WINTER 2006

COUNSEL FOR THE ROAD AHEAD℠

InterConnect

A PUBLICATION OF BENESCH FRIEDLANDER COPLAN & ARONOFF LLP'S TRANSPORTATION AND LOGISTICS GROUP

Welcome to our new *InterConnect*!

Eric L. Zalud, Chair, Transportation and Logistics Practice Group

Well, it is actually only the "look" that is new. We have not changed our goal of providing you with insight into the latest issues affecting transportation and logistics from a legal perspective. We are still providing "counsel for the road ahead."℠

As our *InterConnect* newsletter enters its third year of publication, we hope you agree that it is more helpful than ever. We always welcome your feedback and suggestions for topics you think we should cover. We hope you enjoy this issue and look forward to future issues.

The BMC-32 Endorsement: It's Not for Everyone

For the past several months, the Federal Motor Carrier Safety Administration ("FMCSA") has been receiving comments from the public on its proposal to eliminate the requirement that motor carriers keep a current BMC-32 endorsement on file with the FMCSA in Washington. With the endorsement in place, a shipper can be sure that the carrier has cargo coverage with claims limits of $5,000 per vehicle or $10,000 per occurrence. If necessary, a shipper can make a claim directly against the insurance company. FMCSA wants to eliminate the requirement, but, based on a survey of the several hundred comments it has received, the shipping public is begging them to keep it. FMCSA believes that shippers are smart enough to bargain for the cargo coverage they need. The shippers and their trade associations are sure that they are not.

Shippers using contracts may think that the government is watching out for them and their cargo, but most of the time it is not.

The BMC-32 endorsement was under fire even before FMCSA's recent efforts to get out of the insurance endorsement business. As a result of the Interstate Commerce Commission Termination Act ("ICCTA"), in recent years FMCSA has required the endorsement from common carriers only. Shippers using contracts may think that the government is watching out for them and their cargo, but most of the time it is not.

While the shippers are begging FMCSA to continue and to expand its regulation of motor carriers' insurance policies, the courts have been dealing with litigation addressing the BMC-32 and its limitations. In the U.S. District Court for the Eastern District of New York, a shipper challenged FMCSA's rule that only common carriers need to file the BMC-32 endorsement. In *M. Fortunoff of Westbury Corp. v. Peerless Ins. Co.*, *260 F. Supp. 2d 524 (E.D.N.Y. 2003)*, the district court sided with the shipper in favor of a requirement that all carriers file the BMC-32 endorsement. The court reasoned that since ICCTA abolished the distinction between common and contract carriers, all carriers and their insurance companies should now be subject to the same insurance requirements. The decision was based in part on the language in ICCTA [49 U.S.C. § 13906(a)(3)] that empowered DOT to require all motor carriers to have cargo insurance and on the court's reading of the legislative history surrounding ICCTA.

Peerless, the insurance company for the carrier, appealed the district court's decision. The Court of Appeals reversed. Based on its understanding of the differences between common carriage and contract carriage before ICCTA and after, the court concluded that Congress had given DOT the discretion to require a carrier to have cargo insurance or not,

continued on page 2

IN THIS ISSUE:

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Friedlander Coplan & Aronoff LLP
Attorneys at Law

The BMC-32 Endorsement: It's Not for Everyone

from page 1

and the discretion to establish rules regarding which motor carriers are required to have insurance and which ones are not. Given the history of motor carrier regulation and ICCTA, the court held that DOT's decision to establish different rules for common carriers and for contract carriers was not arbitrary.

What does the *Fortunoff* case mean to shippers and carriers? As demonstrated by the facts in *Fortunoff* and the decision of the Court of Appeals, the BMC-32 applies only in the context of a common carrier relationship. Since most freight now moves under contract, the endorsement has become less of a factor.

With the result in *Fortunoff*, shippers should be on notice that they must take care with the terms and conditions in their contracts covering the cargo claim exposure. A "standard" carrier agreement should include provisions requiring that the carrier provide and maintain standard motor truck cargo legal liability insurance with limits that equal the anticipated maximum value of goods to be tendered on one trailer. The carrier should be obligated to provide evidence that the required insurance is in place.

Although we agree with FMCSA that shippers and carriers should deal with each other rather than rely on government regulation, cargo insurance issues in contracts create contract administration and due diligence problems for shippers and carriers. Does the shipper have a current insurance certificate on file with the carrier? Does the carrier's cargo insurance policy include exceptions that severely undercut the scope of the insurance coverage? Are the policy limits adequate to cover the claim?

Notwithstanding the problems, most shippers rely on contract carriage services and will continue to do so. FMCSA's effort to eliminate the BMC-32 is part of a trend that will not be reversed any time soon. Shippers need to become familiar with their needs with respect to cargo insurance coverage and make their purchasing decisions accordingly.

For more information on this topic, contact Robert Spira at rspira@bfca.com or 216.363.4413.

Shopping Around: Buying a Trucking Company Through Asset vs. Stock Acquisition

The transportation industry is in an interesting state of flux right now. While demand seems to be at or near an all-time high, trucking companies sometimes find rates below their costs and are, of course, having difficulty finding qualified drivers. This turmoil creates a situation where many trucking companies are available for acquisition. With a motivated seller, lack of interest by conventional financial sources, and some creative thinking, some recent acquirers have been able to convince a seller to "take back" the lion's share of the financing by way of seller notes. By having the seller take back most of the financing in the form of seller notes, paid out over a period of years, acquirers are often able to obtain conventional asset-backed financing based on the value of the business assets. This can enable purchasers to avoid the need to seek an equity player or debt financing from more costly sources.

Asset or Stock Deal

When representing a business acquirer, one of the first decisions to be made is whether to structure the transaction as an asset or stock acquisition. While conventional wisdom seems to favor an asset purchase from the buyer's perspective, a stock purchase can be advantageous under certain circumstances. What follows are some of the factors to consider when determining whether a stock or asset sale works best for your acquisition.

What leads many buyers to favor an asset acquisition is the relative simplicity of it. The opportunity to acquire the seller's assets, seemingly without the risk of potential liability for the seller's past actions, is very appealing. Additionally, most buyers prefer an asset sale because the new purchase price allows the buyer to increase or "step-up" the value of the assets (subject to negotiations with the seller). The higher valued assets can then be depreciated more quickly by the new owner. For the seller, an asset sale creates dreaded double taxation. First, the seller is taxed on the appreciated assets (assuming it's a C corporation) and capital gains tax if the old corporation is terminated. Conversely, in an all-stock sale, the seller only pays capital gains tax based on the stock appreciation.

Of course, ways exist to mitigate any potential taxes by shifting the burden from one party to the other. Additionally, other factors may drive the parties towards either an asset or stock transaction. For example, if the seller's contracts do not contain assignability clauses, the buyer in an asset deal must obtain the consent of the other parties to the contracts it wishes to continue.

Who's Liable

The issue of liability is often the paramount factor driving buyers towards asset purchases. While due diligence is always a necessary and integral component of any acquisition, it is certainly heightened in a stock transaction. All acquisitions, in part, are about identifying, quantifying, and limiting risk. Identifiable risks can be quantified to various degrees such as debt, accounts payable, litigation, unpaid taxes, and accrued but unpaid interest.

Unknown liabilities may include lawsuits that might arise in the future, undiscovered environmental liability, and various financial issues. These risks are generally not assumed by the buyer in an asset deal; however, key exceptions exist to this general rule. For example, some forms of successor liability arise where the seller and buyer are indistinguishable to the general public. The best due diligence cannot ensure that these potential risks do not surface in the future.

While conventional wisdom seems to favor an asset purchase from the buyer's perspective, a stock purchase can be advantageous under certain circumstances.

Reps & Warranties

Representations, warranties, and covenants are a key focus of all sophisticated buyers. Transportation acquisitions have their own unique potential liabilities which must be addressed. If not dealt with properly, the repercussions can last forever, or at least long enough to cripple the acquirer.

Representations and warranties are predicated on the assumption that the seller has sufficient assets for the purchaser to recover against, should any one of the representations be breached resulting in economic harm to the buyer. The seller's assets, however, may have been depleted or sheltered in such a way as to make it difficult or impossible for the buyer to recover any monetary damages.

Creating Baskets

One way of countering this is by creating a "basket." Baskets typically have some predetermined dollar amount that is a "hold-back" from the total purchase price. Typically, this might amount to 10% to 25% of the purchase price depending on the business, the comfort level of the buyer, and the relative positions of the parties. Oftentimes, baskets are structured with a "floor" and/or "cap." With a floor, no payments are made out of the basket until all claims in total reach a minimum dollar figure. Caps establish the maximum total value of liability for which the seller is exposed (outside of some sort of fraud or other actionable offense). Caps may be equal to the hold-back amount.

In some transactions, the seller strongly favors a stock sale. In exchange for this concession, the buyer may be able to convince the seller to "take back" a portion of the purchase price through seller financed notes. This may enable the buyer to seek more modest, conventional term loan financing to cover the balance of the purchase price and a standard revolving credit facility to finance ongoing operations. Conventional financing, with its more modest rates, along with a graduated multi-year payout to the seller through seller notes, can make certain acquisitions very attractive to a buyer even if undertaken as a stock transaction.

Sometimes, seller notes can be subject to the basket provisions, providing a fairly comfortable period to discover any undisclosed or unknown liabilities.

Thinking Outside the Box

Critical to the success of undertaking an acquisition (or selling a business) is engaging a team of experts with the experience of having undertaken numerous sales and acquisitions. Moreover, it is prudent to find someone with industry specific experience. Experienced counsel should bring more to the table than merely documenting the deal. They should provide advice as to how to structure the transaction, industry trends in the transportation market, and financial sources, among many other critical items. Thinking outside traditional acquisition structures can be a valuable asset to any potential purchaser.

For more information on this topic, contact Tom Washbush at twashbush@bfca.com or 614.223.9317.

Benesch Web Site Now Featuring Podcasts

Benesch has recently launched podcasts, known as "The Benesch Beat." The podcasts feature wide-ranging legal issues addressed by the firm's attorneys. The podcasts will be sent directly to individuals who subscribe to the free service, and are also posted on Benesch's website, **www.bfca.com**. You can go to the website and listen to a specific program, or you can download it onto your MP3 player and listen to it at your convenience.

Check out the seven podcasts that are currently online. New podcasts will be published at least once a month and whenever breaking legal decisions and issues of interest arise.

Benesch's Transportation and Logistics Conference to be Held in Columbus March 2nd

Join us for a fast-paced afternoon of timely, relevant presentations for any business involved in transportation and logistics. You will be informed and up-to-date in just a few hours after attending our annual Columbus conference: "Maximizing Opportunities and Minimizing Risks in Transportation and Logistics: How the Law Can Help." We will cover topics ranging from safety compliance, to the latest legislative happenings, to what is new in the global supply chain, and contract and insurance issues. Additionally, keynote speaker Kenneth B. Ackerman, President of K.B.Ackerman Company, will give a speech entitled *A Quarter Century of Change in the Industry: What You Can Do About It*. Wrap up the day with a cocktail reception blending business and pleasure.

When: 1:00-6:00 PM, March 2, 2006
Where: The Athletic Club of Columbus
136 East Broad Street
Columbus, OH 43215

To register: Megan Thomas, 216.363.4174 or mthomas@bfca.com

On the Horizon

DRI Trucking Law Conference

March 30-31, 2006 | Chicago, IL

Eric Zalud will be attending.

Transportation and Logistics Council and the Transportation Loss Prevention and Security Associations' Joint Annual Conference

April 2-5, 2006 | San Antonio, TX

Eric Zalud will be speaking on "Multimodal Transportation—Domestic and International Cargo Loss and Damage Issues."

Transportation Lawyers Association Annual Conference

May 17-20, 2006 | Orlando, FL

Marc Blubaugh will be moderating a panel discussion on "The 3PL Revealed: A Riddle Wrapped in a Mystery Inside an Enigma." Eric Zalud is the Educational Program Committee Chairman for this conference.

Association of Transportation Law Professionals Annual Meeting

June 11-13, 2006 | Seattle, WA

Bob Spira will participate in a panel discussion on "SAFETEA: How it will Impact the FMCSA Licensing of Brokers and Forwarders."

Conference of Freight Counsel

June 25-26, 2006 | Kansas City, MO

Eric Zalud will be attending.

For more information about the Transportation and Logistics Group, please contact one of the following:

Eric Zalud
216.363.4178
ezalud@bfca.com

Marc Blubaugh
614.223.9382
mblubaugh@bfca.com

Frank Reed
614.223.9304
freed@bfca.com

Robert Spira
216.363.4413
rspira@bfca.com

Thomas Washbush
614.223.9317
twashbush@bfca.com

Pass this copy of *InterConnect* on to a colleague, or email kmasuga@bfca.com to add someone to the mailing list.

Cleveland
2300 BP Tower
200 Public Square
Cleveland, Ohio 44114
Phone: 216.363.4500
Fax: 216.363.4588

Columbus
88 East Broad Street
Suite 900
Columbus, Ohio 43215
Phone: 614.223.9300
Fax: 614.223.9330

Benesch Pacific LLC
Foreign Representative Office
15F One Corporate Avenue
222 HuBin Road
LuWan District Shanghai 200021
P.R. China
Phone: 86 21 6122 1098
Fax: 86 21 6122 2418

www.bfca.com

BENESCH
Friedlander Coplan & Aronoff LLP
Attorneys at Law