R & G Probst (Diamond Driving School)

ASSESSMENTS

Penalties

PENALTIES (RCW 51.48.017)

Failure to keep records of employee hours

In assessing a penalty under RCW 51.48.030 for failure to keep records of an employee, the Department may assess a separate penalty for each employee for which records were not kept. ***….In re R & G Probst (Diamond Driving School),*** **BIIA Dec., 00 11968 (2001)** [*Editor's Note*: *Affirmed*, *Probst v. Department of Labor & Industries*, 121 Wn. App 288 (2004).]

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BEFORE THE BOARD OF INDUSTRIAL INSURANCE APPEALS
STATE OF WASHINGTON

IN RE: R & G PROBST ET UX DBA DIAMOND DRIVING SCHOOL	)	**DOCKET NO. 00 11968**
FIRM NO. 846,031-01	)	**DECISION AND ORDER**

APPEARANCES:

Employer, R & G Probst et ux, dba Diamond Driving School, by
Fristoe, Taylor & Schultz, LTD., P.S., per
Don W. Taylor

Department of Labor and Industries, by
The Office of the Attorney General, per
James S. Johnson, Assistant

The employer, R & G Probst et ux, dba Diamond Driving School, filed an appeal with the Board of Industrial Insurance Appeals on March 22, 2000, from a Notice and Order of Assessment by the Department of Labor and Industries dated March 13, 2000. The notice assessed taxes, penalties, and interest due and owing to the State Fund in the sum of $68,028.76. **AFFIRMED.**

DECISION

Pursuant to RCW 51.52.104 and RCW 51.52.106, this matter is before the Board for review and decision on timely Petitions for Review filed by the employer and the Department of Labor and Industries. The Board received the employer's Petition for Review on June 18, 2001, and the Department's Petition for Review was received on July 2, 2001. Both parties seek review of a Proposed Decision and Order dated April 30, 2001, in which the Department's Notice and Order of Assessment dated March 13, 2000, was reversed and the matter remanded to the Department with directions to calculate and assess premiums, interest, and penalties due for employees of Diamond Driving School during the period January 1, 1997 through December 31, 1999, from the records of Diamond Driving School, which shall be produced by Mr. and Mrs. Probst et ux, dba Diamond Driving School, and to reduce the penalty for failing to register from $21,204.58 to $500; to assess a penalty of $250 for failing to reproduce records; to vacate the penalty of $8,750 for failing to keep adequate records to determine taxes due; and to thereafter issue a new Notice and Order of Assessment of industrial insurance taxes pursuant to the provisions of this order.

The Board has reviewed the evidentiary rulings in the record of proceedings and finds that no prejudicial error was committed and the rulings are affirmed. We reserve further discussion on Exhibit Nos. 1 and 2 for later in our decision.

We have granted review in this matter solely to address the issue of the penalties assessed by the Department of Labor and Industries against Mr. and Mrs. Probst et ux, dba Diamond Driving School (Diamond). We conclude that our industrial appeals judge was incorrect regarding the modification of the penalties assessed under RCW 51.48.010 and RCW 51.48.030. We agree, however, with the Proposed Decision and Order that the driving instructors, although independent contractors, were covered workers under the Industrial Insurance Act. The Notice and Order of Assessment, including the penalties, will be affirmed in its entirety.

The Proposed Decision and Order accurately reflects the factual basis of Diamond's business plan and other evidence presented by both Diamond and the Department of Labor and Industries. We will set forth only those facts sufficient to explain our decision.

The employer, Gary Probst, and his wife, Roselani, founded the Diamond Driving School in Lakewood, Washington, in 1996. The purpose of the Diamond Driving School was to provide driving instruction to both adults and to teenagers between the ages of 16 and 18 years old. At its inception, Diamond was a joint venture involving Mr. and Mrs. Probst and two other persons, David Sedelmeier and Murray Taylor. Each person brought a different skill or resource to the partnership. Originally, as partners, each of the three principals (Mr. Probst, Mr. Sedelmeier, and Mr. Taylor) was excluded from mandatory coverage under the Industrial Insurance Act. Eventually Diamond decided to expand the business through the use of driving instructors working as independent contractors. The lead person in this venture, Gary Probst, conferred with an attorney and attempted to design a business plan that would create independent contractors/driving instructors who would be exempt from most business related fees, including industrial insurance. By 1999, there were 15 separate school locations throughout the state of Washington. The majority of these, however, were located within a 35-mile radius of the headquarters located at Lakewood, Washington.

Diamond asserts in this appeal that the driving instructors associated with the company were true independent contractors exempt from industrial insurance coverage because they were not "workers" as that term is utilized in RCW 51.08.180(1). Further, Diamond asserts that the driving instructors are exempt from coverage under the Act because they meet the alternate exception as provided in RCW 51.08.195. We reject both of these contentions.

The question of the status of the driving instructors is thoroughly and correctly resolved in the Proposed Decision and Order. For our discussion here, we would note the liberal purposes of the Act to provide for sure and certain relief for injured workers. RCW 51.04.010 and RCW 51.12.010. The goal of the Act is to reduce the suffering caused by **employment** related injuries. However, the question of coverage under the Industrial Insurance Act is not resolved by a simple analysis of whether or not there is an employer/employee relationship. *Novenson v. Spokane Culvert & Fabricating Co*., 91 Wn.2d 550 (1979). There may be coverage even when not otherwise obvious. The intent of the Act is to mitigate the consequences of injuries in the workplace and to extend coverage unless clear exceptions or exclusions can be demonstrated. RCW 51.12.020, RCW 51.08.180, and RCW 51.08.195.

Diamond contends that the driving instructors are not covered under the Act because they are true independent contractors. Although an independent contractor would not normally be considered an employee or worker for workers' compensation purposes, RCW 51.08.180 makes an exception for those independent contractors where the essence of their contract of service is their own **personal labor**. Thus, if the "essence" of the contractual relationship between an employer and an independent contractor is the personal labor of the independent contractor, the resulting working relationship is covered. The Washington Supreme Court, in *White v. Department of Labor & Indus*., 48 Wn.2d 470 (1956), explained that an independent contractor is not covered under the Act when the contractor: (1) must of necessity own or supply machinery or equipment as distinguished from the usual hand tools; or (2) obviously could not perform the contract without assistance; or (3) who of necessity or choice employs others to do all or part of the work contracted. Diamond did not establish that the driving instructors met any of these criteria. We conclude that the essence of the contract between Diamond and the driving instructors was the personal labor of the instructors.

For example, using the criteria of *White*, none of the instructors supplied any equipment. All the cars utilized for driving instruction were owned by Diamond. The record is clear that each of the contractors could perform the contract without assistance. The third element of *White* provides that an independent contractor is not covered under the Industrial Insurance Act where the contractor by necessity **or choice** employs others to do all or part of the work contracted. There is no persuasive evidence that indicated any of the driving instructors hired other individuals to conduct driving instruction on their behalf or as an extension of their contract with Diamond. In an assessment case the employer has the burden of proof to show that the Notice of Assessment is incorrect.

RCW 51.48.131. Applying the three-pronged criteria of *White*, we are persuaded that the essence of the contract between the driving instructors and Diamond was the personal labor of the instructors. *In re Peter M. Black Real Estate, Inc*., BIIA Dec., 88 1191 (1989); *In re David C. Broyles*, Dckt. Nos. 98 12803 and 98 15319 (Dec. 28, 1999). The driving instructors are, therefore, covered workers under RCW 51.08.180(1).

Diamond also asserts that the driving instructors are excluded from coverage under the alternate exception in RCW 51.08.195. This statute excludes certain employments from coverage if six specific elements are met. Satisfying some or a majority of the elements is **not** sufficient to gain the exception from coverage. Diamond must establish **each** element to exempt the driving instructors from industrial insurance coverage. *Daniels v. Seattle Seahawks*, 92 Wn. App. 576 (1998). Diamond did not prove all six elements. Specifically, Diamond did not establish that the work or service was outside the usual course of business for which the service is performed or that the service is performed **outside all the places of business of the enterprise for which the service is performed or that the individual is responsible both under the contract and in fact for the cost of the principal place of business from which the service is performed**. RCW 51.08.195(2). The driving instructors used Diamond Driving School locations for class instruction and Diamond owned automobiles for the driving phase of instruction. The instructors' limited home offices were not the places where services were performed. Thus, the service of providing drivers' instruction occurred at locations owned and operated by Diamond whether that was physical classroom space or automobiles used for the driving portion of instruction.

We need not address the remaining five elements in RCW 51.08.195, however, we are not satisfied that the driving instructors were truly free from control by Diamond. RCW 51.08.195(1). While the driving instructors had great latitude in hours worked, this is not the same as being free from the control or direction of the performance of the service. For example, Diamond handled all the money received. Tuition fees were given to Diamond. Diamond in turn deducted for expenses and paid the instructors. It appears that Diamond controlled many other aspects of the business, including advertising. We note also that the driving instructors maintained home offices for tax purposes. These home offices were not the principal place of business for the instruction services. Further, the driving instructors did not offer their services generally to other driving schools. RCW 51.08.195(3).

In summary, all the driving instructors employed by Diamond were independent contractors, the essence of whose contract was their own personal labor and who did not meet all of the criteria for an exception to employment set forth in RCW 51.08.195. The driving instructors are covered under the Industrial Insurance Act.

We turn now to the question of the premiums or taxes and penalties assessed by the Department of Labor and Industries.

As to the premiums assessed, we note that the hours for these instructors were estimated by the Department under RCW 51.16.155. The Department is authorized to estimate payroll and resulting industrial insurance premiums where the employer refuses to provide the necessary information and records. Diamond refused to provide any useful information that would lead to a more accurate assessment. Although Mr. Probst now states that he has "1099s" and other records available upon which to calculate premiums, we believe that RCW 51.48.030 and RCW 51.48.040 operate to bar Mr. Probst from now challenging the assessed premiums based on an estimate. In this regard, we do not believe that Exhibit Nos. 1 and 2, the alleged 1099 forms, can or should be considered as a basis for computing industrial insurance taxes on appeal to this Board. Even these limited records were not provided to the Department when requested. They were admitted without objection, but they form no basis for our decision.

The Legislature has imposed a considerable penalty for the failure of an employer to keep the kind of records needed to determine industrial insurance taxes due. *In re AEX Corporation*, BIIA Dec., 90 5314 (1992). There is a corollary between the dual requirements to both maintain appropriate records (RCW 51.48.030) and to make those records available (RCW 51.48.040). The statutory pattern places the burden and requirement on employers both to have and make available records that can be used to determine if premiums and taxes are due and in what amount. Failure to produce records has the same effect as keeping no records at all. For example, RCW 51.16.155 allows the Department to estimate premiums where the employer "refuses" to file a payroll report. We find that Diamond refused to produce records when properly requested by the Department and any records offered now fall within the bar provided in RCW 51.48.040.

Diamond was assessed a penalty of $21,204.58 under RCW 51.48.010 for failure to secure industrial insurance coverage for workers. This section provides that any employer who fails to secure payment of compensation for workers may be liable to a maximum penalty in the amount of $500 or in a sum double the amount of the premiums incurred prior to securing payment of compensation, whichever is greater. Our industrial appeals judge determined that the decision to

set penalties was a "discretionary" act by the auditor, and the auditor had abused this discretion. This Board, however, has previously stated that the Legislature's use of the word "may" in RCW 51.48.010 means only that the penalty is not mandatory. The question of penalty assessment is subject to a de novo review on appeal and the standard of review is based upon the preponderance of the evidence. *In re C & R Shingle*, BIIA Dec., 88 2823 (1990) and *In re Sawyers Motor Sports*, BIIA Dec., 90 3344 (1992).

In *C & R Shingle* we remanded the appeal to the Department to reassess the penalty based on three factors: (1) whether the employer intended to avoid the burdens of the Industrial Insurance Act; (2) the amount of taxes incurred prior to the employer's registering with the Department; and (3) whether the employer had a good faith basis for believing that it was not subject to the provisions of the Industrial Insurance Act. We do not deem it necessary to remand this matter to the Department for further review of the penalty as we find the record sufficient on each of these points to determine the appropriateness of the penalties assessed. *In re C. M. Stephens Enterprises*, Dckt. No. 91 3059 (June 16, 1993).

Applying our three-part test to Diamond, we first find that Diamond clearly intended to avoid the burdens of the Industrial Insurance Act. Mr. Probst made a considerable effort to arrange a business plan so that the driving instructors would be regarded as independent contractors for all purposes. To this end, Mr. Probst secured an IRS opinion, concluding that the driving instructors were independent contractors. The question of whether independent contractors are covered workers for industrial insurance purposes depends on the special requirements of the Industrial Insurance Act. An IRS opinion has only limited bearing on our analysis. Exhibit No. 6. In any event, it is clear that Diamond was specifically trying to avoid as many costs of doing business as possible, including industrial insurance costs.

The second part of our test in *C & R Shingle* concerns the amount of industrial insurance taxes incurred prior to registration with the Department. The premiums assessed by the Department were large, covering a period of three years and 35 different driving instructors, for a total amount of $27,828.35.

The third part of our test in *C & R Shingle* is whether the employer had a good faith basis for believing that the business was not subject to the provisions of the Industrial Insurance Act. This part is closely allied with the first part of our test. It is clear that Mr. Probst was conscientious in his efforts to avoid coverage of the Industrial Insurance Act and that his efforts were based on careful planning and legal advice. Weighed against this, however, is Diamond's lack of cooperation and

recalcitrance in cooperating with the Department's more detailed investigation and audit of his enterprise. Mr. Probst tenaciously held to his view that the Diamond driving instructors were not employees. He may have thought that any cooperation with the Department might create the appearance of being subject to the Act. Instead, his actions obstructed the Department's statutory obligation to administer the Industrial Insurance Act. Specifically, Diamond did not comply with the Department's subpoena. The examples of blank contracts and other limited documentation that Mr. Probst did provide were wholly inadequate. Diamond's recalcitrance negates any presumption about good faith. For example, Diamond's lack of cooperation could have stemmed from a desire to hide the relationship with the driving instructors. We do not accept the testimony on behalf of Diamond on this issue, and we affirm the penalty assessed under RCW 51.48.010 in its entirety in the amount of $26,204.58.

We next consider the second largest category of penalty, those assessed under RCW 51.48.030. The penalties assessed under this section are also subject to de novo review on appeal based on a preponderance test. This penalty was assessed for failure to keep records of employee hours. We already have determined that Diamond's failure to cooperate with the Department's review and audit process precludes it from offering records at this juncture. A record cannot be said to be "preserved" within the meaning of RCW 51.48.030 if it is not presented when requested. The statutory scheme does not allow the employer to pick and choose when to present employment records. The Department is authorized to assess a penalty for failure to keep records ranging from $250 or 200 percent of the quarterly tax for each such offense, whichever is greater. In this case, the Department assessed $250 for each driving instructor employed. This represents a total penalty of $8,750 or $250 times 35 driving instructors. The number 35 comes by way of the Department of Licensing and Superintendent of Public Instruction records regarding the driving instructors associated with Diamond Driving School. We conclude that the Department's assessment of $8,750 was correct based on WAC 296-17-35201(4), which provides that the failure to keep records on any employee shall constitute one offense. *In re Michael J. Coyle et ux, dba Michael J. Coyle Co.*, Dckt. Nos. 95 0381 and 95 0382 (October 29, 1998). Thus, the failure to keep records on each of the 35 driving instructors constitutes 35 separate offenses.

The Department also assessed a penalty of $250 for Diamond's refusal to submit books, records, and payrolls for inspection by the Department. Diamond's Petition for Review concedes that after receiving the Department's subpoena for records on October 28, 1999, it did not produce

records adequate to determine premiums due to the State Fund. Diamond's Petition for Review, page 5, lines 14-16. Diamond asserts that it had records available and shifts the burden to the Department for the purpose of making the arrangements to review or copy the necessary records. There is no basis for Diamond's attempt to shift the burden of producing records in this matter. RCW 51.48.040 authorizes a penalty of $250 for failure to produce records and that penalty will be affirmed.

Finally, we note that the Department assessed penalties in interest for unpaid past premiums pursuant to RCW 51.48.210. The correctness or propriety of these penalties and interest are nowhere addressed in Diamond's Petition for Review. It is perhaps consistent with Diamond's theory of the case that no premiums are due that this matter was not addressed. However, in the absence of any evidence, or even argument, on this issue we must conclude that the Department's additional assessment of penalties and interest for the unpaid premiums is proper and should be affirmed.

In conclusion, the driving instructors employed by Diamond were covered employees under the Industrial Insurance Act. The premiums, interest, and penalties assessed by the Department were authorized by statute and supported by the evidence in the record. The Notice and Order of Assessment dated March 13, 2000, is affirmed.

FINDINGS OF FACT

1. On March 13, 2000, the Department of Labor and Industries issued Notice and Order of Assessment No. 0277374 to Roselani Y. Probst and Gary R. Probst et ux, dba Diamond Driving School, for taxes, penalties, and interest owing to the State Fund in the sum of $68,028.76 for all of the four quarters of 1997, 1998, and 1999. On March 22, 2000, the employer, Diamond Driving School, filed a Notice of Appeal with the Board of Industrial Insurance Appeals. On April 10, 2000, the Board granted the appeal and directed that further proceedings be held to resolve the issues on appeal.

2. During the period January 1, 1997 through December 31, 1999, Mr. and Mrs. Probst et ux, dba Diamond Driving School, were providing services to the public for driving instruction and were duly licensed with both the Department of Licensing and Superintendent of Public Instruction to do so. Each instructor's license was tied to Diamond as the designated employer.

3. During the period January 1, 1997 through December 31, 1999, Diamond Driving School was the owner or lessor of multiple classroom facilities and properly equipped automobiles that were used by instructors to perform their contract for services with Diamond.

4. During the period January 1, 1997 through December 31, 1999, Diamond Driving School contracted with various licensed individuals to provide both classroom and driving instruction to students throughout the state of Washington. Pursuant to contract, each instructor was paid for the time spent instructing students and such time was reported to Diamond Driving School on a weekly basis.

5. During the period January 1, 1997 through December 31, 1999, Diamond Driving School controlled the manner of driving instruction services by providing commercial advertising, a phone service with call forwarding, mandatory insurance coverage, payment of leases and utilities, collected and deposited instruction fees from students, reviewed instructor's performance, complied with licensing requirements through inspection, paid each instructor for the hours spent instructing students, and issued certificates of completion to each student.

6. During the period January 1, 1997 through December 31, 1999, Mr. and Mrs. Probst et ux, dba Diamond Driving School, intended to avoid the burdens of the Industrial Insurance Act.

7. The service of instructing students how to drive for a fee was the only service being provided by Diamond Driving School to the public and was the only service that each instructor was performing pursuant to contract with Diamond Driving School.

8. Each driving instructor did not, independent of Diamond Driving School, hold themselves out to the public as operating a business of teaching individuals to drive, nor were the costs of the principal place of business being paid entirely by the instructors.

9. Each driving instructor entered into a written contract for services with Diamond Driving School. In keeping with the contract, each instructor maintained a home office, was eligible for business deductions for federal income tax purposes and filed a schedule of expenses, had a Uniform Business License with the state, and maintained a separate set of books or records for income and expenses. Each instructor set their own schedule of instruction with students. However, the driving instructors' home offices were not the principal place of business for the driving instruction.

10. Diamond Driving School failed to present records when requested by the Department of Labor and Industries through its authorized auditor, Peter Doellinger, for driving instructors employed by Diamond during the audit period of January 1, 1997 through December 31, 1999.

11. After receiving a subpoena for records covering the audit period of January 1, 1997 through December 31, 1999, from the Department of Labor and Industries on October 28, 1999, Mr. and Mrs. Probst et ux, dba Diamond Driving School, failed to demonstrate a good faith basis that the employer was not subject to industrial insurance as it did not produce any records adequate to determine the status of the driving instructors for the purposes of the industrial insurance coverage and to determine if industrial insurance taxes were owed to the State Fund.

12. During the period January 1, 1997 through December 31, 1999, Diamond Driving School employed 35 driving instructors based on records maintained by the Superintendent of Public Instruction. The Department of Labor and Industries estimated the amount of industrial insurance premiums due for this period in the amount of $27,828.35.

13. During the period January 1, 1997 through December 31, 1999, Mr. and Mrs. Probst et ux, dba Diamond Driving School, did not register any of the driving instructors with the Department of Labor and Industries or pay industrial insurance premiums.

14. During the period January 1, 1997 through December 31, 1999, the individual instructors were under independent contract with Diamond Driving School to provide instruction to students, the essence of which was his or her personal labor.

15. The instructors of Diamond did not own or provide machinery or equipment for the performance of their contract.

16. The instructors could perform their instructing services for Diamond without assistance.

17. The instructors did not employ others to perform the services of instruction under contract.

18. During the period of audit, Gary Probst, David Sedelmeier, and Murray Taylor were general partners and exempt from industrial insurance coverage.

CONCLUSIONS OF LAW

1. The Board of Industrial Insurance Appeals has jurisdiction over the parties and the subject matter of this appeal.

2. Mr. and Mrs. Probst et ux, dba Diamond Driving School, during the period of January 1, 1997 through December 31, 1999, qualified as an employer for purposes of industrial insurance in accordance with the provisions of RCW 51.16.060 and the definitions contained in RCW 51.08.070 and RCW 51.08.180.

3. During the period January 1, 1997 through December 31, 1999, Mr. and Mrs. Probst et ux, dba Diamond Driving School, did not qualify as an exempt employer under the provisions of RCW 51.08.195.

4. During the period January 1, 1997 through December 31, 1999, driving instructors employed by Mr. and Mrs. Probst et ux, dba Diamond Driving School, were covered workers under the Industrial Insurance Act within the meaning of RCW 51.08.180 and *White v. Department of Labor & Indus*., 48 Wn.2d 470 (1956).

5. Mr. and Mrs. Probst et ux, dba Diamond Driving School, are barred under RCW 51.48.030 and RCW 51.48.040 from questioning before this Board the correctness of the Department's assessment of industrial insurance premiums for the period January 1, 1997 through December 31, 1999.

6. The Department of Labor and Industries was authorized to estimate the premiums due from Mr. and Mrs. Probst et ux, dba Diamond Driving School, within the meaning of RCW 51.16.155 in the amount of $27,828.35.

7. The Department of Labor and Industries was authorized to assess penalties against Mr. and Mrs. Probst et ux, dba Diamond Driving School, within the meaning of RCW 51.48.010 in the amount of $21,204.58.

8. The Department of Labor and Industries was authorized to assess penalties against Mr. and Mrs. Probst et ux, dba Diamond Driving School, within the meaning of RCW 51.48.030 and WAC 296-17-35201(4) in the amount of $8,750, or $250 for each offense of failing to maintain records.

9. The Department of Labor and Industries was authorized to assess a penalty against Mr. and Mrs. Probst et ux, dba Diamond Driving School, within the meaning of RCW 51.48.040 in the amount of $250.

10. The Department of Labor and Industries was authorized to assess penalties and interest against Mr. and Mrs. Probst et ux, dba Diamond Driving School, within the meaning of RCW 51.48.210 in the amount of $9,995.83.

11. The Notice and Order of Assessment of industrial insurance taxes dated March 13, 2000, which assessed Mr. and Mrs. Probst et ux, dba Diamond Driving School, taxes, penalties, and interest due and owing to

the State Fund for all four quarters of 1997, 1998, and 1999, in the amount of $68,028.76, is correct and is affirmed.

It is so ORDERED.

Dated this 5th day of December, 2001.

BOARD OF INDUSTRIAL INSURANCE APPEALS

/s/_____
THOMAS E. EGAN Chairperson

/s/_____
FRANK E. FENNERTY, JR. Member

/s/_____
JUDITH E. SCHURKE Member