Oak Harbor Freight Lines v. Sears Comes Back to Haunt Shippers and Brokers

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I first reported on this case, Oak Harbor v. Sears, 420 F. Supp. 2d 1138 (W. Dist. WA 2006) in the *TIA Logistics Journal* in August 2006. The U.S. Circuit Court of Appeals for the 9th Circuit has affirmed the decision of the district court, holding both Sears and its broker, NLC, jointly and severally liable for more than $400,000 in freight charges (Oak Harbor Freight Lines, Inc. v. Sears Roebuck and Company, 2008 US App. Lexis 1046, filed January 18, 2008). While the U.S. Court of Appeals opinion will be reviewed in more detail below, in the big picture, Sears asserted three defenses: (1) its carrier contract between Oak Harbor (carrier) and NLC (broker) waived Oak Harbor's recourse against Sears; (2) the carrier contract was a sole contract for the freight shipments and the bills of lading were merely receipts; and (3) Oak Harbor is equitably estopped from collecting because otherwise Sears is subjected to double-payment liability. The Court of Appeals affirmed the District Court and struck down all three defenses. Before looking in more detail at the defenses and the Court's analysis, it is important to review some of the essential facts of the case.

The bills of lading, billing and payment between the parties generally followed this pattern: (1) Oak Harbor sent NLC a billing invoice at least three days after Oak Harbor delivered the freight, and Oak Harbor expected to be paid by NLC within 30 days of the date shown on the invoice; (2) after auditing the invoices, NLC billed Sears weekly for the freight charges that had accumulated since the last billing date; (3) Sears paid NLC about five days after receiving the bill from NLC; and (4) NLC paid Oak Harbor, with the funds received from Sears, about 25 days after NLC received Oak Harbor's billing invoice.

In mid-2004, Oak Harbor learned that Sears would no longer use NLC as its broker as of January 2005. By the end of November 2004, Oak Harbor was owed more than $400,000 for shipments of Sears' freight. On December 12, 2004, NLC sent Oak Harbor a letter recommending that Oak Harbor seek payment directly from Sears. In response to inquiries by Oak Harbor concerning payment, Sears denied liability and informed Oak Harbor that NLC was responsible for the freight charges. By the time Oak Harbor sought collection from Sears, Sears had paid $227,202.50 to NLC for freight charges invoiced by Oak Harbor. In early 2005, Oak Harbor sued both NLC and Sears in Washington State for "monies due."

In reaching its holdings, the district court explained that NLC was liable to Oak Harbor under the Carrier Contract.

The District Court did not premise Sears' liability on the Carrier Contract, but interpreted the bills of lading generated by Sears and Oak Harbor as imposing liability on Sears, *which the Carrier Contract did not limit.*

The Court of Appeals next reviewed standard terms of bills of lading and stated that they contained the usual default terms. Under the default terms the shipper/consignor is liable for freight charges unless the bill of lading is marked, "nonrecourse." Sears was the shipper/consignor and its bills of lading did not contain a nonrecourse clause. Consequently Sears is liable on the outbound shipments. Similarly, the consignee is liable on the inbound/return shipments unless the bills of lading are marked "prepaid." In short Sears is liable under the terms of the bills of lading unless there is a written agreement that states otherwise. Sears then raised the three defenses listed above.

Here's how the court dealt with Sears' defenses:

Carrier Contract-Waiver

The parties to a freight shipment generally are free to assign liability for the payment of freight charges through a contract separate from the bill of lading. Such a contract may provide that "the shipper agrees absolutely to pay the charges, or...merely that he shall pay if the consignee does not pay...or...that only the consignee shall be liable for the freight charges, or that both the shipper and the consignee may be made liable." "It is only where the parties fail to agree or where discriminatory practices are present that the bill of lading default terms bind the parties." Sears contends that the Carrier Contract between Oak Harbor and NLC waived Oak Harbor's

recourse against Sears under the otherwise-applicable default liability provisions of the bills of lading.

Although it is well established that a contract between the parties to a bill of lading-the *shipper*, the *carrier*, and the *consignee*-can allocate liability for payment of freight charges, *there is no support for the proposition that a contract with a broker, who is not a party to the bill of lading, can do the same. Sears cites no authority to support its proposition that a contract between a carrier and a broker can modify the default liability provisions of a bill of lading.*

According to the court, "Only Oak Harbor and NLC executed the Carrier Contract. Sears was neither named in, nor a signatory to, that agreement. *The Carrier Contract never mentions or refers to Sears by name or description. The Carrier Contract makes no express or implied statements that Sears will not pay Oak Harbor for the shipments, nor does the contract make any express or implied statements that Oak Harbor will not seek payment from Sears. The Carrier Contract merely provides that NLC will be liable for freight charges regardless of whether or not NLC is paid. To hold as Sears' wishes would permit a shipper to insulate itself from liability for the payment of freight charges by the simple act of using a broker. We hold that the Carrier Contract did not alter Sears' liability for the freight charges under the bills of lading.*

Carrier Contract-Sole Lawful Contract

Sears also argues that the Carrier Contract was the sole lawful contract for the freight shipments and that the bills of lading were merely receipts. Sears first notes that, in 1992, when Oak Harbor and NLC executed the Carrier Contract, federal law required that Oak Harbor enter into a written agreement to charge below-tariff rates. [49 C.F.R. § 1053.1 (1991) (repealed June 20, 1992]. Oak Harbor concedes that it intended the Carrier Contract to comply with that regulation. As a result, Sears reasons, Oak Harbor and NLC intended that the Carrier Contract be the sole legal contract for shipments, thereby foreclosing the possibility that the bills of lading had any effect other than as receipts.

The former regulation that Sears cites did not presume to control all aspects of a carriage agreement. Rather, the regulation provided only that such agreements "shall be in writing, shall provide for transportation for a particular shipper or shippers, shall be bilateral and impose specific obligations upon both carrier and shipper or shippers and shall cover a series of shipments during a stated period of time." Critically, the regulation did not require that the agreement be the exclusive contract for the carriage of goods. Consequently, the regulation does not displace the default liability provisions for bills of lading.

Contrary to Sears' argument, the court went on to state that there were no irreconcilable differences between the Carrier Contract and the bills of lading. They operate concurrently and in harmony to provide the key terms for Sears' freight shipments. The bills of lading contain no price terms, while the Carrier Contract determines the price for the shipments. The Carrier Contract does not address Sears' liability for payment of freight charges, while the default provisions in the bills of lading make Sears liable. The bills of lading identify the shipper, consignor and consignee; describe where the goods are to be picked up and where they are to be delivered; and contain the payment liability terms of "prepaid" or "collect" to the bills of lading, none of which the Carrier Contract provides.

Equitable Estoppel

Sears further argues that it "paid NLC for the majority of the freight charges at issue," and, as "an innocent party," it "should not be required to pay twice. Whether the shipper or the carrier bears the risk if a freight forwarder, broker or consolidator fails to forward a freight payment, or if a consignee fails to forward a freight payment, is a question of first impression for this circuit.

Sears' argument ignores that it paid only $227,202.50 of the $426,417.94 in charges incurred by Oak Harbor in shipping Sears' freight. Sears never paid the nearly $200,000 in freight charges to NLC or Oak Harbor, even though Sears received the full benefit of both services.

In support of its position, Sears relies primarily on the Sixth Circuit's decision in Olson Distributing Systems, Inc. v. Glasurit America, Inc., 850 F.2d 295 (6th Cir. 1988). In that case, a motor carrier sought payment from a shipper for freight bills that the carrier had submitted to a freight forwarder. The shipper paid the freight forwarder, but the freight forwarder absconded with the money and never paid the carrier. Although the bills of lading were marked "prepaid," and the shipper did not sign the "nonrecourse" clause on the bills of lading, the Sixth Circuit held that the risk of loss should rest with the carrier.

The Sixth Circuit pointed to four critical facts in reaching its holding. First, the carrier provided the shipper with freight bills stating that the freight

charges were to be paid to the freight forwarder, not the carrier. Thus the carrier's own bills indicated that the carrier should not expect payment from the shipper. Second, the carrier did not diligently bill the freight forwarder for shipments, waiting until "two to three months after the last delivery" before sending any freight bills to the freight forwarder. Third, the carrier violated then-current credit regulations established by the Interstate Commerce Commission (ICC) which, had the carrier followed, would have allowed the carrier to identify that the freight forwarder was absconding with the money. Finally, had the carrier notified the shipper sooner, the carrier could have limited its losses. The court concluded: "Here the doctrine of equitable estoppel requires that the loss fall on the carrier because its actions had the effect of lulling the shipper into believing that it was expecting and receiving payment from the freight forwarder."

We agree with the District Court that Olson is an "outlier," the extreme facts of which bear little resemblance to what happened here. Three of our sister circuits—the Fourth, Fifth and Eleventh Circuits-have reached a conclusion at odds with Olson on facts much closer to those before us. Those courts have held that a shipper should bear the risk when it chooses to pay for freight charges through a broker rather than directly to the carrier. As noted by the District Court in Oak Harbor, the policy reasons for this result are persuasive. The Fifth Circuit wrote:

> "We think that our result comports with economic reality. A freight forwarder provides a service. He sells his expertise and experience in booking and preparing cargo for shipment. He depends upon the fees paid by both shipper and carrier. He has few assets, and he books amounts of cargo far exceeding his net worth. Carriers must expect payment will come from the shipper, although it may pass through the forwarder's hands. While the carrier may extend credit to the forwarder, there is no economically rational motive for the carrier to release the shipper. The more parties liable the greater the assurance for the carrier that he will be paid."

Furthermore, as those courts have explained, the shipper, and not the carrier, is in the best position to avoid liability for double payment by dealing with a reputable freight forwarder, by contracting with the carrier to eliminate the shipper's liability or by simply paying the carrier directly.

Sears contends that Southern Pacific Transportation supports its position. In Southern Pacific Transportation, the Court stated, "double payment cases constitute their own category and stand against the placement of duplication of liability upon an innocent party." Sears' reliance is misplaced. The Court refused to grant an estoppel defense to a shipper/consignor because, among other reasons, the shipper/consignor was paid for the goods, but the carrier was not paid for its services; and the shipper/consignor, having failed to mark the bill of lading as "nonrecourse," remained primarily liable for the freight charges. The Court acknowledged that some cases applied equitable estoppel to bar recovery of freight charges by a carrier. But the Court noted that those cases applied estoppel only in limited circumstances: "Each and all of them involved a carrier's misrepresentation, such as a false assertion of prepayment on the bill of lading, upon which a consignee detrimentally relied only to find itself later sued by the carrier for the same freight charges."Carriers involved in misrepresentation "constitute their own category and stand against the placement of duplication of liability upon an innocent party."

With respect to the outbound shipments as to which Sears was shipper/consignor, we agree with the District Court that the Hawkspere, Strachan and National Shipping line of authority best applies to the facts of this case. Sears generated the bills of lading and failed to protect itself with a "nonrecourse" designation. In addition, Sears selected NLC and directed Oak Harbor to submit its bills through NLC.

With respect to the return shipments, Sears was not an "innocent consignee." The bills of lading clearly were marked "collect," which put Sears on notice that payment was due. In addition, Sears undertook no actions to limit its liability. In particular, Sears could have elected to pay Oak Harbor directly, but did not, and thereby assumed the risk that NLC would fail to forward payment. Furthermore, unlike in Olson, Oak Harbor did not extend credit to NLC in violation of federal regulations, and it immediately sought payment from Sears when NLC abrogated its responsibility to forward Sears' freight payments. Had the bills of lading been marked "prepaid," Sears could have argued that it relied detrimentally on a representation by Oak Harbor. But they were not so marked. *Thus, we hold that equitable estoppel does not bar Oak Harbor's recovery of freight charges from Sears, notwithstanding Sears' payment of a portion of those freight charges to NLC.*

Writer's Comment

First the bad news: The court in its analysis initially raises a dark specter, namely that a broker and a carrier cannot contractually agree that only the broker is responsible for payment of freight charges to the carrier. In doing so, the court ignores the statutory rights of the parties to contract away rights they may have under the transportation code (except for insurance and safety matters) under 49 USC 14101(b); and US Supreme Court precedent (So Pac. Transp v. Commercial Metals).

Now the good news: The court also suggests that a properly-drafted contract *could* restrict the carriers' rights to collect from a shipper. The court goes on to provide some guidance by suggesting that there are three options for restricting the carriers' collection rights by contract: the contract must identify the shipper by name; and/or the contract must state that the shipper does not have to pay the carrier; and/or the contract must state that the carrier will not seek payment from the shipper.

In this case NLC, the broker, stated in the contract that it was liable for the freight charges and in fact referred to itself as the "Broker/Shipper." Thus NLC made itself an easy target for the court to hold liable. Of course another view of this case is that small carrier sues Sears and Sears was a "deep pocket" and a sophisticated shipper so it was not too difficult to find them liable.

The principal learning from this case is that carefully-drafted contracts are essential in order to help protect a shipper from the risk of double-payment liability. You will note that the Sears contract was dated 1992, before the sunset of the ICC, so you can see that is imperative that transportation contracts be kept current.

It should be noted that other U.S. Circuit Courts of Appeal have upheld the "equitable estoppel" defense in order to prevent double-payment liability. They are the Third, Sixth, Seventh and Eighth circuits. In the First and Second circuits there are District Court cases which have upheld the defense. The Fourth, Fifth, Ninth and Eleventh circuits have rejected the defense. With the current split in the circuits the issue is ripe to go to the U.S. Supreme Court for resolution.

NOTE: Items in italics indicate writer's emphasis.

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