Managing Supply Chain Risk

Best Practices to Avoid Liability for Your Supplier's Freight Costs

By Nicholas Ellis and Vanessa Miller

In the manufacturing sector and particularly in the automotive industry, most companies operate on a just-in-time basis. Each level of the supply chain maintains minimal inventory levels and instead relies on frequent deliveries of supplies that arrive and are used within a short period. Companies may maintain only a few days, or even a few hours, of inventory at any given time.[1] When everything functions smoothly, the rewards are greater efficiency and lower inventory costs. However, if even one supplier in the chain fails to meet its obligations, the effects can be felt throughout the supply chain. Thus, when a supplier fails to meet its obligations, goods may need to be shipped on an expedited basis. If expedited shipping is needed on an ongoing or frequent basis, the associated costs can mount rapidly. This is particularly true if expediting requires the use of air freight, which can cost tens of thousands of dollars per day.[2]

While each situation must be evaluated on its own merits, in our experience, most major manufacturers' terms and conditions provide that suppliers are responsible for expedited freight costs unless the delays are directly attributable to the buyer. However, what happens if the supplier refuses or is unable to pay the bill when it comes due? Can the freight

AT A GLANCE

In most industries, buyers expect their suppliers to pay any expedited freight needed to ensure timely delivery. But what happens if the supplier doesn't pay the freight company? Can the freight company look to the customer for payment? Buyers should follow certain best practices to mitigate the risk that they could be on the hook for their suppliers' expedited freight costs.

company look to the customer for payment? At least under Michigan law, the answer usually is no. However, companies should employ best practices when dealing with expedited freight issues to mitigate their risk of falling into an exception to the rule.

Michigan Court of Appeals: Customer is not liable for supplier's unpaid freight costs

The Michigan Court of Appeals addressed customer liability for supplier shipping costs in *Landstar Express America, Inc v Nexteer Automotive Corporation*. In *Landstar*, a plaintiff shipping company provided expedited freight services to a supplier that subsequently collapsed and ceased operations, leaving in excess of $5 million in unpaid freight charges. Unable to collect from the supplier, the freight company sought payment from the supplier's customer under two different theories. The freight company alleged that the customer should be held directly liable for the contract price under a doctrine of "consignee liability." Alternatively, the freight company alleged that the customer was "unjustly enriched" because it had avoided the harms it would have incurred had the supplier failed to meet its delivery obligations without paying for the expedited freight that had made this possible.[3]

A full discussion of the doctrine of consignee liability could fill a law review article on its own. The idea of such a doctrine (suggested largely by freight companies) has its roots in cases dating back more than 150 years suggesting that, in some cases, a contract may be implied to require that the consignee (the party receiving the shipment) be liable to pay the freight company if the consignor (the party delivering the goods to the freight company for shipment) fails to do so.[4]

In the early 1900s, a line of cases merged these discussions of consignee liability with interpretations of the now-defunct filed-rate doctrine[5] under the Interstate Commerce Act to create a *statutory* rule requiring that the consignee pay the filed rate if the consignor failed to do so.[6] The last of the statutes underlying the filed-rate doctrine was repealed in 1995; the recent trend among courts has been to recognize that there is no *common-law* rule requiring a consignee to be liable to pay for shipments if the consignor fails to do so.[7]

In *Landstar*, the Court rejected the freight company's assertion of a common-law doctrine of consignee liability and affirmed that under Michigan law, the party responsible to pay the freight company is the party that contracted with the company for the shipment.[8] In doing so, the Court recognized that prior cases that had enforced a doctrine of consignee liability did so under the now-repealed provisions of the Interstate Commerce Act, not a rule of common law.[9] However, the Court left open the possibility that, where there is no contractual expression of the parties' intent regarding responsibility for paying for the shipment, a court might look to any common-law presumptions that may exist regarding liability.[10] The Court of Appeals also left open the possibility that a separate contract could be formed through the consignee's acceptance of bills of lading requiring the consignee to pay for the shipment.[11]

Next, the Court rejected the supplier's alternative argument that the customer should be held liable under a theory of unjust enrichment.[12] In doing so, the Court relied primarily on the rule that a party cannot claim unjust enrichment if there is an express contract governing the subject matter of the dispute.[13] Although there is some inconsistency in Michigan jurisprudence as to whether an express contract between two parties bars claims for unjust enrichment against a third party,[14] the Court placed great emphasis on the fact that both of the relevant contracts (customer-supplier and supplier-freight company) consistently reflected the expectation of all parties (including the freight company) that the supplier was the party responsible to pay for the shipments.[15] While the customer may have received a benefit in the form of timely deliveries, this was a benefit it was entitled to receive under its contract with the supplier.[16]

Best practices and real-world application for manufacturers

What does this mean for manufacturers? The Michigan Court of Appeals' decision in *Landstar* generally reinforces what most companies likely take for granted: their suppliers are responsible to pay for expedited shipments. While the Court rejected *Landstar*'s arguments regarding consignee liability and unjust enrichment, the decision leaves open several issues; it remains possible that different circumstances may yield different results.

By applying the Court's decision in *Landstar* and general principles applicable to claims for unjust enrichment, there are several best practices that companies should follow to

limit the risk that they could be responsible for a supplier's shipping charges:

- Contracts should clearly and unequivocally address the supplier's obligation to pay for expedited freight costs.
- Carefully review any bills of lading or delivery confirmations and reject any language purporting to obligate the company as consignee of the goods to pay for the shipment. The supplier must agree that it is solely responsible for payment of shipping costs.
- When expedited freight is required, the supplier should be the party responsible for contacting the freight company and arranging the shipments.
- When possible, a supplier should use its own freight providers. If it is necessary to use the company's existing provider, the company should clearly document in writing that orders placed by the supplier are for the supplier's separate account.
- Steps should be taken to ensure that all invoices are addressed directly to the supplier.
- Companies should not allow any impression or misunderstanding that a supplier is acting on their behalf when arranging for expedited freight.
- Avoid any statements that could be construed as a representation regarding the supplier's ability to pay or a suggestion that the company will ensure payment. ■

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ENDNOTES

1. See, e.g., *Johnson Controls, Inc v TRW Vehicle Safety Sys, Inc*, 491 F Supp 2d 707, 709–710 (ED Mich, 2007) (noting that just-in-time delivery is a standard practice in the automotive industry).
2. *Landstar Express America, Inc v Nexteer Automotive Corp*, 319 Mich App 192, 197; 900 NW2d 650 (2017) ($5 million in expedited freight costs incurred over a span of seven months).
3. *Landstar Express America, Inc*, 319 Mich App at 192.
4. See, e.g., *Davis v Pattison*, 24 NY 317 (1862) (addressing whether an implied contract arose at the time consignee accepted goods from the freight company).
5. In an effort to prevent unfair business practices in the rail industry, the Interstate Commerce Act required common carriers to file their rates with the Interstate Commerce Commission. Carriers were not permitted to deviate (or discount) from the approved rates. See *Pittsburgh, C, C & St L Ry Co v Fink*, 250 US 577, 581; 40 S Ct 27 (1919).
6. *Pittsburgh*, 250 US at 579 and *New York Central & H R R Co v Whitney Co*, 256 US 406, 408; 41 S Ct 509 (1921).
7. *Western Home Transport, Inc v Hexco, LLC*, 28 F Supp 3d 959, 967–969 (D ND, 2014); *Canadian Nat Ry v Vertis*, 811 F Supp 2d 1028, 1037 (D NJ 2011); *Transit Homes of Am Division of Morgan Drive Away, Inc v Homes of Legend, Inc*, 173 F Supp 2d 1185, 1190–1191 (N D Ala 2001) (plaintiff cites to no authority holding that it could recover unpaid freight charges from a consignee in the absence of a federally mandated duty under the Interstate Commerce Act); and *Fikse & Co v US*, 23 Cl Ct 200, 202–204 (1991) (rejecting contention that a consignee's acceptance of the shipment by itself creates an express or implied obligation to pay the freight charges).
8. *Landstar Express America, Inc*, 319 Mich App at 199–200 (citing *Penn R Co v Marcelletti*, 256 Mich 411, 414; 240 NW4 (1932)).
9. *Id.* at 201 n 3.
10. *Id.* at 204 (citing *EW Wylie Corp v Menard, Inc*, 523 NW2d 395, 399 (ND 1994)).
11. *Id.* at 200 ("In [*New York Cent R Co v Brown*, 281 Mich 74; 274 NW 715 (1937)] the Court noted that by accepting the shipment and exercising dominion over it, the consignee had 'entered into the contract expressed in the bill of lading.' [Internal citation omitted.] And because the contract indicated that the defendant was the 'consignee' and that the freight was to be charged to the consignee, the defendant could not escape liability.").
12. *Id.* at 205–206.
13. *Id.* at 204 (citing *Belle Isle Grill Corp v City of Detroit*, 256 Mich App 463; 666 NW2d 271 (2003)).
14. *Id.* at 201–203 (citing *Morris Pumps v Centerline Piping, Inc*, 273 Mich App 187, 194; 729 NW2d 898 (2006)).
15. *Id.* at 205–206.
16. *Id.*