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AVOIDING SHIPPER/CONSIGNEE DOUBLE PAYMENT LIABILITY

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"Double, double, toil and trouble, fire burn and cauldron bubble"
–from the three witches' chorus, Wm. Shakespeare's *Macbeth*.

It is now beyond question that shippers and consignees face potential double payment liability to motor carriers for freight transportation charges. Three federal court cases, two of them being 2008 "cases of first impression" in the 9th and 11th Federal Judicial Circuits, have recently imposed "double payment liability" upon an innocent shipper or consignee. Double payment liability for non-brokered shipments was imposed upon consignee Kawasaki Motors in the 8th Circuit case of *Harms Farms Trucking v. Woodland Container and Kawasaki Motors Manufacturing Corp. U.S.A.*, 2006 WL 3483920 (D. Neb.2006); double payment liability for brokered shipments was imposed upon shipper and consignee Sears Roebuck in the 9th Circuit (*Oak Harbor Freight Lines v. Sears, Roebuck & Co. et al*, 513 F.3d 949 (9th Cir., 2008)); and consignees Peters Hospitality and Polaroid Electronics were found doubly liable for loads passing through a freight forwarder in the 11th Circuit (*Spedag Americas, Inc. v. Peters Hospitality and Entertainment Group LLC et al.*, 2008 WL 3889551 (S.D.Fla. 2008)).

These cases illustrate the breadth of potential double payment liability which may arise any time a load moves – regardless of whether or not a transportation intermediary such as a freight broker or freight forwarder is involved. The cases also underscore the importance of shipper/consignee preventative up-front due diligence. As a practicing attorney, your author is reluctant to exercise the literary license of simile by comparing the decisions in *Harms Farms*, *Oak Harbor*, and *Spedag* to Shakespeare's three witches' chorus; nonetheless, a legal cauldron of "double, double, toil and trouble" awaits an unwary shipper or consignee.

The purpose of this article is neither to engage in an overly technical legal analysis nor to disparage motor carriers who bring "double liability" claims against financially viable shippers/consignees; after all the trucking company has performed a valuable service and is simply trying to be paid "once" for that service - even though the financially viable shipper or consignee may have to pay twice with the bankrupt/insolvent third party absconding. The purpose of this article is generally to provide some "front-end" practical suggestions to shippers/ consignees in how to avoid being in court on one of these claims in the first place and more specifically how to do so by exercising due diligence in selecting a freight broker for transportation needs.

In the *Harms Farms* case no broker or freight forwarder was involved, rather consignee Kawasaki Motors directly contracted with shipper Woodland for delivery of 90 shipments of pallets to Kawasaki. Shipper Woodland verbally contracted with motor carrier Harms Farms to deliver the pallets and the motor carrier did so. Shipper Woodland billed consignee Kawasaki for Harms' freight charges. Kawasaki paid Woodland some $27,000 of those charges with Woodland agreeing to forward payment to the motor carrier. Woodland sent a check for partial payment to the motor carrier but the check was returned for insufficient funds and Woodland never made good on the check nor otherwise paid any of the freight charges. Motor carrier Harms Farms then sued consignee Kawasaki in a U.S. District Court in the 8th Judicial Circuit (which encompasses the 7 states of ND, SD, MN, IA, MO, AR, & NE). The District Court held consignee Kawasaki liable to the plaintiff motor carrier for the entire remaining balance of the motor carrier's freight charges notwithstanding that Kawasaki had already paid some $27,000 of those freight charges to the shipper, Woodland (which ultimately was insolvent and statutorily dissolved).

In *Oak Harbor*, a "case of first impression" from the 9th Circuit (the 7 states of WA, OR, CA, MT, ID, NV, & AZ), Sears Roebuck Co. contracted with broker National Logistics to secure motor carriage of Sears' product. The broker in turn contracted with motor carrier Oak Harbor to move the freight. Sears was the shipper on some of the loads and the consignee on others. Before suit was filed Sears had paid the broker in excess of $225,000 from which the broker was to pay Oak Harbor. The broker did not pay Oak Harbor and Oak Harbor sued both the broker and Sears. Sears asserted that its $225,000 in payments to the broker should be credited as an off-set against Oak Harbor's $425,000 claim. The Court rejected Sears' arguments and held Sears jointly liable with the broker for Oak Harbor's entire claim.

In *Spedag*, a "case of first impression" from the 11th Circuit (the 3 states of GA, FL,& AL), air freight carrier Spedag entered into a contract with freight forwarder Transworld Freight Systems whereby Transworld agreed to pay carrier Spedag for transporting electronic equipment from shippers in Asia to US consignees Peters Hospitality Group LLC and Polaroid Consumer Electronics LLC. Freight forwarder Transworld agreed to bill and collect freight charges from Peters and Polaroid and to forward such payments to Spedag. Spedag transported the equipment on straight bills of lading identifying Peters and Polaroid as consignees. Consignees Peters and Polaroid promptly paid the freight charges to freight forwarder Transworld, however, after a time the freight forwarder stopped remitting payment to Spedag. Eventually Transworld filed for bankruptcy having collected some $850,000 from consignees Peters and Polaroid which Transworld had not remitted to freight carrier Spedag.

Spedag then sued consignees Peters and Polaroid contending that they remained liable to Spedag for its entire outstanding freight bills of $850,000 notwithstanding that the consignees had already paid that amount to the now bankrupt freight forwarder Transworld. Peters and Polaroid raised numerous defenses to Spedag's claims. Although the District Court found that there were questions of fact as to Peters' and Polaroid's mitigation of damages defenses the District Court granted summary judgment in favor of Spedag on the issue of "double liability", holding both consignees liable to the carrier for freight charges and leaving only the question of the amount of damages which Peters and Polaroid must pay to a jury.

Double liability claims can be defeated. Clear contractual specifications of liability for freight charges will be upheld as between the contracting parties and proper marking of bills of lading can be a determinative factor ("freight pre-paid" typically imposes primary liability on the shipper while "freight collect" places primary liability on the consignee; but see the 11th Circuit's modified rule adopted in *Nat. Shipping Co. of Saudi Arabia v. Omni Lines, Inc.* 106 F.3d 1544 (11th Cir. 1997). Different facts, different contracts, and different entries on bills of lading may mean different results. However, given the high cost of litigation, even a successful defense of a "you must pay twice" claim hardly feels like a victory – you have simply lost less than you would have otherwise.

What you really want to accomplish is avoiding any such suit in the first place. The U.S. District Court in *Spedag* and the 11th Circuit Court of Appeals in *Omni Lines, Inc.* have recommended selection of a reputable third-party intermediary as one significant, practical means by which shippers/consignees may avoid double liability suits. The *Spedag* Court observed that "consignees . . . can avoid the loss and risk of liability for double payments . . . (by) choosing to deal only with reputable forwarders", and the Court in *Omni Lines* noted that a shipper wishing to avoid liability for double payment "must take precaution to deal with a reputable freight forwarder." The Courts' admonitions regarding forwarders apply equally as well to freight brokers.

Shipper/Consignee out-sourcing of motor carrier transportation needs to freight brokers is prevalent because it simply makes bottom line economic sense. Federal Motor Carrier Safety Administration (FMCSA) findings have empirically documented shipper savings through utilization of brokers. "General commodities brokers and freight forwarders offer valuable services to the business community. They work with motor carriers to find less expensive transportation alternatives for commercial shippers and provide additional services to assist shippers . . . (the "additional services" alluded to in the FMCSA findings include quickly securing vetted motor carrier, confirmation of motor carrier compliance with insurance requirements, administrative/tracking support, and competitive price points) . . . . Without these transportation intermediaries, shippers would have to devote additional resources to locating and negotiating with motor carriers and would likely have to pay higher transportation costs. Smaller businesses in particular would be disadvantaged by not being able to rely on the services provided by brokers and freight forwarders. Available statistics also indicate a growing reliance on these entities in the shipment of goods." Registration of Brokers and Freight Forwarders of Non-Household Goods" (Federal Register Vol. 71, No. 164).

FMCSA April 2006 findings also note that as of April 2006, 16,930 active general commodities brokers were registered with FMCSA and annual applications for broker's licensure had increased by 30% since 2003. Freight brokers come in all sizes; TransCore's™ "2008 Broker Benchmark Survey" (© 2008 TC IP, Ltd) reflects that 47% of all freight broker companies have 5 or fewer employees; 34% have 6-25 employees; 11% have 26-100 employees and the remaining companies have 100+ employees.

As documented by FMCSA's findings, the transportation industry's increased utilization of brokers and a cost-benefit analysis both attest to the bottom-line economic benefit of utilizing broker services as opposed to incurring the cost of establishing an internal "do-it-yourself" transportation division to promptly secure vetted motor carriers at competitive price points. Moreover, the Courts have recommended that shippers/consignees utilize the services of "reputable" forwarders/brokers as a means of avoiding double liability lawsuits (see *Spedag & Omni Lines*, supra). So, what are the markers of a "reputable broker" and how does one exercise due diligence in making that determination? Given the growth in the freight brokerage industry, the disparate sizes of brokerage companies, and the relative ease in qualifying for FMCSA broker certification, one would correctly assume that there are the good, the bad and the ugly.

There are three outstanding markers of a reputable freight broker. A reputable freight broker: (1) has financial stability; (2) carries (a) a higher limit insurance policy/bond which supplements its minimally required $10,000 broker's bond/trust fund, (b) adequate contingent cargo insurance, (c) general liability insurance; and (3) enjoys a long-standing good reputation for service to its customers (shippers/consignees) and prompt payment to motor carriers.

1. **Financial Stability** - Independent companies such as Dun & Bradstreet, commonly "D&B" (www.dnb.com), Experian (www.Experian .com), and Cortera (www.cortera.com) provide wide-ranging business reports including business credit history, liens and lawsuits, UCC filings and summaries of a company's timeliness in debt payments. Although each of these companies can provide good baseline information, this author's preference is D&B. Pursuant to the Federal Acquisition Regulation ("FAR"), D&B's D-U-N-S Number® was adopted as the U.S. Government's contactor ID code for U.S. Government procurement activities and was also adopted as the standard business identifier for federal electronic commerce. You should require a prospective broker to provide you with its D&B "D-U-N-S Number®" (which D&B assigns to each physical location for companies which choose to participate with D&B). Use it as a due diligence tool. Of particular interest in evaluating a freight broker is the broker's D&B "PAYDEX® Score" which evaluates a company's timeliness in debt payments – scores range 1-100 with higher scores generated by a company's payment of debts prior to due date terms, e.g. if a company, on average, pays its debts on the dates such become due per its terms with vendors (typically 30 days) then a PAYDEX® Score of 80 is assigned and if it pays 30 days sooner than due date terms then a PAYDEX® Score of 100 is assigned. Brokers who offer "quick pay" to motor carriers receive higher PAYDEX® Scores and are in a position to negotiate motor carrier freight rate discounts which can be passed on in whole or part to its customers. Quick pay to carriers also solidifies the broker's on-going relationships with the motor carriers. On the downside, a low PAYDEX® Score (less than 80) is a red flag. Caveat: Database info on any company can be stale. Inquire with any third–party information provider regarding last updates and time periods tracked.

Does the broker factor accounts receivable ("A/R")? The freight brokerage business is highly competitive. A competitive freight broker operates on a thin profit margin. If the broker is factoring it's A/R then two bad things are happening: (1) the broker, by discounting its A/R to the factor, is now most likely operating at break-even or worse, and (2) there is now a perfected secured creditor (the factor) with priority rights in the A/R who will not hesitate to exercise its security rights in the A/R should it deem itself insecure. Factoring of A/R by a broker is a definite red flag.

Request that third party reports include UCC filings on the broker. If A/R is being factored the UCC financing statement will clearly state that the secured creditor holds a security interest in "accounts receivable". It is true that lenders other than factors will sometimes secure equipment or mortgage loans with A/R. "Google©" the name of the secured creditor listed on the UCC and check its website – this will typically reflect if the creditor is a factor. If there is any doubt or question of whether a secured creditor is factoring the broker's accounts you can secure the prospective broker's written consent to the creditor's disclosure of any factoring or other security agreements with the broker.

2. (a) **Carries Insurance Supplementing the Broker's Bond/Trust Fund** – The FMCSA requires that any registered freight broker post a minimum broker's bond (a "BMC-84" filing) or establish a trust fund (a "BMC-85" filing) of $10,000.00. As stated at 49 CFR §387.307(b), "The surety bond or the trust fund shall ensure the financial responsibility of the broker by providing for payments to shippers or motor carriers if the broker fails to carry out its contracts, agreements, or arrangements for the supplying of transportation by authorized motor carriers".

Most brokers simply comply with the $10,000 minimum. However, a broker may elect to purchase supplemental insurance/bond coverage for higher limits. The supplemental limits provide a layer of insurance protection in the event that a broker defaults on its obligations (see 49 CFR §387.307(b) above) and the $10,000 bond/trust fund is exhausted. Supplemental coverage is typically offered in increments up to $100,000 ($10,000 bond plus $90,000 supplemental policy). While larger supplemental limits may be offered, premiums for such are correspondingly higher and must be passed on to a customer. A broker that carries a higher limit supplemental policy and remains competitive with its price points is the broker of choice. This is true for several reasons. First, obtaining supplemental coverage demonstrates the broker's commitment to fulfill its obligations; second, both the bond and supplemental policy/bond proceeds are available should the broker fail in that commitment; and third, insurers offering such coverage require the broker to meet more stringent underwriting requirements than are required of a broker who simply posts a minimum ($10,000) surety bond or trust fund. If the broker cannot meet those underwriting requirements then that is a sign that perhaps you too should not do business with that broker. Go to the FMCSA's "SAFER" website (www.safer.fmcsa.dot.gov) and follow the links to track a broker's filings with the FMCSA. Caveat: note that the "SAFER" website will only reflect whether a broker has met its minimally required $10,000 bond/trust fund requirement - "SAFER" does not show voluntary higher limits coverage data. Voluntary higher limits coverage should be documented via an ACCORD™ certificate of coverage.

2. (b) **Contingent Cargo Insurance** – As a protection for itself and its customers a freight broker will (or should) secure ACCORD™ certificates of coverage of a motor carrier's primary cargo and motor vehicle liability insurance. Additionally, a broker should carry its own contingent cargo insurance and you should require the broker to provide you with an ACCORD™ certificate of coverage for such. Contingent cargo insurance is "contingent"; it provides cargo coverage upon the contingency that the motor carrier's primary cargo insurance denies coverage or is insolvent (note that additional contingent cargo coverage "triggers" may apply). Levels of coverage should be adequate to cover the value of the cargo on any one shipment. While $200,000 in contingent cargo coverage is typically adequate, a shipper whose cargo will exceed such should require a higher level; which can be accomplished by a special endorsement to the policy or via "spot coverage".

2. (c) **General Liability Insurance** – Although you will not qualify (in all likelihood) as an "insured" under a broker's general commercial liability policy, the fact that the broker carries such is nonetheless significant in evaluating a broker. A broker with "nothing to lose" may skimp on this coverage. A broker operating without a general commercial liability policy of at least $1,000,000 is a red flag. Get an ACCORD™ certificate of coverage for such.

3. **Reputation** – A broker's length of time in business should be given due consideration. Longevity bears on a broker's experience and establishes a longer track-record for evaluation. Longevity is not the sole criterion by which to judge a broker – every long-standing business began as a new-start and even General Motors went bankrupt. However, experience and a track record are as significant in the freight brokerage business as they are in any other business.

When choosing a broker think of it similarly to interviewing a job applicant. Like a prospective employee, a broker will not provide you with a poor reference source, but recognizable (to you) long-standing customers of the broker who vouch for the broker's service record is a positive sign; a broker's reluctance or inability to provide those references is a red flag. As previously discussed a broker's D&B PAYDEX® Score will provide "prompt pay" information which directly correlates with the broker's relationship and reputation with motor carriers.

Due diligence in freight broker selection can greatly reduce the potential for a shipper or consignee being exposed to a double payment liability claim. Exercise that due diligence lest ye find yourself boiling in a cauldron of "double, double, toil and trouble."

AUTHOR BIOGRAPHY

Mr. Huff is a practicing attorney in Duluth, Georgia. He was lead counsel for the prevailing plaintiff in *Miller v. Harco National Insurance Co. et al.* , 241 F.3d 1331 (11th Cir. 2001), 274 Ga. 387 (2001), 280 F.3d 1353 (11th Cir. 2002) a "case of first impression" expanding the scope of FMCSA motor carrier liability coverage following certified questions by the 11th Circuit Court of Appeals to the Georgia Supreme Court.