No. 18-

IN THE

Supreme Court of the United States

MACMILLAN-PIPER, INC.,
A WASHINGTON CORPORATION,

Petitioner,

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 I

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

MACMILLAN-PIPER, INC., a Washington corporation,

Respondent

STATE OF WASHINGTON EMPLOYMENT SECURITY DEPARTMENT

CORPORATE DISCLOSURE FORM

Pursuant to Supreme Court Rule 29.6, petitioner MacMillan-Piper, Inc. provides the following Corporate Disclosure Statement:

1. Petitioner MacMillan-Piper Inc. has no parent corporation, and no publicly held company owns 10% or more of its stock.

TABLE OF CONTENTS

Table of Contents

TABLE OF APPENDICES

TABLE OF CITED AUTHORITIES

Page

CASES

Page

Page

Page

STATUTES AND OTHER AUTHORITIES

Page

Page

Page

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). The present action involves MacMillan-Piper, Inc. ("MP"). App. A. The Washington Supreme Court denied review in this case on July 12, 2018. *See* App. D.

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. 59a. 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

Four interstate motor carriers are petitioning this Court for a writ of certiorari. They share certain common

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.

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

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.[2]

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. § 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,

2. 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/.

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.[3] The owner/operators were generally paid a percentage of the fee paid to the carrier by the customer.

There are significant differences in the carriers' operations, however. Unlike the other carriers, MP is not a trucking company. Rather, it performs drayage[4] services for its customers acting as a container freight station for international import and export cargo. App. 31a. Basically, it transloads its customers' cargo from one mode of conveyance to another, for example, from a rail car into a steamship line container. *Id.*[5] MP does not own any

3. 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.

4. Drayage involves a truck picking up a container from a point designated by the customer, such as the port, and then transporting the loaded container to another point designated by the customer, such as the rail head for out-shipment or local delivery. App. 31a. Again, demand for cargo transport is cyclical in the drayage business.

5. In doing so, it assists customers when U.S. Customs & Border Protection asks to inspect cargo. MP unloads the cargo, makes it available for inspection, and then reloads it.

trucking equipment for drayage. When customers need such services, MP offers the loads to owner/operators, who have the necessary equipment. *Id*. However, the terms of the relationship between MP and its owner/operators are consistent with those of the other carriers.

MP's president, Steve Stivala, explained that because MP does not own its own trucking equipment, it does not hire employees to provide such services because they only use owner/operators; he declared that if MP could not use owner/operators *MP would leave the drayage business.* App. 39a.[6]

(3) The State Targeted Washington's Trucking Industry

Reversing Washington public policy that had long treated owner/operators as independent contractors,[7]

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6. This unrebutted fact demonstrates the impact of state regulation on a carrier's services. *See Pistolesi v. Calabrese*, 2015 WL 1573364 at *6 (S.D.N.Y. 2015) (preemption applies to regulations that would have the logical effect of limiting the number of actors in the market).

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

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").[8] The UETF targeted the trucking industry and its historical use of owner/operators.[9] 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' 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

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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.

8. 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.

9. 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."

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.[10]

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 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 petitioning carriers (for taxes, penalties, and interest. As to MP, ESD

10. 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.

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. In MP's case, ESD's Commissioner eventually affirmed the assessments, a final agency action for purposes of judicial review, app. B, and MP sought review in superior court. The court affirmed the assessments. App. C.

On appeal, the Washington Court of Appeals affirmed the trial court decision. App. A. That opinion 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. D.

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 court's opinion interprets 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. 11a. Second, it adopts the Ninth Circuit's limitation on FAAAA preemption with regard to statutes of "general applicability." App. 12a. Finally, it allows federally-mandated equipment leasing contract terms to be used as evidence of control by carriers over owner/operators. App. 8a-10a.

(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).[11] 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*).[12]

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.[13]

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11. 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.

12. 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 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.

13. *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

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*, 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

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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).

apply this Court's requisite analysis of the law's impact on carrier prices, routes, or services.[14] 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 (*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.

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14. *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).

(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.[15] As such, the State's actions affect

15. 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. *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

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.[16] This fact *alone* makes it impossible for an owner/operator *ever* to meet the test of Wash. Rev. Code § 50.04.140. The Washington court ruled that other federally-mandated terms in an equipment lease may be evidence of carrier direction or control.[17] As will be established *infra*, that decision

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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.

16. *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).

17. *Compare* App. 7a-10a 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

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 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.[18] The California Supreme Court held in *Dynamex Operations*

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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).

18. 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.

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.[19]

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 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).

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19. 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.

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.[20] Indeed, one of the courts *conceded* that there is advocacy "from some quarters" for applying ESD's analysis of independent contractors elsewhere. *Swanson Hay*, 404 P.3d at 528-29.

(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

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20. 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 Industries, 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*.

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. 38a-39a.

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. 39a. 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.[21] 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.[22] 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.

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,"

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21. 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.

22. 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.

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.[23] 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 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

23. 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.*

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.[24]

(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-mandated elements in equipment leases as evidence of carrier direction or control over owner/operators.[25] Such a

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24. 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).

25. The *Swanson Hay* court focused on the fact that owner/operators do not operate under their federal licenses. 404 P.3d at 540-41. But federal law *requires* owner/operators to operate under

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.[26] ESD concluded in each case that federally-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.

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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.

26. In addition to the provisions of 49 C.F.R. §§ 376.11 and 376.12 referenced *supra*, ESD highlighted the fact that MP must provide written authorization for equipment to be leased to other carriers. App. 48a. This is a federal requirement, 49 C.F.R. § 376.22, designed to ensure accountability for the leased equipment. ESD noted further that MP has the right to take possession of the equipment to complete a shipment if the owner/operator breaches the contract. App. 49a. But completion of contracts is not just related to services––it *is* the service that carriers offer their customers.

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.[27] *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 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

27. 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.

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.[28]

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.[29]

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28. The court in *Swanson Hay* asserted that the ICC's ostensible rationale for its rule was incorrect. 404 P.3d at 532. 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 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.

29. *See, e.g.*, *Reed v. Indus. Comm'n*, 534 P.2d 1090 (Ariz. App. 1975) (government regulations imposed on carriers and, in

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

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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).

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 MP's 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 — UNPUBLISHED OPINION OF THE COURT OF APPEALS OF THE STATE OF WASHINGTON, DIVISION ONE, FILED DECEMBER 26, 2017

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

November 8, 2017, Oral Argument;
December 26, 2017, Filed

No. 75534-0-I

MACMILLAN-PIPER INC.,
A WASHINGTON CORPORATION,

Appellant,

v.

STATE OF WASHINGTON, EMPLOYMENT SECURITY DEPARTMENT,

Respondent.

Appeal from King County Superior Court. Docket No: 15-2-23444-7. Judge signing: Honorable Mariane C Spearman. Judgment or order under review. Date filed: 07/18/2016.

UNPUBLISHED OPINION

VERELLEN, C.J. — This appeal includes the question whether trucking owner-operators who contracted

with MacMillan-Piper, Inc. (MacMillan) qualified for the statutory independent contractor exemption from unemployment taxes. Consistent with a recent decision by Division III of this court in *Swanson Hay Co. v. State Employment Security Department*,[1] we conclude MacMillan exerted extensive control over the method and detail of how the driving services were to be performed and therefore did not establish it was entitled to an exemption under RCW 50.04.140(1)(a).

The Federal Aviation Administration Authorization Act (FAAAA) preempts state laws that significantly impact motor carriers' prices, routes, or services.[2] Because the Employment Security Act (ESA), Title 50 RCW, applies generally to state employers and has a tenuous relationship with the carrier's prices, routes, or services, the ESA is not federally preempted in this setting.

The Employment Security Department (Department) calculated the original audit assessment amount based on the records MacMillan provided. MacMillan does not establish the assessment was arbitrary and capricious or that its due process rights were violated.

Therefore, we affirm.

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1. 1 Wn. App. 2d 174, 404 P.3d 517 (2017).

2. 49 U.S.C.A. § 14501(c)(1).

Appendix A

FACTS

MacMillan is involved in drayage, the moving of freight containers and cargo a short distance from point to point, often from the port to a rail yard or other designated place. To provide those services, MacMillan contracts with "owner-operators" who own tractors or tractor-trailers. The owner-operators provide the trucking equipment with drivers to perform drayage services for MacMillan. MacMillan operates under authority from the Federal Motor Carrier Safety Administration and the Department of Transportation. The owner-operators haul freight using MacMillan's operating authority.

The owner-operator contracts include provisions addressing the obligations of the owner-operators, such as (i) MacMillan has the "right to full possession and control" of the equipment during the lease term, (ii) owner-operators must report for duty at 7:30 a.m. with adequate fuel for a full day's work, must notify MacMillan by 7:00 a.m. if they will not be available that day, and must give two weeks' notice if they will not be available for two or more consecutive days, (iii) an owner-operator's refusal to perform a dispatch is considered a material breach of the agreement, (iv) owner-operators shall haul no freight for other carriers during the lease term without MacMillan's written permission, (v) drivers must meet federal and state safety requirements and may be rejected by MacMillan "for any reason," (vi) owner-operators must submit to MacMillan records of hours on duty, daily inspections, vehicle tonnage, log sheets and other documents, (vii) owner-operators must "immediately" report collisions or

citations to MacMillan, maintain the equipment consistent with regulations, perform daily re-trip inspections, consent to installation of communication equipment "at the sole discretion and for the sole benefit of MacMillan-Piper," and display decals or placards on the equipment indicating it is leased to MacMillan.[3]

Other than requiring owner-operators to report for duty daily at 7:30 a.m., MacMillan does not set or control the hours owner-operators work, choose the routes they drive, or dictate the order in which they make deliveries. The owner-operators are responsible for all operating expenses, including maintenance, licensing, fuel, tolls, permits, insurance, and costs for any laborers or drivers they hire.

In 2011, the Department audited MacMillan. The audit determined that 69 owner-operators should be reclassified as "in employment" instead of independent contractors under the ESA. The Department issued MacMillan a tax assessment covering the first quarter of 2009 through the third quarter of 2011 in the amount of $130,440.81. MacMillan filed an administrative appeal. The administrative law judge (ALJ) denied MacMillan's motion for summary judgment. The ALJ granted the Department's cross-motion for summary judgment, ruling the owner-operators were in MacMillan's employment under RCW 50.04.100 and not exempt under RCW 50.04.140(1) because they performed personal services for wages, which benefited MacMillan, and they were not free from MacMillan's control or direction.

3. Administrative Record (AR) at 216-17.

The ALJ denied MacMillan's motion to dismiss the assessments and held an evidentiary hearing to determine the accuracy of the assessed amount. The ALJ entered an initial order finding that 30 percent of the payments MacMillan made to owner-operators were for driving services and were thus taxable. The ALJ found that two of the drivers should have been excluded because the only instruction they received was where to pick up and transport the freight, and they each had their own motor carrier authority.

On review, the commissioner's review office issued the commissioner's final decision affirming the ALJ's ruling. The commissioner confirmed that MacMillan exerted "extensive controls over the methods and details of how the driving services are to be performed by the owner-operators"[4] and failed to satisfy the requirements of RCW 50.04.140(1)(a). The commissioner did not address the remaining elements of the independent contractor exemption test. MacMillan appealed, and the King County Superior Court upheld the order.

MacMillan appeals.

ANALYSIS

Although there are minor differences in facts and arguments, we agree with Division III's conclusion in *Swanson Hay* that owner-operators with similar contracts are not exempt from unemployment taxes.[5]

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4. AR at 1116.

5. 404 P.3d at 523.

Judicial review of the commissioner's decision is governed by the Administrative Procedure Act (APA), ch. 34.05 RCW.[6] We sit in the same position as the superior court and apply the standards of the APA directly to the record before the agency.[7] On review of a decision by the commissioner, we give great deference to the commissioner's factual findings and substantial weight to the agency's interpretation of law.[8]

I. RCW 50.04.140(1) Exemption

Under Washington's ESA, employers must contribute to the unemployment compensation fund for the benefit of their employees.[9] The ESA is intended to mitigate the effects of involuntary unemployment by applying the "'insurance principle of sharing the risks, and by the systematic accumulation of funds during periods of employment.'"[10] Courts liberally construe the statute to accomplish this goal, viewing "with caution any construction that would narrow" coverage.[11]

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6. RCW 34.05.510; RCW 50.32.120.

7. *W. Ports Transp., Inc. v. Emp't Sec.*, 110 Wn. App. 440, 449, 41 P.3d 510 (2002).

8. *Wilson v. Emp't Sec. Dep't of State*, 87 Wn. App. 197, 200-01, 940 P.2d 269 (1997).

9. RCW 50.01.010; RCW 50.24.010.

10. *Penick v. Emp't Sec. Dep't*, 82 Wn. App. 30, 36, 917 P.2d 136 (1996) (quoting RCW 50.01.010).

11. *W. Ports*, 110 Wn. App. at 450 (citing *Shoreline Cmty. Coll. Dist. No. 7 v. Emp't Sec. Dep't*, 120 Wn.2d 394, 406, 842 P.2d 938 (1992)).

"[E]xemptions from taxation statutes are strictly construed in favor of applying the tax, with the burden of proof on the party who seeks the exemption."[12] An individual may be both an independent contractor for some purposes and engaged in "employment" for purposes of the state's broad definition of covered employment.[13]

"Employment" is defined under RCW 50.04.100. Unless an exemption applies, "employment" exists if the worker performs personal services for the alleged employer and if the employer pays wages for those services.[14] RCW 50.04.140 includes an exemption to unemployment taxes.[15] The inquiry under the statute is not whether owner-operators are independent contractors for other purposes but whether they meet all of the prongs of the exemption test contained in the ESA, "regardless of common law definitions."[16] The term "employment" under the ESA is "unlimited by the relationship of master and servant as known to the common law or any other legal relationship."[17] The ESA offers two methods to establish the exemption under RCW 50.04.140. MacMillan focuses its argument on the "control" subsection of the first method.

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12. *Id.* at 451 (citing *In re Assessment Against Fors Farms*, 75 Wn.2d 383, 387, 450 P.2d 973 (1969)).

13. *Id.* at 458.

14. *Id.* at 451.

15. RCW 50.04.140.

16. *W. Ports*, 110 Wn. App. at 459.

17. RCW 50.04.100; *W. Ports*, 110 Wn. App. at 458-59.

Appendix A

Under RCW 50.04.140(1), the employer must prove:

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

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

(c) Such individual is customarily engaged in an independently established trade, occupation, profession, or business, of the same nature as that involved in the contract of service.[18]

MacMillan argues that federally mandated lease terms do not preclude an independent contractor relationship and that in *Western Ports Transportation, Inc. v. Employment Security Department*, this court wrongly decided that such owner-operator lease provisions establish control for purposes of unemployment taxes.[19] Specifically, MacMillan contends that *Western Ports* conflicts with 49 C.F.R. § 376.12, which requires carriers to "assume complete responsibility" for the operation of the leased equipment and to have "exclusive possession, control, and use of the equipment."[20]

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18. RCW 50.04.140(1) (emphasis added).

19. 110 Wn. App. 440, 41 P.3d 510 (2002).

20. 49 C.F.R. § 376.12(c)(1).

49 C.F.R. § 376.12(c)(4) provides:

> Nothing in the [required exclusive possession, control and use provision] is intended to affect whether the lessor … is an independent contractor or an employee of the authorized carrier lessee. An independent contractor relationship may exist when a carrier lessee complies with 49 U.S.C. 14102 and attendant administrative requirements.[21]

This qualifying provision is silent about the other federal lease requirements and safety regulations governing the relationship between motor carriers and owner-operators, which are included in MacMillan's contract.[22]

MacMillan asserts "[i]t is contrary to extensive authority that makes it clear that when the government controls the contract provisions, it is *the government*, not the contracting parties, exercising control."[23]

Thus, the critical inquiry is whether it is improper to consider the federally mandated limitations required for lease provisions for owner-operators. This court in *Western Ports* recognized it is proper to consider them,[24] and the

21. 49 C.F.R. § 376.12(c)(4).

22. *W. Ports*, 110 Wn. App. at 456-57.

23. Br. of App. at 38.

24. *W. Ports*, 110 Wn. App. at 454.

Swanson Hay court arrived at the same conclusion.[25] We agree. Importantly, the statutory standard is independent of and unrelated to common law concepts underlying the independent contractor analysis in other settings. Here, "control" in its plain meaning extends to the right to control, regardless of the source. We decline to look beyond the plain language. The previously listed lease provisions provide MacMillan an extensive right to control the method and details of driving services.

MacMillan argues it established the second and third elements of RCW 50.04.140. We do not reach these two elements given our conclusion on the control element of RCW 50.04.140(1).

II. Federal Preemption

MacMillan argues federal law preempts the assessment. MacMillan focuses on *Rowe v. New Hampshire Motor Transport Association*,[26] arguing that decision overruled *Western Ports*.

"'The purpose of Congress is the ultimate touchstone' in every preemption case."[27] "We address preemption claims presuming Congress did not intend to supplant

25. *Swanson Hay*, 404 P.3d at 532-33.

26. 552 U.S. 364, 128 S. Ct. 989, 169 L. Ed. 2d 933 (2008).

27. *W. Ports*, 110 Wn. App. at 457 (quoting *Retail Clerks Int'l Ass'n v. Schermerhorn*, 375 U.S. 96, 103, 84 S. Ct. 219, 222, 11 L. Ed. 2d 179 (1963)).

state law."[28] "In Washington, there is a strong presumption against finding preemption and state laws are not superseded by federal law unless it can be determined it is the clear and manifest purpose of Congress."[29] As noted in *Swanson Hay*, the *Western Ports* court did not address express preemption, but more recent authority instructs that state laws that affect prices, routes, or services in "'only a tenuous, remote, or peripheral … manner'"[30] do not trigger express preemption.

MacMillan contends, unless preempted, the federally mandated lease provisions will *always* establish control and, unlike the carriers in *Swanson Hay*, MacMillan does not own any trucks. Thus, without preemption, its business model will become obsolete.

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28. *Id.* (quoting *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 654-55, 115 S. Ct. 1671, 131 L. Ed. 2d 695 (1995)).

29. *Dep't of Labor & Indus. v. Lanier Brugh*, 135 Wn. App. 808, 815-16, 147 P.3d 588 (2006).

30. *Rowe*, 552 U.S. at 371 (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 390, 112 S. Ct. 2031, 119 L. Ed. 2d 157 (1992)); *Dilts v. Penske Logistics, LLC*, 769 F.3d 637, 643 (9th Cir. 2014) (quoting *id.*); *see also Dan's City Used Cars, Inc. v. Pelkey*, 569 U.S. 251, 133 S. Ct. 1769, 1773, 185 L. Ed. 2d 909 (2013) ("Although [49 U.S.C.] § 14501(c)(1) otherwise tracks the ADA's air-carrier preemption provision, the FAAAA formulation's one conspicuous alteration—addition of the words 'with respect to the transportation of property'—significantly limits the FAAAA's preemptive scope. It is not sufficient for a state law to relate the 'price, route, or service' of a motor carrier in any capacity; *the law must also concern a motor carrier's 'transportation of property.'")* (emphasis added).

In cases in which courts have found preemption, the statute established a binding requirement on how the *service* was to be performed.[31] The ESA is a generally applicable background law for state employers, similar to the meal and rest break laws in *Dilts v. Penske Logistics, LLC*[32] and the minimum wage laws in *Filo Foods, LLC v. City of SeaTac*[33] and *Californians for Safe and Competitive Dump Truck Transportation v. Mendonca*.[34] MacMillan does not establish the unemployment tax directly regulates the transportation of property or the service of a motor carrier,[35] nor does MacMillan distinguish the holding in First Circuit cases that "motor carriers are not exempt 'from state taxes, state lawsuits of many kinds, and perhaps most other state regulation of any consequence.'"[36]

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31. *See Rowe*, 522 U.S. at 372-73 (holding the FAAAA preempted state tobacco laws, recognizing the state statute directly targeted trucking and delivery services and the licensing statute required "carriers to offer a system of services that the market does not now provide" and would "freeze into place services that carriers might prefer to discontinue in the future."); *Morales*, 504 U.S. at 388 (holding the FAAAA preempted state standards against deceptive airline fare advertising because each standard included an express reference to airfares, and the standards collectively established "binding requirements as to how tickets may be marketed if they are to be sold at given prices.")

32. 769 F.3d 637 (9th Cir. 2014).

33. 183 Wn.2d 770, 357 P.3d 1040 (2015).

34. 152 F.3d 1184 (9th Cir. 1998).

35. *See Dan's City*, 569 U.S. at 261, 265.

36. *Schwann v. FedEx Ground Package Sys., Inc.*, 813 F.3d 429, 440 (1st Cir. 2016) (quoting *DiFiore v. Am. Airlines, Inc.*, 646 F.3d 81, 89 (1st Cir. 2011)).

MacMillan emphasizes the $53,833.69 in unemployment insurance tax liability it will owe over a nearly three-year period would increase its operating costs. But as the Ninth Circuit recognized, a state law will not be preempted "just because it shifts incentives and makes it more costly for motor carriers to choose some routes or services *relative* to others, *leading the carriers to reallocate resources or make different business decisions.*[37]

Here, MacMillan offered declarations in support of summary judgment suggesting the unemployment taxes would severely impact its business model, but none of those declarations stated the unemployment tax would be a determinative factor affecting its model.[38] MacMillan relies on cases from other jurisdictions, but those cases are not persuasive; such a conclusory impact does not trigger field or conflict preemption.[39]

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37. *Dilts*, 769 F.3d at 647 (emphasis added).

38. *See* AR at 72-85.

39. *See Schwann*, 813 F.3d 429, 440 (acknowledging the state's interference with a business decision implicates the way in which a company chooses to allocate its resources would have a "logical effect" on routes, but that court did not perform its analysis under the control prong of its statute. That court also clarified that "motor carriers are not exempt 'from state taxes, state lawsuits of many kinds, and perhaps most other state regulation of any consequence.'" (quoting *DiFiore*, 646 F.3d at 89)); *see also Vargas v. Spirit Delivery & Distrib. Servs., Inc.*, 245 F. Supp. 3d 268, 283-84 (D. Mass. 2017) (noting the freedom from control prong is one of the typical elements used to determine independent contractor statutes in many states and for purposes of federal law and thus are less likely to have an effect on a carrier's pricing, routes, and services. The court acknowledged

We agree with *Swanson Hay* and conclude there is no preemption in this setting.

III. Audit and Assessment

MacMillan argues the Department's audits and assessments are arbitrary and capricious. We disagree.

Courts may reverse a final order that is arbitrary and capricious.[40] An administrative agency order is arbitrary and capricious if it is willful and unreasoning and disregards or does not consider the facts and circumstances underlying the decision.[41] "An action will not be held arbitrary and capricious when exercised honestly and upon due consideration, even where there is room for two opinions."[42]

Here, the Department calculated its assessment based on the total remuneration reported on MacMillan's

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empirical evidence is not necessary, but the proponent "must still make more than conclusory allegations" that such a finding "would have a significant impact on its process, routes or services." And it recognized that the policy behind statutory schemes that protect workers are "traditionally within the police powers of the state and that while many rules and regulations applicable to carriers affect their price, routes and services, such impact is generally tenuous and does not require the carriers to change their business model.").

40. RCW 34.05.570(3)(i).

41. *Beatty v. Washington Fish and Wildlife Com'n*, 185 Wn. App. 426, 341 P.3d 291 (2015).

42. *W. Ports*, 110 Wn. App. at 450.

Internal Revenue Service 1099 forms as nonemployee compensation and backed out wages that exceeded the maximum taxable wage base. MacMillan argues the Department arbitrarily failed to bifurcate remuneration between equipment and services, resulting in overinflated taxes. But MacMillan did not provide the Department with records as required by RCW 50.12.070 and WAC 192-310-050 on which contrary calculations could be made.

RCW 50.12.070(1)(a) requires employers to keep true and accurate work records "containing such information as the commissioner may prescribe." The commissioner requires employers to keep records of worker total gross pay period earnings, the specific sums withheld from the earnings of each worker, and the purpose of each sum withheld to equate to net pay.[43] Employers are also required to keep payroll and accounting records,[44] and they must keep these records open to inspection.[45] When an employer fails to provide sufficient wage information during an audit, the Department may generate an "arbitrary report," in which it may calculate an assessment based on "information otherwise available to the [D]epartment."[46] This report is "deemed to be prima facie correct."[47]

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43. WAC 192-310-050(1)(g)-(i).

44. WAC 192-310-050(2)(a).

45. RCW 50.12.070(1)(a).

46. WAC 192-340-020; RCW 50.12.080.

47. RCW 50.12.080.

MacMillan did not produce records showing which portions of the 1099 payments were for wages and which were for equipment lease. MacMillan only offered testimony from a forensic accountant who "researched the costs of trucking by reviewing articles and websites on the internet and by talking to selected trucking companies," but he did not review any of MacMillan's records showing an equipment allocation, or talk with any owner-operators.[48]

MacMillan does not establish the Department acted arbitrarily and capriciously.

MacMillan argues the audit violated both procedural and substantive due process. "Procedural due process requires notice and an opportunity to be heard prior to final agency action."[49] "To establish a procedural due process violation, the party must establish that he or she has been deprived of notice and opportunity to be heard prior to a final, not tentative, determination."[50] An agency violates substantive due process when its decision is "irrational, arbitrary and capricious" or "was tainted by improper motive."[51]

MacMillan had notice of the assessment and an opportunity to be heard before the Department's final

48. AR at 1040 (Finding of Fact 4.26).

49. *Motley-Motley, Inc. v. State*, 127 Wn. App. 62, 81, 110 P.3d 812 (2005).

50. *Id.*

51. *Id.* at 82.

order. Once the Department issues an assessment, the employer has 30 days to file an appeal.[52] If the employer does not file a timely appeal, the assessment becomes final.[53] By filing an appeal, MacMillan had an opportunity to be heard before the assessment became final. And "to constitute a violation, the party must be prejudiced. Prejudice relates to the inability to prepare or present a defense."[54] MacMillan does not establish it was prejudiced in its ability to prepare or present its challenge to the assessment.

MacMillan's substantive due process claim focuses on an alleged improper/bad-faith motive by the Department, including the Department's failure to implement its prior agreement in similar audits that 70 percent of remuneration should be allocated to equipment. MacMillan relies on *Motley-Motley, Inc. v. State*, but that case addressed substantive due process related to property rights and land use decisions.[55] MacMillan does not offer compelling authority that those same fundamental rights attach to an audit, or that a de novo hearing and two stages of judicial review did not ameliorate those concerns.

MacMillan contends the assessment is "void" because it exceeded statutory authority. But orders are void only if there is a defect in personal or subject

52. RCW 50.32.030.

53. RCW 50.32.030.

54. *Motley-Motley*, 127 Wn. App. at 81 (citation omitted).

55. 127 Wn. App. 62, 110 P.3d 812 (2005).

matter jurisdiction.[56] MacMillan does not establish the commissioner administered authority outside of "the provisions of the act itself and the rules prescribed thereby."[57] An agency lacks subject matter jurisdiction only when it does not have authority to adjudicate the "type of controversy" in question.[58] Here, the Department has broad subject matter jurisdiction to issue orders and notices of assessment for unemployment insurances taxes.[59]

We conclude the Department's assessments were not arbitrary and capricious, nor did they violate due process.

Therefore, we affirm.

/s/
MANN and COX, JJ., concur.

56. *Marley v. Dep't of Labor & Indus.*, 125 Wn.2d 533, 537-38, 886 P.2d 189 (1994).

57. *In re Jullin*, 23 Wn.2d 1, 15, 158 P.2d 319 (1945).

58. *Marley*, 125 Wn.2d at 539; *Dougherty v. Dep't of Labor & Indus.*, 150 Wn.2d 310, 317, 76 P.3d 1183 (2003); *Magee v. Rite Aid*, 167 Wn. App. 60, 72-73, 277 P.3d 1 (2012).

59. Title 50 RCW; *Marley*, 125 Wn.2d at 542.

APPENDIX B — DECISION OF THE EMPLOYMENT SECURITY DEPARTMENT OF THE STATE OF WASHINGTON, DATED AUGUST 31, 2015

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

Review No. 2015-0256-CP

Docket No. 01-2012-21703T

IN RE :

MACMILLAN-PIPER, INC. DECISION

Tax ID No. 331454-00-0

DECISION OF COMMISSIONER

This is an unemployment insurance tax dispute between the Employment Security Department (" Department") and the interested employer, MacMillan-Piper, Inc. ("MP"). The Department conducted an audit of MP for 2009, 2010, and first three calendar quarters of 2011. As a result of the audit, 71 individuals hired by MP during the period at issue were reclassified as employees of MP and their wages were deemed reportable to the Department for unemployment insurance tax purposes. *See* Exhibit 1, pp. 145-153. The Department issued an Order and Notice of Assessment on December 21, 2011, assessing MP contributions, penalties, and interest in the amount of $130,440.81. *See* Exhibit 2. MP 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, MP 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 MP's first three motions in their entirety, but granted in part and denied in part MP'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 Motion for Partial Summary Judgment, holding· that the owner-operators were in "employment" of MP pursuit to RCW 50.04.100 and that their personal services were not exempted from coverage pursuant to RCW 50.04.140. Thereafter, the parties proceeded to the evidentiary hearing to determine the correct amount of the contributions, penalties, and interest. After the evidentiary hearing the OAH issued a Tax Case Initial Order, holding that 30 percent of the remuneration MP paid to the owner operators constituted wages pursuant to RCW 50.04.320(1) and that the penalties imposed upon MP

1. MP's four motions were filed with and heard by the OAH in conjunction with two oth er matters: *In re Swanson Hay Company Inc.*, OAH Docket No. 01-2012-21705T and *In re Hatfield Enterprizes, Inc.*, OAH Docket No . 01-2012-21704T.

during the period in question should be waived pursuant to RCW 50.12.220(6).

MP timely petitioned the Commissioner for review of the OAH's rulings in many of the prehearing motions. Specifically, MP 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 MP 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.

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 to involuntarily 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 tenn "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 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 unemployment compensation laws. *See In re Coast Aluminum Products, Inc.,* Empl Sec. 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

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

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 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 of1937, ch. 162, § 19(g)(5).

Appendix B

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 other 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 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); S*chuffenhauer 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); I*n 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-operator 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-operator's 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(l)(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.

Appendix B

In this case, the interested employer, MP, was founded in 1969; and since then, it has been providing prompt, efficient services for shippers around the globe. Currently, MP, is the largest container freight station in the Pacific Northwest and operates four facilities in Seattle and two facilities in Tacoma. MP handles both import and export cargo, ranging from lumber and paper to steel, dry bulk commodities, and refrigerated goods. MP unloads approximately 11,000 railcars annually; and it trans-loads, de-vans, load-outs, or drays roughly 6·,000 containers per month. *See* Exhibit 1, p. 181.

MP's core business is to serve as a container freight station for international cargo import and export. MP's business deals primarily with export cargo, which is loaded into containers shipped through ports. MP trans-loads the cargo between different modes of conveyance. For example, MP primarily trans-loads freight from trailers and railcars into steamship line containers. *See* Declaration of Stivala in Support of Employers' Motion for Summary Judgment on Federal Preemption ("Decl. of Stivala") ¶ 3.

Secondarily, MP engages in the drayage business so as to better serve its customers. The drayage business uses trucking equipment to handle container pickup from points designed by the customers, and then deliver the containers to where the cargo will be loaded, and finally deliver the containers to their destinations such as port terminals. MP enters into equipment lease agreements with owner-operators who will provide trucking equipment and driving services to support MP's drayage business. *See* Decl. of Stivala ¶ 4.

Appendix B

As discussed above, the Department conducted an audit of MP for various quarters in 2009, 2010, and 2011; and, subsequently, reclassified the owner-operators as employees of MP and deemed their wages to be reportable for unemployment insurance tax purposes. MP 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 MP'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 Lvnch, 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 preemption 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*

Appendix B

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 MP's federal preemption argument. MP 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. MP 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 Steve Stivala, President of MP. According to Pursley, the assessments imposed by the Department on motor carriers will fundamentally change the business models of both motor carriers and owner-operators throughout Washington, because the Department will effectively eliminate a historical cornerstone of the trucking. industry. The effect of this material change will dictate the employment relationship that motor carriers must use in their operations going forward, which will

impact their prices, routes, and services. *See* Declaration of Pursley in Support of Employers' Motion for Summary Judgment on Federal Preemption ("Decl. of Pursley"), ¶ 10. Pursley asserts that the assessments will impact services because the carriers will be forced to provide trucking services only through employees and to purchase expensive trucks and trailers and hire drivers to operate the equipment, which in turn will severely curtail the carriers' operational flexibility. *See* Decl. of Pursley¶ 11. The Department's restructuring of the trucking industry will also require carriers to alter their routes to avoid liability under Washington's Employment Security Act and will thus prevent carriers from making their own decisions about where to deliver cargo. *See* Decl. of Pursley ¶ 12. Finally, Pursley asserts that the assessments Will likely have a significant impact on prices because of the additional employment-related taxes such as state and federal social security, taxes and unemployment insurance taxes, which will Undoubtedly have to be recouped by raising prices. *See* Decl. of Pursley ¶ 13. According to Stivala, reclassifying the owner-operators as employees will increase the amounts paid to the owner-operators including unemployment insurance taxes; and it will also require a huge capital outlay to purchase equipment for reclassified employees to operate, around 65 trucks, which will directly affect the prices that would have to be charged for drayage services. In light of the attendant costs of carrying owner-operators as employees, Stivala asserts that it would not make economical sense for MP to continue to offer drayage services. *See* Decl. of Stivala ¶ 5.

Additionally, MP 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. MP 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* MP's Petition for Review at 3.

While MP'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 judicia1 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 MP 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 MP 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, MP contends that the OAH erred in denying its motion to dismiss void assessment in this case. MP 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. MP 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 MP 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.

Appendix B

Employment

In its Petition for Review, MP further contends that the OAH erred in granting the Department's motion for partial summary judgment, thereby finding that the owner-operators were in "employment" of MP 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. MP's arguments on these two issues are not persuasive.

MP 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 MP as defined in RCW 50.04.100. *See* RCW 50.04.080; RCW 50.24.010. If the owner-operators' employment is not established, MP is not liable for the assessed items. If employment is established, MP is liable unless the services in question are exempted from coverage.

We consider the issue of whether an individual is in employment subject to this overarching principle: The purpose of the Employment Security Act, Title 50 RCW, is to mitigate the negative effects of involuntary unemployment. This goal can be achieved only by application of the insurance principle of sharing the risks, and by the systematic accumulation of funds during periods of employment. To accomplish this goal, the Act is to be liberally construed to the end that unemployment benefits are paid to those who are entitled to them. *See* RCW 50.01.010; *Warmington v. Emp't Sec. Dep't*, 12 Wn.

App. 364, 368, 529 P.2d 1142 (1974). This principle has been applied so as to generally find the existence of an employment relationship. *See, e.g., All-State Constr. Co.*, 70 Wn.2d at 665; *Penick*, 82 Wn. App. at 36.

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

In this case, MP primarily serves as a container freight station for international cargo import and export. To support its core business, MP also engages in providing drayage services to its customers under authority granted by the federal government. *See* Declaration of Ilao in Support of Department's Cross-Motion for Partial Summary Judgment ("Decl. of Ilao"), Exhibit C,

p. 1. MP contracts with the owner-operators to provide the transportation or drayage services. *See* Decl. of Ilao ¶5. Here, the owner-operators performed truck-driving services to support MP's drayage business, which is a key component of MP's import and export business. As such the owner operators' personal services directly benefited MP's business operation. Moreover, it is beyond dispute that MP paid wages for the services provided by the owner-operators. *See* Decl. of Ilao, Exhibit C, Appendix B—Schedule of Rates. Consequently, the administrative law judge correctly concluded that the owner-operators were in employment of MP 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 MP 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 at239.

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 MP and the owner-operators referred to the owner-operators as lessors. *See* Decl. of Ilao, 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 contactor" for unemployment insurance tax purposes. The first three criteria in each test are essentially identical in all aspects that are relevant to this case. The employer is required to prove that an individual meets all of the criteria in one of the tests in order to qualify that individual for this exemption. Therefore, if an individual fails to meet any single criterion, he or she

will not be considered an "independent contractor" and the employer is liable for contributions based on wages paid to the individual pursuant to RCW 50.24.010.

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

In this case, MP entered into standard equipment lease agreements with the owner operators-governing the relationship between the parties. *See, e.g.,* Decl. of Ilao, Exhibit C. On the one hand, the owner-operators enjoy some autonomy with regard to the performance of their truck-driving services. For example, the owner-operators may operate the trucking equipment themselves or they are free to hire their own employees to operate the equipment. MP does not control the work hours of the owner-operators except that the owner-operators are expected to work day shift when port terminals are open for business (in order to obtain or ship cargo from the terminals). *See* Decl. of Stivala ¶ 4. The owner-operators are not required to work fulltime. *See* Supplemental Declaration of Stivala in Support of Employer's Opposition to Department's Cross-Motion for Summary Judgment ("Supp. Decl. of Stivala") ¶ 5. Although MP dispatches the owner operators to locations designated by the customers,

it has no control over the routes that the owner-operators take to pick up and deliver a load. Nor does MP control the order in which the owner operators complete the deliveries. *See* Supp. Decl. of Stivala ¶ 3. Moreover, the owner-operators pay all costs associated with operation of the leased equipment, such as maintenance, repairs, fuels, lubricants, and tires. *See* Decl. of Ilao, Exhibit C, ¶ 9A. The owner-operators are also responsible for licenses, permits, and taxes necessary for the operation of the leased equipment. *See* Decl. of Ilao, Exhibit C, ¶ 9B. The owner-operators are responsible for claims arising out of damage to cargo, trailers, dollies, or other equipment. *See* Decl. of Ilao, Exhibit C, ¶ 21.

On the other hand, MP 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 agreements, MP has full possession and control of the leased equipment during the entire period of the lease. The leased equipment must be marked with decals/placards displaying MP's name, motor carrier number, and USDOT's identification number. *See* Decl. of Ilao, Exhibit C, ¶ 7. The owner-operators are required to remove all markings and decals/placards upon termination of the lease. *See* Decl. of llao, Exhibit C, ¶ 15. During the term of the lease, MP prohibits the owner-operators from hauling freight for any other carriers unless MP gives prior written consent. *See* Decl. of llao, Exhibit C, ¶ 18. The owner-operators are required to immediately report any accidents and to further follow MP's written procedures as outlined in its vehicle safety policy. *See* Decl. of llao, Exhibit C, ¶ 20. The owner-operators must

also immediately report to MP all violations resulting in citation issued by federal, state, or local authorities. *See* Decl. of llao, Exhibit C, Appendix C, ¶ 5. If the owner-operators refuse to deliver cargo or withhold delivery of consigned goods, MP may take possession of the cargo or goods in order to complete the delivery and recover all expenses incurred in so doing. *See* Decl. of llao, Exhibit C, ¶ 24. MP also requires the owner-operators to install two-way radio equipment or cellular phones to maintain direct contact with MP's dispatch department. *See* Decl. of llao, Exhibit C, ¶ 27. The owner-operators are required to submit various records to MP, including record of hours on duty, driving, and off duty; record of daily inspection of the leased equipment; record of vehicle tonnage; daily log sheets along with equipment interchange receipts, proofs of delivery, scale tickets, and fuel receipts; and monthly maintenance record. *See* Decl. of llao, Exhibit C, Appendix C, ¶¶ 1, 2, & 4. MP requires the owner-operators to report for duty by 7:30 a.m. daily and with adequate fuel supplies to operate a full day. The owner-operators must notify MP by 7:00 a.m. of any leased equipment that will not be available for use. The owner-operators are expected to provide two week advance notice if any truck will not be available for dispatch for two or more consecutive days. If the owner-operators refuse to perform a dispatch, such refusal constitutes a material breach of the lease, and MP has the right to discontinue the use of the leased equipment. *See* Decl. of Ilao, Exhibit C, Appendix C, ¶ 3. Finally, the owner-operators are required to comply with all safety regulations mandated by MP and by federal, state, and local authorities, *see* Decl. of Ilao, Exhibit C, Appendix C, ¶ 6; and failure to do so may result in

immediate termination of the lease at the sole discretion of MP. *See* Decl. of llao, Exhibit C, ¶ 2.

The above-referenced requirements imposed by MP are generally incompatible with freeing the owner-operators from its control and direction; in other words, MP 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 owner-operators have not met the first criterion—freedom from control or direction—under RCW 50.04.140(l)(a) and (2)(a). Because MP has failed to show that the owner-operators were free from its direction and control under RCW 50.04.140(l)(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 owner-operators' services for MP constitute non-exempt employment pursuant to RCW 50.04.100.

In its Petition for Review, MP argues that the federally-mandated controls over equipment cannot logically be considered control over the means and methods of operating the equipment. *See* MP's Petition for Review at 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 MP 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).

MP further contends that the administrative law judge ignored evidence establishing a lack of direction and control when deciding liability on summary judgment. *See* MP's Petition for Review at 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* ¶¶ 4.12 & 4.23 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 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).

Finally, in its cross Petition for Review, the Department does not challenge the OAH's conclusion that Bill Horwitz and Jasbir Kalirae were *not* employees of MP for unemployment insurance tax purposes. Consequently, we will adopt the OAH's findings of fact and conclusions of law in its Initial Order issued on December 23, 2015 with regard to those two individuals.

Amount of Wages Subject to Assessment

RCW 50.12.070 requires employers to keep true and accurate work records containing such information as the Commissioner may prescribe. *See* RCW 50.12.070(1)(a). Specifically, the Commissioner requires employers to keep records of the workers' total gross pay period earnings, the specific sums withheld from the earnings from each worker, and the purpose of each sum withheld to equate. to net pay. *See* WAC 192-310-050(1)(g) & (1)(h). Employers are also required to keep payroll and accounting records. *See* WAC 192-310-050(2)(a). Pursuant to WAC 192-340-020, if an employer fails to provide necessary payroll or other wage information during an audit, the Department may rely on RCW 50.12.080 to determine payroll and wage information based on information otherwise available to the Department. In particular, RCW 50.12.080 authorizes the Department to arbitrarily make a report on behalf of an employer, based on knowledge available to the Department, if the employer fails to make or file any report; and the report so made shall be deemed to be

prima facie correct. Prima facie evidence means evidence that will establish a fact or sustain a judgment unless contradictory evidence is produced. *See* EVIDENCE, Black's Law Dictionary (10th ed. 2014).

Here, the Department used the amount reported by MP 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 MP 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 MP introduces contradictory evidence.

Indeed, during the evidentiary hearing below, MP 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 MP to the owner-Operators constituted wages for unemployment insurance tax purposes and that the remaining 70 percent was for equipment rental. In its cross Petition for Review, the Department does not challenge Bishop's qualification as an expert to testify on the relevant issue; but, instead, it contends that Bishop "did not see any documents from [MP] that broke down the remuneration," *see* Finding of Fact 4.24; that Bishop did not interview any owner-

operators or secure records from the owner-operators, *see* Finding of Fact 4.26; and that Bishop only relied on "articles and websites on the internet" and conversations with "selected trucking companies." *See* Finding of Fact 4.26. The Department argues that Bishop's testimony was not based on evidence or records unique to MP. *See* Department's Cross Petition for Review at 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

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."

his or her opinion on evidence not admissible in evidence and to base his or her opinion on facts or data perceived by or *made known to* the expert at or before the hearing.[6] Expert opinions lacking an adequate foundation should be excluded. *See Walker v. State*, 121 Wn.2d 214, 218, 848 P.2d 721 (1993). But, pursuant to ER 703, an expert is not always required to personally perceive the subject of his or her analysis. That an expert's testimony is not based on apersonal 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 MP 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

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."

Operational Costs of Trucking"), and talked to selected industry representatives (i.e). CFO Karen Ericson of Oak Harbor Freight Lines and VP Larry Pursley of Washington Trucking Association). 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 4.26. 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, MP 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 MP. 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 1

92-310-030(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, MP provided the Department with any information (adequate or otherwise) on its drayage business involving the owner-operators; (2) the Department had failed to act upon any information provided by MP; or (3) the Department had advised MP of no liability based upqn any information provided by MP. As such, MP 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, MP uses leased trucks-with-drivers or owner-operators to support its drayage operation. According to one declaration submitted by MP, 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. MP 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, MP, 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. Cornm'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 discretionary waiver of penalties under RCW 50.12.220(6). Here, MP 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 MP'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 MP's failure to timely pay contributions on owner-operators' wages is not due to its fault and, thus, MP 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.

Appendix B

Evidentiary Rulings

MP 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, MP 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* MP's Petition for Review at 1-2.

The granting or denial of a motion in limine is addessed 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).

ln this case, the OAH denied MP's motion for summary judgment on federal preemption ground as well as MP'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 MP for unemployment insurance tax purposes. As a result of these rulings, the only remaining issues for the evidentiary hearing involved the correct amount 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 OAR'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**. MP is not liable for the contributions, penalties, and interest assessed pursuant to RCW 50.24.010 regarding Bill Horwitz and Jasbir Kalirae. However, MP is liable for the contributions and interest assessed pursuant to RCW 50.24.010 regarding the owner-operators for the period of 2009, 2010, and first three calendar quarters of 2011. Only 30 percent of the remuneration paid by MP 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.

Dated at Olympia, Washington, August 28, 2015.*

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

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

APPENDIX C — ORDER OF THE SUPERIOR COURT OF THE STATE OF WASHINGTON IN AND FOR THE COUNTY OF KING, DATED JULY, 2016

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

No. 15-2-23444-7 SEA

MACMILLAN-PIPER INC.,

Petitioner,

v.

STATE OF WASHINGTON, EMPLOYMENT
SECURITY DEPARTMENT,

Respondent.

ORDER ON REVIEW OF AGENCY ACTION

This matter came on regularly for hearing on May 27, 2016 before the above-entitled court pursuant to the Washington Administrative Procedure Act; the Commissioner of the Employment Security Department was represented by ROBERT W. FERGUSON, Attorney General, and ERIC D. PETERSON, Senior Assistant Attorney General; attorneys PHILIP TALMADGE and AARON RIENSCHE appeared on behalf of petitioner MACMILLAN-PIPER, INC. The court has considered all of the pleadings filed in support of, and in opposition to,

the petition, the agency record as well as the arguments of counsel.

Under the Employment Security Act, all Washington employers are required to contribute to the unemployment compensation fund for the benefit of their employees. These contributions are set aside as a financial reserve for the benefit of workers who become unemployed through no fault of their own. RCW 50.01.010. Persons who perform services for wages or are under contract calling for the performance of personal services are "employees" for purposes of the Act. RCW 50.04.100. If the employer can prove that the workers are independent contractors, they are exempt from the contribution requirement. RCW 50.04.140.

MacMillan-Piper, Inc. (MP) is a motor carrier that transports its customers' cargo from one mode of conveyance to another such as from a rail car to a steamship container. MP does not own any trucks. Instead it contracts with truck owner/operators to perform "drayage" services to move the cargo. MP has traditionally considered these owner/operators as independent contractors rather than employees. The Employment Security Department (ESD) conducted an audit of MP for 2009, 2010 and the first 3 quarters of 2011. As a result of the audit, 71 individuals hired by MP were re-classified as employees and their wages were subject unemployment taxes. MP was issued contributions, penalties and interest totaling $130,440. MP appealed the assessment. The hearing examiner (OAH) upheld the ESD's findings that the operators were in "employment"

of MP and that their personal services were not exempt from coverage. The OAH also found that only 30% of the monies paid to the owner-operators constituted wages. MP petitioned the Commissioner for review of the OAH's rulings. The Commissioner found that the services of the owner/operators constituted "employment" under the Act and that MP failed to prove that they were independent contractors. The current appeal ensued.

STANDARD OF REVIEW

Judicial review of the administrative decision of the Commissioner of the Employment Security Department is governed by the Washington Administrative Procedures Act (APA). RCW 34.05.510. The burden of proving that the agency action is invalid is on MacMillan-Piper. The court shall grant relief only if it determines that MP has been substantially prejudiced by the agency action because:

1. The order, statute or rule upon which the order is based is unconstitutional on its face or as applied; or

2. The order is outside the statutory authority of the agency; or

3. The agency has engaged in unlawful procedure or decision-making process or failed to follow a prescribed procedure; or

4. The agency has erroneously interpreted or applied the law; or

5. The order is not supported by substantial evidence; or

6. The order is arbitrary or capricious.

In evaluating disputed issues of fact, the court is limited to review of the agency record. RCW 34.05.558. The agency's factual findings must be upheld if supported by substantial evidence. The evidence must be viewed in the light most favorable to the party that prevailed at the administrative hearing.

Petitioners seek a judicial determination that the assessment is void under four theories:

1. ESD's audits were done in bad faith resulting in a determination that is arbitrary and capricious.

2. The actions of the ESD were pre-empted by the FAAA, the Federal Aviation Administration Authorization Act of 1994.

3. The ESD failed to prove that owner/operators rendered personal services to MP so they did not meet the definition of employment. RCW 50.04.100.

4. Even if ESD met its burden of "employment," the owner/operators are exempt under RCW 50.04.140.

Appendix C

VOID ASSESSMENT

Petitioners argue that the ESD inflated the assessments owed by including equipment rentals which are not subject to taxation. Only wages for personal services are subject to taxation. RCW 50.04.320. By including the equipment rentals in the assessment, petitioners argue that the ESD acted arbitrarily, capriciously and in bad faith resulting in an assessment that is void.

Agency action is arbitrary and capricious if it is willful and unreasoning and taken without regard to the attending facts or circumstances. *Rios v. Dep't of Labor & Indus.,* 145 Wn.2d. 483 (2002). The IRS 1099 forms that MP issued to the owner/operators did not distinguish between payments for equipment rental and payments for wages. Instructions for 1099 forms instruct employers that "rents" are to be reported in Box 1 and "non-employee compensation" in Box 7. MP reported both wages and equipment rentals in Box 7. MP did not keep track of wage information since it did not consider itself to be the employer of the owner/operators. ESD took the position that MP owed taxes on 100% of the wages reported in Box 7 of the 1099 form because it failed to differentiate wages from rents. MP took the position that it should not be assessed any contributions for wages.

When an employer fails to supply the necessary payroll or wage information, the commissioner may arbitrarily make a report based on information available and this report shall be deemed to be prima facie correct. RCW 50.12.080. MP successfully rebutted this presumption

with the testimony of its expert, Steven Bishop, and the OAH reduced the assessment for wages to 30% of the total remuneration reported. The OAH also waived any penalties for late payment finding the failure to timely pay was not the employer's fault.

MP argues that ESD knew that the assessment was incorrect because it failed to account for payments for *any* equipment rental and it should have made the effort to determine an accurate bifurcation amount. However, the burden is on the employer to maintain records of wages paid, not ESD. RCW 50.12.070. MP has failed to establish that ESD's actions were arbitrary and capricious.

PRE-EMPTION UNDER THE FAAA

Petitioners argue that the action of the Washington Employment Security Department (ESD) in classifying some of its owner/operators as employees rather than independent operators resulting in an assessment of $53,833 in unpaid unemployment taxes is pre-empted by the FAAA. The FAAA preemption provision provides that states may not enact laws or regulations having the force and effect of law related to a price, route or service of any motor carrier with respect to the transportation of property. 49 U.S.C. §14501(c)(1). They argue that converting owner/operators into employees under the ESD Act will result in the elimination the use of owner/operators in the trucking industry due to the increased cost. This will result in effectively re-structuring the industry and will have a substantial impact on prices, routes and services. Petitioner acknowledges that state

regulation of employer and employee relationships with regard to minimum wages and rest breaks are not pre-empted under the FAAAA. *Dilts v. Penske Logistics, LLC*, 769 F.3d. 637 (9th Cir. 2014); *Filo Foods, LLC. v City of SeaTac*, 183 Wn.2d 807 (2015). But Petitioner claims that case law draws a distinction when it comes to employers and owner/operators. In these types of cases, Petitioner argues, courts have consistently held that such interference is preempted. State regulations having the purpose of enhancing safety are not considered economic regulations that would be subject to preemption. But the cases[1] cited by Petitioner involve the analysis of Massachusetts Independent Contractor statute which involves a three-part test to determine if a worker is an employee or independent contractor. If the person is considered an employee, the Massachusetts statute requires that the employer provide certain benefits to the employee such as days off, parental leave and work-breaks. There is no such requirement under the ESD statute.

The portions of the Concession Agreements preempted in *American Trucking Ass'ns v. City of Los Angeles,* 2009 WL 1160212, were determined to have been enacted to increase efficiency and regulate the drayage market and were not related to motor vehicle safety as claimed by the Port. Similarly, the Michigan regulation mandating that vehicles may only be operated only by employees of a trucking carrier was found to have been enacted to make it easier for drivers to be organized by labor unions and was

1. *Schwann v. FedEx Ground Package Sus.,* 2016 WL 697121; *Massachusetts Delivery Ass'n v. Healey*, 117 F.Supp.3d 86 (2015).

not a safety related provision. *In re Federal Preemption of Provisions of the Motor Carrier Act,* 566 N.W.2d 299 (1997). Therefore, it was preempted by the FAAA. They noted that nothing in the Motor Carrier Act was intended to change the application of state tax laws applicable to motor carriers. 566 N.W.2d. at 302. The court in *Schwann* also noted that motor carriers are not exempt from state taxes or other state laws that are more or less uniform and therefore pose no patchwork problem. 813 F.3d at 440.

The Maine law that was preempted in *Rowe v. New Hampshire Motor Transport Assn.,* 128 S.Ct 989 (2008), forbid licensed tobacco retailers from using a delivery service unless the service provided a specific recipient-verification process. This statute specifically focused on trucking and motor carriers and thereby created a direct connection with motor-carrier services. The Employment Security Act requires all employers, not just motor carriers, to contribute to the unemployment compensation fund for their employees. It is not directed at motor carriers or the trucking industry. There is no mention of state unemployment law in the federal motor carrier statutes and regulations. *Western Ports Transportation v. Employment Security Dept.,* 110 Wn.App. 440, 457 (2002).

The fact that a law will likely increase a motor carrier's operating costs does not make the law related to prices, routes or services. State tax laws that are uniformly applied to all employers are not preempted by the FAAA.

Appendix C

EMPLOYMENT UNDER RCW 50.04.100

All Washington employers are required to contribute to the unemployment compensation fund for their benefit of their employees. RCW 50.01.010. Employment is defined as (1) personal service of whatever nature, unlimited by the common law definition of master and servant (2) in exchange for wages. RCW 50.04.100. The Employment Security Act is to be liberally construed to find the existence of an employment relationship since this furthers the goal of the Act to reduce the negative effects and suffering caused by involuntary unemployment. RCW 50.01.010.

Petitioners argue that ESD has not properly assessed the ESA to the owner/operators because they do not render personal services to the carriers. The test for employment is whether the worker performs services clearly for the benefit of the employer. There needs to be a connection between the personal services performed and the benefit received by the employer. The Commissioner found that the owner-operators performed truck-driving services to support MP's drayage business which is a key component of MP's import-export business. As such, the owner operators' personal services clearly benefitted MP's business operations. There is substantial evidence in the record to support this finding.

INDEPENDENT CONTRACTOR EXEMPTION

Employers are exempt from contribution to the unemployment compensation fund if the worker is

determined to be an independent contractor rather than an employee. To be considered an independent contractor, all of the following three factors are required:

1. The worker is free from control and direction in performance of the work under contract and in fact; and

2. The service is either outside the usual course of business for which such service is performed or the service is performed outside of the employer's usual place of business; and

3. The worker is engaged in an independently established trade or business of the same nature as the contract of service.

Once ESD establishes the existence of an employment relationship, the burden shifts to the employer to establish that the independent contractor exemption applies. The individual must be found to free from employer direction and control both under his or her contract and in fact. RCW 50.04.140(1)(a). The issue is not whether the employer in fact exercises control over the work but whether the employer has the right to do so. The Commissioner found MP failed to prove that the owner/operators were free from direction and control in the performance of their work. The fact that some of the controls imposed by MP are federally mandated does not exclude them from the analysis. *W.Ports*, 110 Wn.App. at 453-54. Employment includes personal service in interstate commerce. RCW 50.04.100.

Appendix C

In this case, MP entered into standard equipment lease agreements with the owner-operators. The owner-operators had some autonomy: they could drive themselves or hire drivers; they could set their own work hours; they could determine what route to drive and what order to do pick-ups and deliveries; they were responsible for all costs associated with the leased equipment such as repairs, maintenance, licenses, taxes and insurance. On the other hand, MP exerted control over the leased equipment during the period of the lease. MP required that MP's logo, motor carrier number and USDOT ID number be displayed on the equipment and it had to be removed when the lease terminated. MP exercised control over the owner-operators as well. They could not haul for any other carrier without MP's consent; they were required to immediately report any traffic citations or accidents; they were required to install two-way radios or phones to maintain contact with MP dispatch; they were required to report to duty by 7:30 am daily with adequate fuel and provide two weeks' notice if they would not be available for two or more days of work; they were required to submit records to MP of hours of driving, vehicle tonnage, proofs of delivery, daily log sheets, scale tickets, fuel receipts and monthly maintenance records. The Commissioner found that these requirements imposed by MP directed not only the end result of the work but the actual performance of the work and agreed with the OAH that the owner-operators were not free from MP's direction and control. There is substantial evidence in the record to support this finding.

Appendix C

For the reasons stated above, the Commissioner's Order is affirmed.

Dated this ___ day of July, 2016.

e-filed
The Honorable Mariane C. Spearman

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

THE SUPREME COURT OF WASHINGTON

No. 95442-9

MACMILLAN-PIPER, INC.,

Petitioner,

v.

DEPARTMENT OF EMPLOYMENT SECURITY,

Respondent.

ORDER

Court of Appeals No. 75534-0-I

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:

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

DATED at Olympia, Washington this 12th day of July, 2018.

For the Court

s/_____
CHIEF JUSTICE