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The *InterConnect* FLASH!

Practical Bursts of Information Regarding Critical Independent Contractor Relationships

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FLASH NO. 45
FAILING TO FOLLOW THE GUIDANCE FROM THE "RECIPE BOOK" MAY BE VERY COSTLY

The Federal Leasing Regulations are often referred to within the industry as the "Recipe Book" for the typical independent contractor/owner-operator business model. The Regulations provide the ingredients that must be contained in a contract between the motor carrier and the owner-operator, and very often require that the contract "clearly specify," "must specify," or "clearly state," certain substantive content related to those ingredients. The Regulations also provide guidance regarding the conduct of a motor carrier with its owner-operators, the content of which is not required to appear in the contract. Thus, the objective is to ensure the contract and conduct comply with the Regulations and each reflects the other.

Section 376.12(h)—Chargeback Items—is a particularly important ingredient. Under this subpart, the contract must clearly specify all items that may be initially paid by the motor carrier, but ultimately "charged back" or deducted from the owner-operator's compensation at the time of payment or settlement, including how the amount of each item will be computed.

A deduction for the cost of fuel, a major expense of an owner-operator, is a chargeback item governed by 376.12(h). Not following the guidance from the Recipe Book and making certain your contract and conduct are in sync appears to have resulted in a $3.8 million misstep for a motor carrier.

In a decision rendered in a class action lawsuit just before the holiday season, an Indiana Judge determined that language in the contract between Celadon Trucking and its owner-operators did not reflect the actual pattern and practice of the motor carrier with respect to chargebacks for the cost of fuel. Although not a case brought under the Regulations, the "lessons learned" are the same.

Under the Celadon contract, the owner-operator was responsible for the purchase of fuel. To purchase fuel at truck stops, Celadon provided the owner-operators with fuel cards. When the owner-operator purchased fuel from Flying J using the fuel card, the receipt showed the fuel was purchased at the cash price displayed on the pump (the "Pump Price"). The Pump Price reportedly reflected a modest discount of approximately six cents a gallon. Celadon then charged back the Pump Price to the owner-operator's compensation. This fact pattern is very typical within the truckload segment of the industry, and more so with motor carriers that operate under a split board (*i.e.*, independent contractors *and* employee drivers).

However, Celadon did not pay Flying J the Pump Price, but instead paid a significantly discounted price (the "Discount Price"). The Court focused on a provision in the contract that authorized Celadon to deduct from the owner-operator's compensation *"advances or other extensions of credit"* made by Celadon to an owner-operator. The Court decided that the section was unambiguous and construed the plain and ordinary meaning of the words without consideration of outside evidence. Under the plain and ordinary meaning of the words *"advance"* and *"extension*

of credit," the Court determined that Celadon advanced or extended credit for fuel purchases in the amount that Celadon actually paid (the Discount Price), not for the higher Pump Price which Celadon never paid and was never obligated to pay. As a result, the Judge awarded the Plaintiffs' class $3.8 million plus prejudgment interest, reported to be in the range of $1.7 million.

The harsh reality is that there was nothing unusual about Celadon's practice. There is no legal requirement that a motor carrier pass through all or any portion of a fuel discount that it may receive. The fact that Celadon has a large component of company drivers that run the miles and use the fuel to allow Celadon to be entitled to a deeper discount, should be attributable to that larger portion of the fleet and is very typical. However, the contract between Celadon and its owner-operators failed to clearly specify the chargeback for fuel in a manner consistent with its actual practice. The contract must include that disclosure. With the significance of the cost of fuel in an owner-operator's expenses, it is a significant subject that requires heightened scrutiny and clarity in disclosure. The result may have been different if the contract simply stated that "the amount charged back to the owner-operator for the cost of fuel shall be the cash price at the pump as evidenced by the receipt the owner-operator receives at the time of purchase."

For the industry, a decision like this has an unfortunate impact on other motor carriers. The fact that a major motor carrier's conduct was specifically exposed and examined both in a complaint and most certainly in the Judge's decision, creates a potential risk within the industry of another round of "copycat" lawsuits. Thus, the bottom line action item for motor carriers that operate with owner-operators is to review their agreements and make certain that the ingredients called for by the Recipe Book are present, and that the motor carrier's actual conduct is in sync with the contract.

The Benesch Transportation and Logistics Practice Group certainly has a very experienced team that is well versed in this area of the law and can provide any assistance that may be needed or desired.

Additional Information

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