



WHO SHOULD PAY?

Legal Corner

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As you know, the shipping industry is full of intermediaries. There are, to name a few, freight forwarders, customs brokers, freight brokers, NVOCCs, freight payment companies, shipper's agents, and shippers associations. The fundamental transportation activity consists of a carrier transporting goods for a shipper and delivering them to a consignee. Depending on the circumstances of any given transaction, however, and commercial decisions made by the shipper and consignee, one or more intermediaries may become involved in a shipping transaction. Sometimes, shipping transactions are set up in a way that either the shipper or the consignee pays one of these intermediaries instead of the carrier, assuming that the intermediary will forward the funds to the carrier. And sometimes this doesn't happen. The intermediary either goes out of business or absconds with the money. In such cases, the carrier will often sue the shipper or the consignee, or both. Who should pay? Should the shipper or consignee that has already paid the intermediary have to pay the freight charges twice by also paying the carrier? Or should the carrier suffer the consequences of the non-payment?

The basic rule concerning freight payments is that the shipper owes the money to the carrier since it is the person that hired the carrier to perform the transportation and appears as a party on the carrier's bill of lading contract. Once the goods have been delivered to the consignee, the consignee becomes a party to the bill of lading by accepting the benefits of the transportation and may also owe the carrier for the freight charges. In lawsuits in these so-called "double payment" cases, carriers will rely on the basic rules set forth above and argue that the shipper - - or consignee - - must pay again. Typically, the shipper or consignee will argue that it's not fair for them to have to pay twice and that, for some reason, the carrier must suffer the loss.

These cases are not infrequent in the ocean shipping industry. For example, in the case of

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Mediterranean Shipping v. Elof Hansson, Inc., Hansson purchased goods from a company named Fenesty in Houston, Texas and had them shipped to Tanzania. Hansson arranged for payment to Fenesty through a Swedish Bank under a letter of credit. Pursuant to the letter of credit, payment was to be made to Fenesty upon the presentation of certain documents, including bills of lading marked “freight prepaid.” Hansson was shown as the shipper on Mediterranean Shipping’s (“MSC”) bills of lading because it did not wish to have its own buyer in Tanzania know who the supplier in Texas was. Through a freight forwarder, Fenesty booked these cargoes with MSC showing Hansson as the shipper and requested that MSC issue freight prepaid bills of lading which it did, without, however, requiring Fenesty to pay the freight charges at that time. Fenesty presented the freight prepaid bills of lading to the bank and received payment under the letter of credit. However, Fenesty terminated its business without paying MSC its freight charges. MSC then sued Hansson. The court in this case found that MSC would have to bear the cost of Fenesty’s failure to pay. The court reasoned that MSC had issued freight prepaid bills of lading which Hansson relied upon to pay Fenesty under the letter of credit. Despite the fact that MSC knew nothing about the letter of credit or the payment arrangements between Hansson and Fenesty, the court held that MSC needed to suffer the loss because it had created the situation where Hansson detrimentally relied upon the freight prepaid bills of lading to make the payment to Fenesty.

In the case of *National Shipping Co. of Saudi Arabia v. Omni Lines*, the court reached the opposite conclusion. In that case, a freight forwarder booked cargo with NSCSA on behalf of Omni. NSCSA issued a bill of lading marked “freight prepaid” without, however, requiring that the freight be paid before the cargo was shipped. The freight forwarder issued an invoice to Omni for NSCSA’s freight charges and Omni paid the freight forwarder. The freight forwarder failed to pay NSCSA and went out of business. NSCSA sued Omni for the freight charges and asked that Omni be required to pay them again. This court in this case decided that Omni would have to pay twice. It said that the bill of lading is a contract between the carrier and the shipper and the carrier has a contractual right to expect payment pursuant to that contract. Notwithstanding the fact that NSCSA issued a freight prepaid bill of lading, it was entitled to collect the freight charges from Omni.

Two different cases with similar facts yet they reached diametrically opposite conclusions. How can this be? The answer is that the federal courts in the United States do not agree on the standard by which these kinds of cases should be decided. In a recent case in 2003, the United States Court of Appeals for the Fourth Circuit explained that the courts have adopted two basic views

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of who should bear the risk when an intermediary that has been paid the freight charges by the shipper or consignee fails to forward the payment to the carrier. This court referred to the two standards as the “assumption of risk” view and the “equitable estoppel” view. The court described the “assumption of risk” view as holding that “a shipper remains liable to a carrier, regardless of a shipper’s payment to [an intermediary], unless the carrier intentionally released the shipper from its duty to pay under the bill of lading.” Under this approach,

. . . only if the carrier has released the shipper from liability under the bills of lading is the shipper discharged from his duty to pay the carrier by remitting payment to the [intermediary]; otherwise, the shipper, by choosing not to pay the carrier directly, assumes the risk that the [intermediary] might fail to forward the freight payment on to the carrier.

The court described the “equitable estoppel” view as holding that “when a shipper pays freight to [an intermediary] and the [intermediary] subsequently fails to forward the payment on to the carrier, the shipper does not remain liable to the carrier, so long as the circumstances indicate that the carrier *led the shipper to believe* that payment to the cargo consolidator would discharge the debt.”

Since a carrier will very rarely intentionally release a shipper from its duty to pay under the bill of lading, the courts adopting the “assumption of risk” standard almost always find that the carrier is entitled to be paid and thus, the shipper or consignee must pay twice. Adopting this standard, therefore, makes the court’s decision relatively easy. It is not so simple with the “equitable estoppel” standard because this standard encourages the court to look for actions taken by the carrier that “led the shipper to believe that payment to the cargo consolidator would discharge the debt.” As you can imagine, the shippers in these cases can give the court a multitude of reasons why the carrier led them to believe that payment from the intermediary was acceptable. In point of fact, however, these cases almost always come down to a decision based upon the issuance of a “freight prepaid” bill of lading. When the court finds for the shipper in an equitable estoppel case, you can understand the probable thought pattern, even if it is not expressed. If the carrier issues a “freight prepaid” bill of lading it should insist that freight actually be prepaid prior to transporting the goods. If the carrier wishes to collect the freight charges at destination, it should issue a “freight collect” bill of lading. In this view, it is the carrier who makes the decision about what kind of bill of lading to issue and the carrier can easily protect itself. Also, one might say that if a carrier issues a “freight prepaid” bill of lading at the request of an intermediary without actually requiring prepayment of the freight, it is, in essence, agreeing to give credit to that intermediary. Therefore, it should bear the consequences if

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the intermediary fails to pay. However, the justification for the assumption of risk” standard is also pretty compelling. As one court adopting that view put it:

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 forwarders 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 that are liable, the greater the assurance for the carrier that he will be paid.

Although this statement is directed towards freight forwarders, it could as easily apply to any other type of intermediary. The basic point is a solid one. What carrier in its right mind would release the shipper or consignee - - or any other party connected to the shipping transaction - - from the responsibility to pay the carrier’s freight charges? All you have to do is read the definition of “Merchant” in any carrier’s bill of lading to understand the truth of this statement.

There is also a subset of the “double payment” cases involving shippers’ associations. The typical case arises in the following fashion. Various shippers form a non-profit shippers’ association to obtain volume rates for their goods. They book their shipments directly with the association and the association, in turn, books consolidated cargoes with the carrier. The association bills and collects from the shipper/members for the freight charges and pays the carriers. At some point, the shippers’ association goes out of business without paying the carriers. The carriers then sue the shipper/members whose cargo they handled. The courts that have decided these types of cases have not adopted a “assumption of risk” or “equitable estoppel” analysis. Their view has usually been that a shippers’ association is an agent for its members who are, therefore, principals in the transactions with the carriers. Since payment to the association was merely payment to the shipper/member’s own agent, and the shipper/member is responsible for the actions, or inactions, of its agent, the shipper/member therefore remains liable to the carrier for the freight charges.

As you can see, this can be a complex area and it is not easy to predict how a given court will approach one of the “double payment” cases. How can a shipper or consignee protect itself? The best answer comes from one of the court decisions. Should the shipper wish to avoid liability for double payment, it should either take care to choose a reputable intermediary to pay, or pay the carrier directly.

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