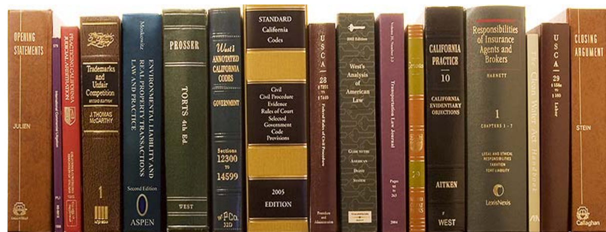

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LAWYERS

TRANSPORTATION LAW UPDATE

NEWSLETTER

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SURVIVING A CUSTOMER'S BANKRUPTCY

Like most businesses, motor carriers regularly extend credit to their customers, typically for 7 to 30 days. This extension of credit creates a risk of loss as bankruptcy filings have become more commonplace. In fact, broker bankruptcies have skyrocketed in 2008 and early 2009, and are expected to continue throughout the year. While you cannot prevent customers from filing for bankruptcy petitions, the following protections can be implemented to limit, or possibly eliminate, losses upon such filings.

Prior to a Bankruptcy Filing:

1. *Keep receivables current*: You can limit the extent of your loss by keeping your receivables current. By contract and/or rules tariff, insist that interest be paid on delinquent accounts and/or provide discounts for early payment. These tools can increase your chances of being paid on time, and in the ordinary course of business. As discussed below, having customers pay you in their ordinary course of business can protect against payments being claimed as preferences in a bankruptcy.

2. *Keep multiple payers responsible*: Motor carriers generally have recourse against multiple entities, including the customer with whom it dealt, and also the consignor and the consignee under the bill of lading. Thus, if a customer files for bankruptcy, a motor carrier can pursue payment from another source. Many brokers require a waiver of this right, as do some shippers. However, you should be aware that surrender of these collection rights can leave you with only a single source of collection.

THE CONVERGENCE OF LOAD SECUREMENT AND LIABILITY FOR CARGO DAMAGE

Cargo securment is regulated primarily by 49 C.F.R. § 392.9 which provides, among other tings, that a driver may not operate a commercial motor vehicle and a motor carrier may not require or permit a driver to operate a commercial motor vehicle, unless the cargo is properly distributed and adequately secured. The Carmack Amendment to the Interstate Commerce Act, 49 U.S.C. § 14706, sets forth a shipper's sole recourse against a motor carrier for loss or damage to goods transported in interstate commerce under a bill of lading. A shipper makes its case under the Carmack Amendment by establishing delivery of the cargo to the motor carrier in good condition, arrival in damaged condition, and damages. The burden then shifts to the motor carrier to establish that it was free of negligence and to establish the that the damage was caused by any of the following: act of God, act of public enemy, act of the shipper, act of a public authority, or the inherent vice or nature of the goods.

CARRIER LOADS AND SECURES THE CARGO

Where the carrier loads and secures the cargo, 49 C.F.R. § 392.9 can serve as a valuable tool on the side of the shipper in deflecting a carrier's contention that it was free from negligence; similarly, if the carrier can establish compliance, it may have the beginnings of a complete defense. It is imperative, therefore, that carriers maintain and follow procedures for the safe loading and securement of cargo, have appropriate securement devices available in each trailer, and properly train drivers and others on the loading procedures.

Unfortunately, proper loading alone is not enough for a carrier to avoid liability for damage to cargo. It is only a first step, as a carrier must also prove that the damage was caused by an act of god, act of public enemy, act of the shipper, the public authority, or the inherent vice or nature of the goods.

SURVIVING A CUSTOMER'S BANKRUPTCY

3. *Extend liens for payment*: As a motor carrier, you have a statutory lien for payment of freight charges for shipments in your possession that can be exercised upon customer default. You can enlarge the force and effect of such liens contractually by having the customer agree ahead of time that the lien would cover any goods in the carrier's possession for payment of past due as well as present freight charges.

4. *Avoid the right to setoff*: When freight is damaged or destroyed, many shippers withhold payment of invoices unrelated to the damaged shipment as a setoff to the claim for damages. To prevent this delay in payment, and the resulting increase in risk, you should provide by contract and/or rules tariff that freight charges are to be paid without offset, that freight claims will be considered only after full payment of freight charges, and that freight claims will be adjusted separately with the participation of your insurer.

Upon the Filing of Bankruptcy by a Customer:

1. Stop all shipments in transit and arrange for the return of the freight to your warehouse. Prepare a notice of lien on such shipments.
2. Stop all efforts to collect the past due account as against the customer who filed for bankruptcy protection. The bankruptcy filing creates an automatic stay that bars you from further action to collect as against that entity. You may, however, collect the debt against other responsible parties under the bill of lading. Under certain circumstances, you may also file a request for relief of the automatic stay.

3. Gather copies of all open invoices and the corresponding proofs of delivery as of the filing date, along with copies of the entire account statement. These will be needed to prove your claim for payment.

4. File a Proof of Claim before the bar date. Under a chapter 11 bankruptcy (a business reorganization), creditors are not required to file a Proof of Claim if the debt is listed correctly in the schedule of liabilities prepared by the debtor or trustee, and if the debt is not listed as "disputed," "contingent" or "unliquidated." However, it is recommend that unsecured creditors always file a Proof of Claim, just to be on the safe side and to ensure that the claim is properly stated.

5. Review payments received from the bankrupt debtor within 90 days preceding the bankruptcy filing date. These may be subject to a preference claim.

Handling a Claim for Preference:

A preference or preferential transfer under Section 547(b) of the federal bankruptcy code is a payment (or transfer of an interest in property) received by a creditor within a defined period prior to the payer (debtor) filing bankruptcy. The purpose of the law is to discourage disparate treatment between creditors. The law allows for the recovery of certain payments so that they can be re-allocated among the creditors pursuant to the bankruptcy rules.

Preferential transfers or payments are recovered by bankruptcy trustees. However, you should be aware that not all payments made just prior to bankruptcy are preferences, and there are several defenses that can save you at least some portion of those payments. The analysis of whether a particular payment is properly considered a preference is complex and fact specific, and thus cannot be fully explained here. However, it is important to understand the basic concepts in order to protect your payments that may otherwise be taken back.

A payment is preferential only if the payment:
1. Is made for the benefit of the creditor;
2. Is made on a past due account;
3. Is made while the debtor is insolvent;
4. Is made within 90 days preceding bankruptcy filing; and
5. Enables the creditor to receive more than it would have if the debtor was liquidated in bankruptcy.

There are defenses to a claim of preference, and Trustees will often negotiate the amount to be returned. The common defenses including the following:

The "*Ordinary Course of Business*" defense, which requires the creditor to establish that:
1. The debt paid was incurred in the ordinary course of business;
2. The payment was ordinary between the debtor and creditor; or
3. The payment was made according to ordinary business terms, that is, in conformance with industry norms.

The "*Subsequent New Value*" defense generally applies where the creditor and debtor have an open or "running account" relationship. The defense can apply if:
1. The creditor has received a preferential payment against which there is no defense;
2. The creditor advanced additional unsecured credit to the debtor after this preference payment; and
3. This additional credit remains unpaid (in whole or in part) as of the date of the bankruptcy filing.

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PRACTICE GROUP SUCCESSES AND ACTIVITIES

Hillary Arrow Booth and Associate **Ian Culver** obtained a summary judgment in favor of a broker who the shipper alleged acted as a carrier. The shipper alleged a claim under the Carmack Amendment, but the court agreed with our position that the broker acted within the bounds of a broker's duties, and therefore the Carmack Amendment did not apply as a matter of law.

Hillary Booth and **Tim Swickard** filed a Petition for Reconsideration on behalf of the California Trucking Association, Refrigerated Carriers' Conference seeking to revise the ATCM applicable to transport refrigerator units. While the Petition was denied, it caused the California Air Resources Board to take the position seriously, and ultimately contributed to an extension of the compliance date.

Hillary Arrow Booth and Associate **Ian Culver** obtained a judgment in favor of a broker on claims of indemnity against a carrier that violated a broker-carrier agreement by re-brokering cargo and then failing to defend the broker when the shipper sued to recover damages for theft of the cargo.

Hillary Arrow Booth spoke on the allocation of responsibility for cargo damage based upon cargo securement and security related regulations at the annual conference of the Transportation Lawyers' Association in May 2009.

BANKRUPTCY, *cont'd*

This defense, should it succeed, would allow the creditor to reduce the preference exposure by the "new value" given the debtor. The creditor must prepare an analysis showing the date of each preference payment, along with the dates of invoices for debts claimed as "new value." Only those amounts invoiced after the preference payment, will be subtracted from the amount due back to the estate under the preference.

The "*Contemporaneous Exchange for New Value*" defense generally applies to payments that are cash on delivery, cash in advance, or cash with order. To succeed with this defense, the creditor must prove that:

1. The value (payment) given to the creditor equals the value the debtor received.
2. The debtor and creditor both intended the transfer to be contemporaneous.
3. The exchange was, in fact, contemporaneous.
4. A specific measure of "new value" was provided to the debtor. The new value provided generally must actually enhance the worth of the debtor's estate.

The "*Solvency*" Preference Defense is difficult and expensive to prove, as a debtor is presumed to be insolvent 90 days before filing. To succeed, the creditor must prove, with sound financial evidence, that the debtor was not insolvent during the preference period. Expert testimony of a financial consultant is almost always required and, as there is no method for measuring the insolvency of a company under the Generally Accepted Accounting Principles (GAAP), the proof can be very difficult.

There are multiple defenses to a claim of preference, and Trustees will often negotiate. Thus, it may be worthwhile to dispute a claimed preference.

LOAD SECUREMENT, *cont'd*

SHIPPER LOADS AND SECURES THE CARGO

In some instances, the shipper may prefer to load the cargo itself. In those situations, the liability is not always easy to determine. The clearest legal authority comes from *U.S. v. Savage Truck Line, Inc*. 209 F.2d 442, 445 (1954): "When the shipper assumes the responsibility of loading, the general rule is that he becomes liable for the defects which are latent and concealed and cannot be discerned by ordinary observation by the agents of the carrier; but if the improper loading is apparent, the carrier will be liable notwithstanding the negligence of the shipper." Savage Truck Line, Inc. was a carrier that transported six airplane engines for shipper United States. In transit, one or more of the engines shifted while the truck handled a curve, causing the truck to cross over into oncoming traffic whereupon one of the engines fell upon a passing truck, killing its driver. The engines had been loaded by agents of the shipper United States, who also encased the engines in cylindrical containers and fastened them to the truck. Among the claims made was a claim made by the United States as shipper against Savage Truck Line, Inc. as carrier for damages to the engines. Because the driver for Savage Truck Line, Inc. knew or should have known by the circumstances that the engines were improperly secured, the carrier was found liable to the shipper for the loss.

When the shipper loads the freight and the bill of lading contains the words "shipper's load and count" or words to that effect, a carrier is not liable for damages to the cargo that is shown to be caused by the improper loading. In such instances, the burden shifts to the shipper to show that the goods were loaded properly and, if it cannot do so, it may recover from the carrier *only* after demonstrating that an

ABOUT OUR FIRM

We are a mid-sized firm providing our clients with first-rate lawyering and professional service at a good value. Most importantly, we see ourselves as being in partnership with our clients. We treat our clients' concerns as our own. Further, it is not by accident, but by design, that many of the Firm's partners are involved in government and politics. Our ability to maneuver our clients' interests through the maze of government requirements, or to obtain government cooperation, is a critical and unique benefit of working with our Firm. We service the litigation, transactional, and regulatory needs of clients in many industries including transportation, manufacturing, energy, recycling, real estate, high-tech, construction, and entertainment. Our success is built upon the professionalism, dedication, and performance of each individual in our Firm. While we plan for future growth, we are determined to retain these qualities and continue to provide energetic and creative representation to our clients.

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SECUREMENT, *cont'd*

independent act of negligence on the carrier's part contributed to the damage. However, if the defects in the loading were apparent to the driver or the carrier, and the carrier or driver failed to correct the defects, it may still be liable.

Accordingly, where the shipper loads the cargo, it may be liable if the carrier can establish negligence on the part of the shipper of which the carrier was not and could not have been aware. Better yet, if the operative bill of lading reads "shipper's load and count," the shipper bears the initial burden of proving proper loading and may only recover from the carrier if it can show that some independent negligence of the carrier contributed to the damage.

SHIPPER LOADS AND SECURES THE CARGO UNDER SEAL

Where the shipper loads and secures the cargo under seal, and such seal serves an important purpose from a policy perspective (*i.e.*, to preserve the integrity of sensitive cargo), the carrier will generally not be held liable for cargo damage occasioned by the shipper's improper loading.

However, even where the carrier has been ordered by the shipper not to open or inspect the cargo, or where the shipper has loaded the cargo in such a manner as to make inspection impracticable or impossible, a carrier remains responsible for the safe securement of the cargo. In those instances, under 49 C.F.R. § 392.9(b)(4), the driver is absolved only of the duty to assure himself that the cargo is properly distributed and adequately secured and to inspect the cargo from time to time over the course of the transportation. Thus, the carrier may remain liable for accidents caused by shifting loads even when the shipper has loaded and sealed the trailer