NEWSLETTERS

InterConnect FLASH! No. 31 – Bad Facts, Bad Law, Lessons Learned (Yet Again)

The InterConnect FLASH! Practical Bursts of Information Regarding Critical Independent Contractor Relationships

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There certainly is a bittersweet reaction within the industry regarding the recent Oregon Court of Appeals' decision in 3P Delivery Inc. vs. Employment Department Tax Section 254 Or App. 180 (2012). The reality of that decision is that bad facts make bad law, but there is an opportunity to learn some lessons from it all. In its decision, the Court found employee status for drivers who were parties to both an independent contractor operating agreement with a federally licensed motor carrier and an equipment lease with that same motor carrier. At first glance this is not particularly surprising, since direct motor carrier to independent contractor/owner-operator transactions are generally viewed as dangerous because they raise a red flag as to their genuineness and legitimate arm's length nature. However, the decision comes from a state that has an otherwise good owner-operator exemption in its statutes.

ORS 656.047 excludes from the definition of employment "transportation performed by motor vehicle for a for-hire carrier by any person that leases their equipment to a for-hire carrier and that personally operates, furnishes and maintains the equipment and provides services thereto." However, both the Administrative Law Judge (ALJ), who initially determined employee status, and the State Court of Appeals focused on the reality of the actual arrangement between the drivers and the motor carrier and were less than impressed with the words and phrases found in the documentation.

In a nutshell, the facts were that 3PD was a "last mile" delivery service which, in and of itself, is a segment that has its own set of issues regarding proper worker classification. 3PD delivered goods to customers for major retailers like Home Depot and Lowe's. The motor carrier and the drivers were parties to a typical independent contractor operating agreement ("ICOA") pursuant to which the drivers leased trucks to the motor carrier and provided driver services under the motor carrier's operating authority. The pitfall in this instance, however, was that the drivers also initially leased these trucks directly from the motor carrier pursuant to a separate equipment lease agreement in order to provide them back to the motor carrier under the terms of the ICOA.

Further, the equipment lease arrangement was a "full service lease" under which the motor carrier deducted from the driver's weekly settlements a flat fee for maintenance, insurance and fuel. Such a full service lease would almost automatically appear to take away any legitimate entrepreneurial decision-making from the driver, particularly with the inclusion of fuel. Quite typically, under full

service leases from a third party, insurance may be include as well as maintenance, although not necessarily on a flat rate, and very rarely is fuel included, since it is arguably a variable cost.

Finally, the equipment lease provided that it would terminate immediately upon termination of the ICOA. Thus, the ALJ found that the operator had no real interest in the truck beyond providing services to the motor carrier. He had no "possessory interest" so as to allow him to "furnish" the equipment as required by the statute. Thus, both the ALJ and the court viewed the transaction as essentially a legal fiction and a sham.

There are certainly those who view this interpretation of the owner-operator statutory exemption as incorrect and unnecessarily narrow. However, the Court of Appeals unfortunately could have been more diligent in considering the details of the Oregon Legislature's drafting of the statute.

Thus, the "bitter" part of the decision is that the arguably aggressive conduct of a motor carrier that has a respectable owner-operator exemption available to it creates disturbing ramifications, not only for the "last mile" segment of the industry, but also for all other segments as well. The "sweet" part of the decision is that it provides sound guidance as to how to strictly comply with the statutory provision so as to allow a motor carrier to participate in a legitimate "lease/lease-back" arrangement.

That being said, however, we maintain that, to the extent possible, the equipment lease arrangement should not be a direct motor carrier to owner-operator transactional relationship. An independent source of the vehicle is always helpful, whether it is from an affiliated entity or otherwise. To the extent that maintenance and insurance are involved, we regularly encourage that there be alternatives available to the equipment leasee rather than a captive "full service lease". This allows the owner-operator entrepreneurial discretion in decision-making with respect to the costs that affect his or her business. In any event, fuel should certainly be excluded.

And finally, avoid a blatant and obvious "tying" relationship between the termination of the Operating Agreement and the equipment lease. As qualified driver supply tightens, which the industry is currently experiencing and will continue to face, a legitimate equipment lease arrangement in our view remains a viable business transaction. Equipment leases can be used as a valuable recruiting tool in attracting independent contractor owner-operators to provide service to a motor carrier under its operating authority as contemplated by the Federal Leasing Regulations.

In the event that this information resonates with you, we at Benesch would be happy to have the conversation with you regarding the appropriate steps in revisiting the necessary documentation and conduct so as to avoid the pitfall that has percolated from Oregon.

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