

Third Party Contract Issues Concerning Motor Carriers, Brokers, and Shippers

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I. INTRODUCTION

The growth of third party participation in the movement of interstate freight by motor carriers¹ and the diminishing administrative oversight of

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1. The latest government figures indicate that approximately 16,930 active general commodities brokers are registered with the Federal Motor Carriers Safety Administration (FMCSA) as of April 17, 2006. The number of property broker applications has increased by thirty percent since 2003. Approximately 1,040 active general commodities freight forwarders are registered with the FMCSA and applications filed annually have increased by approximately

such movement² has increased the necessity to design contracts that will reflect the role of the various business interests involved. These changes in the industry require a well-founded understanding of liabilities involved in the movement of interstate freight and an awareness of the consequences that might flow from poorly drafted documents.

Significant contract litigation has arisen because parties have not understood or identified the specific roles they are undertaking in a freight movement. This is a particularly serious problem because the rights and liabilities of the multiple parties vary based on their relationship with the immediate contracting party. In most instances, rights and liabilities of parties also depend on the types of parties that will be involved in a three-party freight movement.

One very common issue that arises with regard to third party contracts involves the difference between an express classification of a transportation provider and the provider's actual activities. For instance, a broker is defined as

a person, other than a motor carrier or an employee or agent of a motor carrier, that as a principal or agent sells, offers for sale, negotiates for, or holds itself out by solicitation, advertisement, or otherwise as selling, providing, or arranging for, transportation by motor carrier for compensation.³

However, while holding a license as a broker, the provider might pursue contract or operations practices in a manner that exceeds the definitional scope of a "broker" and thereby effectively engage in the transportation as a motor carrier or shipper. Courts will take cognizance of the formal titles that parties adopt within contracts. However, courts will also look beyond such titles to determine what tasks parties are actually engaged in⁴ or performing⁵ in order to determine whether or not the authority that a party possesses is controlling.⁶

eighty percent since 2003. Registration of Brokers and Freight Forwarders of Non-Household Goods, 71 Fed. Reg. 50,115, 50,116 (Aug. 24, 2006).

2. In *Freight Transport Free-for-all*, William J. Augello addressed the problems arising from "Missing Monitors" and explained that "[e]xcept when it comes to motor carrier safety issues, transportation companies are not monitored," nor are intermediaries and third parties. William J. Augello, *Freight Transport Free-for-all*, INBOUND LOGISTICS, May 2006, at 32, available at <http://www.inboundlogistics.com/articles/fineprint/fineprint0506.shtml>; See also Mark J. Andrews, *The Old ICC Broker Regs, Alive and Well, or at Least Alive*, THE LOGISTIC J., Jan. 2003, at 5.

3. 49 U.S.C. § 13102(2) (2000); 49 C.F.R. § 371.2(d) (2006).

4. See *United States v. California*, 297 U.S. 175, 181-82 (1936); See also *EnSCO, Inc. v. Weicker Transfer & Storage Co.*, 689 F.2d 921, 925-26 (10th Cir. 1982).

5. See *Phoenix Assurance Co. v. K-Mart Corp.*, 977 F. Supp. 319, 326 (D.N.J. 1997).

6. *Id.*; See also *Tokio Marine & Fire Ins. Group v. J.J. Phoenix Express, Ltd.*, 104 F. Supp. 2d 946, 948 (N.D. Ill. 2000).

*Schramm v. Foster*⁷ highlights the contract problems that might arise when third party providers become engaged in activities beyond the scope of their authority.⁸ In *Schramm*, a broker who appeared to be acting as a carrier for the interstate shipment of goods was sued for personal injury damages that occurred during the transportation.⁹ Despite fairly strong evidence by the plaintiff that the broker should be held liable as a shipper, the broker was eventually able to escape liability thanks to an extensive analysis of the services held out and provided.¹⁰ In the opinion of one noted legal commentator, this case provides several lessons that are fundamental to creating valid and enforceable contracts in the realm of third party transportation:

Contracting can make a difference. Courts will refer to the monikers ascribed to the contracting parties in the various contacts involved in a 3PL shipping scenario in an effort to assess liabilities among those parties. Consequently, as often is stated, it is important to memorialize the contractual relationships to properly designated contracting parties.¹¹

II. COMMON CONTRACTUAL ISSUES

Third party surface transportation providers operate in an extremely competitive environment. As a result of time pressures and the need to maintain efficient and flexible operations, parties have tended to neglect several critical considerations that implicate their business and which could be addressed by proper contract drafting. The failure to sufficiently design contracts that contemplate these issues has led to many significant legal problems outlined below.

A. DOUBLE BROKERING

A growing practice in third party transportation operations involves “double brokering.”¹² The legislative and administrative regulations that underlie third party transportation do not contemplate double brokering, and the practice only exists because the Federal Motor Carrier Safety

7. *Schramm v. Foster*, 341 F. Supp. 2d 536, 543-48 (D. Md. 2004).

8. *Id.* at 540-43.

9. *Id.* at 541.

10. *Id.* at 543-44.

11. Eric L. Zalud, *Careening to the Future with 3PLs and 4PLs*, 3 Fed. Carr. Rep. (CCH) No. 1470, at 11 (Sept. 30, 2005).

12. This involves the practice of a broker receiving a shipment from a shipper and subsequently tendering the shipment to another broker for movement by a motor carrier. It is frequently done without the shipper's knowledge or the motor carrier's knowledge. No written or even oral contracts exist between the shipper and the second broker or between the motor carrier ultimately used and the initial broker. *Jets Prolink Cargo, Inc. v. Brenny Transp., Inc.*, No. Civ. 02-1294 ADMRLE, 2003 WL 22047910, 1 n.1 (D. Minn. Aug. 29, 2003).

Administration has mainly focused its attention on “safety-related” matters.¹³ Initially, participants should be aware and concerned over the legality of double brokering. While there do not appear to be any reported administrative or court decisions that deal with this precise issue, double brokering is often considered illegal in light of the wording of federal regulations.¹⁴ A review of the Regulations shows:

- (1) 49 C.F.R. § 371.2(a) defines a broker as “a person who, for compensation, arranges, or offers to arrange, the transportation of property *by an authorized motor carrier*.”¹⁵
- (2) 49 C.F.R. § 311.2(d): “Brokerage or brokerage service” is defined as “the arranging of transportation or the physical movement of a motor vehicle or of property. It can be performed on behalf of a *motor carrier, consignor or consignee*.”¹⁶
- (3) 49 C.F.R. § 371.3 covers the records to be kept by brokers and requires the broker, in part, to keep data of:
 - (a) the originating carrier;
 - (b) bill of lading or freight bill number;
 - (c) the amount of any collected freight charges and the date of payment to the carrier;¹⁷
- (4) 49 C.F.R. § 371.7 provides that a broker shall not:
 - (a) “perform or offer to perform any brokerage service (including advertising) *in any name other than in which its registration is issued*”; and
 - (b) “directly or indirectly, represent its operation to be that of a carrier.”¹⁸

While these regulations are no “clarion” of good draftsmanship, the regulations appear to be clear enough to indicate that a three-part relationship is contemplated with, for instance, a motor carrier, a broker, and a consignor or consignee.¹⁹ The regulations also seem to indicate that the broker must be performing on behalf of a motor carrier or the consignor/consignee.²⁰ When a second broker is involved, is that person or entity providing service on behalf of a motor carrier or the consignor/consignee particularly where the remuneration of the second broker is established and comes from the first broker? It seems that this is not the case. The second broker would appear to be acting on behalf of the first broker and not for an entity named in 49 C.F.R. Section 311.2(d).

In order to understand the double brokering practice, it is also perti-

13. See Augello, *supra* note 2.

14. 49 C.F.R. § 371.7 (2007).

15. *Id.* at § 371.2(a) (emphasis added).

16. *Id.* at § 371.2(c) (emphasis added).

17. *Id.* at § 371.3(a).

18. *Id.* at § 371.7 (emphasis added).

19. *Id.* at § 371.2(c).

20. *Id.*

ment to see that 49 C.F.R. Section 371.2(a) specifies that the third party transportation arrangement must involve transportation by an authorized motor carrier.²¹ Section 371.2 does not mention another broker or freight forwarder or logistics company.²² Because the initial broker has no relationship with the motor carrier providing the service in a double brokering situation, the initial broker has therefore not adequately arranged transportation by an authorized motor carrier in compliance with Section 371.2.

A broker might argue that the phrase “or offer to arrange” in Section 371.2 implicitly permits double brokering. However, the term “offer to arrange” probably more accurately relates to the holding out of the service of being a broker which is regulated under 49 C.F.R. Section 371.7(a).²³ This also seems evident when reviewing 49 C.F.R. Section 371.3 because the information or records that a broker must keep does not include information in broker-to-broker situations.²⁴ In light of 49 C.F.R. Section 371.7, it also appears that actual broker services in a double broker situation are not being done in the name of the initial broker as to the carrier nor in the name of the second broker as far as the shipper is concerned.²⁵

At best, a broker could argue that the second broker was acting as an agent of the first broker. This argument might be difficult to sustain because (a) shippers rarely are aware of, or authorize, double brokering, and (b) motor carriers are usually not aware of double brokering or generally do not consent to one broker acting as an agent under the brokers’ double brokering agreement.

If a broker utilizes the service of a second broker on behalf of the shipper’s movement, the broker would be providing a “non-brokerage service” under 49 C.F.R. Section 371.2(d) and would be considered an agent of the shipper, assuming the shipper was aware that the tendered shipment was to be given to a second broker.

The broker could only accomplish the objective of double brokerage if, in reality, the broker were considered an agent of the shipper and not an independent third party. Most shippers would probably not want to undertake the resulting legal obligations in such a relationship.

Apart from the issue of legality, double brokering raises significant issues concerning the proper payment of freight charges and the distribution of liability in personal injury damage claims. While most sensible motor carriers and brokers do not engage in double brokering and ship-

21. *Id.* at § 371.2(a).

22. *Id.* at § 371.2.

23. *Id.* at § 371.7(a).

24. *Id.* at § 371.3.

25. *Id.* at § 371.7(a).

pers distance themselves when they are aware of it, contract provisions are particularly helpful in thwarting the practice or establishing how it will be conducted.²⁶

A simple alternative to double brokering, which would avoid the problems that double brokering creates, is to utilize a “referral agreement.” Under a referral agreement, federally regulated brokers may enter into a written contract in which the brokers agree to refer motor carriers to other brokers when the broker who has accepted a load from a shipper is unable to engage an available or reliable motor carrier.²⁷ The referring broker will only refer to motor carriers who have been advised of the specifics of the load and payment and which the referring broker has used in the past without problems. However, the receiving broker would have the responsibility to make its own independent investigation of the motor carrier and to actually contract with the referred motor carrier. A reasonable referral fee, payable within a reasonable period to the referring broker, would be paid for a referral that results in the movement of the load.

Other contractual terms in a referral agreement might include non-compete considerations wherein the broker to whom the carrier was referred would agree not to have the referred motor carrier handle brokered loads on an exclusive basis. The contract might also incorporate confidentiality and indemnification clauses that would hold the referring party harmless from all liability that might arise from use of the referred motor carrier.

The referral agreement approach is clearly legal because the broker contracted by the shipper actually performs the service contemplated. The agreement between the brokers merely reflects two parties mutually making a referral for a possible reasonable fee with no liability exposures and with reasonable “competitive” protection. It is difficult to understand why this simple contractual procedure hasn’t been adopted broadly in lieu of double brokering.

26. A typical clause between a broker and a carrier on this subject might read: “CARRIER WILL NOT RE-BROKER, ASSIGN, OR INTERLINE THE SHIPMENTS HEREUNDER WITHOUT PRIOR WRITTEN CONSENT OF BROKER. If CARRIER breaches this provision, BROKER shall have the right of paying the monies it owes CARRIER directly to the delivering carrier, in lieu of payment to CARRIER. Upon BROKER’S payment to delivering carrier, CARRIER shall not be released from any liability to BROKER under this Agreement. CARRIER assumes all risk of loss and shall defend, indemnify, and hold BROKER harmless for any liability arising out of violation of this paragraph including consequential damages, costs, expenses, and reasonable attorney fees.”

27. See generally William Leung, *The Dual Role of the Freight Forwarder: Vastframe Camera Ltd. v. Birkart Globistics Ltd.*, 2005 High Court of Hong Kong 117, Stone J., 5 October 2005, 38 J. MAR. L. & COM. 97, 98 (2007) (discussing the contractual relationship between shippers, carriers, and brokers); *Prolink Cargo, Inc. v. Brenny Transp., Inc.*, 2003 WL 22047910, at *1 (D. Minn.) (discussing the nature and limits of double brokering).

B. SELECTION OF A QUALIFIED CARRIER

Brokers can be held liable for damages that arise from negligence or breach of contract in the selection and enforcement of proper procedures for qualifying carriers before brokers make arrangements for the engagement of the carriers. While recovery for such damages is normally sought under tort claims, contractual terms that set forth exactly what duties a broker will undertake may prevent or ameliorate the risk of liability. Although there are some general negligence principles that apply to the selection of carriers, parties can be subject to varying principles based on a particular state's law.

*Professional Communications, Inc. v. Contractor Freighters, Inc.*²⁸ involves analysis of such varying principles. In *Professional Communications*, a shipper brought suit against the broker, carrier, and warehouse, alleging negligent shipping, storing, and maintaining of a shipment of cell phones that moved from Florida to Maryland.²⁹ One of the issues the court raised was whether Maryland law would apply the doctrines of *lex loci delicti*, which results in the application of the procedural law of the forum state, and the application of the substantive law of the place/state of the wrong.³⁰ While the court felt it was appropriate to apply either Florida or Maryland law in the case, it found that laws in both jurisdictions were essentially in line with general negligence principles covering duty, breach, harm, and proximate cause.³¹ While in this specific case the state's laws did not prejudice the parties, state law could, in a specific factual situation, not only bear on the issue of negligence *per se* but also possibly affect the measure of damages and available legal fees.

In a contract, it would be possible to set forth the specific duties that the broker is required to undertake. For instance, parties might specify that the carrier tendering freight must (a) be a registered carrier with the FMCSA;³² (b) hold insurance consistent with federal requirements or specific requirements made known by shipper;³³ (c) operate suitable equipment; and (d) maintain a "satisfactory" rating from the FMCSA.³⁴ Other clauses in a well-drafted contract could cover "choice of law" issues as well as "alternative dispute resolution" clauses.

28. Prof'l Comm'n, Inc. v. Contract Freighters, Inc., 171 F.Supp.2d 546 (D. Md. 2001).

29. *Id.* at 549.

30. *Id.* at 550. Maryland belongs to the minority of states that continue to apply *lex loci delicti*. *Id.*

31. *Id.* at 552.

32. 49 U.S.C. § 13902 (2000).

33. 49 U.S.C. § 13906 (2000); 49 C.F.R. §§ 387.1-387.17 (2006); 49 C.F.R. §§ 387.301-387.323 (2006).

34. 49 C.F.R. § 385.5 (2006).

C. FREIGHT CLAIMS

A frequently litigated area between shippers and carriers involves liability for cargo loss and damage.³⁵ This area is of significant importance in the use of third party intermediaries. Although the broker status does not contemplate that brokers will not be involved in the issue of freight liability or claims,³⁶ it is not uncommon for broker-shipper contracts to provide that the broker will handle such claims. Significant questions that affect the broker-motor carrier relationships arise when a broker by contract takes on freight claim obligations. Where such a contract is ambiguous with regard to the scope of the liability or does not clearly identify which party handles liability claims, the contract becomes subject to common law interpretations of similar situations where the applicable precedents might vary significantly from one state to the next. It is therefore clear that the assignment of freight claim duties, if engaged in, should be covered by a clear and effective contractual provision in the broker's contract with the shipper and the motor carrier.

D. INSURANCE AND OFFSETTING

Brokers that undertake responsibility for loss and damage claims or the handling of such claims have increasingly engaged in or become subject to the abusive practice of offsetting.³⁷ The practice of a shipper or broker to offset a cargo claim against freight charges has existed for many years but was controlled to a certain extent by early dictates of the Interstate Commerce Commission.³⁸ After the virtual demise of the "filed rate doctrine"³⁹ and because the successors of the ICC took no further action, courts now willingly accept the common law right to offset under

35. See generally TRANSPORTATION LAW INSTITUTE, CARRIER LIABILITY IN AN EVOLVING REGULATORY ENVIRONMENT: CLAIMS AND ANTITRUST (University of Denver College of Law 1980); See also WILLIAM J. AUGELLO & GEORGE CARL PEZOLD, FREIGHT CLAIMS IN PLAIN ENGLISH (Transportation Claims & Prevention Council, Inc., 3d ed. 1995).

36. Apart from the fact that a broker's function by definition "does not involve actual transportation other than by a motor carrier," court decisions have found brokers not liable for loss and damage claims on the basis that the Carmack Amendment, which covers the matter, is inapplicable to brokers. 49 U.S.C. § 13102(2) (2001), 49 C.F.R. § 371.2(a) (2001); See, e.g., Hewlett-Packard Co. v. Brother's Trucking Enter., Inc., 373 F.Supp.2d 1349, 1351-52 (S.D. Fla. 2005).

37. See Henry Seaton, *Don't Accept Freight Charge Setoffs: The Practice is Potentially Lethal for Carriers*, COM. CARRIER J., Jan. 2003, at 16, available at <http://www.etrucker.com/apps/news/article-asp?id=32363>

38. In administrative rulings the I.C.C. held that shippers should pay it freight charges and litigate the cargo claim separately. A Silent But Deadly Omission, COM. CARRIER J., Dec. 2006, <http://www.etrucker.com/apps/news/article.asp?id=56799>.

39. The "filed rate doctrine" provided that motor carriers were entitled to receive their freight charges as set forth in their lawful tariffs under almost any situation. See, e.g., Maislin Indus. v. Primary Steel, 497 U.S. 116 (1990); James C. Hardman, *Motor Common Carriage and the Filed Rate Doctrine*, 57 TRANSP. PRAC. J. 404 (1990).

state law or to offset by a contract term allowing it.⁴⁰ There are numerous problems with offsetting in the context of third party surface transportation, including the following:

- (1) Shippers and brokers act as judge and jury to decide the propriety and amount of the setoff;
- (2) Brokers who look to shippers for business use unreasonable, if not unconscionable, setoff provisions for the shippers' benefit without regard to the carrier's interests;⁴¹
- (3) Brokers offset the value of the cargo claim of one shipper against freight charges due from other shippers;⁴²
- (4) If the broker is not liable for freight claims, legal questions arise as to the broker's authority to act on the claim and as to the extent of that authority to compromise and settle;
- (5) Most carriers' insurance will frequently not honor a claim if the insurer is not involved in the mitigation and settlement process and in most instances will not approve a settlement until a reasonable investigation is made and until damages are confirmed.⁴³

The consequence of these problems is that carriers, in particular small carriers, will suffer cash flow issues and may even go out of business because the only recourse against discriminatory offsetting is to engage in costly and lengthy suits in court for outstanding freight charges.⁴⁴

In defense of offsetting practices, shippers and brokers often argue that carriers do not take loss and damage claims seriously and delay investigations and settlement as long as possible or ultimately go out of business before a claim is paid. These are non-meritorious claims because (a) motor carriers are obligated to carry cargo insurance⁴⁵ and thus the insurer is obligated for the cargo claim irrespective of whether the carrier personally defaults, and (b) if the shipper or broker legitimately feels that the carrier is abusing the investigation process, there is nothing to preclude the shipper or broker from filing a lawsuit immediately upon the damage or loss. Further, declination of claim is not a prerequisite to a lawsuit.

Brokers will often purchase their own cargo insurance, commonly referred to as "Contingent Cargo Liability Insurance," whereby the broker's insurer has an opportunity to adjust and defend any claim against

40. 49 C.F.R. § 371.7(a) (2007).

41. Seaton, *supra* note 37, at 16.

42. *Id.*

43. *Id.*

44. Henry Seaton, a strong advocate of contracting against setoffs, explains that many small carriers also have factoring agreements which require motor carriers to warrant that each freight invoice is due, owing, and not subject to setoff, defense, or adjustment. Any setoff of a large cargo claim can place the carrier in default of the factoring agreement and reach in the seizure of all of its accounts receivable and other collateral. Seaton, *supra* note 37, at 9.

45. 49 C.F.R. § 387.301 (2007).

the broker.⁴⁶ In such instances, coverage is provided if the motor carrier fails to pay a claim for which the carrier is liable and the shipper looks to the broker for payment of the claims.⁴⁷

William Augello notes that in some instances contingent insurers have disavowed liability on the grounds that a broker did not have an insurable interest.⁴⁸

To avoid this result, Mr. Augello suggests that the shipper and broker should enter into a contract whereby the broker assumes liability for transit losses that would create such an interest.⁴⁹ While this solution may resolve the problem that Mr. Augello addresses⁵⁰ the broader issue is whether encouraging shippers to look to the broker for settlement of cargo claims will erode the shipper's historic strong claim status against carriers. Furthermore, why would anyone, except possibly some shippers who merely want as much insurance coverage as possible, require a freight broker to assume the liabilities of a motor carrier? After all, a competent broker will investigate and know the carriers with whom he is doing business and will have a contract with such carriers that spells out liability terms for loads that the carriers are handling for a mutual customer.

By law, motor carriers are liable for the care and custody of freight entrusted to them and therefore should be first in the line of recovery.⁵¹ Cargo insurance, primary or contingent, must be evaluated by brokers based on a logical and educated evaluation of the risk involved and based on the insurance product itself - a task which may be eased by consultation with insurance counsel, consultants, and insurance brokers or agents.

46. 49 C.F.R. § 387.311 (2007).

47. Seaton, *supra* note 37, at 9.

48. WILLIAM J. AUGELLO, *LOGISTICS AND THE LAW* (Transportation Claims & Prevention Council, Inc., 2001).

49. *Id.*

50. The contractual liability assumed might create primary liability in the broker for goods in transit. The Transportation Consumer Protection Council in 1999 offered a primary cargo-insurance policy developed by a company called BROKER FIRST, which permitted brokers to assume the liability which Mr. Augello proposes, e.g., legal liability for loss and damage by contractual arrangements with shippers. William J. Augello, *A Break-Through for Truck Brokers in LOGISTICS MANAGEMENT & DISTRIBUTION REPORT*, 35 (October 1999). The value of such proposal was contested by various members of the transportation community and it does not appear to be a product on the market at this time. See William J. Tucker, *The 'Downside' of Making Brokers Liable*, *TRAFFIC WORLD*, November 1, 1999, at 6, available at http://www.tuckerco.com/articles_letters/articles/twarticle.shtml.

51. However, freight forwarders, who have Carmack liability, are required to have cargo insurance including an FF Endorsement Form. 49 C.F.R. § 387.403 (2007). To the extent the loss or damage was caused by a motor carrier with whom the freight forwarder contracted, the freight forwarder would have a right of indemnification and/or contribution. 49 U.S.C. § 14706(a) (2005). See, e.g., *Season-All Indus, Inc. v. Merch. Shippers*, 417 F. Supp. 998 (W.D. Penn. 1976).

III. BROKERAGE OPERATIONS AND MODEL CONTRACTS

A. OPERATIONAL CONSIDERATIONS

In the *Schramm* case, the broker had contracts with more than 20,000 licensed motor carriers.⁵² Even smaller brokers than the broker involved in *Schramm* may have hundreds, if not thousands, of such contracts because the nature of the brokerage business is to have a “stable” of potential motor carriers available when shippers call for brokerage service.

Many shippers will attempt to deal directly with the motor carrier initially and will only resort to brokerage services when they are unable to find a willing motor carrier. Thus, movements tendered to the brokers are frequently made at the last moment possible to meet delivery times or are not the most attractive loads in terms of rates and requirements, necessitating the use of a broker to find a motor carrier who is essentially desperate for a shipment. A broker who accepts an assignment to arrange for motor carriage must feel confident that the load can be brokered at a price that guarantees a profit. This pressure also accounts, in part, for double brokering because the initial broker does not want the shipper to know of his inability to sate the tender if such occurs. Some of the larger motor carriers attempt to avoid brokered loads because such loads are usually lower rated and fear exists about the financial stability and/or honesty of the broker to pay the freight charges agreed upon.⁵³ Smaller carriers and “one-operator” shops are much more prevalent participants in third party movements.⁵⁴

These variations in services also result in a proliferation of different types of contracts between the motor carrier and a broker. For instance, in a casual relationship that is initiated for one shipment with a new motor carrier for an immediate or short-notice movement, a detailed, custom contract is simply not feasible from a business standpoint. If a continuing relationship exists between the broker and motor carrier, a detailed contract is feasible and advisable.⁵⁵ Similarly, in shipper-broker contracts, when a shipper has a “stable” of brokers it uses, a separately negotiated and written contract is not always available before a load is tendered. If a continuing relationship exists, however, a detailed negoti-

52. *Schramm v. Foster*, 341 F. Supp 2d 536, 541 (D. Md. 2004)

53. See, e.g., Marc Meskin, *The Broker's Role*, TRANSP. TOPICS, Feb. 26, 2007, at p. 9, available at <http://www.ttnews.com/members/topnews/0017088.html>.

54. Smaller carriers are more dependent upon “brokered” loads because they do not have a sales force or a sales force of significant depth to solicit shippers for the direct tender of sufficient freight.

55. The difference was recognized by the American Trucking Associations, hereafter ATA, in their model contracts for the carrier-broker relationship two distinct contracts were drafted and adopted.

ated or standard contract should be created to guide the parties' cooperation.

Shipper-broker and broker-carrier contracts are overwhelmingly adhesion contracts that vary only with regard to rate information and specifics of the shipment involved.⁵⁶ The fact that many brokers and carriers who engage in hauling brokered loads are frequently small sole proprietors who have little business training makes contractual engagement, especially when adhesion contracts are involved, a rocky road. As William Augello, Esq., a highly knowledgeable observer, indicates,⁵⁷ “[u]nfortunately, experience has demonstrated that many brokers do not thoroughly read these [costly contractual liability terms] and conditions, and even when they do, [they] do not comprehend their legal significance.”⁵⁸ Unfortunately, the same can be said for many motor carriers when a broker presents a contract.

B. ADVENT OF MODEL CONTRACTS

The circumstances and problems inherent in third party operations have exposed the need for model contracts. In response, shippers, motor carriers, brokers, and even railroad associations have begun to develop and implement such agreements. Currently, there exist at least three model contracts involving third party operations: (1) The “Shipper/Broker Transportation Agreement”⁵⁹ developed by the National Industrial Transportation League (NITL) and the Transportation Intermediaries Association (TIA); (2) The “Broker/Carrier Agreement” developed by the TIA;⁶⁰ and (3) the American Trucking Association’s (ATA) Carrier/Broker Agreements.⁶¹ A model contract is a sage objective. Such a contract potentially not only decreases the time and cost of negotiating multiple and individual contracts simply because of an individual drafter’s

56. See William J. Augello, *Brokers and the Law*, THE LOGISTICS J. 1 (January 2003).

57. *Id.*

58. *Id.*

59. NAT'L INDUS. TRANSP. LEAGUE (NITL) & TRANSP. INTERMEDIARIES ASS'N (TIA), BROKER/SHIPPER TRANSPORTATION AGREEMENT (2004), available at <http://www.nitl.org/ModelBrokerContractFinalv1.pdf>.

60. Press Release, Am. Trucking Ass'n, Motor Carriers Concerned about Model Broker/Shipper Contract (2004), available at <http://www.truckline.com/NR/exeres/DF485755-6176-4802-BE16-698F613F2434.htm>.

61. Press Release, Am. Trucking Ass'n, ATA Unveils Motor Carrier/Broker Agreements (Aug. 15, 2006), available at <http://www.truckline.com/NR/exeres/7F828CD6-2E33-46A0-9886-4F524E80E653.htm>. The ATA and the NITL also promulgated a model carrier/shipper contract. AM. TRUCKING ASS'N & NAT. INDUS. TRANSP. LEAGUE, MODEL TRUCKLOAD MOTOR CARRIER/SHIPPER AGREEMENT WITH COMMENTARIES, 2004, available at <http://www.nitl.org/ModelMotorCarrierShipperwithGeneralInstructions.pdf>. The NITL and the Intermodal Association of North America are collaborating to develop a shipper/broker intermodal transportation agreement, but it has not been adopted yet.

writing style, but also reflects the assessment by a learned group of drafters and diverse interested parties that the provisions are written clearly in covering the essentials of the subject matter. A model contract is not necessarily a complete and inflexible document that precludes modifications, additions, or deletions, but it also minimizes the need for such actions. Moreover, a model contract exposes, if not eliminates, contracts that are essentially negotiated by mere economic strength underlined by possible greed or ignorance of the need to mutually share in the benefits of a business relationship.

William Augello, despite his recognition that a significant problem exists in the current contract practices with regard to the inability of participants to understand the significance of contract terms,⁶² strangely rejects the “model contract” approach and feels that individually negotiated contracts are ordinarily always necessary.⁶³ While his views are hardly defensible in light of the current “mess” that exists in the industry, participants in the industry have not yet shown enthusiasm for the model contracts that have been promulgated.⁶⁴

It is felt that some of the problems of acceptance were a result of the fact that the various association sponsors have not publicized and explained the benefits of their products sufficiently. Since the initial press releases of the introduction of the various model contracts, there have not been any notable educational endeavors to discuss the advantages of the contracts or to explain how to implement the documents. Nor has there been any publicity of successful acceptance and implementation of the models by signatories.

The fact that the various models differ in critically substantive areas and have resulted in open public criticism may also have hindered their use. For example, after review of the NITL-TIA Model Shipper/Broker Agreement, the ATA advised its members and motor carriers to be leery of the agreement on the basis that the contract required the broker to agree that any motor carrier to be utilized would have to sign a bilateral contract which had unreasonable requirements.⁶⁵

The NITL-TIA Model Shipper/Broker Agreement has a specific clause dictating what provisions are to be included in contracts with motor carriers. Among the provisions are the following:⁶⁶

- A. Carrier shall agree to defend, indemnify, and hold BROKER and SHIPPER harmless from all damages, claims or losses arising out of its per-

62. William J. Augello, *'Model Contracts' Not the Right Model*, *The Fine Print*, INBOUND LOGISTICS, Sept. 2005, <http://www.inboundlogistics.com/articles/fineprint/fineprint0905.shtml>.

63. *Id.* at 52.

64. See, e.g., Bill Carey, *Whose Model Kit?*, *TRAFFIC WORLD*, Sept. 4, 2006, at 22.

65. *Id.*

66. NITL, *supra* note 59, at § 4(A), (B), (E).

formance of the Agreement, including cargo loss and damage, theft, delay, damage to property, and personal injury or death.

- B. Carrier shall agree that its liability for cargo loss and damage shall be no less than that of a Common Carrier as provided for in 49 USC 14706 (the Carmack Amendment). Exclusions in Carrier's insurance coverage shall not exonerate Carrier from this liability.

* * *

- E. Carrier shall authorize BROKER to invoice SHIPPER for services provided by the Carrier. Carrier shall further agree that BROKER is the sole party responsible for payment of its invoices and that under no circumstances will Carrier seek payment from the shipper, consignee, or BROKER's customer.

It is clear that the ATA had cause to take issue with this model contract. Each of the cited provisions if in fact attempted to be imposed on a motor carrier would be completely offensive to the interests of the motor carrier. The broad indemnity clause could very well be illegal in some states because it includes indemnification against the parties' own negligence.⁶⁷ Significantly, the indemnity clause in the ATA-NITL model contract between shippers and carriers provides that "[n]either party shall be liable to the other party for any claims, actions, or damages due to the negligence of the other party."⁶⁸ This raises the question why the NITL would endorse a different indemnification clause in the NITL-TIA Shipper/Broker Agreement.

Stipulating that only brokers must pay carriers,⁶⁹ thereby relieving the shipper and others, also appears to be an unworkable requirement considering the history of brokers who were often financially unable to make such payments or who fled with such funds. The broker's bond, an alternative to requiring outright payment by the broker, does not offer a feasible remedy to carriers because such a bond is limited to a certain dollar amount⁷⁰ and brings with it several related collection problems.⁷¹

Interestingly, when the TIA Model Broker/Carrier Agreement was issued, it did not fully comply with the dictates of the TIA-NITL Shipper/Broker Agreement. For instance, unlike the requirements under the Shipper/Broker Agreement, the Broker/Carrier Agreement's indemnification provisions in Clause 1(H)(i) state that:

BROKER AND CARRIER shall defend, indemnify and hold harmless

67. See, e.g., N.C. GEN. STAT. § 62-212 (2006); S.C. CODE ANN. § 58-23-110 (2006).

68. TRANSP. INTERMEDIARIES ASS'N (TIA), BROKER - CARRIER AGREEMENT, Version 1.1, § 1(H)(i) (2006).

69. NITL, *supra* note 59, at 4(E).

70. 49 C.F.R. § 387.307(a) (2007).

71. While courts have allowed carriers to file suit directly against surety insurers, the insurers have advised some carriers that if the insured raises the question about an offset, payment will not be made, and also that insurers will not pay unless or until a court judgment is secured.

from any claims, actions, or damages, arising out of their respective performance under this Agreement. Neither Party shall be liable to the other for any claims, actions, or damages due the negligence of the other Party.⁷²

Thus, for some reason, the Broker/Carrier contract does not automatically indemnify the shipper. The two model contracts also differ with respect to the carrier's rights to demand payment from the other contract partners. Contrary to Clause 4.E of the Shipper/Broker agreement,⁷³ the TIA Model Broker/Carrier contract gives a carrier a limited right to seek payment from the shipper or other party responsible unless the shipper has paid the charges to the broker.⁷⁴

A fair evaluation of the NITL-TIA Shipper/Broker Contract would lead one to conclude that the drafters did not really realize that a three-party relationship is involved in these transportation agreements, and that any contract must reflect the needs and interests of all three parties to be effective. The attempt of NITL and TIA to dictate the terms that must be included in the third party agreements has hindered the success of the proposed model contracts and has invariably led to criticism by the ATA and others.⁷⁵

Unlike the NITL and the TIA, the ATA did not draft a shipper/broker contract. Instead, the ATA concentrated on drafting a broker/carrier contract at the same time as TIA efforts were under way to draft a similar model agreement. While the parties attempted to coordinate their efforts, the fact that the TIA-NITL Shipper/Broker Contract was already published and the fact that it contained the offensive provisions discussed above acted as a barrier to achieving a coordinated effort. Both contracts were completed at approximately the same time and are substantively similar. After the release of the two documents, however, it became apparent that the most critical differences involved one issue that many motor carriers were most concerned about⁷⁶ and that involves recourse to the shipper for freight charges if the broker fails to collect and remit

72. TIA, *supra* note 68, at 1(H)(i).

73. NITL, *supra* note 59, at 4(E).

74. TIA, *supra* note 68, at D(i). Significantly, the first sentence in the clause reads: "The Parties agree that BROKER is the *sole party* responsible for payment of CARRIER's charges." *Id.* (emphasis added). It would appear that the end result is that the carrier is expected to be a "bill collector" if the shipper does not pay. *See id.*

75. Robert Digges, Jr., Esq., Assistant General Counsel, in addition to denigrating specific provisions of the TIA-Broker-Carrier Contract, argued that it, in general, is "especially slanted" in favor of brokers and shippers. Todd Spencer of the 141,000 member Owner-Operator Independent Driver Association shared the view that the TIA Contract was biased and "totally self-serving and unfairly disadvantageous to the trucker, the carrier, in that relationship." *See Carey, supra* note 64.

76. *See* Henry Seaton, *TIA Model Contract Not Pretty – Don't Sign Away Recourse For Freight Charges*, COM. CARRIER J., Aug. 2006, at 44. An ATA representative indicated that "shipper recourse" became the major issue" between TIA and ATA and ultimately led to the

freight charges. The major historical complaints that motor carriers had regarding “brokers” were that motor carriers failed to receive freight charges and the brokers just disappeared owing them money.⁷⁷ Many observers thought a model contract would resolve this issue while making “contracting” more efficient.⁷⁸

C. SHIPPER RECOURSE

As previously noted, under the TIA’s model contract the carrier must give the broker “X” days notice before the carrier contacts the shipper to demand freight charges,⁷⁹ and the contract relieves the shipper of liability if the shipper satisfies the charges.⁸⁰ The ATA’s Model Contract is strangely silent on the subject presumably because the subject was proverbially such a “hot potato” that its resolution should be left to the contracting parties.

In the past, and perhaps still today, the vast majority of broker-carrier contracts provided that the motor carrier would only look to the broker for its freight charges - a provision arising because shippers required a complementary provision from brokers in shipper-broker contracts that there would be no recourse for carriers seeking payment directly. While many courts have precluded motor carriers from recovering freight charges from shippers when such clauses exist, the cases virtually all involve a factual situation where the shipper has already paid the freight charges to a broker. The courts, on an equity basis, will not allow the shipper to be “double-dipped.”⁸¹

However, some courts have held that a shipper was liable to a motor carrier even though payment was made to a third party. In *National Shipping Co. of Saudi Arabia v. Omni Lines*,⁸² for instance, the court noted that intermediaries have few assets and that carriers have a contractual right to expect payment from the shipper under a bill of lading.⁸³ The court stated:

Carriers must expect payment will come to the shipper, although it may pass

two organizations’ attempt to issue a joint model contract failing. See Carey, *supra* note 64, at 22-23.

77. S. Kinsler, *Motor Freight Brokers: A Tale of Federal Regulatory Pandemonium*, 14 Nw. J. INT’L L. & BUS. 289, 290-291 (1994).

78. See Henry Seaton, *Who pays the freight?*, COM. CARRIER J. 30 (2007); Henry Seaton, *Don’t Bank on Brokers: Protect Your Right to Seek Payment from Shippers*, COM. CARRIER J. 21 (2002).

79. TIA, *supra* note 68, at 2.D(i).

80. *Id.*

81. See, e.g., *Hampton v. Paramount Pictures Corp.*, 279 F.2d 100, 104-05 (9th Cir. 1960).

82. *Nat’l Shipping Co. of Saudi Arabiav. Omni Lines, Inc.*, 106 F.3d 1544, 1544 (11th Cir. 1997).

83. See *id.* at 1547.

through the [intermediary's] hands. While the carrier may extend credit to the [intermediary], there is no economical and rational motive for the carrier to release the shipper. The more parties that are liable, the greater assurance the carrier will be paid.⁸⁴

Pressure on the shipper to be ultimately responsible for freight charges appears to be a logical position for the following reasons:

- (a) It should force shippers to be more concerned about the brokers it selects and conducts business with. Brokers are expected to select responsible and responsive motor carriers. The shipper could bear the same or similar responsibility in choosing "brokers" and be responsible for freight charges or face negligent entrustment charges; and
- (b) It would encourage shippers (i) to monitor payments through the broker to shippers; (ii) to consider third party payment programs where banks and third parties would distribute payments; or (iii) to have direct billing of freight charges to the shipper.

Shippers are not generally opposed to (b)(i) or (b)(iii), but are concerned about the potential of (b)(ii) although such programs were used extensively in carrier freight payments in the past. Steps that a carrier might take to provide that a broker or freight forwarder is considered an agent of its shipper/customers and that freight charges will be paid include the following:

- (1) Provide in contract that broker comply with federal regulations requiring segregation of funds;
- (2) Contract to make broker guarantor of payment in case shipper does not pay;
- (3) Have carrier's name appear on the bill of lading and not broker's name as the carrier of record;
- (4) Do not accept "non-recourse" shipments;
- (5) Prepare a rules circular indicating that recourse under the bill of lading is reserved and reference the circular in all contracts;
- (6) Send all invoices to the party liable for freight charges in care of the intermediary;
- (7) Request an accounting of the broker if timely payments are not being made and, if a timely response is not received, put shipper on notice that you are preserving recourse to the shipper.⁸⁵

Another protective device that may apply in a particular factual situation involves the "constructive trust" theory. In effect, this theory holds that the monies an intermediary receives from a shipper to pay freight charges are really the funds of the shipper and belong to the carrier providing the service, thus giving the carrier the rights of a secured creditor

84. *Id.*

85. Henry Seaton, *Don't Bank on Brokers: Protect Your Right to Seek Payment from Shippers*, *supra* note 78.

in a bankruptcy proceeding.⁸⁶ This theory has also been used to a broker's advantage in *New Prime v. Professional Logistics Management*⁸⁷ where a broker was held not to be obligated to pay a carrier unless the broker received funds from the shipper.⁸⁸ Overall, case law is diverse and unreliable in determining the rights and liabilities of the parties in respect to freight charges and clearly and empathetically indicates that the parties should, by contract, attempt to clarify how freight charges should be applied.⁸⁹

During the negotiations of the respective model contracts, a suggestion was made to the ATA, the TIA, and the NITL to resolve this issue with a "differential payment schedule." Under this payment schedule, the broker and carrier could agree on one payment period and the shipper and broker could agree on another, perhaps more convenient, payment period. The periods, however, would be fixed so that the motor carrier would always be assured that a reasonable period was available upon default to notify the shipper before the shipper was obligated to pay the broker.⁹⁰ The difference in the payment period would be a reasonable period, whether it might be ten days or less.⁹¹

According to the proposal, shippers would never be forced to pay the broker at a sooner time. The broker also would never be forced to pay the motor carrier sooner than agreed upon. As a result, the shipper would not pay the broker unless it had evidence that the motor carrier was paid by the broker and would receive immunity for payment of freight charges to the broker until the motor carrier was paid. Immunity only applies if the shipper waits until the fixed contract payment period term passes and as long as the shipper does not receive written notice from the motor carrier that the broker defaulted. The broker is not precluded from paying the motor carrier earlier but must do so at least by the time agreed to with the carrier. If a default occurs, the carrier may

86. *Parker Motor Freight, Inc. v. Fifth Third Bank*, 116 F.3d 1137, 1140 (6th Cir. 1997) (while *Parker* did not decide whether the "trust fund" theory extended to broker and logistics company, one commentator indicates "applying the Court's reasoning, an argument can be made that trust fund remedy is equally applicable to third party brokers and logistics companies as well."); See also *Transp. Revenue Mgmt. v. Freight Peddlers, Inc.*, 2000 WL 33399885 (D.S.C.), Fed. Carr. Cas. ¶ 84, 141 (D. S.C. 2000). Paul D. Keenan, *Motor Carriers' Use of the Railroad Trust Fund Doctrine to Collect Freight Charges*, 6 THE TRANSP. LAWYER 3, 31 (1997).

87. *New Prime, Inc. v. Prof'l Logistics Mgmt. Co.*, 28 S.W.3d 898, (Mo. App. 2000).

88. *Id.* at 904.

89. See, e.g., *Delta Pride Catfish, Inc. v. Marine Midland Bus. Loans, Inc.*, 767 F.Supp. 951, 960-64 (E.D.Ark. 1991); *In re Penn Cent. Transp. Co.*, 486 F.2d 519, 523-27 (3rd Cir. 1973); *In re Columbia Gas Sys. Inc.*, 997 F.2d 1039, 1056 (3rd Cir. 1993); *In re Iowa R.R. Co. v. Moritz*, 840 F.2d 535, 545 (7th Cir. 1988); *Parker*, 116 F.3d at 1142; *Transp. Revenue Mgmt.*, 2000 WL 33399885.

90. *Id.*

91. *Id.*

timely notify the shipper of the broker's default before the shipper's contractual payment period is reached and payment, in fact, is made to the broker. If the broker, in fact, pays the motor carrier earlier than the shipper's contract payment date and the broker and carrier give notice, adequate to the shipper, of satisfactory payment, the shipper could, at that point, make earlier payment to the broker, but would not be obligated to do so. The payment period in the shipper-broker contract would be the contractual payment date. Contract language suggested by the proposal was as follows:

(a) *Motor Carrier-Broker Contract:*

Broker shall pay Motor Carrier's freight charges within __ days after delivery and submittal of the necessary documents to bill Shipper. Broker warrants that the payment period is not less than __ days before Shipper is obligated to pay Broker. Motor Carrier shall not directly bill or seek payment from Shipper unless Broker defaults in remittance and written notice is given by the Motor Carrier to broker and a designated employee of the Shipper prior to Shipper's payment to Broker. Motor Carrier and Broker may agree in a joint written remittance advice to the Shipper after such default notice that payment has been made by the broker, but, in the absence of such agreement, the Shipper may reasonably hold the amount otherwise due in a trust account until a court or arbitration order directs such payment with reasonable interest.

(b) *Broker-Shipper Contract:*

Shipper shall pay Broker's freight charges in not less than __ days unless it receives written notice prior to such payment that the motor carrier utilized to transport Shipper's freight has not been paid freight charges by the Broker. If such notice is received, Shipper may withhold payment related to said shipment until Broker and Motor Carrier jointly, in writing, give advice to Shipper that the freight charge payment may be released to Broker or the Carrier or, in the absence of such mutual advice, until a court or an arbitration order directs such payment.

A highly-respected shipper representative indicated that the proposal had merit. A highly-respected broker, however, rejected the possible remedy essentially because it would affect the broker's working capital requirement. In any respect, however, the proposal, to date, has not been adopted.

While the working capital issue is a valid concern, it is based on the supposition that most brokers either need the shipper's payment before the broker can afford to pay the carrier or chooses to do so, and that a motor carrier should recognize and accept this "need-choice" at the risk of losing freight charge payment. The differential date interval as noted previously could be ten days or less and any adequately capitalized business should be able to carry a reasonable working capital burden. An individual or entity that could not carry such a burden would reflect the

current severity of risk which motor carriers are attempting to minimize. Further, the TIA's treatment of broker payments, in one commentator's view, should be as troubling to small brokers as it is to carriers.⁹² The TIA contract turns the broker from an agent of the principal to transmit shipper's payments into a principal who is solely responsible for the carrier even upon default of the shipper.⁹³

Until the three relevant parties, shippers, brokers, and carriers, recognize that their interests are intertwined and that the advantages of a single model agreement in terms of time, costs, and compliance outweigh the benefits of existing model contracts, the work already expended will be for naught.

IV. CONCLUSIONS

The problems that exist in third party operations must and should be resolved by reinstatement of reasonable and effective federal governmental oversight complemented by similar oversight of participants individually or through their trade associations. The attempt to draft model contracts that would be acceptable to all parties involved in third party surface transportation movement was a significant step in the right direction and should not be abandoned. The respective groups that drafted these model contracts should learn from their attempts and seek to remedy the continuing problems that have arisen from initial use and review.⁹⁴ If this is not done, "contracting" will continue to be unnecessarily expensive and time consuming. Until adequate model contracts are implemented, success in business deals will continue to be measured by the relative economic strength of the respective parties. Until suitable model contracts are drafted and accepted in the wonderful world of logistics, it would behoove contract participants to appreciate the importance of written contracts in their operations and to negotiate and implement reasonable and clear terms.

92. See Henry Seaton, *TIA Model Contract Not Pretty*, COMM. CARRIER J., August 2006, at 44.

93. *Id.*

94. Kenneth E. Siegel and Ronald H. Usem, Remarks at the TLA Regional Seminar, Model Broker-Carrier Contracts: The Best Thing Since Sliced Bread or the End of Western Civilization as We Know It (Jan. 19, 2007) (Messer's Siegal and Usem felt that the parties would be successful in achieving true model contracts based on the analysis and comments received from interested parties who have been afforded the opportunity to review the various documents).