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The Transportation Brief®

The Transportation Brief

A quarterly newsletter of legal news for the clients and friends of Scopelitis, Garvin, Light & Hanson.

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Unanticipated Risks May Arise From 3PL Operations

Whether due to customer demands or general market forces, transportation companies increasingly offer full-service logistics solutions to their customers. Expanding service offerings without careful legal analysis, however, may expose your company to unwanted liability risk with customers, the public, and government regulators.

Liability can arise from seemingly mundane acts

Because brokers are only authorized to arrange for transportation by motor carrier, a broker tendering freight to a rail carrier may be considered to be acting as a freight forwarder, thus exposing itself to cargo claim liability that may be uninsured. In addition, because federal law defines an indirect air carrier (IAC) as any entity using the services of another IAC to provide air transportation, a company offering to arrange for the movement of goods with a shipper and tendering those goods to an air carrier is itself acting as an IAC. A logistics company acting as an IAC, but failing to comply with security procedures imposed on IACs, is subject to civil penalties for non-compliance and substantial liability in the event of an unanticipated loss.

Liabilities to government regulators are also a concern

For instance, a licensed freight forwarder may offer to arrange for an international shipment with a Vessel Operating Common Carrier. A freight forwarder, however, is prohibited from arranging for moves in foreign ocean commerce unless the freight forwarder is a licensed Ocean Transportation Intermediary (OTI). Federal regulation allows for imposition of monetary penalties of $5,500 to $27,500 per day against entities engaged in unlicensed OTI operations.

This is a sampling of issues that may arise when an entity expands its logistics offerings. Although some risks can be mitigated, the most effective means of avoiding these types of claims is to identify potential legal liabilities before expanding service offerings.

Norman R. Garvin, Richard A. Clark, Nathaniel G. Saylor, Indianapolis

Briefly...

Contingent Coverage Caveats

Third-party logistics (3PL) providers frequently procure "contingent" insurance coverage. Contingent cargo coverage is more prevalent than contingent auto liability coverage, but the premised purpose of both coverages is similar; namely, to insure a loss when the at-fault motor carrier's insurer denies or fails to provide coverage. Contingent policies do not provide coverage excess to motor carrier policies.

Due to unfavorable terms, many contingent cargo policies provide almost illusory protection to both the insured and the party suffering the loss. Generally, claims are only insured if the 3PL has followed strict carrier selection procedures. Worse, some contingent cargo policies contain exclusions based upon the underlying motor carrier's operations, the applicability of which only come to light after the incident.

The value of certain contingent auto liability policies is even more suspect because the for-hire motor carrier's auto liability insurer must provide coverage to the public due to its BMC-91 filing with the FMCSA, regardless of the policy terms. Thus, the insolvency of the motor carrier's insurer is the primary and limited risk for which premiums are being paid.

Andrew K. Light, Indianapolis

Freight Forwarding/ Brokerage Update

Is your company acting as a freight forwarder or as a broker? A recent appellate court decision indicates that the answer depends upon the services rendered with respect to the individual shipment. The issue is important because of the differing liabilities and regulatory schemes facing freight forwarders and brokers.

Freight forwarders are typically liable for cargo claims, are required to issue bills of lading, and must file and maintain cargo insurance with the FMCSA. They provide assembly, consolidation, break-bulk, or distribution services and may utilize the services of carriers from several modes of transportation. Brokers, who are also regulated by the FMCSA, are authorized to arrange for transportation of goods by motor carrier only and are typically not liable for cargo claims.

According to a recent California case, even if your company is a licensed freight forwarder, it may avoid cargo claim liability if it holds brokerage authority and only brokers the load in question. On the other hand, to the extent a broker is providing freight forwarder services, cargo claim liability will likely arise.

Norman R. Garvin, Nathaniel G. Saylor, Indianapolis

Cleary Communicate Your Role When Offering Transportation Services

Many transportation providers now offer services in a number of different capacities, including as a motor carrier, property broker, 3PL, freight forwarder or indirect air carrier (IAC). Although multiple types of operating licenses allow companies to offer a full array of services, it is important to fully understand the legal and regulatory distinctions inherent to each type of operation and the liabilities associated with each.

For example, property brokers, 3PLs, and, to a certain extent, IACs – unlike motor carriers — are not normally liable for highway accident or cargo claim liabilities incurred during transportation. However, providers that do not clearly distinguish when they are operating as a motor carrier, rather than as an intermediary, can face unexpected exposure. For that reason, it may be advisable to form separate corporate entities in which to perform each type of transportation service, and, at minimum, it may be prudent to separate a company's brokerage and logistics operations into a company distinct from the motor carrier entity. Even then, however, the provider should clearly distinguish in its contract, shipping documents, and other communications with customers under what circumstances it is acting as a motor carrier rather than as an intermediary and what level of liability, if any, it is assuming for its role in the transportation.

Timothy W. Wiseman, Indianapolis

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Mileposts

3PL Liabilities Addressed Through Contract and Compliance Review

The liabilities assumed by a transportation service provider when it performs a variety of third-party logistics (3PL) services may be reduced through scrutiny of the provider's documentation, transportation agreements, and regulatory compliance. Such review is provided by members of the Scopelitis firm's regulatory, business, and insurance groups.

Norm Garvin, Andy Light, and Tim Wiseman in the Indianapolis office, along with Bill Brejcha in Chicago, regularly review a wide range of agreements, tariffs, and bills of lading. They caution that when a motor carrier is acting as a broker – particularly in the absence of a contract – its underlying documentation should specify the brokerage services provided. Further, Indianapolis partners Greg Feary and Jeff Toole, who provide counsel on the variety of indemnification and other insurance-related issues that arise in 3PL scenarios, remind companies to pay close attention to liability concerns.

An alternative to a single company's providing various 3PL services through a number of different agreements is to provide each type of service through a different entity. Any member of the Firm's restructuring team – Garvin, Light, Feary, Jay Robinson, Todd Metzger, or Greg Ostendorf in Indianapolis and Brejcha in Chicago – can assist company owners whose core services are changing to help them determine whether restructuring is a route they should consider.

On the intermodal front, Dan Barney in the Washington, D.C. office and Chris McNatt in Los Angeles have been collaborating on behalf of indirect air carrier (IAC) clients, advising IACs on compliance with federal air cargo security rules and hazardous materials/dangerous goods regulations. Along with Tim Wiseman, they also represent IACs in civil-penalty enforcement proceedings brought by the federal agencies imposing these requirements. McNatt also has worked with Garvin and Light on behalf of freight forwarders requiring Ocean Transportation Intermediary licenses and those with cases before the Federal Maritime Commission.

For the Record

We are pleased to announce that **James T. Spolyar** and **Braden K. Core** began their practices this Fall as associates in the Indianapolis office.

The Scopelitis firm has been retained by the American Trucking Associations to act as its national legislative counsel, alerting and advising the ATA on independent contractor bills, laws, and other legislative initiatives throughout the country. For more information please contact **Greg Feary** in the Indianapolis office.

For her contributions to the legal community, Indianapolis partner **Carla Hounshel** has been nominated and accepted as a Distinguished Fellow of the Indianapolis Bar Association.

Tim Wiseman has been re-elected as a managing partner and will continue his service with Greg Feary and Lynne Lidke on the Scopelitis firm's management committee.

Congratulations to Indiana native **John Hill** on his appointment as Administrator of the Federal Motor Carrier Safety Administration.

On the Road

Chris McNatt will moderate a freight claims panel at the Transportation Lawyers Association's 2007 Regional Seminar, January 20, in **Chicago**. Norm Garvin, Andy Light, Bill Brejcha, Leonard Kofkin, Don Vogel, Rich Clark and Greg Ostendorf will also attend.

Norm Garvin will participate in the National Tank Truck Carriers' Winter Board Meeting, February 7-9, in **Naples, Florida**.

Mike Langford will attend the Trucking Industry Defense Association's 2007 Mini Seminar, February 8, in **Miami**.

In Honor of Mac McCormick

It is with great sadness that we acknowledge the passing of Indiana native Clarence "Mac" McCormick III, Chairman and CEO of Bestway Express, Inc., and chairman-elect of the American Trucking Associations. His untimely death in late October marks the loss of a loyal friend, dedicated business leader, and beacon of light for the many he touched in his short 55 years. The Scopelitis firm dedicates this *Transportation Brief* to the memory of our good friend Mac.

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Dispatches

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Eric Habig notes that recent appellate court decisions in Illinois and Iowa have refused to give effect to back-solicitation clauses in broker-carrier contracts. These clauses, which prohibit carriers from directly procuring loads from the brokers' customers, may not be enforceable unless they plainly prohibit carrier-customer contact and clearly indicate that the broker considers customer information to be a trade secret.

Chris McNatt recommends that customs brokers remain cognizant of not only customer-required security measures and insurance levels for appointed motor carriers, but also their own insurers' requirements as well. Recent trends have shown an upswing in **insurer audits of customs brokers** concerning the selection of underlying service providers to assure that brokers are utilizing providers that are properly insured.

Norm Garvin reminds motor carriers to recognize the differences between interlining—providing a through service by a combination of two carriers' services—and interchanging—physically transferring the freight-carrying vehicle between the two carriers. While both services should be done pursuant to a written contract, motor carriers should be mindful of the regulations applicable to both interlining and interchanging and be aware that different liabilities are assumed with respect to each.

The Transportation Brief® is intended as a report to our clients and friends on legal developments affecting the transportation industry. The published material does not constitute an exhaustive legal study and should not be regarded or relied upon as individual legal advice or opinion. Scopelitis, Garvin, Light & Hanson would be pleased to provide more specific information or individual advice on matters of interest to our readers.

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PER DIEM ALERT!

IRS Guidance May Jeopardize Per Diem Programs

On November 9, 2006, the IRS released guidance that significantly impacts per diem expense reimbursement programs. In its Revenue Ruling 2006-56, the IRS concluded that a trucking company's per diem program abused the IRS rules for tax-free expense reimbursement because the program failed to account for reimbursements that exceeded the current $52.00 per day federal meals and incidental expense (M&IE) rate. As a result, all of the company's M&IE expense reimbursements – not just the excess of the $52.00 per day rate – were reclassified as wages subject to income and employment tax.

This Revenue Ruling emphasizes the importance of capping per diem reimbursements at the federal M&IE rate because the consequence can result in significant tax liability for motor carriers. The IRS indicates it will not enforce its new ruling prior to January 1, 2007, and so all motor carriers should assure that their per diem programs are compliant for the new year.

Steven A. Pletcher,
Indianapolis, IN

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