



## THE FREIGHT PAYMENT BLUES

**Legal Corner**

By David Street, IHSAs Legal Counsel

June 2015

A case recently filed in the United States Bankruptcy Court in the District of New Jersey illustrates the problems with shippers using third party freight payment companies to compensate their carriers. This case arose out of the implosion of TransVantage Solutions, Inc. ("TransVantage") when it was discovered that its President and sole director had embezzled millions of dollars from the freight payments entrusted to the company by its customers, which created an approximate shortfall of \$40 million in the company's freight payment funds. It appears this embezzlement had been ongoing since the 1990s and the sums deposited by shippers for payment of their carriers had been used to finance an extravagant lifestyle for the company's owners and managers. Following discovery of this embezzlement, TransVantage declared bankruptcy. Shortly thereafter, criminal charges were filed against TransVantage's former President, which are still pending.

A trustee was appointed to oversee the liquidation of TransVantage's estate. As you are probably aware, the role of a trustee is to gather the assets of the estate and distribute those funds to the creditors of the bankrupt company. As part of this process, the trustee will examine whether there have been any preferential or fraudulent transfers from the assets of the estate. If there have been such transfers, the trustee may institute legal action against the recipients of those funds to recover money for the estate. Of course, the trustee does not do all of this by him or herself. She hires lawyers to represent the estate. And, you can rest assured, lawyers representing bankrupt estates are extremely aggressive in devising theories and taking actions to recover assets for the estate.

In the TransVantage case, the trustee and his lawyers have sued over five hundred shippers and carriers seeking a return of payments to the estate. These lawsuits allege that the payments to the carriers were made as part of an ongoing Ponzi scheme whereby TransVantage used funds it was given by shippers which were earmarked to pay certain carriers to pay other carriers that had

*The contents of this article do not constitute legal advice. You should always consult an experienced attorney about legal issues that arise from particular situations as the individual facts may warrant different legal conclusions in a given case. Mr. Street is a partner at the law firm of GKG Law, P.C. and serves as IHSAs FMC attorney.*

performed services for different shippers. Thus, the trustee has alleged, carriers were getting money to which they were not entitled and shippers were having their obligations satisfied with other people's money.

The trustee further alleges that, because of the embezzlement, TransVantage did not have enough funds to pay all of the carriers' freight bills for which it had been given money by the shippers. Therefore, according to the complaints, TransVantage was insolvent at the time that it made these payments. This is another reason why the payments were fraudulent. As the complaints state:

The payment of the Fraudulent Transfers were made while TransVantage Solutions was insolvent or rendered TransVantage Solutions insolvent, and was therefore fraudulent as to TransVantage Solutions' other creditors, when the sum of TransVantage Solutions' debts were greater than its assets and TransVantage Solutions could only operate on reliance of new funds it received from Customers to maintain TransVantage Solutions' business operations and pay the transportation bills of its other Customers.

There is precedent for collecting monies paid out pursuant to a Ponzi scheme in the Bernie Madoff case, in which a number of Madoff's customers who had been paid their supposed stock market earnings were forced to return the money to the estate for distribution to other customers who lost money with Madoff.

Although most of the suits by the trustee have been filed against the carriers that received payments from TransVantage, as noted above, a number of suits have also been filed against TransVantage's shipper customers. However, customers that have not been sued by the trustee, or settled these cases, are not out of the woods. In fact, having paid TransVantage once for their transportation services, they may be forced to pay again if their carriers are forced to return the money to the TransVantage estate. To the extent those carriers do not receive all of the freight monies they charged their customers, it is probable they will seek to have the customers pay them through indemnification actions. Whether those indemnification actions will ultimately succeed may depend upon the individual facts of each case. There are, however, numerous previous cases where shippers have been forced to pay carriers twice when middlemen have absconded with the original payment of freight charges. Undoubtedly, the TransVantage carriers will be relying on those cases if they seek indemnification - - and double payment - - from their shipper customers. Even those

*The contents of this article do not constitute legal advice. You should always consult an experienced attorney about legal issues that arise from particular situations as the individual facts may warrant different legal conclusions in a given case. Mr. Street is a partner at the law firm of GKG Law, P.C. and serves as IHSA's FMC attorney.*

customers that succeed in fending off these indemnification claims will still have to suffer the loss of management time, legal expense and headaches of having to deal with them.

It is easy to see the theoretical advantages of using a freight payment company. Frequently, such companies perform audits of the freight rates as well. Therefore, the shipper does not have to devote time and manpower to this laborious process. In addition, checking freight rates, including additional, surcharges, etc. can be a very technical process, which requires a good deal of expertise to successfully accomplish. The problems with entrusting shipper's money to freight payment companies, however, frequently outweigh these benefits. First, it is difficult for a shipper to adequately monitor where its money is going and how it is used. The flow of funds from multiple shippers to multiple carriers through a freight payment company can be very complicated and difficult to track. Moreover, so long as the shipper's carriers are being paid - - or are failing to notify the shipper that they are not being paid - - it is very easy for a shipper to simply assume everything is going well at the freight payment company. Moreover, freight payment companies frequently accumulate huge amounts of cash, which, as in the TransVantage situation, enables them to hide irregularities for considerable amounts of time. The combination of these factors, plus the inevitable impact of human nature, which tends to avoid complicated situations and leave well enough alone when things seem to be going smoothly puts freight payment companies in the position of providing a great deal of temptation to their owners and managers as a result of the combination of large amounts of money and little oversight. As can be seen by the large number of freight payment company disasters over time, this combination of factors is frequently toxic.

What can shippers who wish to enjoy the benefits of freight payment and audit companies do to protect their money? One obvious answer is to do extensive due diligence on freight payment providers before choosing one to entrust with the shipper's funds. Obviously, length of time in the business is not a very good indicator of the strength, honesty or reliability of a freight payment provider. As can be seen from the TransVantage situation, embezzlement schemes can last a very long time before they are discovered. Some things that shippers might look for include whether the freight payment provider is independently audited by a reputable accounting firm and will regularly share its audited accounts with its customers, and whether the freight company has insurance to protect itself, as well as its customers as "loss payees, in the event of employee dishonesty. Some freight payment companies also advertise that they have created "bankruptcy-remote" structures to

*The contents of this article do not constitute legal advice. You should always consult an experienced attorney about legal issues that arise from particular situations as the individual facts may warrant different legal conclusions in a given case. Mr. Street is a partner at the law firm of GKG Law, P.C. and serves as IHSA's FMC attorney.*

protect shipper's funds. This of course, presumes that the funds the shipper pays go directly to the bankruptcy-remote entity and that the funds are actually paid out to the carriers.

Most importantly, once a freight payment company is chosen, shippers need to be constantly vigilant in auditing the freight company's operations. Each shipper should make sure it receives regular reports on the status and flow of its funds and should ensure that its payments are segregated into a dedicated account. Each shipper should also frequently check with its carriers to make sure they are getting paid on a timely basis by the freight payment company and determine whether they have made any refunds to the freight payment company that the shipper has not received. An annual audit of the shipper's spend with the freight payment company would also be helpful. Finally, shippers should always be eternally suspicious of, and eternally vigilant over, third parties that handle significant amounts of money on their behalf. Don't be a victim of the next payment company scandal . . . and there will surely be one.

*The contents of this article do not constitute legal advice. You should always consult an experienced attorney about legal issues that arise from particular situations as the individual facts may warrant different legal conclusions in a given case. Mr. Street is a partner at the law firm of GKG Law, P.C. and serves as IHSA's FMC attorney.*