employment to the relation of master and servant. If the common law relationship of master and servant was to obtain, the legislature would have so stated. …
>
> . …
>
> "It is unnecessary to determine whether the common law relation of master and servant exists between respondent and [appellants] … because the parties are brought within the purview of the unemployment compensation act by a definition more inclusive than that of master and servant."

13 Wn.2d 457, 464-65, 125 P.2d 246 (1942) (quoting *McDermott v. State*, 196 Wash. 261, 266, 82 P.2d 568 (1938)).

Within a matter of three years, however, in *Henry Broderick Inc. v. Riley*, 22 Wn.2d 760, 157 P.2d 954 (1945)

and *Seattle Aerie No. 1 of Fraternal Order of Eagles v. Commissioner of Unemployment Compensation & Placement*, 23 Wn.2d 167, 168, 160 P.2d 614 (1945), the inconsistency was revived, with the majority holding in both cases that the initial step of determining whether an individual is in "employment" requires an analysis—even before considering exemptions—of whether the parties stand in an independent contractor relationship under common law.

Days after *Seattle Aerie* was filed and months after the filing of *Broderick*, the ESA newly-enacted by the 1945 legislature became effective, with its revised definition of employment, which reaches "personal service, of whatever nature, *unlimited by the relationship of master and servant as known to the common law or any other legal relationship* . …" LAWS OF 1945, ch. 35, § 11 (emphasis added).

The Commissioner's position in decisions published as precedential has been that while *Seattle Aerie* remains good law for other purposes, it is no longer good law on the scope of "employment" for unemployment compensation purposes. In a 1969 case that, like *Seattle Aerie*, involved the taxpayer's engagement of a musical ensemble, the Commissioner observed that *Seattle Aerie* would have been pertinent had the law not changed, but "the modification in the definition of the term 'employment' is most significant … [and] makes the decision in the *Eagles* case inapplicable to the present case." *In re Ida's Inn*, No. 68-19-P, 1969 WL 102104, at *5 (Wash. Emp't Sec. Dep't Comm'r Dec. 773, Jan. 13, 1969). In a 1983 case, the

Commissioner found the fact situation to be "practically on all fours with the facts found in *Seattle Aerie*" but reached a different outcome because "[u]nfortunately for [the appellant,] Mr. Fuller, the statute was amended that same year to make the definition much more inclusive for unemployment tax purposes." *In re Clayton L. Fuller*, No. 2-07013, 1983 WL 492331, at *2 (Wash. Emp't Sec. Dep't Comm'r Dec. 744, 2d Series Oct. 31, 1983).

In its 1947 decision in *Skrivanich v. Davis*, our Supreme Court recognized that the 1945 act materially modified the language from which the *Broderick* and *Seattle Aerie* courts inferred that determining whether one was in "employment" required deciding whether one was a "servant" working for "wages":

> It is to be noted that in the 1943 act … employment meant service "performed for wages or under any contract of hire" *suggesting by that phraseology alone* a relationship of master and servant; whereas, in the 1945 act, upon which the instant case rests, the term "employment" is defined as meaning
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> '… personal service, of whatever nature, unlimited by the relationship of master and servant as known to the common law or any other legal relationship, [including service in interstate commerce,] … performed for wages or under any contract calling for the performance of personal services.'

> 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.

29 Wn.2d 150, 158, 186 P.2d 364 (1947) (emphasis added) (some alterations in original) (quoting Rem. Rev. Stat. § 9998-150 (Supp. 1945)).

If the carriers are contending that the common law distinction between servants and independent contractors applies not to the definition of "employment" but to the "freedom from control" requirement for exemption, we disagree on that score as well. The legislature adopted the language of the "freedom from control" requirement suggested by the Social Security Board's draft bill; it did not use the language incorporating the "control" that distinguished servants and independent contractors under Washington common law. At the time, the test in Washington for that purpose was "whether or not the employer retained the right, or had the right under the contract, to control the mode or manner in which the work was to be done." *Sills v. Sorenson*, 192 Wash. 318, 324, 73 P.2d 798 (1937) (and cases cited therein). The statutory "freedom from control" exemption requirement adopted in 1937 and reenacted in 1945 is forward-looking and broader ("has been and will continue to be free from control or direction over the performance of such service") and

emphasizes that the freedom from control must be "both under [the contractor's] contract of service and in fact." RCW 50.04.140(1)(a).

We agree that since the legislature did not define the word "control" in the ESA, cases from other contexts can be consulted for the meaning of that word alone. But we agree with the Department that 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)(a), it is cases applying Title 50 RCW, not common law cases, that are controlling.

2. We will not disregard control or direction because it is required in a regulated industry

The carriers and amicus contend that in applying the "freedom from control" exemption, we should not consider control or direction that the carriers are required to exercise under federal regulations. They argue that carrier compliance with federal lease regulations is not "control" by the carriers, it is control by the federal government. Br. of Appellant System at 33-34. Or as amicus puts it, quoting a National Labor Relations Act[12] case, "'[i]t is *the law* that controls the driver.'" Br. of Amicus Curiae at 13 (alteration in original) (quoting *N. Am. Van Lines, Inc. v. Nat'l Labor Relations Bd.*, 276 U.S. App. D.C. 158, 869 F.2d 596, 599 (1989)). The parties recognize that *Western Ports* addressed this same argument. In *Western Ports*,

12. 29 U.S.C. §§ 151-169.

this court agreed that "a number of the controls exerted by Western Ports … are dictated by federal regulations," but stated, "Even so, RCW 50.40.100 suggests that the Department properly can consider such federally mandated controls in applying the statutory test for exemption." 110 Wn. App. at 453. Amicus argues that this language was dictum. The Department argues it is stare decisis. System argues that *Western Ports*' reasoning has "been rejected by pervasive and more current authority." Reply Br. of Appellant System at 16.

a. *Western Ports'* holding was not dicta, but we believe the issue merits closer review

When a court unquestionably issues a holding based on multiple grounds, none of the grounds are dicta. *See In re Pers. Restraint of Heidari*, 174 Wn.2d 288, 293, 274 P.3d 366 (2012). Language suggesting that a court is speaking hypothetically can suggest that a statement is dictum, but in *Western Ports*, the court addressed the argument that federal control did not count first, and addressed it directly, before going on to explain that it would reach the same result "even if" it ignored federal control. 110 Wn. App. at 454. This reflects multiple grounds for the decision, not dicta.

As for the issue of whether we are required to apply the doctrine of stare decisis and our Supreme Court's "incorrect and harmful" standard before disagreeing with Division One, there is room for debate on that issue. See the two concurring opinions in *In re Personal Restraint*

of Arnold, 198 Wn. App. 842, 851-55, 396 P.3d 375 (2017). This author has concluded that we are not. At a minimum, "[i]t is not inappropriate for this court to consider whether a previous opinion is incorrect and harmful in the course of deciding whether or not to follow it." *Id.* at 850 (SIDDOWAY, J., concurring).

Western Ports reasoned that by including service in interstate commerce in the statutory definition of "employment," RCW 50.40.100 suggests that the Department properly can consider federally mandated controls. Since the reference to interstate commerce is only vaguely suggestive and System directs us to more recent case law, we believe the parties' arguments on this issue warrant closer review.

b. Federally mandated control is relevant and must be considered under the plain language of RCW 50.04.140(1)(a)

To determine whether federally mandated control should be ignored, we begin with the language of this first requirement for the exemption. RCW 50.04.140(1)(a) says that it must be "shown … that … [s]uch 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."

Our fundamental objective in construing a statute is to ascertain and carry out the legislature's intent. *Arborwood Idaho, LLC v. City of Kennewick*, 151 Wn.2d 359, 367, 89 P.3d 217 (2004). The language at issue must

be evaluated in the context of the entire statute. *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000). Where the statute's meaning is plain on its face, we give effect to that meaning as expressing the legislative intent. *Arborwood*, 151 Wn.2d at 367. At the same time, we avoid interpretations that are "'[s]trained, unlikely or unrealistic.'" *Simpson Inv.*, 141 Wn.2d at 149 (alteration in original) (quoting *Bour v. Johnson*, 122 Wn.2d 829, 835, 864 P.2d 380 (1993)).

Although the exemption requirement does not say that the control or direction to be assessed is control or direction exercised by the employer, it is implicit and necessary to a reasonable reading of the requirement that the employer exercise the control or direction. The other two requirements of the exemption look to the employee's relationship with the employer. The "freedom from control" requirement speaks of control under the "contract of service," meaning the contract with the employer. RCW 50.04.140(1)(a). And control or direction over the service provider that is exercised by a third party with no involvement by the employer has no relevance to the employee's economic insecurity.

But there is no textual basis for concluding that the control exercised by the employer must be control it has freely chosen to exercise, as opposed to control it is required to exercise by law.

The case law on which System and amicus rely does not persuade us to read such a limitation into the Washington exemption requirement. To begin with, the

cases are from other jurisdictions, and almost all arise in the distinguishable contexts of workers' compensation or the duty to collectively bargain under the National Labor Relations Act. The Washington Legislature has already approached owner-operators differently for workers' compensation and unemployment compensation purposes, exempting them as workers for the first purpose but not the second.[13] And identifying individuals with whom a business must collectively bargain is fundamentally different from identifying individuals whose capped wages a business must multiply by 0.065 or less and contribute to an unemployment benefit fund. We could reject the case law on which System and amicus rely as unhelpful on these bases alone.

But we also find the reasoning unpersuasive. Take the three out-of-state decisions dealing with workers' compensation on which amicus relies. *Wilkinson v. Palmetto State Transportation Co.*, 382 S.C. 295, 676 S.E.2d 700 (2009), and *Hernandez v. Triple Ell Transport, Inc.*, 145 Idaho 37, 175 P.3d 199 (2007), rely on the reasoning announced in the first of the three, *Universal Am-Can, Ltd. v. Workers' Compensation Appeal Board*, 563 Pa. 480, 762 A.2d 328 (2000). In that case, the Pennsylvania court held, "Because a motor carrier has no ability to negotiate aspects of the operation of leased equipment that are regulated, these factors may not be considered in resolving whether an owner-operator is an independent contractor or employee." *Id.* at 334; *and see Wilkinson*, 676 S.E.2d at 703; *Hernandez*, 175 P.3d at 205.

13. *See supra* note 8.

This reasoning is too simplistic to resolve the issue presented to us. The implication is that only freely chosen employer control counts. But before that conclusion can be drawn, consideration must be given to why the legislature identified control as a factor in imposing the unemployment insurance tax. Is it because freely chosen control is disfavored and should be penalized? Or is it because the fact that a service provider is controlled or directed by the employer is one indicator of dependence? The purpose of the "ABC" requirements has been said to be to distinguish between "the person who pursues an established business of his own, who is not ordinarily dependent upon a particular business relationship with another for his economic survival, and other persons who are dependent upon the continuance of their relationship with a principal for their economic livelihood." Asia, *supra*, at 87. Control may be an indicator of dependence whether control is imposed by Congress or by the employer.

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. If we viewed the statute is ambiguous, we would give substantial weight to its interpretation by the Department, as the agency that administers the statute. *Dep't of Revenue v. Bi-Mor, Inc.*, 171 Wn. App. 197, 202, 286 P.3d 417 (2012). We agree with Division One's conclusion in *Western Ports* that federally mandated control counts.

3. The carriers have not demonstrated the required freedom from control and direction

System and Swanson did not assign error to any of the Commissioner's findings of fact.[14] They are verities on appeal. *Kittitas County v. Kittitas County Conserv. Coal.*, 176 Wn. App. 38, 55, 308 P.3d 745 (2013). At issue with respect to those appellants is whether the Commissioner's findings support his conclusion that they failed to demonstrate that the owner-operators whom they paid for services were free from control and direction.

As for Hatfield, the Commissioner determined as a matter of summary judgment that it failed to demonstrate the "freedom from control" requirement for exemption. We review that decision de novo, viewing the evidence in the light most favorable to Hatfield, as the nonmoving party. *Verizon Nw.*, 164 Wn.2d at 916.

The following evidence of the carriers' relationship with their owner-operators during the audit periods is undisputed:

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14. System and Swanson complain that this is a hypertechnical shortcoming and that we should glean their challenges to factual findings from their petitions in the trial court and their briefing on appeal. Extensive numbered findings were made following the administrative hearings and were almost entirely adopted by the Commissioner. Those findings are the intended and judicially economical way to identify evidence sufficiency challenges. RAP 10.3(g); *see* RAP 10.3(h). Moreover, none of the carriers identified RCW 34.05.570(3)(e) (insufficient evidence) as a basis for seeking judicial review.

- Swanson's, System's, and Hatfield's lease agreements with their owner-operators gave the carriers exclusive control and possession of their owner-operators' trucking equipment.

- The owner-operators' services were performed under the carriers' operating authority. Swanson's and Hatfield's agreements required owner-operators to mark their equipment with the carrier's name, address, and operating authority number.

- Swanson and System required their owner-operators to notify the carrier of any accident.

- Swanson required owner-operators to provide photos of freight they hauled, when requested.

- Swanson provided owner-operators with medical and dental coverage, which would be fraudulent if they were independent contractors.

- Swanson allowed owner-operators to store equipment at its premises if they wanted to, and approximately half of the owner-operators did.

- Swanson was responsible for overload violations.

- Swanson required owner-operators to file daily logs, daily vehicle condition reports, scale tickets, toll receipts, delivery receipts, maintenance reports and records, and all other reports, documents, and

data required by law; System likewise required owner-operators to submit delivery paperwork to it. Hatfield more generally required owner-operators to comply with all rules and regulations applicable to their operations, and it reserved the right to immediately terminate their lease in the event of a violation.

- Swanson billed customers and paid 88 percent to the owner-operators less deductions such as fuel charged by owner-operator to Swanson and insurance purchased through Swanson. System and Hatfield likewise billed customers and paid the owner-operators for transporting their customers' freight.

- If a customer failed to pay, Swanson would still pay the owner-operator unless the failure to pay was caused by the conduct of the owner-operator; System similarly paid the owner-operator whether or not its client paid it.

- While owner-operators could find their own loads on return trips, they had to get Swanson's permission to accept the load and Swanson would do the billing.

- System's contract with its owner-operators required all drivers to meet its minimum qualifications, gave System the right to disqualify any driver it found unsafe or unqualified, required compliance with its drug and alcohol policy including random testing, required the owner-operators to operate the equipment in compliance with System's other

rules and regulations, and gave it the right to immediately terminate the agreement if the owner-operator committed an act of misconduct detrimental to System's business.

- System's contract with its owner-operators prohibited them, without System's written consent, from assigning or subcontracting to another party or trip leasing the equipment to other carriers.

- System prohibited owner-operators from transporting a third person without its prior approval, and its contract provided that it could take physical possession of the owner-operators' equipment at its discretion.

- System's contract included nondisclosure protections for customer information that survived termination of its agreement with an owner-operator.

- None of Hatfield's owner-operators carried their own insurance, although they were responsible for the cost of cargo and liability insurance borne by Hatfield.

- Hatfield held all licenses and fuel permits.

- Hatfield's owner-operators were required to maintain the leased equipment in good repair, mechanical condition, running order, and appearance, including by washing and cleaning it as frequently as required to maintain a good public image.

- Hatfield retained the right to discuss and recommend actions against an owner-operator's employees or agents in the event they damaged Hatfield's customer relations through their negligence. It also retained the right to take possession of the owner-operator's equipment and cargo, and complete a shipment itself if it believed the owner-operator had breached the contract in a manner creating liability for Hatfield.

- Hatfield required owner-operators to have a safety inspection of the leased equipment at least once every 90 days at a federally approved inspection station.

The carriers bear the burden of showing qualification for the exemption from unemployment insurance taxation. *Grp. Health Coop. of Puget Sound, Inc. v. Wash. State Tax Comm'n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967). Their terms of agreement and practice with owner-operators support the Commissioner's conclusion (including as a matter of law, in Hatfield's case) that the carriers failed to demonstrate that their owner-operators have been and will continue to be free from control or direction in performing services, both under their contract of service and in fact. The nature of the relationship is similar to that presented in *Western Ports*, where the owner-operator was found to be an employee for the purposes of unemployment insurance taxation despite the fact that he "owned his own truck, paid for his own truck repairs, fuel and insurance, chose his own routes and could have hired another driver to operate his equipment." *W. Ports,* 110 Wn. App. at 453.

B. Independently Established Business

The Commissioner's decision that the exemption provided by RCW 50.04.140(1) did not apply to Swanson or System was independently supported by his conclusion that they did not demonstrate the third requirement for the exemption: that the owner-operators were "customarily engaged in an independently established trade, occupation, profession, or business, of the same nature as that involved in the contract of service" with the alleged employer. RCW 50.04.140(1)(c). This element may be satisfied by proof of "'an enterprise created and existing separate and apart from the relationship with the particular employer, an enterprise that will survive the termination of that relationship.'" *Jerome v. Emp't Sec. Dep't*, 69 Wn. App. 810, 815, 850 P.2d 1345 (1993) (quoting *Schuffenhauer v. Dep't of Emp't Sec.*, 86 Wn.2d 233, 238, 543 P.2d 343 (1975)).

> The following factors provide indicia of an independently established business: (1) worker has separate office or place of business outside of the home; (2) worker has investment in the business; (3) worker provides equipment and supplies needed for the job; (4) the alleged employer fails to provide protection from risk of injury or non-payment; (5) worker works for others and has individual business cards; (6) worker is registered as independent business with state; and (7) worker is able to continue in business even if relationship with alleged employer is terminated.

Penick, 82 Wn. App. at 44. The most important factor in determining whether an individual is independently engaged is the seventh: the ability to continue in business even if the relationship with the alleged employer is terminated. *Affordable Cabs, Inc. v. Emp't Sec. Dep't*, 124 Wn. App. 361, 371-72, 101 P.3d 440 (2004) (citing *All-State Constr. Co. v. Gordon*, 70 Wn.2d 657, 666, 425 P.2d 16 (1967)).

The Commissioner recognized that the first, second, and third factors weighed in favor of the owner-operators' independence since they work in their trucks, outside their home; have a substantial investment in their trucking equipment; and provide other supplies needed for the transportation of goods. He also recognized that some, but not all, of the owner-operators had registered businesses in the State of Washington. But other factors were absent. The most significant to the Commissioner was that the individuals engaged as owner-operators by Swanson and System did not have their own operating authority and had not worked for others. The Commissioner characterized holding one's own operating authority as a "paramount" factor in determining whether the owner-operators had independent enterprises. 2 AR(SH) at 279.

Both carriers argue that it is actually against federal law for an owner-operator to have his or her own operating authority and haul goods for a carrier. But this is semantics. A truck owner working as an owner-operator can apply for and acquire operating authority. He or she just will not be able to operate *as* an owner-operator under that authority because when he or she leases equipment and works as

an owner-operator, federal law requires the service to be performed under the lessee-carrier's authority. The truck owner can still have and hold operating authority in reserve. The Commissioner's point, a legitimate one, is that if the truck owner's lease ends, he or she will have more entrepreneurial options by holding his or her own operating authority.

The carriers vigorously disagree with the Commissioner's treatment of independent operating authority as a paramount factor. There is conflicting authority from other jurisdictions as to its importance. *Compare Stafford Trucking, Inc. v. State*, 102 Wis. 2d 256, 264, 306 N.W.2d 79 (Ct. App. 1981) (possessing operating authority is an important indicator of an independently established business), *with W. Home Transp., Inc. v. Idaho Dep't of Labor*, 155 Idaho 950, 953, 318 P.3d 940 (2014) (if the individual's business is to operate as an owner-operator, then possessing operating authority is "completely inconsequential and irrelevant").

The carriers' own evidence and argument suggest that having operating authority is relevant. As the carriers tell us, the reason for the independent operator business model in the trucking industry is "[b]ecause demand in the contemporary American trucking industry fluctuates so dramatically" and owner-operators "provide carriers … with a flexible supply of trucking equipment." Br. of Appellant System at 3-4. The obvious corollary is that in periods of dramatically reduced demand, owner-operators go unused. Perhaps in some future case, a carrier will prove that despite dramatically reduced demand, an

owner-operator whose services are no longer needed by his or her primary carrier will be needed by other carriers. No such evidence was presented here. None of the owner-operators had worked for more than one carrier.

In Swanson's case, six of the seven disputed owner-operators had registered businesses. However, of the six owner-operators with registered businesses, Swanson contracted with two of them in their capacities as individuals, rather than as businesses. Swanson provided protection for risk of nonpayment of customers. When it comes to the most important factor—the ability to continue in business even if the relationship with the employer is terminated—Swanson presented no evidence that even in a period of dramatic reduced demand, their former owner-operators would be able to continue in business leasing to others. Its evidence and argument was that "owner-operators make the business decision to 'work exclusively for one carrier to establish and cultivate that particular business relationship.'" Reply Br. of Appellant Swanson at 15 (quoting 7 AR(SH) ex. Z, at 3).

System presented even less evidence of owner-operator engagement in independent business. Though the owner-operators owned their own trucks, were responsible for the costs of operating them, and maintained their own financial books, System presented no evidence that the owner-operators had registered or licensed businesses or business cards. System also protected the owner-operators from nonpayment.

The Commissioner's findings supported his conclusion that Swanson and System failed to meet their burden of demonstrating that their owner-operators were engaged in independently established businesses.

Issue Three: Whether the Assessments Should Be Set Aside as Void

The final issue raised by System and Hatfield is whether the Department's assessments should be set aside as void, as a result of constitutional violations.[15] System argues that the Department violated procedural due process when its employees failed to comply with its standards requiring adequate training, independence, and professional care, and that it violated substantive due process by targeting the trucking industry and essentially directing auditors to find liability. Hatfield makes arguments similar to System's and argues in addition that the Department assessed taxes on its equipment despite knowing it was unlawful to do so.

The APA authorizes three types of judicial review of agency action. Under RCW 34.05.570(2), courts are authorized to review the validity of agency rules. Under RCW 34.05.570(3), they are authorized to grant relief from "an agency order in an adjudicative proceeding." All other agency action or inaction is reviewable by courts under RCW 34.05.570(4). Relief for persons aggrieved

15. Only Swanson sought judicial review on the basis that the Commissioner's decision was arbitrary and capricious. It does not contend on appeal that the Department's assessments are void.

by the performance of this last category of agency action or inaction is available if the agency's action or inaction is unconstitutional, outside the agency's statutory or other legal authority, arbitrary or capricious, or taken by persons not lawfully entitled to take the action. RCW 34.05.570(4)(c).

Hatfield's and System's petitions for judicial review sought only one type of relief: relief under RCW 34.05.570(3) from the Commissioner's order in the adjudicative appeal. They did not seek relief under RCW 34.05.570(4) for the acts or omissions of department employees engaged in the audits. *See* CP at 98-101, 318-21.[16] The question on appeal, then, is whether their constitutional rights were violated in the administrative appeals process.

The only reasoned argument by System and Hatfield as to how conduct of department employees in the audit process relates to a deprivation of their rights in the administrative appeals process is that the Commissioner

16. In a separate action, System, the Washington Trucking Associations, and five other carriers sought money damages from the Department and department employees who had engaged in the complained-of audit conduct, asserting claims for relief under 42 U.S.C. § 1983 and tortious interference with contract. In a decision filed earlier this year, the Supreme Court held that the § 1983 claim was barred by comity and the tortious interference claim was barred by the exclusive remedy provision of the ESA, RCW 50.32.180. *Wash. Trucking Ass'ns v. Emp't Sec. Dep't*, 188 Wn.2d 198, 393 P.3d 761, *cert. denied*, 199 L. Ed. 2d 124 (2017). In arriving at its decision, our Supreme Court observed that the carriers had an adequate remedy in their ability to appeal the assessments, including to obtain judicial review of challenges that could not be resolved by the ALJ or the commissioner.

erred by failing to exclude the Department's evidence. They cite the requirement of the APA that the presiding officer in an adjudicative proceeding "shall exclude evidence that is excludable on constitutional or statutory grounds or on the basis of evidentiary privilege recognized in the courts of this state." RCW 34.05.452(1). They argue that the remedy for the constitutional violations they assert is the exclusion of unlawfully obtained evidence, citing *Mapp v. Ohio*, 367 U.S. 643, 655, 81 S. Ct. 1684, 6 L. Ed. 2d 1081 (1961), *State v. Miles*, 160 Wn.2d 236, 156 P.3d 864 (2007), *McDaniel v. City of Seattle*, 65 Wn. App. 360, 828 P.2d 81 (1992), and *Barlindal v. City of Bonney Lake*, 84 Wn. App. 135, 925 P.2d 1289 (1996). Br. of Appellant System at 47 n.56.

Even if the carriers could support their arguments for exclusion of the Department's evidence with proof of a procedural or substantive due process violation by department employees, the exclusionary rule does not apply in the administrative appeal of an unemployment insurance tax assessment. The two civil cases the carriers cite do not help them. In *McDaniel*, this court refused to extend the exclusionary rule to civil suits that are not quasi-criminal in nature and that do not seek to exact a penalty or forfeiture. 65 Wn. App. at 366. *Barlindal*, like our Supreme Court's decision in *Deeter v. Smith* before it, merely recognized that in forfeiture proceedings, which are quasi-criminal in nature, the Fourth Amendment[17] exclusionary rule applies. 84 Wn. App. at 141 (citing *Deeter v. Smith*, 106 Wn.2d 376, 377-79, 721 P.2d 519 (1986)). As the Court observed in *Deeter*, "[A] forfeiture

17. U.S. Const. amend. XIV.

proceeding is quasi criminal if it is intended to impose a penalty on an individual for a violation of the criminal law." 106 Wn.2d at 378 (citing *One 1958 Plymouth Sedan v. Pennsylvania*, 380 U.S. 693, 700-02, 85 S. Ct. 1246, 14 L. Ed. 2d 170 (1965)). The appeal of an unemployment insurance tax assessment is not quasi-criminal. The Commissioner properly concluded that the exclusionary rule did not apply.

The Department conduct about which System and Hatfield complain also does not amount to a constitutional violation. Addressing procedural due process first, for there to be a procedural due process violation, we must find that the State deprived an individual of a constitutionally protected liberty or property interest. *Smith v. State*, 135 Wn. App. 259, 277, 144 P.3d 331 (2006). The carriers rely on an asserted property interest in a benefit: a right to be audited under the Department's standards requiring adequate training, independence, and professional care.[18] But "'[t]o have a property interest in a benefit, a person clearly must have more than an abstract need or desire' and 'more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it.'" *Town of Castle Rock v. Gonzales*, 545 U.S. 748, 756, 125 S. Ct. 2796, 162 L. Ed. 2d 658 (2005) (quoting *Bd. of Regents of State Colls. v. Roth*, 408 U.S. 564, 577, 92 S. Ct. 2701, 33 L. Ed. 2d 548 (1972)). Such entitlements are

18. The Department argues that the audit procedures had no application to Hatfield and also defends most of the conduct of department employees that the carriers claim was improper. Given the two grounds on which we can reject this assignment of error by the carriers, we do not address these additional issues.

"not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law." *Roth*, 408 U.S. at 577.

No Washington statute or regulation mandates the Department's adherence to its audit procedures, let alone in a manner suggesting that a taxpayer entitlement was being created. *See Castle Rock*, 545 U.S. at 764-65 (even a statute mandating certain action by government employees "would not necessarily mean that state law gave *respondent* an *entitlement* to *enforcement* of the mandate. Making the actions of government employees obligatory can serve various legitimate ends other than the conferral of a benefit on a specific class of people."). Internal audit procedures are not law. *Joyce v. Dep't of Corr.*, 155 Wn.2d 306, 323, 119 P.3d 825 (2005). No property interest is demonstrated by System and Hatfield.

Turning to System's and Hatfield's substantive due process claims, substantive due process bars certain government actions regardless of the fairness of the procedures used to implement them. *Daniels v. Williams*, 474 U.S. 327, 331, 106 S. Ct. 662, 88 L. Ed. 2d 662 (1986). It is concerned with respect for those personal immunities that "are 'so rooted in the traditions and conscience of our people as to be ranked as fundamental,'" *Rochin v. California*, 342 U.S. 165, 169, 72 S. Ct. 205, 96 L. Ed. 183 (1952) (quoting *Snyder v. Massachusetts*, 291 U.S. 97, 105, 54 S. Ct. 330, 78 L. Ed. 674 (1934), *overruled in part on other grounds by Malloy v. Hogan*, 378 U.S. 1, 84 S. Ct. 1489, 12 L. Ed. 653 (1964)), "or are 'implicit in the concept

of ordered liberty,'" *id.* (quoting *Palko v. Connecticut*, 302 U.S. 319, 325, 58 S. Ct. 149, 82 L. Ed. 288 (1937), *overruled on other grounds by Benton v. Maryland*, 395 U.S. 784, 89 S. Ct. 2056, 23 L. Ed. 2d 707 (1969)). An agency's decision resulting from a failure to follow its own procedures may be so arbitrary and capricious that it amounts to a violation of substantive due process. *Nieshe v. Concrete Sch. Dist.*, 129 Wn. App. 632, 641, 127 P.3d 713 (2005).

The substantive component of due process, like its procedural component, requires that System and Hatfield establish that they were deprived of life or of a constitutionally protected liberty or property interest. *Id.* & n.17. The inability to make that threshold showing is fatal to a substantive due process claim. *Nunez v. City of Los Angeles*, 147 F.3d 867, 871 (9th Cir. 1998). It is fatal to the carriers' claims.

Finally, System and Hatfield cite this court's decision in *Washington Trucking Ass'ns* as holding that "[the Employment Department's] assessments are invalid if they result from audits that violate [the Department's] own standards." Br. of Appellant System at 46 (citing *Wash. Trucking Ass'ns v. Emp't Sec. Dep't*, 192 Wn. App. 621, 647, 369 P.3d 170 (2016), *rev'd*, 188 Wn.2d 198, 393 P.3d 761, *cert. denied*, 199 L. Ed. 2d 124 (2017)). Their citation is to a discussion of whether the plaintiffs' § 1983 claims asserted against department employees were barred by the principle of comity because state law provides an adequate remedy. It was in that context that this court observed that the plaintiffs *alleged* that department assessments were invalid if they violated department

audit standards. The court's holding was that the plaintiffs "have the ability to argue [that] before the ALJ," who "has the authority to address these arguments." *Wash. Trucking Ass'ns*, 192 Wn. App. at 646-47. No view was expressed that there was any merit to that allegation by the plaintiffs.

Affirmed.[19]

/s/
Siddoway, j.

WE CONCUR:

/s/
Korsomo, J.

/s/
Fearing, C.J.

19. Swanson and System both request attorney fees, but neither cites authority to support their requests. Their requests are denied. *See* RAP 18.1.

APPENDIX B — DECISION OF THE EMPLOYMENT SECURITY DEPARTMENT OF THE STATE OF WASHINGTON, DATED AUGUST 25, 2015

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

Review No. 2015-0255-CP

Docket No. 01-2012-21704T

In re:

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

DECISION OF COMMISSIONER

This is an unemployment insurance tax dispute between the Employment Security Department ("Department") and the interested employer, Hatfield Enterprizes, Inc. ("Hatfield"). The Department conducted an audit of Hatfield for the period of first, second, and third quarters of 2009; first, second, and fourth quarters of 2010; and first and second quarters of 2011. As a result of the audit, the following 15 individuals hired by Hatfield during the period at issue were reclassified as employees of Hatfield and their wages were deemed reportable to the Department for unemployment insurance tax purposes: Sean Moriarty, Vernon Osterberg, Ronald Dionne, Len Teal, Eldon Kemmerer, Gary Flansburg, Richard Ferguson, Martin Scofield, Andrew Lamoreaux, Thomas

Osborne, Juan Martinez, Ronald Dove, Joseph Eisenhour, Kendal Naccarato, and Adcox Robert. *See* Exhibit 1, pp. 79-80. The Department issued an Order and Notice of Assessment on February 7, 2012, assessing Hatfield contributions, penalties, and interest in the amount of $13,616.53. *See* Exhibit 2. Hatfield filed a timely appeal from the Order and Notice of Assessment. *See* Exhibit 3.

The parties filed extensive motions before the Office of Administrative Hearings ("OAH") prior to the evidentiary hearing held on September 16 and 17, 2014. Specifically, Hatfield filed the following four motions: Motion for Summary Judgment on Federal Preemption, Amended Motion to Dismiss Void Assessments, Motion to Compel, and Consolidated Motions in Limine.[1] The OAH denied Hatfield's first three motions in their entirety, but granted in part and denied in part Hatfield's Consolidated Motions in Limine. On the other hand, the Department filed a Cross-Motion for Partial Summary Judgment and a Motion to Exclude Witnesses and Strike Exhibits. The OAH granted in part and denied in part the Department's Motion to Exclude Witnesses and Strike Exhibits. The OAH further granted the Department's Cross-Motion for Partial Summary Judgment, holding that the 15 individuals (or owner-operators) were in "employment" of Hatfield pursuant to RCW 50.04.100 and that their personal services were not exempted from coverage pursuant to RCW 50.04.140. Thereafter, the parties proceeded to the evidentiary hearing to determine

1. Hatfield's four motions were filed with and heard by the OAH in conjunction with two other matters: *In re Swanson Hay Company, Inc.*, OAH Docket No. 01-20 12-21705T and *In re MacMillan-Piper. Inc.*, OAH Docket No. 01-2012-21703T.

the correct amount of the contributions, penalties, and interest. After the evidentiary hearing, the OAH issued a Tax Case Initial Order, holding that 30 percent of the remuneration Hatfield paid to the 15 owner-operators constituted wages pursuant to RCW 50.04.320(1) and that the penalties imposed upon Hatfield during the period in question should be waived pursuant to RCW 50.12.220(6).

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

Appendix B

Preemption

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

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

Generally speaking, FUTA applies to employers who employ one or more employees in covered employment in at least 20 weeks in the current or preceding calendar year or who pay wages of $1,500 or more during any calendar quarter of the current or preceding calendar year. *See* 26 U.S.C. § 3306(a)(1). Under FUTA, the term

"employee" is defined by reference to section 3121(d) of the Internal Revenue Code. *See* 26 U.S.C. § 3306(i). In turn, 26 U.S.C. § 3121(d)(2) defines "employee" to be any individual who, under the *usual common law rules* applicable in determining the employer-employee relationship, has the status of an employee. In 1987, the IRS issued Revenue Ruling 87-41, distilling years of case law interpreting "usual common law rules" into a more manageable 20-factor test.[2] While these 20 factors are commonly relied upon, it is not an exhaustive list and other factors may be relevant. Furthermore, some factors may be given more weight than others in a particular case. In 1996, the IRS reorganized the 20 factors into three broad categories: behavioral control, financial control, and relationship of the parties. *See* IRS, *Independent Contractor or Employee? Training Materials*, Training 3320-102 (October 30, 1996). However, regardless of the length and complexity of the tests developed by IRS to clarify coverage issue for federal taxation purposes, we have cautioned that FUTA does not purport to fix the scope of coverage of state unemployment compensation laws. *See In re Coast Aluminum Products, Inc.*, Empl.

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

Sec. Comm'r Dec. 817 (1970) ("A wide range of judgment is given to the several states as to the particular type of statute to be spread upon their books." *(quoting Steward Machine Co. v. Davis*, 301 U.S. 548, 593 (1937))).

State legislatures tend to cover employers and employment that are subject to the federal taxation. Although the extent of state coverage is greatly influenced by federal statute, each state is free to determine the employers who are liable for contributions and the workers who accrue rights under its own unemployment compensation laws. Here in Washington, the first version of the Employment Security Act (or "Act"), which was then referred to as "Unemployment Compensation Act," was enacted by the state legislature in 1937. *See* Laws of 1937, ch. 162. This first version of the Act contained a definition of "employment," *see* Laws of 1937, ch. 162, § 19(g)(1)[3]; and a three-prong "independent contractor" or ABC test. *See* Laws of 1937, ch. 162, § 19(g)(5).[4]

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

4. In the first version of the Act, the "independent contractor" or ABC test read as follows:

> Services performed by an individual for remuneration shall be deemed to be employment subject to this act unless and until it is shown to the satisfaction of the director that: (i) Such individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact; and (ii) Such service is either

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The legislature introduced major revisions to the definition of "employment" in 1945 by adding, among other things, the phrase "*unlimited* by the relationship of *master and servant as known to the common law or any other legal relationship.*" *See* Laws of 1945, ch. 35, § 11 (emphasis added). The added language greatly expanded the scope of the employment relationship as covered by the Employment Security Act beyond the scope of the employment relationship as covered by FUTA. *Compare* RCW 50.04.100 *with* 26 U.S.C. § 3306(i) and 26 U.S.C. § 3121(d)(2); *see also In re All-State Constr. Co.*, 70 Wn.2d 657, 664, 425 P.2d 16 (1967) (the test to be applied in determining the employment relationship under the Act is a statutory one; and common law distinctions between employees and independent contractors are inapplicable); *Skrivanich v. Davis*, 29 Wn.2d 150, 158, 186 P.2d 364 (1947) (the 1945 legislature intended and deliberately concluded to extend the coverage of the Act and by express language to preclude any construction that might limit the operation of the Act to the relationship of master and servant as known to the common law or any other legal relationship); *Unemp't Comp. Dep't v. Hunt*, 17 Wn.2d 228, 236, 135 P.2d 89 (1943) (our unemployment

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> outside the usual course of the business for which such service is performed, or that such service is performed outside of all the places of business of the enterprises for which such service is performed; and (iii) Such individual is customarily engaged in an independently established trade, occupation, profession or business, of the same nature as that involved in the contract of service.

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

compensation act does not confine taxable employment to the relationship of master and servant, but brings within its purview many individuals who would otherwise have been excluded under common law concepts of master and servant, or principal and agent). Since then, the definition of "employment" under the Act has remained largely unchanged. Moreover, the "independent contractor" or ABC test has also remained the same, except that in 1991 the legislature added a separate, six-prong test to the traditional three-prong test. *See* ESSB 5837, ch. 246 § 6, 52nd Leg., Reg. Sess. (Wash. 1991); *compare* RCW 50.04.140(1) *with* RCW 50.04.140(2).

Over the years, the appellate courts in Washington as well as the Commissioner's Review Office (as the final agency decision-maker on behalf of the Department) have grappled with the concept of "employment" under RCW 50.04.100 and applied the "independent contractor" test under RCW 50.04.140 in various factual scenarios, finding any given relationship either within or outside the intended scope of the Act. *See, e.g., State v. Goessman*, 13 Wn.2d 598, 126 P.2d 201 (1942) (barbers were held to be in employment of the barber shop; but the legislature later enacted RCW 50.04.225 to exempt barbers from covered employment); *Skrivanich*, 29 Wn.2d 150 (crew members were in employment of the fishing vessel); *All-State Constr. Co.*, 70 Wn.2d 657 (siding applicators were in employment of the construction company); *Miller v. Emp't Sec. Dep't*, 3 Wn. App. 503, 476 P.2d 138 (1970) (individuals performing bucking and falling activities were in employment of the logging contractor); *Schuffenhauer v. Emp't Sec. Dep't*, 86 Wn.2d 233, 543 P.2d 343 (1975)

(clam diggers were in employment of the wholesaler of clams); *Daily Herald Co. v. Emp't Sec. Dep't*, 91 Wn.2d 559, 588 P.2d 1157 (1979) (bundle droppers were in employment of the newspaper publisher); *Jerome v. Emp't Sec. Dep't*, 69 Wn. App. 810, 850 P.2d 1345 (1993) (food demonstrators were in employment of the food demonstration business); *Affordable Cabs, Inc. v. Emp't Sec. Dep't*, 124 Wn. App. 361, 101 P.3d 440 (2004) (taxicab drivers were in employment of the taxicab company); *but, see, e.g., Cascade Nursing Serv., Ltd. v. Emp't Sec. Dep't*, 71 Wn. App. 23, 856 P.2d 421 (1993) (nurses were not in employment of the nurse referral agency); *In re Judson Enterprises, Inc.*, Empl. Sec. Comm'r Dec.2d 982 (2012) (no employment relationship was found because a business entity could not be an employee unless it was shown that the business entity is actually an individual disguised as a business entity).

Two state appellate decisions pertained specifically to the trucking industry. In *Penick v. Emp't Sec. Dep't*, 82 Wn. App. 30, 917 P.2d 136 (1996), Division Two of the Court of Appeals dealt with the relationship *between* a motor carrier who owned the trucks *and* the drivers who were hired to drive the trucks ("contract drivers"). In that case, the motor carrier owned the trucks and operated them under its authority from the Interstate Commerce Commission. The carrier supplied fuel, repairs and maintenance, license, and insurance; and it also handled state and federal reporting requirements. The contract drivers paid their own federal income tax, social security and medicare taxes, and motel and food expenses; they did not receive sick leave, vacations, or

other benefits. The contract drivers could hire a "lumper" if they needed help in loading or unloading. The contracts, which could be terminated by either party at any time, entitled the contract drivers to 20 percent of the gross revenue generated by the loads they hauled. In the event of an accident, the contract drivers were required to pay damages not covered by the $2,500 deductible of the carrier's insurance policy. The contract drivers were also liable for shortage and cargo damage. The drivers often installed a variety of amenities on their assigned trucks to make life on the road more comfortable. The motor carrier secured the load for the outgoing trip, and the contract drivers occasionally obtained their own loads. Any driver was free to reject an offer to haul a load secured by the carrier and, instead, could choose to haul a load obtained by the driver. The carrier obtained return loads for about half the trips, and the drivers found their own return loads for the other half of the trips. The motor carrier handled the billing and collection and provided bi-weekly draws for trip expenses to the drivers. It also made bi-weekly payments to the drivers for their share of the payment for a particular haul. The carrier required its drivers to clean the inside and outside of the truck, adhere to all federal and state laws and safety regulations, and to call in every day by 10 a.m. while en route. But the motor carrier allowed the drivers to select their own routes and to select their driving hours, so long as the hours complied with legal requirements regarding maximum driving time and rest periods. The carrier also permitted the drivers to take other people with them. *Id* at 34-35. After examining all relevant facts, the *Penick* court held that the contract drivers were in employment of the motor

carrier pursuant to RCW 50.04.100 and that their driving services were not exempted from coverage under the "independent contractor" test pursuant to RCW 50.04.140. *Id.* at 39-44. However, the *Penick* court did not address the coverage issue pertaining to the owner-operators (who owned the trucks but leased them to the carrier) because the motor carrier prevailed on that issue before the Commissioner's Review Office and did not appeal. *Id.* at 39. Because the Commissioner's Review Office did not publish the decision in the *Penick* matter, our holdings in that matter cannot be deemed precedential. *See* RCW 50.32.095 (commissioner may designate certain decisions as precedents by publishing them); *see also W. Ports Transp., Inc. v. Emp't Sec. Dep't*, 110 Wn. App. 440, 459, 41 P.3d 510 (2002) (unpublished decisions of Commissioner have no precedential value).

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

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

by the owner-operator and, accordingly, it failed the first prong of the "independent contractor" test under RCW 50.04.140(1Xa). *Id* at 452-54. The *W. Ports* court also considered and rejected the Carrier's contention that federal transportation law preempted state employment security law. *Id* at 454-57.

In this case, the interested employer, Hatfield, is an interstate motor carrier duly licensed by the U.S. Department of Transportation and the Federal Motor Carrier Safety Administration (the successor agency to Interstate Commerce Commission). Hatfield operates throughout the lower 48 states, and it is based in Spokane Valley, Washington. *See* Declaration of Hatfield in Support of employers' Motion for Summary Judgment on Federal Preemption ("Decl. of Hatfield") ¶ 3. Hatfield is a family-owned business and has been in operation since approximately 1989. *See* Decl. of Hatfield ¶ 2. Hatfield uses two types of drivers to support its business operation: First, it hires approximately 38 *employee* drivers to drive the equipment it owns; second, it leases approximately 10 *trucks with drivers* from third parties commonly known in the trucking industry as owner-operators. *See* Decl. of Hatfield ¶ 4. According to Hatfield, the use of owner-operators is a common .and widespread practice within the trucking industry; and it provides operational flexibility that allows Hatfield to meet the fluctuating demand for trucking services without having to make substantial investment in trucking equipment. *See* Decl. of Hatfield, 4.

As discussed above, the Department conducted an audit of Hatfield for various quarters in 2009, 2010, and

2011; and, subsequently, reclassified 15 owner-operators as employees of Hatfield and deemed their wages to be reportable for unemployment insurance tax purposes. Hatfield moved the OAH for summary judgment on federal preemption ground, essentially arguing that it is entitled to judgment as a matter of law because RCW 50.04.100 and RCW 50.04.140 as applied to motor carriers of the trucking industry in Washington is preempted by the Federal Aviation Administration Authorization Act of 1994 ("FAAAA"). The crux of Hatfield's argument is that the Department's efforts in applying RCW 50.04.100 and RCW 50 .04.140 to the trucking industry will eliminate the use of owner-operators from the trucking industry and effectively restructure that industry, resulting in a substantial impact on its prices, routes, and services. The Department responded by arguing that the Washington's leading case, *W. Port*, has rejected the argument that the state employment security law is preempted by federal motor carrier law, and that preemption should not apply because any impact its application of RCW 50.04.100 and RCW 50.04.140 may have on motor carriers is far too tenuous, remote, or peripheral to be preempted.

Federal preemption is based on the United States Constitution's mandate that the "Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby." *See* U.S. CONST., art. VI, cl. 2; *see also Ameriguest Mortg. Co. v. Washington State Office of Atty. Gen.*, 170 Wn.2d 418, 439, 241 P.3d 1245 (2010) (federal law may preempt state law by force of the Supremacy Clause of the United States Constitution). A state law that conflicts with federal

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

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

(2008) *(quoting Morales v. Trans World Airlines*, 504 U.S. 374, 378, 112 S. Ct. 2031 (1992)). The provision specifically provides that "a State . . . may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service of an air carrier . . . ." *See* 49 U.S.C. § 41713(b)(1).

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

> . . . [A] State ... may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service of any motor carrier . . . with respect to the transportation of property.

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

In *Morales*, the Court first encountered the identical preemption provision under the ADA; and the Court adopted its construction of the term "related to" from

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

> . . . (1) that "[s]tate enforcement actions having a connection with, or reference to," carrier "'rates, routes, or services' are pre-empted"; (2) that such pre-emption may occur even if a state law's effect on rates, routes, or services "is only indirect"; (3) that, in respect to pre-emption, it makes no difference whether a state law

> is "consistent" or "inconsistent" with federal regulation; and (4) that pre-emption occurs at least where state laws have a "significant impact" related to Congress' deregulatory and pre-emption-related objectives.

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

In the meantime, the Ninth Circuit Court of Appeals has on several occasions spoken on the FAAAA' s preemptive effects on state law. For example, in *Californians for Safe & Competitive Dump Truck Transp. v. Mendonca*,

152 F.3d 1184, 1189 (1998), the Ninth Circuit held that California's prevailing wage law, a state law dealing with matters traditionally within a state's police powers, had no more than an indirect, remote, and tenuous effect on and, thus, was not "related to" the motor carriers' prices, routes, and services within the meaning of the FAAAA's preemption clause. Most recently, the Ninth Circuit, in holding that California's meal and rest break laws were not preempted by FAAAA, reasoned that:

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

> contribute to an impermissible "patchwork" of state-specific laws, defeating Congress' deregulatory objectives.

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

It is against the backdrop of the U.S. Supreme Court's decisions in Morales, Rowe, *Pelkey* as well as the Ninth Circuit's decisions in *Mendonca* and *Dilts* that we now confront Hatfield's federal preemption argument. Hatfield contends that the FAAAA preempts the Washington's Employment Security Act as applied to the trucking industry because it directly affects and, therefore, is "related to" the prices, routes, and services of its motor carrier business. Hatfield introduced three declarations in its motion for summary judgment to support its contention: (1) a declaration by Larry Pursley, Executive Vice President of Washington Trucking Association; (2) a declaration by Joe Rajkovacz, Director of Governmental Affairs & Communications for the California Construction Trucking Association; and (3) a declaration by Kent Hatfield, owner of Hatfield Enterprizes, Inc. According to Pursley, the assessments imposed by the Department on motor carriers will fundamentally change the business models of both motor carriers and owner-operators throughout Washington, because the Department will effectively eliminate a historical cornerstone of the trucking industry. The effect of this material change will dictate the employment relationship that motor carriers must use in their operations going forward, which will

impact their prices, routes, and services. *See* Declaration of Pursley in Support of Employers' Motion for Summary Judgment on Federal Preemption ("Decl. of Pursley"), ¶ 10. Pursley asserts that the assessments will impact services because the carriers will be forced to provide trucking services only through employees and to purchase expensive trucks and trailers and hire drivers to operate the equipment, which in tum will severely curtail the carriers' operational flexibility. *See* Decl. of Pursley ¶ 11. The Department's restructuring of the trucking industry will also require carriers to alter their routes to avoid liability under Washington' s Employment Security Act and will thus prevent carriers from making their own decisions about where to deliver cargo. *See* Decl. of Pursley ¶ 12. Finally, Pursley asserts that the assessments will likely have a significant impact on prices because of the additional employment-related taxes such as state and federal social security taxes and unemployment insurance taxes, which will undoubtedly have to be recouped by raising prices. *See* Decl. of Pursley ¶ 13. Hatfield reiterates the same assertions in his declaration. *See* Declaration of Pursley in Support of Employers' Motion for Summary Judgment on Federal Preemption ¶¶ 9-12.

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

subsequent U.S. Supreme Court's decision in *Rowe*. *See* Hatfield's Petition for Review at pp. 3-4.

While Hatfield's arguments are appealing and we are tempted to address the merits of the federal preemption issue, we must be mindful of our limited authority as a quasi-judicial body. As a general proposition, the Commissioner's Review Office, being an office within the executive branch of the state government, lacks the authority or jurisdiction to determine whether the laws it administers are constitutional; only the courts have that power. *See* RCW 50.12.010; RCW 50.12.020; *Bare v. Gorton,* 84 Wn.2d 380, 383, 526 P.2d 379 (1974); *In re Kellas,* Empl. Sec. Comm'r Dec.2d 825 (1991) (Commissioner's Review Office is part of an administrative agency in the executive branch of government and is thus without power to rule on constitutionality of a legislation; that function is reserved to judicial branch of government); *In re Bremerton Christian Schools*, Empl. Sec. Comm'r Dec.2d 809 (1989); *In re Ringhofer*, Empl. Sec. Comm'r Dec.2d 145 (1975). On the other hand, the superior court, on judicial review of a final agency order issued by the Commissioner's Review Office, may hear arguments and rule on the constitutionality of the Department's order. *See* RCW 34.05.570(3)(a) (the court shall grant relief from an agency order in an adjudicative proceeding if the order, or the statute or rule on which the order is based, is in violation of constitutional provisions on its face or as applied). Consequently, in keeping with the authority of the highest tribunals of Washington State and federal jurisprudence, we are of the view that, to the extent the Washington's Employment Security Act as applied to

motor carriers of the trucking industry implicates the Supremacy Clause of the United States Constitution (on the basis that the Department's enforcement effort is allegedly preempted by the FAAAA), the Commissioner's Review Office, as an executive branch administrative office, is not the appropriate forum to decide such a constitutional issue.

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

Finally, the Commissioner's Review Office, as the final decision-maker of an executive agency, is bound by the state appellate court's decisions; and Hatfield has not supplied any authorities for us to do otherwise. As such, to the extent that the *W. Port* court already considered and rejected the argument that federal transportation laws preempted state employment security law, *see W. Ports*, 110 Wn. App. at 454-57, we concur with the OAH that the Washington's Employment Security Act as applied to motor carriers of trucking industry is not preempted

by the FAAAA preemption clause. Consequently, we will adopt the OAH's analysis in its Order Denying Employers' Motion for Summary Judgment on Federal Preemption issued in this matter on January 29, 2014.

Void Assessment

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

Employment

In its Petition for Review, Hatfield further contends that the OAH erred in granting the Department's motion for partial summary judgment, thereby finding that the 15 owner-operators were in "employment" of Hatfield

pursuant to RCW 50.04.100 and that their services were not excluded from coverage pursuant to the "independent contractor" exemption under RCW 50.04.140. Hatfield's arguments on these two issues are not persuasive.

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

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

Appendix B

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

In this case, Hatfield is engaged in the interstate trucking business; and it provides contract hauling with authority from the U.S. Department of Transportation and the Federal Motor Carrier Safety Administration. Hatfield's business involves loading/unloading and transportation of cargo from one point to another including such related activities that are customary within the trucking industry. *See* Declaration of Cooper in Support of Department's Cross-Motion for Partial Summary Judgment ("Decl. of Cooper") ¶ 5. Here, the 15 owner-operators performed truck-driving services for Hatfield. As such, the owner-operators' personal services

directly benefited Hatfield's business. Moreover, it is beyond dispute that Hatfield paid wages for the services provided by the owner-operators. *See* Decl. of Cooper, Exhibit C, Appendix B ("Hatfield Enterprizes, Inc., will pay 82 [percent] of the gross revenue on all freight hauled"). Consequently, the administrative law judge correctly concluded that the 15 owner-operators were in employment of Hatfield pursuant to RCW 50.04.100. *See, e.g., Penick*, 82 Wn. App. at 40 (as transportation of goods necessarily required services of truck drivers, it was clear that the carrier directly used and benefited from the drivers' services).

Independent Contractor Exemption

The services performed by the owner-operators are taxable to Hatfield unless they can be excluded pursuant to some other provisions of Title 50 RCW. *See Skrivanich,* 29 Wn.2d at 157. The provisions of the Act that exclude certain services from the definition of employment are found at RCW 50.04.140 through RCW 50.04.240, RCW 50.04.255, RCW 50.04.270, and RCW 50.04.275. The burden of proof rests upon the party alleging the exemption. *See All-State Constr.*, 70 Wn.2d at 665. Just as RCW 50.04.100 is to be liberally construed to the end that benefits be paid to claimants who are entitled to them, the provisions of Title 50 RCW that exclude certain services from the definition of employment are strictly construed in favor of coverage. *See, e.g., In re Fors Farms, Inc.*, 75 Wn.2d 383, 387, 450 P.2d 973 (1969); *All-State Constr.*, 70 Wn.2d at 665. Because the Act is intended for the benefit of a group that society seeks to aid, any exemption available

through the application of these tests must be scrutinized even more closely than an exemption to a tax levied purely for revenue-raising purposes. *See Schuffenhauer*, 86 Wn.2d at 239.

In this case, the only exception that concerns us is found at RCW 50.04.140(1) and (2). The truck-driving services performed by the owner-operators are excepted from employment only if all of the requirements of either section are met *See All-State Constr.*, 70 Wn.2d at 663. Here, the agreements between Hatfield and the owner-operators referred to the owner-operators as contractors. *See* Decl. of Cooper, Exhibit C. This contractual language, however, is not dispositive of the issue of whether the services at issue were rendered in employment for purposes of the Act. Instead, we consider all the facts related to the work situation. *Penick*, 82 Wn. App. at 39.

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

Appendix B

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

In this case, Hatfield entered into nearly-identical contracts with the owner-operators governing the relationship between the parties. On the one hand, the owner-operators enjoy some autonomy with regard to the performance of the truck-driving services. For example, Hatfield does not control the hours that the owner-operators work, nor does it require them to work fulltime. The owner-operators are not required to accept the loads offered by Hatfield; and they can, and sometimes do, decline loads. Once the owner-operators accept the loads, they decide the route they will take for pick-up and delivery. The owner-operators may also broker their own loads for their return trips. *See* Supplemental Declaration of Hatfield in Support of Employer's Opposition to Department's Cross-Motion for Summary Judgment ¶¶ 3 & 4. The owner-operators are liable for deductibles and other expenses that are not covered by insurances; and such insurances are provided by Hatfield at the owner-operators' own expense. The owner-operators are also liable for shortage or loss of cargo or for other damage to the commodities transported; and they are responsible for their own bobtail and physical damage coverage. *See* Decl. of Cooper, Exhibit C, ¶ IX.

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

breached the contract in a manner so as to render Hatfield liable for the shipper, consignee, or any governmental authority, Hatfield can take possession of the owner-operator's equipment and commodities being hauled, and complete the shipment. Ultimately, Hatfield may terminate the contract if an owner-operator has violated the safety rules or regulations of any governmental agencies. *See* Decl. of Cooper, Exhibit C, ¶ XII.

The above-referenced requirements imposed by Hatfield are generally inconsistent with freeing the owner-operators from its control and direction; in other words, Hatfield is not just interested in the *end result* of the transportation services performed by the owner-operators, but it also concerns itself as to "*how*" the transportation services are to be performed by the owner-operators. *See Jerome*, 69 Wn. App. at 817 (a putative employer's ability to control was evidenced by the fact that it could enforce the control by unilaterally deciding not to give referrals to any food demonstrator). In sum, we concur with the administrative law judge that the 15 owner-operators have not met the first criterion -- freedom from control or direction -- under RCW 50.04.140(1)(a) and (2)(a). Because Hatfield has failed to show that the owner-operators were free from its direction and control under RCW 50.04.140(1)(a) and (2)(a), we do not need to address the remaining criteria of the three-prong test under RCW 50.04.140(1) or the six-prong test under RCW 50.04.140(2). We therefore conclude that the 15 owner-operators' services for Hatfield constitute non-exempt employment pursuant to RCW 50.04.100.

Appendix B

In its Petition for Review, Hatfield argues that the federally-mandated controls over equipment cannot logically be considered control over the means and methods of operating the equipment. *See* Hatfield's Petition for Review at p. 4. This argument, however, has been specifically rejected by the *W. Ports* court:

> It is true that a number of the controls exerted by Western Ports over the services performed by Mr. Marshall are dictated by federal regulations that govern the use of leased trucks-with-drivers in interstate commerce. Even so, RCW 50.04.100 suggests that the Department properly can consider such federally mandated controls in applying the statutory test for exemption, in that "service in interstate commerce" is specifically included in the statutory definition of "employment." RCW 50.04.100 ("'Employment' ... means personal service of whatsoever nature, . . . including service in interstate commerce[.]") It would make little sense for the Legislature to have specifically included service in interstate commerce as "employment" only to automatically exempt such service under RCW 50.04.140 based on federal regulations that require a high degree of control over commercial drivers operating motor vehicles in interstate commerce . . . .

See W. Ports, 110 Wn. App. at 453-54. As such, the administrative law judge did not err in considering the federally-mandated controls over leased trucks-with-

drivers (in addition to those controls exerted by Hatfield itself over the owner-operators' truck-driving services) to conclude that the owner-operators have not met the first criterion under RCW 50.04.140(1)(a) and (2)(a).

Hatfield further contends that the administrative law judge ignored evidence establishing a lack of direction and control when deciding liability on summary judgment. *See* Hatfield's Petition for Review at p. 5. This contention, however, is not supported by the record on summary judgment. Indeed, the administrative law judge considered all relevant evidence, including evidence showing a lack of direction and control (*see* ¶¶ 4.20 & 4.21 in Order Granting Department's Cross-Motion for Partial Summary Judgment), before reaching his conclusion on the liability issue. *See* ¶ 5.21 in Order Granting Department's Cross-Motion for Partial Summary Judgment.

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

In its cross Petition for Review, the Department requests us to enter additional findings with regard to the "usual course and place of business" criterion under RCW 50.04.140(1)(b) and the "independently established business" criterion under RCW 50.04.140(1)(c). *See* Department's Cross Petition for Review at pp. 4-5. As discussed above, the three-prong test under RCW 50.04.14(1) or the six-prong test under RCW 50.04.140(2) is conjunctive; and failure to meet any one prong means

failure to meet the entire test. Further, because the coverage/liability issue was decided on summary judgment, the record was not adequately developed on the other two criteria under RCW 50.04.140(1)(b) and (1)(c). Consequently, we will decline the Department's invitation to enter additional findings with regard to the criteria under RCW 50.04.140(1)(b) or (1)(c).

Amount of Wages Subject to Assessment

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

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

Indeed, during the evidentiary hearing below, Hatfield introduced Mr. Steven Bishop's expert testimony to contradict the Department's prima facie case and to further fine-tune the amount of wages paid to the owner-operators for their driving services. The OAH admitted and relied on Bishop's expert testimony to conclude that only 30 percent of the total remuneration paid by Hatfield the owner-operators constituted wages for unemployment insurance tax purposes and that the remaining 70 percent was for equipment rental. In its cross Petition for Review, the Department does not challenge Bishop's qualification as an expert to testify on the relevant issue; but, instead, it contends that Bishop "did not see any documents from Hatfield that broke down the remuneration," *see* Finding of Fact 4.12; that Bishop did not interview any owner-operators or secure records from the owner-operators, *see* Finding of Fact 4.14; and that Bishop only relied on

"articles and websites on the internet" and conversations with "selected trucking companies." *See* Finding of Fact 4.14. The Department argues that Bishop's testimony was not based on evidence or records unique to Hatfield. *See* Department's Cross Petition for Review at pp. 3-4. The Department's argument goes to the foundation of Bishop's expert testimony; and, for reasons set forth below, we reject the Department's argument in this regard.

Generally speaking, expert testimony is admissible if the expert is qualified, the expert relies on generally accepted theories in the scientific community, and the testimony would be helpful to the trier of fact. *See Johnston-Forbes v. Matsunaga,* 181 Wn.2d 346, 352, 333 P.3d 388 (2014). A trial court has broad discretion in deciding whether to admit expert testimony, and such a decision will not be disturbed absent a showing of an abuse of that discretion. *See Philippides v. Bernard*, 151 Wn.2d 376, 393, 88 P.3d 939 (2004). If the basis for admitting or excluding the expert evidence is "fairly debatable," the trial court's exercise of discretion will not be disturbed. *See Group Health Coop. of Puget Sound, Inc. v. Dep't of Revenue*, 106 Wn.2d 391, 398, 722 P.2d 787 (1986).

ER 702 generally establishes when expert testimony may be used at trial.[5] ER 703 allows an expert to base his or her opinion on evidence not admissible in evidence and

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

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

Here, Bishop did not personally interview any owner-operators or secure any records from the owner-operators; nor did Bishop see any documents from Hatfield breaking down the remuneration. Instead, Bishop conducted research on the internet regarding the trucking industry (i.e. websites of "The Truckers Report" and "American Transportation Research Institute"), reviewed various articles and studies on the relevant issue (i.e. "The Real Costs of Trucking," "Don't Fly by the Seat of Your Pants: Figuring Cost Per Mile," and "An Analysis of the Operational Costs of Trucking"),

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

and talked to selected industry representatives (i.e. CFO Karen Ericson of Oak Harbor Freight Lines and VP Larry Pursley of Washington Trucking Association). Moreover, Bishop also spoke with Kent Hatfield (owner of Hatfield) regarding the nature of his operations and further obtained income tax returns from Hatfield's CPA to analyze the appropriate shares/percentages between wages and equipment rental. The administrative law judge scrutinized Bishop's underlying information and determined that it was sufficient for Bishop to form an opinion on the issue of bifurcating the amounts between wages and equipment rental. *See* Finding of Fact 4.14. As such, the administrative law judge did not abuse his discretion by admitting Bishop's testimony in this case. Furthermore, regardless of any concession or stipulation that may have been made by the Department in other trucking cases, the fact remains that the Department did not introduce any countervailing evidence *in this case.* Thus, we are left with Bishop's expert testimony only. In short, Hatfield has successfully rebutted the Department's prima facie case on the amount of wages subject to assessment; and we are satisfied that a 30/70 split between wages and equipment rental is an appropriate formula for Hatfield. We will therefore adopt the OAH's findings of fact and conclusions of law in its Initial Order issued on December 23, 2015 with regard to the appropriate amount of wages that should be subject to assessment.

Waiver of Penalties

If the tax contributions are not paid on time, a late payment penalty of 5 percent is assessed for the first

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

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

circumstances enumerated under WAC 192-310-030(7)(a) are non-exclusive, we have the discretion to consider additional facts and circumstances in adjudicating an employer's request for discretionary waiver of penalties.

In this case, Hatfield uses leased trucks-with-drivers or owner-operators to support its interstate trucking operation. According to one declaration submitted by Hatfield, the owner-operators have long been an important component of the trucking industry, both nationally and locally. The owner-operators are utilized in most, if not all, sectors of the industry, including long-haul trucking, household goods moving, and intermodal operations. The vast majority of interstate truck load transportation businesses in Washington operate to some extent through contractual relationships with owner-operators for operational flexibility: contracting with independent owner-operators enables the carriers to provide on-demand and as-needed deliveries and to address variations in the need to move cargo without having to purchase expensive equipment. *See* Declaration of Pursley in Support of Employers' Motion for Summary Judgment on Federal Preemption ¶ 7. Hatfield is one of many employers in the trucking industry who have treated the owner-operators as independent contractors for unemployment insurance tax purposes. Although our decision in *Penick* is not precedential (as it is not published pursuant to RCW 50.32.095), we did hold owner-operators were exempt from coverage under RCW 50.04.140 in that case. *See Penick*, 82 Wn. App. at 39. The validity of our decision in *Penick* with regard to owner-operators was called into question by the *W. Ports* decision, where the court decidedly held

that an owner-operator was not exempt from coverage under RCW 50.04.140. *See W. Ports*, 110 Wn. App. at 459. Even in so holding, the *W. Ports* court acknowledged that other jurisdictions had reached opposite conclusion (that owner-operators were not employees for purposes of unemployment compensation law) in similar cases. *Id* at 461. Through a series of appeals filed by employers in the trucking industry, Hatfield, along with other employers, appears to be arguing for modification or reversal of the *W. Ports* decision.

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

therefore adopt the OAH's findings of fact and conclusions of law in its Initial Order issued on December 23, 2015 granting waiver of penalties during the period in question.

Evidentiary Rulings

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

The granting or denial of a motion in limine is addressed to the discretion of the trial court and will be reversed only in the event of abuse of discretion. *See Fenimore v. Donald M. Drake Constr. Co.*, 87 Wn.2d 85, 91, 549 P.2d 483 (1976). A motion in limine should be granted if it describes the evidence objected to with sufficient specificity to enable the trial court to determine that it is clearly inadmissible under the issues as drawn or which may develop during the trial, and if the evidence is so prejudicial that the moving party should be spared the necessity of calling attention to it by objecting when it is offered during the trial. *See Douglas v. Freeman*, 117

Wn.2d 242, 255, 814 P.2d 1160 (1991) (*citing Fenimore*, 87 Wn.2d at 91). The trial court abuses its discretion when its decision is manifestly unreasonable, or exercised on untenable grounds, or for untenable reasons. If the trial court relies on unsupported facts or applies the wrong legal standard, its decision is exercised on untenable grounds or for untenable reasons; and if the trial court, despite applying the correct legal standard to the supported facts. adopts a view that no reasonable person would take, its decision is manifestly unreasonable. *See Mayer v. Sto Indus., Inc.*, 156 Wn.2d 677, 684, 132 P.3d 115 (2006). The appellant bears the burden of proving that the trial court abused its discretion. *See Childs v. Allen*, 125 Wn. App. 50, 58, 105 P.3d 411 (2004).

In this case, the OAH denied Hatfield's motion for summary judgment on federal preemption ground as well as Hatfield's motion to dismiss void assessment. Moreover, the OAH granted the Department's cross motion for partial summary, holding the owner-operators were employees of Hatfield for unemployment insurance tax purposes. As a result of these rulings, the only remaining issues for the evidentiary hearing involved the correct amounts of the contribution, penalties, and interest. Consequently, any testimony and documentary exhibits on federal preemption and void assessment issues would not have been relevant to the issues at the evidentiary hearing. *See* ER 401 (the test of relevancy is whether the evidence has a tendency to make the existence of the fact to be proved more probable or less probable than it would be without the evidence); ER 402 (evidence which is not relevant is not admissible). Here, the OAH did not rely

on unsupported facts, apply the wrong legal standard, or adopt a view that no reasonable person would take in deciding to exclude the evidence. Accordingly, the OAH did not abuse its discretion by excluding the testimony of Pursley, Rajkovacz, Sonntag, Bishop and related exhibits from the evidentiary hearing. Furthermore, because the parties have not brought any other specific challenges to the remaining evidentiary rulings made by OAH, we will adopt (1) the OAH's analysis in its Order Granting in Part and Denying in Part Department's Motions to Exclude Witnesses and Strike Exhibits issued on January 29, 2014; and (2) the OAH's analysis in its Order Granting in Part and Denying in Part Carriers' Consolidated Motions in Limine issued on January 29, 2014.

Now, therefore,

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

Appendix B

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

S. Alexander Liu
Deputy Chief Review Judge
Commissioner's Review Offices

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

APPENDIX C — ORDER OF THE SUPERIOR COURT FOR THE STATE OF WASHINGTON IN AND FOR THE COUNTY OF SPOKANE, FILED JUNE 23, 2016

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

NO. 2015-02-03856-1

HATFIELD ENTERPRIZES, INC., A WASHINGTON CORPORATION,

Petitioner,

vs.

STATE OF WASHINGTON EMPLOYMENT SECURITY DEPARTMENT,

Respondent.

ORDER RE: APPEAL

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

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

Appendix C

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

Dated this 23rd day of June, 2016.

s/_____
HAROLD D. CLARKE, III
Superior Court Judge

APPENDIX D — DECISION BEFORE THE COMMISSIONER OF THE EMPLOYMENT SECURITY DEPARTMENT OF THE STATE OF WASHINGTON, DATED DECEMBER 21, 2015

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

Review No. 2015-2142

Docket No. 122014-00336

In re:

SYSTEM - TWT TRANSPORT
Tax ID No. 575493-00-2

DECISION OF COMMISSIONER

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

The case then went through an extensive procedural history. Suffice it to say that after several years of litigation before the Office of Administrative Hearings ("OAH"), two state superior courts, and one state appellate court, this case was eventually remanded to the OAH for a hearing on the System's administrative appeal from the Department's tax assessment. *See* Stipulation and Order of Dismissal and Order to Disburse Funds in the Registry of the Court. After the remand, the parties entered into stipulated findings of fact agreeing, among other things, that the correct amount of contributions, penalties, and interest in dispute should be $58,300.99 for the audit period in question. *See* Stipulated Finding of Fact No. 11. The OAH heard oral argument from the parties on March 23, 2015 and, thereafter, issued an Initial Order on July 1, 2015 ruling in favor of the Department on all issues involved. On July 30, 2015, System timely petitioned the Commissioner for review of the Initial Order. Pursuant to chapter 192-04 WAC this matter has been delegated by the Commissioner to the Commissioner's Review Office. The Commissioner's Review Office acknowledged System's Petition for Review on August 26, 2015; and, on September 10, 2015, the Commissioner's Review Office received a reply filed by the Department. Having reviewed the entire record (including the audio recording of the hearing) and having given due regard to the findings of the administrative law judge pursuant to RCW 34.05.464(4), we adopt the OAH's findings of fact and conclusions of law in the Initial Order, subject to the following additions and modifications.

Appendix D

PREEMPTION

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

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

Generally speaking, FUTA applies to employers who employ one or more employees in covered employment in at least 20 weeks in the current or preceding calendar year or who pay wages of $1,500 or more during any calendar quarter of the current or preceding calendar year. *See* 26 U.S.C. § 3306(a)(1). Under FUTA, the term

"employee" is defined by reference to section 3121(d) of the Internal Revenue Code. *See* 26 U.S.C. § 3306(i). In turn, 26 U.S.C. § 3121(d)(2) defines "employee" to be any individual who, under the *usual common law rules* applicable in determining the employer-employee relationship, has the status of an employee. In 1987, the IRS issued Revenue Ruling 87-41, distilling years of case law interpreting "usual common law rules" into a more manageable 20-factor test.[1] While these 20 factors are commonly relied upon, it is not an exhaustive list and other factors may be relevant. Furthermore, some factors may be given more weight than others in a particular case. In 1996, the IRS reorganized the 20 factors into three broad categories: behavioral control, financial control, and relationship of the parties. *See* IRS, *Independent Contractor or Employee? Training Materials*, Training 3320-102 (October 30, 1996). However, regardless of the length and complexity of the tests developed by the IRS to clarify coverage issues for federal taxation purposes, we have cautioned that FUTA does not purport to fix the scope of coverage of state unemployment compensation laws. *See In re Coast Aluminum Products. Inc.*, Empl.

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

Sec. Comm'r Dec. 817 (1970) ("A wide range of judgment is given to the several states as to the particular type of statute to be spread upon their books." *(quoting Steward Machine Co. v. Davis*, 301 U.S. 548, 593 (1937))).

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

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

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

> Services performed by an individual for remuneration shall be deemed to be employment subject to this act unless and until it is shown to the satisfaction of the director that: (i) Such individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact; and (ii) Such service is either

Appendix D

The legislature introduced major revisions to the definition of "employment" in 1945 by adding, among other things, the phrase "*unlimited* by the relationship of *master and servant as known to the common law or any other legal relationship.*" *See* Laws of 1945, ch. 35, § 11 (emphasis added). The added language greatly expanded the scope of the employment relationship as covered by the Employment Security Act beyond the scope of the employment relationship as coveted by FUTA. *Compare* RCW 50.04.100 *with* 26 U.S.C. § 3306(i) and 26 U.S.C. § 3121(d)(2); *see also In re All-State Constr. Co.*, 70 Wn.2d 657, 664, 425 P.2d 16 (1967) (the test to be applied in determining the employment relationship under the Act is a statutory one; and common law distinctions between employees and independent contractors are inapplicable); *Skrivanich v. Davis*, 29 Wn.2d 150, 158, 186 P.2d 364 (1947) (the 1945 legislature intended and deliberately concluded to extend the coverage of the Act and by express language to preclude any construction that might limit the operation of the Act to the relationship of master and servant as known to the common law or any other legal relationship); *Unemp't Comp. Dep't v. Hunt*, 17 Wn.2d 228, 236, 135 P.2d 89 (1943) (our unemployment

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> outside the usual course of the business for which such service is performed, or that such service is performed outside of all the places of business of the enterprises for which such service is performed; and (iii) Such individual is customarily engaged in an independently established trade, occupation, profession or business, of the same nature as that involved in the contract of service.

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

compensation act does not confine taxable employment to the relationship of master and servant, but brings within its purview many individuals who would otherwise have been excluded under common law concepts of master and servant, or principal and agent). Since then, the definition of "employment" under the Act has remained largely unchanged. Moreover, the "independent contractor" or ABC test has also remained the same, except that in 1991 the legislature added a separate, six-prong test to the traditional three-prong test. *See* ESSB 5837, ch. 246 § 6, 52nd Leg., Reg. Sess. (Wash. 1991); *compare* RCW 50.04.140(1) *with* RCW 50.04.140(2).

Over the years, the appellate courts in Washington as well as the Commissioner's Review Office (as the final agency decision-maker on behalf of the Department) have grappled with the concept of "employment" under RCW 50.04.100 and applied the "independent contractor" test under RCW 50.04.140 in various factual scenarios, finding any given relationship either within or outside the intended scope of the Act. *See, e.g., State v. Goessman*, 13 Wn.2d 598, 126 P.2d 201 (1942) (barbers were held to be in employment of the barber shop; but the legislature later enacted RCW 50.04.225 to exempt barbers from covered employment); *Skrivanich*, 29 Wn.2d 150 (crew members were in employment of the fishing vessel); *All-State Constr. Co.*, 70 Wn.2d 657 (siding applicators were in employment of the construction company); *Miller v. Emp't Sec. Dep't*, 3 Wn. App. 503, 476 P.2d 138 (1970) (individuals performing bucking and falling activities were in employment of the logging contractor); *Schuffenhauer v. Emp't Sec. Dep't*, 86 Wn.2d 233, 543 P.2d 343 (1975)

(clam diggers were in employment of the wholesaler of clams); *Daily Herald Co. v. Emp't Sec. Dep't*, 91 Wn.2d 559, 588 P.2d 1157 (1979) (bundle droppers were in employment of the newspaper publisher); *Jerome v. Emp't Sec. Dep't*, 69 Wn. App. 810, 850 P.2d 1345 (1993) (food demonstrators were in employment of the food demonstration business); *Affordable Cabs, Inc. v. Emp't Sec. Dep't*, 124 Wn. App. 361, 101 P.3d 440 (2004) (taxicab drivers were in employment of the taxicab company); *but, see, e.g., Cascade Nursing Serv., Ltd. v. Emp't Sec. Dep't*, 71 Wn. App. 23, 856 P.2d 421 (1993) (nurses were not in employment of the nurse referral agency); *In re Judson Enterprises, Inc.*, Empl. Sec. Comm'r Dec.2d 982 (2012) (no employment relationship was found because a business entity could not be an employee unless it was shown that the business entity is actually an individual disguised as a business entity).

Two state appellate decisions pertained specifically to the trucking industry. In *Penick v. Emp't Sec. Dep't*, 82 Wn. App. 30, 917 P.2d 136 (1996), Division Two of the Court of Appeals dealt with the relationship *between* a motor carrier who owned the trucks *and* the drivers who were hired to drive the trucks ("contract drivers"). In that case, the motor carrier owned the trucks and operated them under its authority from the Interstate Commerce Commission. The carrier supplied fuel, repairs and maintenance, license, and insurance; and it also handled state and federal reporting requirements. The contract drivers paid their own federal income tax, social security and medicare taxes, and motel and food expenses; they did not receive sick leave, vacations, or

other benefits. The contract drivers could hire a "lumper" if they needed help in loading or unloading. The contracts, which could be terminated by either party at any time, entitled the contract drivers to 20 percent of the gross revenue generated by the loads they hauled. In the event of an accident, the contract drivers were required to pay damages not covered by the $2,500 deductible of the carrier's insurance policy. The contract drivers were also liable for shortage and cargo damage. The drivers often installed a variety of amenities on their assigned trucks to more life on the road more comfortable. The motor carrier secured the load for the outgoing trip, and the contract drivers occasionally obtained their own loads. Any driver was free to reject an offer to haul a load secured by the carrier and, instead, could choose to haul a load obtained by the driver. The carrier obtained return loads for about half the trips, and the drivers found their own return loads for the other half of the trips. The motor carrier handled the billing and collection and provided bi-weekly draws for trip expenses to the drivers. It also made bi-weekly payments to the drivers for their share of the payment for a particular haul. The carrier required its drivers to clean the inside and outside of the truck, adhere to all federal and state laws and safety regulations, and to call in every day by 10 a.m. while en route. But the motor carrier allowed the drivers to select their own routes and to select their driving hours, so long as the hours complied with legal requirements regarding maximum driving time and rest periods. The carrier also permitted the drivers to take other people with them. *Id.* at 34-35. After examining all relevant facts, the *Penick* court held that the contract drivers were in employment of the motor

carrier pursuant to RCW 50.04.100 and that their driving services were not exempted from coverage under the "independent contractor" test pursuant to RCW 50.04.140. *Id.* at 39-44. However, the *Penick* court did not address the coverage issue pertaining to the owner-operators (who owned the trucks but leased them to the carrier) because the motor carrier prevailed on that issue before the Commissioner's Review Office and did not appeal. *Id.* at 39. Because the Commissioner's Review Office did not publish the decision in the *Penick* matter, our holdings in that matter cannot be deemed precedential. *See* RCW 50.32.095 (commissioner may designate certain decisions as precedents by publishing them); *see also W. Ports Transp., Inc. v. Emp't Sec. Dep't*, 110 Wn. App. 440, 459, 41 P.3d 510 (2002) (unpublished decisions of Commissioner have no precedential value).

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

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

by the owner-operator and, accordingly, it failed the first prong of the "independent contractor" test under RCW 50.04.140(1)(a). *Id.* at 452-54. The *W. Ports* court also considered and rejected the carrier's contention that federal transportation law preempted state employment security law. *Id.* at 454-57.

In this case, the interested employer, System, is an interstate motor carrier duly licensed by the U.S. Department of Transportation and the Federal Motor Carrier Safety Administration (the successor agency to Interstate Commerce Commission). *See* Declaration of Rehwald in Support of Consolidated Motion for Summary Judgment ("Decl. of Rehwald") ¶ 3 at Administrative Record ("AR") 146. System hires approximately 381 company drivers to operate equipment that it owns. In addition, System leases approximately 254 trucks from third parties commonly referred to in the trucking industry as owner-operators. According to Rehwald, the use of owner-operators is common in the industry because of the fluctuating demand for trucking services. System is able to reduce overhead costs and simplify its operations by contracting with owner-operators because the owner-operators own their equipment and lease it to System via a written equipment lease agreement. *Id.* ¶ 5 at AR 147. System uses two different types of leases to lease motor vehicle equipment from an owner-operator: First, it uses a mileage lease on a very limited and infrequent basis, which only affects a small percentage of the owner-operators leasing equipment to System; second, System uses a percentage lease that compensates an owner-operator based on a percentage of the gross revenue generated

by his or her equipment. *Id.* ¶ 6 at AR 148. System's principal office is located in Cheney, Washington; it also has terminals in a number of different states, including California, Arizona, Indiana, Colorado, and Kansas. Both System's company drivers and its owner-operators are dispatched regionally, from regional fleets that serve certain geographic areas. *Id.* ¶ 19 at AR 149. System's load coordinators are responsible for planning and coordinating freight hauling. The load coordinator matches available loads with available trucks and trailers. The loads are hauled by either company drivers or owner-operators. *See* Stipulated Finding of Fact No. 4. System does not dispute that the company drivers are its employees; however, System contends that the owner-operators are not its employees, but independent contractors, for unemployment insurance tax purposes. *See* Stipulated Finding of Fact No. 2.

As discussed above, the Department conducted an audit of System for various quarters in 2007, 2008, and 2009; and, subsequently, reclassified the owner-operators as employees of System and deemed their wages to be reportable for unemployment insurance tax purposes. System moved the OAH for summary judgment on federal preemption ground, essentially arguing that it is entitled to judgment as a matter of law because RCW 50.04.100 and RCW 50.04.140 as applied to motor carriers of the trucking industry in Washington are preempted by the Federal Aviation Administration Authorization Act of 1994 ("FAAAA"). The crux of System's argument is that the Department's efforts in applying RCW 50.04.100 and RCW 50.04.140 to the trucking industry will eliminate

the use of owner-operators from the trucking industry and effectively restructure that industry, resulting in a substantial impact on its prices, routes, and services. The Department responded by arguing that the Washington's leading case, *W. Port*, has rejected the argument that the state employment security law is preempted by federal motor carrier law; and that preemption should not apply because any impact its application of RCW 50.04.100 and RCW 50.04.140 may have on motor carriers is far too tenuous, remote, or peripheral to be preempted.

Federal preemption is based on the United States Constitution's mandate that the "Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby." *See* U.S. CONST., art. VI, cl. 2; *see also Ameriquest Mortg. Co. v. Washington State Office of Atty. Gen.*, 170 Wn.2d 418, 439, 241 P.3d 1245 (2010) (federal law may preempt state law by force of the Supremacy Clause of the United States Constitution). A state law that conflicts with federal law is said to be preempted and is "without effect." *See Cipollone v. Liggett Group. Inc.*, 505 U.S. 504, 516, 112 S. Ct. 2608 (1992). Federal law may preempt state law in any of the three ways: (1) expressly by the federal law's terms; (2) impliedly by Congress' intent to occupy an entire field of regulation; or (3) by the state law's direct conflict with the federal law. *See Michigan Canners & Freezers Assoc. v. Agric. Mktg & Bargaining Bd.*, 467 U.S. 461, 469, 104 S. Ct. 2518 (1984). There are "two cornerstones" of federal preemption jurisprudence: First, the purpose of Congress is the ultimate touchstone in every preemption case; second, where Congress has legislated in a field

traditionally occupied by states, there is a presumption against preemption. *See Wyeth v. Levine*, *555* U.S. 555, 565, 129 S. Ct. 1187 (2009.). Where Congress has superseded state legislation by statute, the courts' task is to identify the domain expressly preempted. To do so, the courts must first focus on the statutory language, which necessarily contains the best evidence of Congress' preemptive intent. *See Dan's City Used Cars, Inc. v. Pelkey*, 133 S. Ct. 1769, 1778 (2013) (internal citations and quotation marks omitted).

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

In 1980, Congress deregulated the trucking industry. *See Rowe*, 552 U.S. at 368 *(citing* Motor Carrier Act of 1980, 94 Stat. 793). Then, a little over a decade later, in 1994, Congress borrowed the preemption language from the ADA to preempt state trucking regulation and thereby

ensure that the states would not undo the deregulation of trucking. *Id. (citing* FAAAA, 108 Stat. 1569, 1605-06). The FAAAA preemption provision states:

> ... [A] State ... may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service of any motor carrier ... with respect to the transportation of property.

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

In *Morales*, the Court first encountered the identical preemption provision under the ADA; and the Court adopted its construction of the term "related to" from its preemption jurisprudence under the Employee Retirement Income Security Act of 1974, defining the term broadly as "having a connection with or reference to airline rates, routes, or services." *See Morales*, 504 U.S. at 384. The Court, however, reserved the question of whether some state actions may affect airline fares in "too tenuous, remote, or peripheral a manner" to trigger preemption, giving as examples state laws prohibiting gambling and prostitution as applied to airlines. *Id.* at 390. Over a decade later, in *Rowe*, the Court examined whether the FAAAA preempted a state's tobacco delivery regulation, which imposed several requirements on drivers of tobacco products. *See Rowe*, 552 U.S. at 369. In holding that the

state's statute was preempted by FAAAA, the Court essentially adopted its reasoning in *Morales*, because ADA and FAAAA consisted of identical preemption language and further because "when judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its judicial interpretations as well." *Id.* at 370 *(quoting Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85, 126 S. Ct. 1503 (2006)). In reaffirming *Morales*, the Court in Rowe explained:

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

Id. (internal citations omitted). Subsequently, the Court cautioned that the breath of the words "related to" did not mean the sky was the limit and that the addition of the words "with respect to the transportation of property" massively limited the scope of preemption ordered by the FAAAA. *See Pelkey*, 133 S. Ct. at 1778 (FAAAA did not preempt state-law claims for damages against a towing

company regarding the company's post-towing disposal of the vehicle) (internal quotation marks omitted). Finally, in *Am. Trucking Ass'n, Inc. v. City of Los Angeles*, 133 S. Ct. 2096 (2013), the Court addressed another aspect of the FAAAA preemption — the "force and effect of law" language, drawing a distinction between a government's exercise of regulatory authority and its own contract-based participation in the market. The Court held that, when the government employed the "hammer of the criminal law" to achieve its intended goals, it acted with the force and effect of law and thus the concession agreement's placard and parking provisions were preempted by the FAAAA because such provisions had the "force and effect of law." *Id.* at 2102-04.

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

> [The meal and break laws] do not set prices, mandate or prohibit certain routes, or tell motor carriers what services they may or may

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

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

In contrast, the Ninth Circuit have held that a complete ban on the use of independent contractors could not survive the FAAAA preemption. *See Am. Trucking Ass'ns, Inc. v. City of Los Angeles*, 559 F.3d 1046, 1056 (9th Cir. 2009) (the independent contractor phase-out

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

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

See Mass. Delivery Ass'n v. Coakley, 769 F.3d 11, 21 (1st Cir. 2014) (internal citation omitted). Following a remand from the First Circuit, the lower district court held that prong B of the Massachusetts' independent contractor

statute was preempted by the FAAAA. *See Mass. Delivery Ass'n v. Healey*, 2015 WL 4111413 (D. Mass. July 8, 2015).

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

According to Pursley, the owner-operators have long been an important component of the trucking industry, both nationally and locally. The owner-operators are utilized in most, if not all, sectors of the industry, including long-haul trucking, household goods moving, and intermodal operations. Motor carriers contract with owner-operators to obtain the owner-operators' equipment to haul freight on an as-needed basis. *See* Declaration of Pursley in Support of Consolidated Motion for Summary Judgment ("Decl. of Pursley") ¶ 6 at AR 93. With the economic deregulation of the interstate trucking industry, the vast majority of trucking business are small businesses, and nearly 96 percent of those businesses operate fewer than 20 trucks and nearly 88 percent operate six trucks

or less. Consequently, the trucking industry is a highly diverse industry, resulting in intense competition and low profit margins. *Id.* ¶ 5 at AR 92. Pursley asserts that the assessments imposed by the Department on motor carriers will fundamentally change the business models of both motor carriers and owner-operators throughout Washington, because the Department will effectively prohibit carriers from using independent owner-operators. According to Pursley, requiring carriers to use employees rather than independent contractors will force carriers to establish and maintain an employee workforce in order to meet peak demand and to considerably build the related infrastructure such as trucks, administrative staff, and garages. Moreover, requiring carriers to convert independent owner-operators into employees will compel carriers to take on additional employment-related costs, including state and federal social security taxes, unemployment insurance taxes, and medical and retirement costs. As a result, carriers would need to raise their prices in order to defray the additional expenses. *Id.* ¶ 10 at AR 94. Finally, Pursley asserts that the Department's effort will lead to diminished economic choices and reduced income for owner-operators by forcing them to get their own motor carrier authority if they are to maintain their independence. *Id.* ¶ 11 at AR 95.

Additionally, System requests us to depart from our state's appellate decision in *W. Ports*, which held that federal transportation law did not preempt state employment security law. *See W. Ports*, 110 Wn. App. at 454-57. System argues that *W. Ports* court never analyzed the FAAAA preemption clause under 49 U.S.C.

§ 14501(c)(1) and that *W. Ports* court's two bases for rejecting the preemption argument are no longer valid in light of the subsequent U.S. Supreme Court's decision in *Rowe*. *See* System's Petition for Review at 3.

While System's arguments are appealing and we are tempted to address the merits of the federal preemption issue, we must be mindful of our limited authority as a quasi-judicial body. As a general proposition, the Commissioner's Review Office, being an office within the executive branch of the state government, lacks the authority or jurisdiction to determine whether the laws it administers are constitutional; only the courts have that power. *See* RCW 50.12.010; RCW 50.12.020; *Bare v. Gorton*, 84 Wn.2d 380, 383, 526 P.2d 379 (1974); *In re Kellas*, Empl. Sec. Comm'r Dec.2d 825 (1991) (Commissioner's Review Office is part of an administrative agency in the executive branch of government and is thus without power to rule on constitutionality of a legislation; that function is reserved to judicial branch of government); *In re Bremerton Christian Schools*, Empl. Sec. Comm'r Dec.2d 809 (1989); *In re Ringhofer*, Empl. Sec. Comm'r Dec.2d 145 (1975). On the other hand, the superior court, on judicial review of a final agency order issued by the Commissioner's Review Office, may hear arguments and rule on the constitutionality of the Department's orders. *See* RCW 34.05.570(3)(a) (the court shall grant relief from an agency order in an adjudicative proceeding if the order, or the statute or rule on which the order is based, is in violation of constitutional provisions on its face or as applied). Consequently, in keeping with the authority of the highest tribunals of Washington State and federal

jurisprudence, we are of the view that, to the extent the Washington's Employment Security Act as applied to motor carriers of the trucking industry implicates the Supremacy Clause of the United States Constitution (on the basis that the Department's enforcement effort is allegedly preempted by the FAAAA), the Commissioner's Review Office, as an executive branch administrative office, is not the appropriate forum to decide such a constitutional issue.

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

Finally, the Commissioner's Review Office, as the final decision-maker of an executive agency, is bound by the state appellate court's decisions; and System has not supplied any authorities for us to do otherwise. As such, to the extent that the *W. Port* court already considered and rejected the argument that federal transportation laws preempted state employment security law, *see W. Ports*, 110 Wn. App. at 454-57, we concur with the OAH that the Washington's Employment Security Act as applied to

motor carriers of trucking industry is not preempted by the FAAAA preemption clause. *See* adopted Conclusions of Law Nos. 11 – 13 in Initial Order.

VOID ASSESSMENT

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

I

First, System contends that the assessment is void because the Department lacked statutory authority to issue the assessment. We disagree. Generally speaking, a Departmental order is void only when the Department lacks either personal or subject matter jurisdiction. *See Marley v. Dep't of Labor & Indus.*, 125 Wn.2d 533, 542, 886 P.2d 189 (1994). The type of controversy over which an agency has subject matter jurisdiction refers to the general category of controversies it has authority to decide, and is distinct from the facts of any specific case. *See Singletary v. Manor Healthcare Corp.*, 166 Wn. App. 774, 782, 271 P.3d 356 (2012). Obviously, the power to decide a type of controversy includes the power to decide wrong, and an incorrect decision is as binding as a correct one. *See Marley*, 125 Wn.2d at 543. "If the type of controversy is within the subject matter jurisdiction, then all other defects or errors go to something other than subject matter jurisdiction." *Id.* at 539. As such, the

assessment in question is void only if System can show that the Department lacked personal or subject matter jurisdiction to issue the assessment. Here, System has not challenged the Department's personal jurisdiction. Moreover, issuing tax assessments to Washington employers, putative or otherwise, for unemployment insurance tax purposes is precisely within the subject matter jurisdiction delegated to the Department by the Washington state legislature. Consequently, we may not void the assessment in question for want of personal or subject matter jurisdiction.

II

System next argues that the assessment is a result of arbitrary or capricious action on the part of the Department. System's argument is not well-taken. In general, courts should not probe the mental processes of administrative officials in making a decision. *See Nationscapital Mortg. Corp. v. Dep't of Fin. Insts.*, 133 Wn. App. 723, 762-763, 137 P.3d 78 (2006) *(citing United States v. Morgan*, 313 U.S. 409, 422 (1941)). In the absence of evidence to the contrary, courts should "presume public officers perform their duties properly, legally, and in compliance with controlling statutory provisions." *Id.* at 763 *(citing Ledgering v. State*, 63 Wn.2d 94, 101, 385 P.2d 522 (1963)). When a court conducts a judicial review of matters of agency discretion, its role is limited to ensuring that the agency has exercised its discretion in accordance with the law and has not abused its discretion. *See* RCW 34.05.574(1); *see also NW Sportfishing Indus. Ass'n v. Dep't of Ecology*, 172 Wn. App. 72, 91, 288 P.3d 677 (2012)

(a reviewing court should avoid exercising discretion that our legislature has placed in the agency). An agency abuses its discretion when it exercises its discretion in an arbitrary and capricious manner. *See Conway v. Dep't of Soc. & Health Servs*., 131 Wn. App. 406, 419, 120 P.3d 130 (2005). An agency action is arbitrary and capricious if it is "willful and unreasoning and taken without regard to the attending facts or circumstances." *See Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n*, 148 Wn.2d 887, 905, 64 P.3d 606 (2003). An agency action is not arbitrary and capricious if the decision is exercised honestly and upon due consideration, even where there is room for two opinions. *Id.* ("[W]here there is room for two opinions, an action taken after due consideration is not arbitrary and capricious. even though a reviewing court may believe it to be erroneous"); *see also DeFelice v. State*, 187 Wn. App. 779, 787-88, 351 P.3d 197 (2015). The scope of review under an arbitrary and capricious standard is extremely narrow, and the party challenging the agency action carries a heavy burden. *See Keene v. Bd. Of Accountancy*, 77 Wn. App. 849, 859, 894 P.2d 582 (1995); *Ass'n of Wash. Spirits & Wine Distrib. v. Wash. State Liquor Control Bd*., 182 Wn.2d 342, 359, 340 P.3d 849 (2015).

In the instant case, System asserts that the Department acted arbitrarily and capriciously when it failed to follow its own internal audit standards and manuals, such as Tax Audit Manual, Status Manual, and Generally Accepted Audit Standards. However, internal policies, directives, and standards do not generally create law that binds the agency, unless they are formally promulgated pursuant to legislative delegation. *See Joyce v. Dep't of Corrections*,

155 Wn.2d 306, 323, 119 P.3d 825 (2005). Accordingly, the Department's failure to adhere to its own internal, nonbinding standards or manuals is not an arbitrary and capricious action *per se.*

More troubling is the fact that the Department expected the tax specialist in this case to find errors, errors of omitting employees, and errors of omitting remuneration. System asserts that such performance expectations violated the audit standards of independence, objectivity, and impartiality, resulting in predetermined liability. We can agree with System this much: The goal of an audit is to determine the accuracy of the material audited, no more and no less. However, an auditing target or quota may be nothing more than assuring that the auditor is conducting the audits thoroughly and adequately. Expecting that the auditors almost always find errors may be nothing more than a statistical reality that most employers make mistakes. Or, as explained by the tax specialist in this case, the pre-audit research by the auditor already established that the employers selected for audit had most likely erred in treating employees as independent contractors. Consequently, performance expectations imposed on an auditor do not in and of themselves make the assessment arbitrary and capricious, unless it can be shown that the auditor intentionally fabricated or manipulated the audit result to meet the performance quota or that the assessment was utterly baseless. In this case, System has not alleged that the tax specialist intentionally fabricated or otherwise manipulated the audit result to meet her performance quota; furthermore, the assessment was

certainly not baseless, especially when its result was consistent with the *W. Ports* decision (finding an owner-operator was in employment of a motor carrier under the Employment Security Act). *See W. Ports*, 110 Wn. App. at 459. Accordingly, we are not persuaded that the Department acted arbitrarily and capriciously in issuing the assessment in question.

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

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

In any event, any misdeeds on the part of the Department in conducting the audit and issuing the assessment, do not warrant a dismissal or exclusion of the assessment in this case. After all, the statutes (i.e. Title 50 RCW) and regulations (i.e. Title 192 WAC) do not require the Department to follow any particular process or abide by any particular standard in conducting tax audits. To the extent that the Department's audit was inadequate, incomplete, or lack of professional due care, System has the right to appeal the assessment and request a hearing before the OAH, and it did so in this case. *See* RCW 50.32.030; *see, e.g., Motley-Motley. Inc. v. State*, 127 Wn. App. 62, 78-79, 110 P.3d 812 (2005) (even if Department of Ecology's investigation of Motley's water right was inadequate, incomplete, and secret, Motley still had the

opportunity to request a hearing before the Pollution Control Hearings Board; and the proceedings before the Pollution Control Hearings Board were *de novo,* without deference to Department of Ecology's initial/tentative decision). Accordingly, we concur with the OAH that System's request to dismiss or exclude the assessment in question shall be denied. *See* adopted Conclusion of Law No. 14.

III

Additionally, System argues that the Department should be "equitably estopped from changing its longstanding position that owner/operators are independent contractors, as evidenced by the *Penick* case and [its] own manuals." System's argument in this regard is not persuasive. A party asserting equitable estoppel must establish: (1) an admission, statement, or act that is inconsistent with a later claim; (2) a reasonable reliance on the admission, statement, or act; and (3) injury that would result to the relying party if the first party is allowed to contradict or repudiate the prior act, statement, or admission. *See Robinson v. Seattle*, 119 Wn.2d 34, 82, 830 P.2d 318 (1992). Equitable estoppel is based on the principle that a party should be held to a representation made or position assumed where inequitable consequences would otherwise result to another party who has justifiably and in good faith relied thereon. *See Wilson v. Westinghouse Elec. Corp.*, 85 Wn.2d 78, 81, 530 P.2d 298 (1975). Equitable estoppel against the government is not favored. *See Finch v. Matthews*, 74 Wn.2d 161, 169, 443 P.2d 833 (1968). Consequently, when

a party asserts the doctrine against the government, two additional requirements must be met: equitable estoppel must be necessary to prevent a manifest injustice, and the exercise of governmental functions must not be impaired as a result of the estoppel. *See Shafer v. State*, 83 Wn.2d 618, 622, 521 P.2d 736 (1974). Finally, a party asserting equitable estoppel must prove each element of estoppel by clear, cogent, and convincing evidence. *See Kramarevcky v. Dep't of Soc. & Health Servs.*, 122 Wn.2d 738, 744, 863 P.2d 535 (1993).

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

the Employment Security Act. *See W. Ports*, 110 Wn. App. at 459.

IV

Finally, System contends that the assessment in this case somehow violated its constitutional due process right. System relies on two U.S. Supreme Court cases, *United States v. Powell*, 379 U.S. 48 (1964) and *United States v. LaSalle Nat'l Bank*, 437 U.S. 298 (1978), for the general proposition that the IRS must use its summons authority in good faith. Those two cases, however, did not address whether and how the taxpayers' due process rights were violated by the IRS-issued summons and, thus, they are not helpful to this tribunal in adjudicating System's due process claim. Without any substantive legal arguments that are supported by citations to the record and legal authorities, we obviously cannot conclude the assessment in this case has violated System's due process right, procedural or substantive.

EMPLOYMENT

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

Appendix D

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

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

clear and direct connection between the personal services provided and the benefit received by the entity sought to be taxed. *See Cascade Nursing*, 71 Wn. App. at 31.

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

Appendix D

INDEPENDENT CONTRACTOR EXEMPTION

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

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

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

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

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

is liable for contributions based on wages paid to the individual pursuant to RCW 50.24.010.

A. Direction and Control.

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

In this case, System entered into standard independent contractor agreements with the owner-operators governing the relationship between the parties. On the one hand, the owner-operators enjoy some autonomy with regard to the performance of their freight-hauling and truck-driving services. For example, the owner-operators are responsible for the costs of operating their equipment, including motor fuel, tires, lubricants, maintenance, repairs, taxes, assessments, licenses, permits, tolls, and scale fees. The owner-operators maintain their own liability and property damage insurance while not operating for System, and are responsible for any insurance deductibles. The owner-operators are also responsible for any other fine or fees imposed against the equipment and cargo. *See* Independent Contractor Agreement ¶ 4 at AR 627-28. Moreover, the owner-operators are solely responsible

for selecting, hiring, training, disciplining, discharging, and setting hours and wages for, its employee drivers and laborers. *See* Independent Contractor Agreement ¶ 24 at AR 630. Finally, the owner-operators pay their own employees and make such deductions or contributions as may be required by regulatory entities. *See* Independent Contractor Agreement ¶ 13 at AR 629.

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

documents and other paperwork, including copies of fuel purchases, daily vehicle condition reports, mileage sheets, delivery receipts, and monthly maintenance reports. *See* Independent Contractor Agreement ¶ 6 at AR 628. Moreover, the owner-operators must submit to System on a timely basis, all driver logs, physical examination certificates, accident reports, and any other required data, documents, or reports. *See* Independent Contractor Agreement ¶ 23(B) at AR 630. The owner-operators must maintain their equipment in good operating condition and supply all safety devices as required by System. *See* Independent Contractor Agreement ¶ 17 at AR 629. The owner-operators are required to operate their equipment in a safe and prudent manner at all times and must ensure their drivers comply with System's policies and procedures and any subsequent revisions thereto. *See* Independent Contractor Agreement ¶ 23(E) at AR 630. At no time shall the owner-operators allow a passenger or a driver to occupy or operate the equipment who has not been approved by System. *See* Independent Contractor Agreement ¶ 15 at AR 629. Further, the owner-operators and their drivers must adhere to System's drug and alcohol policy, including participation in System's random drug and alcohol testing program. *See* Independent Contractor Agreement ¶ 23(D) at AR 630. System retains the right to disqualify any driver supplied by the owner-operators if the driver is found to be unsafe or in violation of System's minimum qualification standards or any policies of System's customers. *See* Independent Contractor Agreement ¶ 23(A) at AR 630. The owner-operators are required to immediately notify System of any accident involving the equipment or the cargo transported by the equipment.

The owner-operators are expected to cooperate fully with System regarding any legal action, regulatory hearing, or other proceeding arising from the operation of the equipment, the relationship created by the agreement, or the services performed under the agreement. Upon System's request, the owner-operators must, at their own expense, provide written reports or affidavits, attend hearings or trials, and assist in securing evidence or obtaining the attendance of witnesses. The owner-operators are also required to assist in investigation, settlement, or litigation of any accident, claim, or potential claim by or against System. *See* Independent Contractor Agreement ¶ 14 at AR 629. If the owner-operators fail to complete timely transportation of commodities, abandon a shipment, or otherwise subject System to liabilities, System has the right to take possession of the shipment and complete the transportation. *See* Independent Contractor Agreement ¶¶ 20, 22 at AR 629. Finally, System may terminate the agreement with any owner-operator if the owner-operator commits an illegal or other misconduct that is detrimental to System or System's business. *See* Independent Contractor Agreement ¶ 21 at AR 629.

The above-referenced requirements imposed by System are generally incompatible with freeing the owner-operators from its control and direction; in other words, System is not just interested in the *end result* of the freight -hauling and truck -driving services performed by the owner-operators, but it also concerns itself as to "*how*" those services are to be performed by the owner-operators. In sum, we concur with the administrative law

judge that the owner-operators have not met the first criterion — freedom from control or direction — under RCW 50.04.140(1)(a). *See* adopted Conclusion of Law No. 9 in Initial Order.

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

> It is true that a number of the controls exerted by Western Ports over the services performed by Mr. Marshall are dictated by federal regulations that govern the use of leased trucks-with-drivers in interstate commerce. Even so, RCW 50.04.100 suggests that the Department properly can consider such federally mandated controls in applying the statutory test for exemption, in that "service in interstate commerce" is specifically included in the statutory definition of "employment." RCW 50.04.100 ("'Employment' . . . means personal service of whatsoever nature, . . . including service in interstate commerce[.]") It would make little sense for the Legislature to have specifically included service in interstate commerce as "employment" only to automatically exempt such service under RCW 50.04.140 based on federal regulations that require a high degree

> of control over commercial drivers operating motor vehicles in interstate commerce ....

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

Relying primarily on *Kamla v. Space Needle Corp.*, 147 Wn.2d 114, 52 P.3d 472 (2002), System contends that "control" in the employment context requires a showing of something more than "general contractual rights," *Id.* at 121; and rather it means "control over the manner in which the wor[k] is done," such that the contractor "is controlled as to his methods of work, or as to operative detail" and "is not entirely free to do the work in his own way." *Id. (quoting* Restatement Second of Torts § 414 cmt. c (1965)). *See* System's Petition for Review at 4. Initially, we note that *Kamla* is a case addressing the issue of whether an employer retained the right to direct a contractor's work so as to bring the employer within the "retained control" exception to the general rule of nonliability for injuries of a contractor, *Id.* at 119; and it is not a case interpreting the "control or direction" criterion under RCW 50.04.140(1)(a). Accordingly, we do not find the *Kamla*'s reasoning readily applicable to the case at hand. However, even if we were to consider *Kamla* as persuasive authority for this case, we find nothing said in *Kamla* is inconsistent

with the decisions interpreting the "control or direction" criterion under RCW 50.04.140(1)(a). As correctly noted by System, we must consider the amount of control exercised over the "methods and details" of the work in evaluating the "control or direction" criterion under RCW 50.04.140(1)(a). *See Jerome*, 69 Wn. App. at 816; *W. Ports*, 110 Wn. App. at 452.

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

In sum, it is not any single contractual right, or any single control over an equipment (federally mandated or otherwise), or any single detail of the personal services rendered, that will help this tribunal distinguish an

independent contractor from an employee; inevitably, it has to be all of those things and more, considered *in aggregate,* that will aid us in deciding whether an individual is an independent contractor or an employee for unemployment insurance tax purposes.

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

The second criterion under RCW 50.04.14)(1)(b) is that the service in question either be performed outside the usual course of business for which such service is performed, or that it be performed outside all places of business of the enterprise for which such service is performed. Regarding the first alternative, System's usual course of business is to transport goods in interstate commerce, and the owner-operators provided truck-driving services to System. As such, the owner-operators' services were performed within, not outside, the usual course of System's business. Accordingly, System fails the first alternative under RCW 50.04.140(1)(b).

Regarding the second alternative under RCW 50.04.140(1)(b), the critical inquiry in this case is whether the trucks owned by the owner-operators but leased to System constitute the places of System's business. *W. Ports* did not address this issue as the court there disposed of the case on the first criterion of the independent contractor test under RCW 50.04.140(1)(a). *See W. Ports*, 110 Wn. App. at 459. Although the court in *Penick* held that the trucks were the carrier's places of business, it relied on the fact that the carrier owned

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

Here, we are dealing with a unique contractual relationship between common carriers and owner-operators that effectuates the lease of equipment (i.e. trucks) along with driving services; and such contractual relationship is subject to extensive federal safety regulations designed for the protection of the public and applying to both motor carriers as well as owner-operators. *See, generally.* Federal Motor Carrier Safety Administration ("FMCSA") Regulations, 49 C.F.R. Parts 300 – 399. In order to clarify the role of federal leasing

regulations and their impact on independent contractor status, the Interstate Commerce Commission (the predecessor agency to FMCSA) promulgated 49 C.F.R. § 376.12(c)(4); which states:

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

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

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

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

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

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

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

C. Independently Established Business.

The third criterion under RCW 50.04.140(1)(c) requires a showing that an individual is customarily engaged in an independently established trade, occupation, profession, or business, of the same nature as that involved in the contract of service with the alleged employer. Proof of independently established business requires evidence of an enterprise created and existing separate and apart from the relationship with the alleged employer, an enterprise that will survive the termination of that relationship. The courts have traditionally examined the following factors as indicia of an independently established business: (1) the worker has a separate office or place of business outside of his or her home; (2) the worker has an investment in the business; (3) the worker provides equipment and supplies needed for the job; (4) the alleged

employer fails to provide protection from risk of injury or non-payment; (5) the worker works for others and has individual business cards; (6) the worker is registered as an independent business with the state; and (7) the worker is able to continue in business even if the relationship with the alleged employer is terminated. *See Penick*, 82 Wn. App. at 44.

Furthermore, when a business plans to operate as an authorized for-hire motor carrier that transports regulated commodities in interstate commerce in exchange for a fee or other compensation, such business must obtain an interstate operating authority (MC number) through the FMCSA. A business may need to obtain multiple operating authorities to support its planned business operations. *See Get Authority to Operate (MC Number)*, Fed. Motor Carrier Safety Admin., http://www.fmcsa.dot.gov/registration/get-mc-number-authority-operate (last visited December 17, 2015). The types of operating authorities include the authority for motor carrier of property (except household goods), the authority for motor carrier of household goods, the authority for broker of property (except household goods), and the authority for broker of household goods. *See Types of Operating Authority*, Fed. Motor Carrier Safety Admin., http://www.fmcsa.dot.gov/registration/types-operating-authority (last visited December 17, 2015). Consequently, one of the unique characteristics about the trucking industry is the federal requirement that an owner-operator obtain an operating authority (MC number) in order to engage in the business of transporting goods in interstate commerce; otherwise, the owner-operator must operate under

another carrier's operating authority. In other words, when it comes to the trucking industry, whether an owner-operator has his or her own operating authority is an *additional paramount* factor for the purpose of proving independently established business under the third criterion of RCW 50.04.140(1)(c). If an owner-operator wishes to sell his or her services, invoice for the services, collect for the services, and maintain safety records as required by federal regulations, all the while continuing to operate his or her truck, maintain the truck, and manage the load, then he or she has the option to obtain the operating authority. And if an owner-operator does not wish to take upon the administrative burdens of running a business, he or she still has the option of leasing onto an authorized motor carrier with operating authority. *See* Douglas C. Grawe, *Have Truck, Will Drive: The Trucking Industry and The Use of Independent Owner-Operators Over Time*, 35 Transp. L.J. 115, 133 (2008). However, if an owner-operator chooses the latter option, certain legal consequences may flow from that choice, one of which is that such owner-operator May be deemed an employee of the carrier for the purpose of unemployment insurance tax under the appropriate circumstances.

In this case, System did not introduce any evidence, documentary or testimonial, to show that the owner-operators at issue here had independently established enterprises or entities during the audit period. The record is devoid of any business registration, business license, UBI number, and account with the Department of Revenue tending to show the existence of an established business entity. As such, it matters not that the owner-operators owned their trucks and were responsible for the costs of

operating those trucks; or that the costs of the trucks or trailers were significant; or that the owner-operators maintained their own financial books reflecting their income and expenses. *See* Appellant's Hearing Brief at 31. The fact remains that the owner-operators had no established business entities that were separate and apart from their own individuals *in the first place.*

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

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

insurance and customers. If the owner-operators were terminated by [the carrier], in all likelihood they would be out of work until they could make similar arrangements with another carrier").

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

Now, therefore,

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

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

S. Alexander Liu
Deputy Chief Review Judge
Commissioner's Review Office

APPENDIX E — OPINION IN THE SUPERIOR COURT FOR THE STATE OF WASHINGTON IN AND FOR THE COUNTY OF SPOKANE

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

NO. 2016-02-00121-6

SYSTEM-TWT TRANSPORT,
A WASHINGTON CORPORATION,

Petitioner,

vs.

STATE OF WASHINGTON
EMPLOYMENT SECURITY DEPARTMENT,

Respondent.

ORDER RE: APPEAL

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

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

Appendix E

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

Dated this 23rd day of June, 2016.

/s/: _____
HAROLD D. CLARKE, III
Superior Court Judge

APPENDIX F — JUDGE'S RULING DENYING APPEAL IN THE SPOKANE COUNTY SUPERIOR COURT, FILED JUNE 23, 2016

SPOKANE COUNTY SUPERIOR COURT

HAROLD D. CLARKE, III
JUDGE
DEPARTMENT 8
Linda Sutton, Judicial Assistant
Joe Wittstock, Court Reporter
SPOKANE COUNTY COURTHOUSE
1116 W. BROADWAY, SPOKANE, WASHINGTON
99260-0350
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June 23, 2016

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

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

Dear Counsel:

This matter came before the Court on April 22, 2016 upon the consolidated appeals filed by Petitioners with regard to the decision by the Employment Security Department to assess the Unemployment taxes on a certain group of truck drivers, namely those that own and operate their

own equipment and carry freight for Petitioners under a contract. Following argument, the matter was taken under advisement.

The procedural history of this case is long and complex. It will not be recited here except to reference Pages 2 and 3 of Petitioner Swanson's brief; Petitioner Hatfield's brief Pages 9, 10 and 11; Petitioner TWT's brief Pages 6 through 12; Respondent's brief Pages 2 through 5 (Swanson); 2 through 7 (Hatfield) and 2 through 9 (System-TWT) as well as the Commissioner's decision in each matter. These documents give a good overview of the process that has occurred over the last several years.

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

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

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

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

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

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

Swanson Hay: Swanson Hay presents a more limited basis for appeal. The question presented is whether the drivers

at issue fall within the Independent Contractor Exemption of RCW 50.04.140. The Court agrees it is the burden of Swanson to prove the drivers fall within the exemption.

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

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

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

The case of *Jerome v. Employment Security,* 69 Wa. App. 810, 850 P2d 1345 (1993) supplies us with a test to make a determination under this statute. The Commissioner used this test but went beyond the test to hold that

whether the owner-operator had their own operating authority under the Federal Motor Carrier Safety Act (FMCSA) is an *additional paramount* (emphasis added by Commissioner) factor to be considered for the purpose of proving independently established business. There is no authority cited for making this an additional factor or a paramount factor.

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

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

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

System TWT / Hatfield Enterprises: System and Hatfield (and Swanson in their briefing) assert that the Department is attempting to fundamentally change the trucking industry in our state by forcing the business model of carriers to change. The evidence demonstrates the trucking industry utilizes independent contractors to meet cyclical demands for capacity. This allows carriers to remain competitive by being flexible in the number of trucks they utilize over time. There are two problems with this assertion. First, it's unknown whether the assessment of unemployment taxes will cause the carriers to alter their business model, and two, it's unclear to this Court what the remedy would be. It would appear that a legislative resolution might be an appropriate approach to this overall philosophical question of how to treat the trucking industry business model for purposes of unemployment taxes.

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

Appendix F

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

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

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

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

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

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

Appendix F

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

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

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

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

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

Appendix F

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

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

Essentially, the owner-operators in these matters owned their equipment; could operate that equipment themselves or hire others to do that; chose to accept work or not from the carrier; chose the route to move the cargo; are

responsible for the maintenance and upkeep of their equipment; pay for fuel; are responsible for insurance or costs thereof for liability and cargo damage; get paid by a percentage of the amount paid by the customer; could transport loads when empty if the load was agreed to by the carrier.

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

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

Regardless, the question is whether the carriers have the right to control the methods and details of the performance of the work, as opposed to the end result of the work. This Court believes an appropriate test as to the issue of control and direction would be to measure those points of control that affect the core of the work being provided. In other words, the key is to examine whether any particular factor is central to the service being supplied, which in this case is the delivery of freight. The Administrative Law Judges and Commissioner developed a laundry list of items they believed demonstrated the right to control the performance of the work, but this Court is left with the belief that such things as keeping the equipment clean,

maintaining correct signage or cooperating in the event of a loss are ancillary to the actual work of hauling, while the issues of maintaining and operating the truck, accepting a load or not, and choosing the route are more central to the question of the moving of freight.

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

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

Sincerely,

s/_____
Harold D. Clarke, III
Superior Court Judge

APPENDIX G — ORDER OF THE SUPREME COURT OF WASHINGTON, FILED JULY 12, 2018

THE SUPREME COURT OF WASHINGTON

No. 95246-9

SWANSON HAY COMPANY, *et al.*,

Petitioners,

v.

EMPLOYMENT SECURITY DEPARTMENT,

Respondent.

ORDER

Court of Appeals
No. 34566-1-III
(consolidated with 34567-0-III and 34568-8-III)

This matter came before the Court on its July 12, 2018, *En Banc* Conference. The Court considered the petition and the files herein. A majority of the Court voted in favor of the following result:

Now, therefore, it is hereby

ORDERED:

Appendix G

That the petitions for review and motions to consolidate are all denied.

DATED at Olympia, Washington this 13th day of July, 2018.

For the Court

/s_____
CHIEF JUSTICE