Crimping Entrepreneurship: The Attack on Motor Carrier Sponsored Equipment Acquisition Programs

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I. INTRODUCTION

It is the dream of many people to become their own boss – to establish a business over which they have control and where the rewards (or losses) are reflective of their ability and efforts expended in the endeavor. There are few industries where a realistic opportunity exists for individuals to achieve their dreams. In many industries, the capital required, the education needed, or other requirements make entry into the market extremely difficult. The trucking industry is a significant exception. The industry is composed of many small trucklines[1] and, more significantly, the use of independent businesspersons as independent contractors is a wide-spread practice.[2]

While there are few statistics reflecting the number of such independent businesspersons leasing motor carrier tractors to motor carriers, it is reasonably estimated that at least 368,000 are engaged.[3] With the anticipated growth of motor carriage in the United States, it can be expected that the number of

1. There are over 458,000 trucking companies of various sizes from the largest, with thousands of vehicles, to companies with only one truck. Seventy percent (70%) of the company driver employees operate six trucks or fewer and 88% of all truck lines can be classified as small businesses. Most are small partnerships or sole proprietors that own only one or two tractors and semi-trailers. *See* Professional Truck Driving Institute, *The Trucking Industry*, *available at* http://www.ptdi.org/careers/industry.aspx.

2. In this paper, the terms "owner-operator," "independent contractor," "independent businessperson," and "entrepreneur" are used interchangeably to reflect an individual who contracts a motor vehicle of which he or she holds title, or under a bona fide lease to a motor carrier, and chooses to drive that vehicle under the contract.

The Commercial Carrier Journal annually surveys the 250 largest motor carriers. In August of 2006, it reported statistics that the carriers had 618,630 drivers either as employees or owner operators and agents. Of this total, 481,967, or approximately seventy-eight percent, were company drivers while 136,663 or approximately twenty-two percent were owner operators. Twenty eight percent of the motor carriers operated solely driver employee fleets, twenty percent of the carriers operated exclusive owner operator fleets, with the remaining operating mixed fleets. *See* Avery Vise, *Another Very Good Year*, Com. Carrier J, Aug. 2006, at 86-96.

3. In 2006, over 1,673,950 truck drivers of Heavy and Tractor-Trailer vehicles were reported operating across the country. *See* U.S. Dep't of Labor: Bureau of Labor Statistics, *Occupational Employment and Wages*, May 2006, *available at* http://www.bls.gov/oes/current/oes533032.htm. The study cited in footnote 2 indicated that approximate 136,663, or twenty-two percent of total operators engaged by the 250 largest truckload carriers, were owner operators. The largest trade association of independent contractors in the trucking industry reports that it had 160,313 members on January 18, 2008. *See* Owner-Operator Independent Drivers Association, *Current OOIDA Membership*, *available at* http://www.ooida.com. The Bureau of Labor Statistics has estimated that independent contractors comprise ten percent of the total heavy-duty, long-haul distance labor force. *See* Inst. for Transp. Research & Educ. N.C., N.C. State Univ., *The Shortage of Long-Haul, Heavy-Duty Truck Drivers in North Carolina*, p. 11 (Sept. 2007). If this ten percent figure was applied to the entire BLS figure above, there would be 167,395 independent contractors in the United States trucking industry. This figure is probably inaccurate in light of the data set forth in footnote 2 and the fact that one trade association claims a membership with comparable numbers. A more reasonable estimate would be that at least 368,269 owner-operators exist based on the twenty-two percent figure in footnote 2.

owner operators will increase unless governmental interference at the federal and/or state level crimp such development.[4] Significantly, body politics have enacted a host of laws which encourage the use of independent contractors in a twisted way. They have done so by placing onerous burdens on the employer-employee relationship.[5] At the same time, however, governments discourage the use of such independent contractors even to the extent of enacting outright statutory provisions which do not recognize the difference between "employment" and "engagement," of an independent businessperson.

In North Carolina, for example, the independent contractor, who as a sole proprietor or a sub-contractor in providing service to a motor carrier, must be covered by workers' compensation insurance.[6] The more insidious interferences arise from body politics adopting unclear criteria for classifying workers and contradictory criteria within the venues, who then repeatedly change its interpretation over time.[7] One can only think of James Madison's sage observation:[8]

> It will be of little avail to the people that the laws are made by men of their own choice; if the laws are so voluminous that they cannot be read or so incoherent that they cannot be understood; if they . . . undergo such incessant changes that no one knows what the law is doing or can guess what it will be tomorrow.

Carriers and individual businesspersons in the motor carrier industry are in such a morass at this time.

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4. Global Insight, Inc., an economic consulting firm, conducted a study for the American Trucking Association and predicted that over the period 2004 – 2014 economic growth will generate a need for a 2.2% average annual increase in long-haul heavy tractor-trailer drivers or an overall increase of 320,000 drivers. Global Insight, Inc., *The U.S. Truck Driver Shortage: Analysis and Forecasts*, (May 2005) *available at* http://www.truckline.com/NR/rdonlyres/E2E789CF-F308-463F-8831-0F7E283A0218/0/ATADriverShortageStudy05.pdf.

5. See Table II to this article. This Table was prepared as part of a study by John Enright and William Dole, *Entrepreneurial Independent Contractors vs. The State*, Heartland Policy Study No. 56 (The Heartland Institute) April 30, 1993 at 7. The authors indicate that companies, by purchasing labor from independent contractors, are able to avoid a morass of government interference and costs. ***Id.*** at 16.

6. N.C. Gen. Stat. Ann. § 97-19 (West 2008). In Colorado, motor carriers must cover independent contractors with workers' compensation insurance or comparable occupational accident insurance. *See* USF Distrib. Serv., Inc. v. Indus. Claim Appeals Office of Colo., 111 P.3d 529 (Colo. App. 2004).

7. For example, see James C. Hardman, *Workers' Compensation and the Use of Owner-Operators in Interstate Motor Carriage: A Need for Sensible Uniformity*, 20 Transp. L.J. 255 (1992) and James C. Hardman, *Unemployment Compensation and Independent Contractors: The Motor Carrier Industry as a Case Study*, 22 Transp. L.J. 260 (1994).

8. James Madison, *Federalist Paper 62: The Senate*, (Feb. 27, 1788), *available at* http://federalistpapers.com/federalist62.html.

II. The "Employment Classification" Issue in Trucking Operations

While the use of independent businesspersons dates back to early trucking operations and has been instrumental in the growth of trucking, there has been a strong reluctance on the part of the federal and state governments to recognize the value of such individuals and how and why the relationship exists and is flourishing in the industry. There is seemingly an underlying perception that motor carriers only use the entrepreneurial independent contractor to avoid employment taxes and employment benefits, and to pay less compensation.[9] The economics of the relationship belie this. There are significant differences between what a carrier remunerates to a driver-employee and to an independent businessperson. Although there is no standardized payment program among carriers, a random selection of a motor carrier which operates with each type of participant indicates independent businesspersons were paid approximately 2.7 times the per mile remuneration paid to driver employee.[10] The percentage difference is intended to compensate the independent contractor for providing driver services, operational costs, employment taxes, a host of business expenses, and, hopefully, provide a profit. If the margin is not sufficient to prove satisfactory to undertake or continue one's own business, the independent businessperson has the option to contract with another motor carrier with a more favorable contract payment schedule or to decide that he or she would be economically better off to become a driver-employee.

Contrary to some perceptions in the legislative and administrative communities, independent businesspersons are not forced into that classification because they could not find a driver-employee position. This is clearly not true in the trucking industry.[11] In some areas of law, for example,

9. The AFL-CIO Building and Construction Trades Department ["BCTD"], for example, calls the use of independent contractors to be a "'scam' of unprecedented magnitude . . ., a thinly-veiled and illegal attempt to boost profits, deny workers health, retirement, workers' compensation, and unemployment benefits, and deprive state and federal governments of hundreds of millions of dollars in tax revenue." *See* AFL-CIO Weblog, *Bill Would End Employers' Worker Misclassification 'Scam,' available at* http://blog.aflcio.org/2007/09/14/bill-would-end-employers-worker-misclassification-scam/.

10. The conclusion was based on an informal and limited review of the advertisements of carriers in The Trucker, a national newspaper for the truckload industries, Vol. 21 No. 1 (Jan. 1-14, 2008); Vol. 20 No. 24 (Dec. 15-31, 2007); Vol. 20 No. 22 (Nov. 15-30, 2007); Vol. 20 No. 21 (Nov. 1-14, 2007).

11. The trucking industry indicates that it is facing a driver shortage which will remain a pressing problem for the industry for years to come. The American Transportation Research Institute ["ATRI"] has prepared a Report, *Critical Issues in The Trucking Industry - 2007* (Oct. 2007). A representative sample of carriers indicated that the driver shortage remains the number one issue facing the trucking industry. The same issue placed first in 2005 and placed second in 2006. Global Insight, Inc., *supra* note 4. Opportunities in either classification are readily available as evidenced by various printed publications available free at truckstops or otherwise and which over seventy percent of the content is opportunity advertisements for driver employees and independent contractors as opposed to news or

there is the feeling that if a person is injured "on-the-job," they should be entitled to receive workers' compensation whether they are an employee or an independent contractor.[12] Workers' compensation, however, was historically predicated on an employer-employee relationship and the concept that the remedy of a job related injury could best be sated by the employer paying for workers' compensation insurance and, in effect, accepting the liability without evidence of fault, and the employee waiving common law negligence relief.[13]

Few, if any, would argue with the above concept, but extending coverage beyond the employer-employee relationship to cover all individuals, including sole proprietors of their own business, is clearly not warranted unless the non-employee voluntarily chooses and pays for such coverage. Yet decisions made in the legal, administrative, and legislative arena indicate that this general view regarding "entitlements" is not limited to the workers' compensation ring, but is also present in other areas of law. The independent contactor relationship is not only under scrutiny to see that the "classification" decision is an honest and defendable one, but under attack in concept alone.

III. EQUIPMENT ACQUISITION IN THE TRUCKING INDUSTRY

Whether a motor carrier or an independent contractor, a challenge exists to obtain the equipment needed for their business to remain competitive and which provides the opportunity to operate efficiently and economically affording the opportunity for profitable operations. Essentially, motor carrier equipment is acquired in three manners.[14]

1. FINANCE Leases in which the financing company either remains as the owner of the vehicle until the lease is satisfied and title passes, or the title passes upon the financing and the financier secures a secured party until the lease terms are satisfied.[15] Such leases are frequently referred to as Conditional Sales Contracts. The term of the lease is definite, the purchase price and schedule of periodic payments set, and at the end of the term if the conditions are met, the title transfers and/or the lien is lifted. During the term,

features. *See* http://www.everyowneroperator.jobs.com/resources/owner-operator-magazines.html for a listing of representative publication.

12. See N.C. Gen. Stat. Ann. § 97-19.1 (West 2008). In Colorado, motor carriers must cover independent contractors with workers' compensation or "comparable" insurance coverage. USF Distrib. Serv., Inc. v. Indus. Claim Appeals Office of the State of Colorado, 111 P.3d 529 (Colo. App. 2004); *See also* Miss. Code Ann. § 71-3-5 (West 2008); Kan. Stat. Ann. § 44-504c(a)(1) (West 2008) ["Unemployment Compensation"].

13. Hardman, *supra* note 7, at 255-56.

14. For a more-detailed discussion of motor carrier equipment leasing, *See* Douglas G. Mayer, *True Leases Under Attack: Lessors Face Persistent Challenges to True Lease Transactions,*" 3 J. of Equipment Lease Financing 1 (2005).

15. State law, to a large extent, will determine the status. *See id.* at 5.

the lessee is considered the owner for tax purposes and secures the value of depreciation.

2. TRAC Leases in which the financing company leases the vehicle to the individual or entity for a term certain with fixed charges. The financing company keeps the title to the vehicle and enjoys the benefit of the depreciation. The parties agree to a schedule similar to an amortization table for determining the value of the vehicle periodically, usually on a monthly basis, and the lessee has the opportunity to purchase the vehicle during the term at the current "TRAC" value.[16] If the lessee does not exercise the foregoing option before or at the terms end, the financing company is obligated to sell the vehicle at fair market value. The lessee, as well as unrelated parties to the lessee, may bid to purchase the vehicle at the termination of the lease. If the sale price is less than the "TRAC" value at the lease's term end, the lessee is obligated to pay the difference to the financing company. If the fair market value sale price exceeds the "TRAC" value at terms end, the financing company may keep the full amount of the sale price or share a portion with the lessee.

3. TRUE Leases are strictly a "lease" or "rental" of the vehicle. The lease may be coupled with an option to buy the equipment. Usually, in the trucking industry, an option is given based on a projected fair market value at the inception of the lease or an option based on actual fair market value at the end of the lease. The lessor maintains the benefits of depreciation during its term and the lessee acquires no ownership rights during the lease term.

Each type of lease has its benefits. For example, a TRUE lease is especially beneficial to independent contractors in the trucking industry because:

(a) The term of lease normally involves a shorter period. The term period cannot exceed 80 percent of the equipment's useful life[17] and the monthly or periodic monetary requirements are less than a finance lease because the lessor keeps the benefit of depreciation which has more value to the lessor then as

16. "TRAC" refers to the Terminal Rental Adjustment Clause that requires the purchase or sale of the vehicle at the term end of the lease. The lessee is required to make an "unknown," open-ended payment to the lessor at lease term end; if the lessor does not receive proceeds of a sale or other disposition of the vehicle sufficient to recover investment plus its return on investment, the lessee must make up the shortfall. *Id.* at 11.

17. *See id.* at 3. For federal leasing guidelines for TRUE leases see *Bulletin No. 2001-19*, Internal Revenue Bulletin (Internal Revenue Serv., Wash., D.C.), May 7, 2001, at 1157-60, *available at* http://www.irs.gov/pub/irs-irbs/irb01-19.pdf.

opposed to the lessee. The lessee writes off the full lease payment as a current expense. Thus, a lower lease payment normally occurs.

(b) At the end of the shorter term period and assuming an option exists, the lessee has a choice. He or she may not exercise the option because they want to secure a newer vehicle which would have better features and/or be under a new warranty period. The market value of equipment may also have fallen and the lessee may feel he or she can get the same vehicle on the open market for less than the option price. The reverse could be true. The tractor is cheaper under the option than buying another vehicle in the market.

John Seibel, one of the pioneers in the field of lease-purchase programs in the trucking industry and current President of a highly-successful carrier related equipment leasing company,[18] indicated that many independent contractors enter a new TRUE lease for a new vehicle after the prior lease terminates as they desire to always have a vehicle under full warranty and with the latest features and accessories.[19] Some independent contractors have exercised options as well as entering into a new vehicle acquisition lease and developed a fleet operation[20] or, if the market price had risen over the option price, to secure title to the vehicle and sell it for a profit on the open market.[21] Mr. Seibel also indicated that with a FINANCE lease, the lessee has more of a visceral feeling that he or she is the "owner." Since the term of such leases is longer, the monthly or periodic payments are less and at the end of the term the lessee is a free and clear owner without any "option" payment or a large "last" payment. The acquisition is normally completed with the payment of one dollar or a nominal payment. Many lessees are also used to taking depreciation because of past experience and feel comfortable in such an arrangement.[22]

A TRAC lease has some of the advantages and disadvantages of each of the above depending on the parties involved and "market movement" during

18. Since the Lease-Purchase Program's inception in 1984, independent contractors of one trucking company Highway Sales, Inc. has served, Dart Transit Company, have purchased a total of 4,531 tractors, 1,333 with TRUE lease with buyout options and 3,198 with FINANCE and/or TRAC leases. Interview with John Seibel, President, Dart Transit Co. (Jan. 18, 2008). See Patricia Smith, *Lease Purchase Programs: Know the Laws*, Heavy Duty Trucking, July 2005, at 54 for information about John Seibel and the Highway Sales Program.

19. *See* Interview with John Seibel, *supra* note 18.

20. A "fleet operation" is a business where one individual or entity contracts two or more vehicles to one or more motor carriers with driver service. The fleet "owner," if an individual may or may not drive a vehicle himself or herself.

21. Generally, in recent years, the used tractor market has been favorable for the independent contractor to consider this option. *Id.*

22. *Id.*

the term. The TRAC leases are more common with bank financing because it affords the most market-value protection to the financier.[23]

Although a number of leasing sources are available to independent contractors, direct financing through programs sponsored by motor carriers is now popular among independent contractors.[24] Carrier sponsored programs may involve direct financing by the motor carrier, indirect financing through an affiliated financing company, or a participating independent third-party financing sources.[25]

IV. THE FUNDAMENTAL "OWNERSHIP" ISSUE

Despite the fact that independent contractors should have free choice in determining how to finance an equipment acquisition, some current statutes involving the employment classification issue have made it difficult for leasing parties to have assurance that the type of lease chosen will not influence the employment status.

The issue arises from the diversity over the meaning of the term "owner-operator" and variants of it in various states as evidenced by the following examples of statutory provisions:[26]

Example 1: Iowa Code 85.61(13)(c):

> An owner-operator who, as an individual or partner, or shareholder of a corporate owner-operator, owns a vehicle licensed and registered as a truck, road tractor, or truck tractor by a governmental agency, is an independent contractor while performing services in the operation of the owner-operators' vehicle if all of the following conditions are substantially present: . . .[27]

23. *Id.*

24. Financing is available through financing and leasing company, captive credit companies of equipment manufacturers, and franchised dealers/distributors of equipment in the motor carrier industry. *See e.g.* Wilson Cross, *Tackling the Equipment Finance Challenge: Varied Lease Options Can Be Tailored to Meet Your Needs*, Private Carrier, March 1998, at 17.

25. Although there are no statistics indicating how many motor carrier-sponsored programs exist, a review of any of the printed publications designed to attract owner-operator attention, *see e.g.* The Trucker, http://www.trucker.com (last visited Mar. 18, 2008), reflect a significant percentage of motor carriers offering lease-purchase plans. *See also* David Cullen, *Let them have trucks: Lease/rental vehicles attract owner-operators*, *available at* http://driversmag.com/ar/fleet_let_trucks_leaserental/ (last visited Mar. 18, 2008). Mr. Seibel also indicated that many such programs have "blossomed" in the past ten years. *See* Interview with John Seibel, *supra* note 18.

26. The Codes of Iowa (Iowa Code Ann. §85.61 (West 2008)), Louisiana (Lạ. Rev. Stat. Ann. § 23:1021 (2004)), Oklahoma (Okla. Stat. Ann. tit. 85, §3 (West 2007)), Kansas (Kan. Stat. Ann. §44-503c (2006)) involved workers' compensation while the Codes of Wyoming (Wyo. Stat. Ann. §27-3-108 (2007)) involved unemployment compensation and that of Washington (Wash. Rev. Code Ann. §51.08.180 (West 2008)) industrial insurance.

27. (Emphasis added). Iowa Code Ann. §85.61 (West 2008) *amended by* Iowa Legis. Serv. S.F.

Example 2: Louisiana Code Revised Statute 23:1021(10):

> <u>"Owner operator" means a person</u> who provides trucking transportation services under written contract <u>to a common carrier, contract carrier, or exempt haulers</u> which <u>transportation services include the lease of equipment or a driver to the common carrier, contract carrier, or exempt hauler</u>. An owner-operator and the drivers provided by an owner-operator, are not employees of any such common carrier or exempt hauler for the purposes of this Chapter if the owner operator has entered into a written agreement with the carrier or hauler that evidences a relationship <u>in which the owner operator</u> identifies itself as an independent contractor. <u>For purposes of this Chapter, owner operator does not include an individual driver who purchases his equipment from the carrier or hauler, and then directly leases the equipment back to the carrier or hauler with the purchasing driver</u>.[28]

Example 3: Oklahoma Code 85-1-§3-6:

> "Employee" shall not include a person, commonly referred to as an owner-operator, who owns or leases a truck-tractor or truck for hire, <u>if the owner-operator actually operates the truck-tractor or truck and if the person contracting with the owner-operator is not the lessor of the truck-tractor or truck</u>. . . .[29]

Example 4: Washington Code 51.08.180(1):

> "Worker" means every person in this state who is engaged in the employment of an employer under this title, whether by way of manual labor or otherwise in the course of his or her employment; also every person in this state who is engaged in the employment of or who is working under an independent contract, the essence of which is his or her personal labor for an employer under this title, whether by way of manual labor or otherwise, in the course of his or her employment, or as a separate alternative, a person is not a worker if he or she meets the tests set forth in subsections (1) through (6) of RCW 51.08.195: PROVIDED, That a person is not a worker for the purpose of this title, with respect to his or her activities attendant to operating a truck which <u>he or she owns</u>, and which is leased to a common or contract carrier.[30]

Example 5: Wyoming Code 27-3-108(x):

2317 & 2320 (West 2008).

28. (Emphasis added). Lạ. Rev. Stat. Ann. § 23:1021 (2004).
29. (Emphasis added). Okla. Stat. Ann. tit. 85, §3 (West 2007).
30. (Emphasis added). Wash. Rev. Code Ann. §51.08.180 (West 2008).

> By an individual who is the <u>owner and operator</u> of a motor vehicle which is leased or contracted with driver to a for-hire common or contract carrier. . .[31]

Example 6: Kansas Code 44-503c(2)(c)

> (2) As used in this subsection:
>
> (c) "<u>owner-operator" means an individual who is the owner</u> of a single motor vehicle that is driven exclusively by the owner under a lease agreement or contract with a licensed motor carrier.[32]

In some instances, the workers' compensation statute – or other similar statute – clearly indicate the term "owner-operator" includes a person who "owns or leases" the equipment.[33] In most instances, however, the term is not specifically defined.[34]

The experience the motor carrier industry had in the state of Missouri is a prime example of what could be a problem for sponsors of lease-purchase programs where TRAC or TRUE leases are involved and the lessee does not have title to the vehicle he or she wishes to use under an operating agreement with a motor carrier. The interpretation of the term "owner and operator" arose in three cases in Missouri.

In the first case, *Harp v. Malone Freight, Inc.*,[35] the operator of the vehicle under lease to the motor carrier was driving a tractor owned by his brother who was leased the vehicle to the motor carrier. The court found the exclusion of workers' compensation coverage did not apply because the statutory provision clearly did not exclude an individual who is an "operator" but not an "owner" of the leased truck.[36]

In *Owner Operator Independent Drivers Ass'n v. New Prime, Inc.*,[37] the applicability of the exclusion arose in the context of a class action for the

31. (Emphasis added). Wyo. Stat. Ann. §27-3-108 (2007).

32. (Emphasis added). Kan. Stat. Ann. §44-503c (2006).

33. *See e.g.* Okla. Stat. Ann. tit. 85, §3(9) (West 2007); Or. Rev. Stat. Ann. § 656.027 (West 2007). In Minnesota, an Administrative Rule also provides the same clarity. Minn. R. 3315.0525 (2008). The same recognition of a leasehold interest is recognized in the Minnesota Unemployment Compensation Statute. Minn. Stat. Ann. § 268.035 Subd. 25b (West 2008).

34. *See e.g.* Ala. Code § 25-1-1 (2007); Fla. Stat. Ann. § 440.62 (West 2006); Ga. Code Ann. § 40-2-87 (West 2008); Ind. Code Ann. § 22-3-7-9(b)(6) (West 2008); Mo. Code Regs. Ann. tit. 8, § 30-3.060 (2004); Tenn. Code Ann. § 50-6-106 (West 2007).

35. Harp v. Malone Freight Lines, 16 S.W.3d 667 (Mo. Ct. App. 2000), *overruled on other grounds by* Hampton v. Big Boy Steel Erection, 121 S.W.3d 220, 223 (Mo. 2003).

36. *Id.* at 670.

37. Owner Operator Indep. Drivers Ass'n v. New Prime, Inc. 133 S.W.3d 162 (Mo. Ct. App. 2004).

return of workers' compensation premiums which the independent contractors made because the motor carrier required workers' compensation coverage. Rejecting the carrier's argument that the definition of "owner," as used in other chapters of the statute, should be used to interpret the term, the court found that since workers' compensation coverage was intended to cover the largest possible class of people, the court felt that, "perhaps," this accounted for the legislators' choice not to adopt the broader definitions of "owner."[38] Noting that the equipment was leased by an affiliated leasing company of *New Prime* and the court specifically found that the lessee would not obtain any ownership interest in the vehicle during the period of the lease, the court applied the strict statutory construction applied by the *Harp* court.[39]

In the third case, *Nunn v. C.C. Mid West*,[40] the individual operator used his truck under a lease-purchase agreement with a leasing company related to the motor carrier. The lease provided that unless Mr. Nunn exercised his right-to-purchase option, "at times during the term of the Lease, no title to tractor shall vest in Lessee."[41] The Administrative Commission found the lease to be invalid in part because of the relation between the carrier and the leasing company.[42] The court rejected this relationship as a basis for finding the lease-purchase agreement was not at "arm's length" and found the lease valid and that the real issue was whether the lease itself created an ownership interest in Mr. Nunn.[43] The carrier raised the same arguments which were presented to the court in the *New Prime* case and after reviewing the decisions in the *Harp* case and the *New Prime* case, the court agreed that the lease did not create an ownership interest in the Lessee.[44]

These three cases resulted in the motor carrier industry seeking a statutory clarification of what was intended by the term "owner and operator" espousing that the term "owner" be defined as set forth in the Federal Leasing and Interchange Regulations, reading: "Owner – a person (1) to whom title to equipment has been issued, or (2) who, without title, has the right to exclusive use of equipment, or (3) who has lawful possession of equipment registered and licensed in any State in the name of that person."[45]

The statute was amended in 2005 and the new exclusion provision provides that a for-hire motor carrier operating under a "Certificate" issued by

38. *Id.* at 172-73.

39. *Id.* at 173.

40. Nunn v. C.C. Midwest, 151 S.W.3d 388 (Mo. Ct. App. 2004).

41. *Id*. at 393

42. The vehicle acquisition agreement was with a totally-owned subsidiary of the parent company of the carrier. *Id*. at 391.

43. *Id*. at 396-97.

44. *Id*. at 399.

45. 49 C.F.R. § 376.2(d) (2001).

a federal or state transportation regulatory agency should not be determined to be the employer of the Lessor as defined at 49 C.F.R. Section 376.2(f).[46] Significantly, in a provision dealing with "statutory employee" liability in the workers' compensation statute, exclusion was also provided for a relationship between a regulated motor carrier and ". . . an owner, as defined in subdivision (43) of Section 301.010, and operator of a motor vehicle".[47]

The cited section defines "owner" as follows:[48]

> (43) "Owner", any person, firm, corporation or association, who holds the legal title to a vehicle or in the event a vehicle is the subject of an agreement for the conditional sale or lease thereof with the right of purchase upon performance of the conditions stated in the agreement and with an immediate right of possession vested in the conditional vendee or lessee, or in the event a mortgagor of a vehicle is entitled to possession, then such conditional vendee or lessee or mortgagor shall be deemed the owner for the purpose of this law [.] . .

It is difficult to understand why the legislators would adopt such a convoluted definition and, while the definition expands the term "owner" beyond title holder, it appears that a TRUE lease, without an option to purchase, would not be excluded under the statutory employee provision. In any respect, it is clear that motor carriers and independent contractors have been and are in undefined territories because of legislators' and revisors' misunderstanding of how motor carrier operations are conducted generally and, in particular, in terms of lease-purchase plans.

V. Motor Carrier-Sponsored Equipment Acquisition Programs and Why They Exist

As previously noted, the trucking industry is one of the few industries where a realistic opportunity exists for individuals to achieve their dream to own and operate their own business. While the comparative capital cost of acquiring a truck and beginning business may be relatively small in relation to other businesses where hundreds of thousands or even millions of dollars are required, it is, and can be, a barrier. A new over-the-road tractor purchased from a franchised truck dealer by an individual owner-operator could cost anywhere from $97,000 to $125,000. A reasonable estimate of an average used tractor that is three years old would range from $55,000 to $65,000. Individuals do not have any significant ability to negotiate a lower purchase

46. Mo. Ann. Stat. § 287.041 (West 2007).
47. *Id.* § 287.040 (West 2007).
48. *Id.* § 301.010 (43) (West 2007).

price.[49]

Complicating the attempt of an individual to become an independent businessperson is the fact that financing companies have traditionally been very conservative in granting credit to individuals for truck purchases or have imposed high interest rates which make it difficult for any individual to succeed since contract payments to owner-operators were essentially flat until the past few years while the cost of equipment and financing has escalated tremendously.[50] Motor carriers on the other hand are in a position to avoid or control some of the risk problems an independent financier encounters, and many have established bona fide programs to allow new entrants achieve their goals or have allowed those already engaged in the business to upgrade their equipment. Motor carriers can make bulk purchases at lower prices and can secure discounted rates and credit terms which allow them to structure their programs at prices and credit terms which help the contractors make and meet the necessary financial commitments with attendant benefits to the motor carrier in terms of fleet size and quality.[51] The following chart shows other typical advantages the motor carrier or a related company has over the independent financier.

TABLE: ADVANTAGES OF THE MOTOR CARRIER OVER THE INDEPENDENT FINANCIER

ITEM	INDEPENDENT FINANCIER	MOTOR CARRIER
1. Background of Individual Applicant	Restricted to normal credit check information.	In addition to normal credit check information, has access to work information and health information as a result of government regulations.

49. Interview with John Seibel, *supra* note 18.

50. *See id.*

51. The motor carriers' benefit, in terms of attracting new entrants into the trucking industry desiring to become entrepreneurs and their own boss, include retaining existing operators who desire to change their status from a driver employee to an independent contractor, or securing individuals from other trucklines who do not offer such plans. The shortage and/or turnover of operators is acute in the industry and it is estimated to increase. *See* Global Insight, Inc., *supra* note 4. The plans offer an opportunity to tap the driver-employee and independent contractor pools. Having new equipment in the operation is beneficial in soliciting and securing freight because vehicle breakdowns decrease, cleaner and more attractive equipment is offered, and vehicle safety is enhanced. *See* Interview with John Seibel, *supra* note 18.

2. Tying Relation	Seldom can or will limit use of equipment to maintaining a contract with a carrier for full term of lease.	Can condition sale or lease to applicants on its use during finance period to subcontract work with it.
3. Purchase/Lease Payments	Has to rely on individual's sending prompt payment and monies not spent on other items.	Payment taken from contract payments otherwise due to individual and remitted to financier.
4. Vehicle Inspections to Assure Vehicle is Not Being Abused and Properly Maintained	Difficult to accomplish because vehicle is mobile and used throughout wide geographic area.	Sees vehicle on more regular basis as it moves between facilities or can be routed to a specific facility for inspection.
5. Contact	Very little if any personal contact after purchase/lease.	Contact virtually every day, frequently personal in nature. Can discuss problems, etc.
6. Damage to Equipment	No prompt notice or knowledge unless individual reports it.	Prompt notice and knowledge without individual reporting it or notice more likely.
7. Breaches	No advance indications except falling behind in payments.	Promptly aware of inactivity, health or injury data or safety problems affecting ability to meet contract terms.
8. Locating After Breach	Limited knowledge as to possible location of	Access to information related to COBRA,

	applicant or vehicle.	inquiries from other carriers individual seeks to serve; assistance of other carriers' sub-contractors to locate equipment.

In respect to item 1 above, motor carriers tend to grant credit with a greater emphasis on "work ethic" rather than current and/or potential financial ability.[52] Thus more individuals with limited financial assets are provided an opportunity to become entrepreneurs and work ethic has proven to be a good indication of success.[53]

Tying arrangements[54] not only account for the advantages of items 3 through 8 above, but also help assure the individual has a viable source of business available to the lessee,[55] and that there are not involuntary gaps in business revenue as an individual might attempt to secure business from other carriers if he or she had the freedom to move the equipment from carrier-to-carrier. Because of government regulations, moving from carrier-to-carrier involves certain obstacles (i.e., application inquiries, drug and alcohol tests, and so on) during which time the individual cannot haul.[56]

Motor carriers would also not consider such programs if it was thought that they would end up financing equipment used in a competitive carrier's operation.[57] Because of the advantages the motor carrier has, the independent businessperson can also secure advantages as follows:

52. Interview with John Seibel, supra note 18.

53. *Id*

54. "Tying" typically involves the seller of a product requiring a purchaser to take another product as well. In the situation under discussion, it refers to the personal practice of lessors of equipment requiring that the equipment be utilized in conjunction with a lease of the equipment with the related motor carrier. Historically, "tying" agreements were held and thought to be per se illegal and third-party financier lease contracts still are essentially void of such provisions whereas motor carriers-sponsored programs normally require such clauses and there is no indication that a legal problem exists. *See* Christian Ahlborn, David S. Evans, & A. Jorge Padilla, *The Antitrust Economics of Tying: A Farewell to per se Illegality*, The Antitrust Bulletin 287-88 (Spring-Summer 2004), *available at* http://www.usdoj.gov/atr/public/hearings/single_firm/comments/219224_b.htm.

55. Carriers will vary the number of vehicles leased to its realistic anticipation of freight which will be available for transportation by independent contractors. A lack of freight availability would not only hinder the independent contractors' ability to be a successful participant; but also hurt the motor carrier contracting the equipment. John Seibel believes "success" of participants is the strongest selling point of a program. Interview with John Seibel, *supra* note 18.

56. *See* 49 C.F.R. § 391 (2008).

57. Interview with John Seibel, *supra* note 18.

(1) Advantage of the Motor Carrier's Purchasing Power. Equipment costs are decreased and thus financing costs are reduced.[58]

(2) Risk Reduction. The motor carrier can afford to gamble on more individuals because the motor carrier's risks, as discussed above, are less than an independent financier's.

(3) Continuity of Subcontract Work. The interest of the motor carrier and the individual in terms of achieving success, i.e. the motor carrier completing a profitable transaction and the individual acquiring the tractor clear and free of any lien, portends that sufficient business is available for the individual to be successful financially. The motor carrier would not offer such programs if sufficient freight were not available and thus the individual has good assurance the opportunity for success exists.

(4) Professional Assistance. The interest of the motor carrier to have the transaction be a success also means that it will be a willing resource to the individual if assistance is needed in finding reputable maintenance shops, or administratively, in securing necessary licenses and permits, insurance, and other information helpful to new businesspersons.

Why would a motor carrier concern itself with helping individuals become a successful independent businessperson? Among the reasons are:

(1) Belief in Entrepreneurship. Many trucklines started as one-person businesses, and owners hold on to the principle that a person works smarter and harder if he or she feels they are working for themselves.

Dart Transit Company is an example of a motor carrier belief in entrepreneurship. In a greeting to independent contractors in a special edition of its newsletter for such contractors, Donald G. Oren, Past President and now Chairman of the carrier stated:

> Dart Transit Company is a unique carrier in that it still believes in the entrepreneurial spirit. Rather than rushing to company owned equipment and driver employees like many other carriers, Dart has maintained its confidence in the independent contractor and remains a 100% independent contractor fleet.
>
> We want you to have the continued opportunity to make basic decisions about your business and to experience the opportunities which exist as an independent businessman.

58. Highway Sales, Inc., for example, normally secures equipment in lots of 100 or more at a cost which could not be matched by an individual making an acquisition. *Id.*

> Some people do not understand what it means to own or control your own tractor with specs of your own desire. Some people do not understand the feeling that one experiences knowing that the harder and/or more intelligent one works, the more money one can earn. Some people do not understand that it's a good feeling to be able to decide how to expend income in the manner and for the purposes you determine.
>
> There are many in this country who want every person to be considered an employee so that their job of collecting taxes or imposing social schemes becomes easier, or because their own economic opportunities are enhanced in an employer-employee situation. Their attitude is that burdens can be transferred to others and economic benefit can be achieved by dealing with the "big guy" instead of many small businessmen such as yourself.
>
> We at Dart don't buy these stories. Dart started with one tractor under contract with an independent contractor and a trailer and has achieved its growth because it believed in the principles we now apply to our relationship with contractors as well as shippers and receivers of the freight we haul.
>
> Because of the threats to that spirit and relationship, we have prepared this document to reaffirm our position and to share it with you. We are confident that you will find it is to your benefit as well as ours to preserve the independent contractor relationship in the trucking industry.[59]

(2) Loyalty. A person who is given a meaningful opportunity to advance oneself and develop his or her own business will become a loyal subcontractor as long as the truckline continues to be fair and equitable in the contractual relationship.[60]

(3) Expansion Opportunities. Many trucklines, because of their size and access to capital do not have the capital to finance a driver-employee fleet.[61] The lease/purchase program allows funds to be used in other facets of the business.

(4) Explore New Markets. Consistent with expansion opportunities as discussed above, there is an extreme shortage of drivers in the industry.[62] The

59. Donald Oren, *To Our Valued Independent Contractors*, THE DART BOARD, Special Edition (October 13, 1988) at 233.

60. Many of the original group of individuals who were the first participants in the Highway Sales program and who have not retired still contract their vehicles to Dart and others have been contracted to Dart in double digit numbers of contract years. Interview with John Seibel, *supra* note 18.

61. It should be noted that the capital requirement is not merely financing the equipment, but is also financing things such as building and staffing maintenance and repair facilities or subcontracting to an independent business, and acquiring parking space since "company" equipment is normally "parked" at company facilities as opposed to owner-operators who generally drive their equipment to their homes or other parking spots.

62. *See* Global Insight, Inc., *supra* note 4, at 21.

"opportunity to become your own boss" can attract new entrants into the industry and to the carrier offering a lease/purchase program. It also affords an opportunity to compete for owner-operators by carriers who have historically only used driver-employees, but, because of the driver shortage, have now instituted owner-operator operations in part to secure "operators."

The advantages to both participants in the program are equally available whether the financing document is between the motor carrier and the independent businessperson or if an "affiliated" leasing company is involved.

VI. STATUTORY/ADMINISTRATIVE/JUDICIAL IMPEDIMENTS

Despite the clear and convincing evidence of the advantages and successes of the Purchase Lease Acquisition programs, states are taking action to preclude such programs or cripple existing programs by statutory provision or court and administrative decisions. An inherent problem facing motor carriers and independent contractors is that the state statutes covering areas in which the employment classification issue arises were frequently enacted to cover locally-based businesses where workers essentially provided service in one state and, to a large extent, in an industrial-factory setting. Even in the trucking industry, most carriers historically were involved in operations in a single state or a limited geographic area because of entry regulations and operational limitations.

The concept of multiple-state industrial or service operations was not envisioned. The deregulation of the trucking industry in the 1980s saw a proliferation of new trucklines and expansion of existing carriers into new territories and carrying a broad range of commodities.[63] While such expansion created new opportunities for business, it also created legal problems of operating in a "patch quilt" of state laws which had little uniformity in text, common law, or in factual application.

The lease-purchase plans are also a factor to consider in terms of needed "uniformity." South Carolina, for example, enacted a statutory provision in 2007 which exempts independent contractors in the trucking industry from workers' compensation coverage unless the equipment is acquired from the

63. Service offerings were limited to territories described in their operating certificates, and truckload carriers were limited to hauling specifically named commodities to limited geographical areas. The equipment and roads were not conducive for long journeys until the emergence of "Turn Pike" and Interstate Highways in the 1950s and, thereafter, with the completion of Designated Interstate Highway System in the late 1970s. This opened up expanded opportunities for motor carriers to extend their operations geographically. *See generally* Paul Stephen Dempsey, *Transportation: A Legal History*, 30 TRANSP. L.J. 235, 273, 293, 313-14, 343, 347 (2003) (discussing the evolution of motor carrier regulation).

motor carrier.[64] In Oklahoma, "owner-operators" who actually operate a truck-tractor or truck for-hire do not fall within the term "employee" for the purposes of workers' compensation with the provision that "the person contracting with the owner-operator is not the lessor of the truck-tractor or truck."[65] Under the Unemployment Compensation Insurance Act of Illinois,[66] employment does not include service performed by an individual as an operator of a truck, truck-tractor, or tractor if six specific factors are satisfied, one of which is that the person or entity:

> Either leases the equipment or holds title to the equipment, provided that the individual or entity from which the equipment is leased, or which holds any security or other interest in the equipment, is not:
>
> (i) The person or entity to which the individual is contracted for service, or
>
> (ii) Owned, controlled, or operated by or in common with, to any extent, whether directly or indirectly, the person or entity to which the individual is contracted for service or a family member of a shareholder, owner, or partner of the person or entity.[67]

Significantly, the legislators included specific definitions of the terms "family members," "ownership," "control," "operations," "persons," or "entity" which, presumably, would cover any and all relationships possible and for all practical purposes precludes lease-purchase plans.[68] This is evidenced by one example of the application of the relevant provision in the Illinois Administrative Code dealing with the issue. The example reads:

> Madison operates a truck for XYZ Trucking, a corporation in which Jefferson is a

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64. South Carolina Workers' Compensation Act, S.C. Code Ann. § 42-1-360(9) (2007). The applicable part of the provision reads:

> (9) an individual who owns or holds under a bona fide lease-purchase or installment-purchase agreement a tractor trailer, tractor, or other vehicle, referred to as 'vehicle', and who, under a valid independent contractor contract provides that vehicle and the individual's services as a driver to a motor carrier. For purposes of this item, any lease-purchase or installment-purchase of the vehicle may not be between the individual and the motor carrier referenced in this title, but it may be between the individual and an affiliate, subsidiary, or related entity or person of the motor carrier, or any other lessor or seller. Where the lease-purchase or installment-purchase is between the individual and an affiliate, subsidiary, or related entity or person of the motor carrier, or any other lessor or seller, the vehicle acquisition or financing transaction must be on terms equal to terms available in customary and usual retail transactions generally available in the State. This individual is considered an independent contractor and not an employee of the motor carrier under this title.

65. Oklahoma Workers' Compensation Act, Okla. Stat. Ann. tit. 85, § 3(9) (West 2008).

66. Illinois Unemployment Insurance Act, 820 Ill. Comp. Stat. Ann. 405/212-1 (West 2008).

67. 820 Ill. Comp. Stat. Ann. 405/212-1(a)(4); *see also* Illinois Administrative Code, Ill. Admin. Code, tit. 56, § 2732.205 (2008) (discussing the application of the provision).

68. 820 Ill. Comp. Stat. Ann. 405/212-1(d).

> five-percent shareholder. Madison holds title to the truck, but ABC Finance Company, which is managed by the brother of Jefferson's father-in-law, holds a lien on the truck. Section 212.1 does not exempt the services Madison performs for XYZ from the Act's definition of "employment", since the individual who operates ABC is a family member of a shareholder of XYZ.[69]

In New Jersey, the unemployment compensation statute provides that an exemption from unemployment compensation coverage exists for:

> Services performed by operators of motor vehicles weighing 18,000 pounds or more, licensed for commercial use and used for the highway movement of motor freight, who own their equipment or who lease or finance the purchase of their equipment through an entity which is not owned or controlled directly or indirectly by the entity for which the services were performed and who were compensated by receiving a percentage of the gross revenue generated by the transportation move or by a schedule of payment based on the distance and weight of the transportation move.[70]

It should be noticed that in each instance there are some variations as to the effect the test would have in terms of the lease-purchase plan and while they may not reflect a significant difference on first impression, the differences could be substantial. Initially, it should be noted that in Oklahoma, Illinois, and South Carolina, no limitation exists in terms of the size or weight of the vehicle, whereas New Jersey indicates the vehicle must weigh a minimum of 18,000 pounds or more. This weight limitation could affect the vehicle fleets of motor carriers engaged in local delivery, home delivery, messenger, courier, and other carriers which utilize smaller vehicles. It should also be noted that New Jersey limits the exemption to "highway movements." Does this include "highway routes within city limits?" Does it only include carriers who provide "X %" of their operations on highways versus city streets?

These statutes indicate the problems faced by carriers who may have facilities in multiple states and/or operate in intrastate or interstate commerce in multiple states. Apart from state statute issues, administrative agencies and the judiciary have considered the lease-purchase program issue and their decisions also account for problems facing motor carriers and independent contractors to engage in a relatively simple business agreement.

In *Byrne Trucking, Inc. v. Employment Division*,[71] for example, individuals entered into hauling contracts with the motor carrier pursuant to an arrangement wherein carrier-owned equipment was leased by the carrier to the operators who in turn leased it back to the carrier. The equipment leases provided that the equipment would be used exclusively in the carrier's service

69. Ill. Admin. Code, tit. 56, § 2732.205.

70. New Jersey Unemployment Compensation Law, N.J. Stat. Ann. § 43:21-19 (West 2002) (emphasis added).

71. Byrne Trucking, Inc. v. Employment Div., 587 P.2d 473, 474 (Or. 1978).

and if the hauling contract with the motor carrier was terminated the equipment lease would automatically terminate and the equipment would be returned to the carrier.[72] The court, in its review, discussed some provisions which are expressed other than in terms of independent contractors, in general, and lease-purchase plans, in particular. The court stated, "the arrangement . . . could have been found to be a subterfuge to make an employee who was operating [the motor carrier's] equipment appear to be something which he was not."[73] Continuing, it was said, "In light of these lease arrangements, the Division and the referee were entitled to look with a jaundiced eye at those situations in which the equipment was purported to have been sold by [the motor carrier] to the operators who then leased it back to [the motor carrier]."[74] It then stated:

> In the absence of proof that the agreements concerning ownership rights to the trucks were actually honored and were not forgotten upon termination of the hauling arrangement and that the agreements were other than paper transactions, [the motor carrier] could be found not to have carried its burden of proof that the services rendered were other than employment. [75]

The court continued, however, to address an issue which is of more concern to motor carriers. The case involved unemployment compensation taxes. One of the factors in resolving the employment classification issue was whether the individual was engaged in an independently established business.[76] The court also found that the fact that the individual owner or owners were purchasing from the carrier or others did not resolve the issue of whether they had an "independently-established business."[77] The court found that there was justification for the finding that the lessors were only using their equipment to make a job for themselves rather than that they were conducting an independently-established business.[78] The court stated: "[t]he operators' testimony that if they were terminated [by the motor carrier] they would make a similar arrangement with another [carrier] is irrelevant. Any workman who loses his job can go to work for someone else – providing there is another job for him to go to."[79] Continuing, the court said: "[u]nemployment compensation is designed to provide protection during those times when an arrangement cannot be made with another firm providing similar service because there is insufficient demand for similar services."[80]

72. *Id.* ("The leases also provide[d] for a purchase option.").

73. *Id.*

74. *Id.*

75. *Id.* (citing Mitchell Bros. Truck Lines v. Employment Div., 587 P.2d 475, 476 (Or. 1978)).

76. *Id.*; *see* Or. Rev. Stat. § 657.600(2)(b) (2005).

77. *Bryne Trucking, Inc.*, 587 P.2d. at 474.

78. *Id.* at 474-75 (the court cited the criteria to establish an "independent established business") (citing Kilpatrick v. Peet, 428 P.2d 405, 409 (Or. 1967)).

79. *Id.* at 475.

80. *Id.*

Apparently, no consideration was given to the fact that independent contractors, as independent businesspersons, voluntarily face the threat that their business might be unsuccessful and suffer demise.

On the other hand, there have been favorable decisions regarding lease-purchase plans. In *North American Van Lines, Inc. v. Nat'l Labor Relations Board*,[81] the motor carrier assisted drivers to finance the purchase of tractor equipment to establish their own business. It offered financing at competitive rates. The court rejected the agency's finding that the program evidenced an "employee" classification finding that the carrier's programs were essentially an "effort to support the drivers' efforts to establish their businesses and completed their contract tasks, as opposed to an effort to assert control over the details or manner of performance."[82] The court stated that the equipment acquisition was of such nature, noting: "NAVL offers [equipment] financing at competitive rates and frequently sells the financing agreement to third parties."[83]

While there is no doubt that the proverbial "con-artists" have existed as they do wherever money is involved and that some "fly-by-night" carriers had sponsored business faulty programs that may have broken existing laws or regulations, there is no evidence that this was and, more importantly, is now a considerable problem.

The proliferation of new programs,[84] the quality and reputation of motor carriers providing such programs,[85] and the acceptance of them by independent businesspersons[86] seemingly leads to the conclusion that the market has adjusted and that the problem programs, to the extent they existed, have been exposed and driven from the field or forced to make changes in their practices.

VII. THE BONA FIDE TEST

It is difficult to conceive why the person or entity which finances an equipment acquisition is per se of critical importance much less fully

81. N. Am. Van Lines, Inc. v. Nat'l Labor Relations Bd., 869 F.2d 596 (D.C. 1989).

82. *Id.* at 604.

83. *Id*.

84. Interview with John Siebel, *supra* note 18.

85. Some carriers, who have equipment acquisition programs such as C.R. England, Inc. and Dart Transit Company, have been recognized as "Elite Leaders" in the trucking industry. Deborah Lockridge, *Honoring Trucking's Elite Leaders Five outstanding trucking executives are recognized with Heavy Duty Trucking's annual Truck Fleet Innovators awards*, HEAVY DUTY TRUCKING, Mar. 2007, *available at* http://www.heavydutytrucking.com/2007/03/ 038a0703.asp; *see* Deborah Lockridge, *Don Oren A lasting legacy of operations and equipment innovation*, HEAVY DUTY TRUCKING, Jan. 2007, *available at* http://www.heavydutytrucking.com/2005/01/ 100a0501.asp; *see generally* Deborah Lockridge, *The Rise of Truckload Rebels With a Cause*, HEAVY DUTY TRUCKING, Jan. 2005, *available at* http://www.heavydutytrucking.com/2005/01/006a0501.asp.

86. Interview with John Siebel, *supra* note 18.

determinative of a person's status as an "independent contractor." The real issue is whether the purchase agreement and/or lease is a bona fide one. If a true legal agreement exists in which the parties have undertaken a contractual obligation for a bona fide purpose and said agreement is enforceable by its terms and in practice, the issue of the motor carrier or an affiliate being a party should be moot.

The bona fide test has been adopted in various state statutory provision or administrative regulations.[87] The bona fide test has also been recognized by the Internal Revenue Service. Although the "Twenty Common Law Factor Test" has been closely associated with the IRS' handling of the employment classification issue, the equipment acquisition program issue is not directly addressed in the test.[88] However, in various internal documents and educational releases, it is clear that the IRS has recognized that that leased vehicles are acceptable as meeting the issue of whether the holding of such equipment represents an investment in equipment and that the issue is whether the acquisition of the equipment was bona fide.[89]

In the Technical Guideline the IRS set forth a simple, concise, and sage test to create a strong influence that an independent contractor status exists as follows:

> (a) he/she owns the equipment or holds it under a bona fide lease arrangement;
>
> (b) he/she is responsible for the maintenance of the equipment;
>
> (c) he/she bears the principle burdens of the operating costs, including fuel, repairs, supplies, insurance, and personal expenses while on the road;
>
> (d) he/she is responsible for supplying the necessary personal services to operate the equipment;
>
> (e) his/her compensation is based upon a division of the gross revenue or a fee based upon the distance of the haul, the weight of the goods, the number of deliveries, or combination thereof; and
>
> (f) he/she generally determines the details and means of performing the services, in conformance with regulatory requirements, operating procedures of the carrier and specifications of the shipper.[90]

The IRS, in reality, has set forth the most extensive discussion of lease-purchase plans and sets forth tests or criteria upon which such programs will be judged.

87. *See, e.g.,* Minn. Stat. § 268.035(25)(b)(1) (2007); *see also* S.C. Code Ann. § 42-1-360 (2007) (with limitation); *see also* Minn. R. 5224.0290(2) (2007) (independent contractor).

88. *See* Rev. Rul. 87-41, 1987-1 C.B. 296.

89. *See, e.g,* I.R.S., EMPLOYMENT TAX PROCEDURE: TRUCKING INDUSTRY-CONTRACTOR OPERATIONS, INTERNAL REV. MAN., 46(10)2, 8479-5 (8-12-75).

90. *Id.*

In *Employment Tax Guidelines: Classifying Certain Van Operators in the Moving Industry*,[91] the IRS essentially weighed the Twenty Factor Test and relegated them by importance into "Critical Fact," "Significant Facts," "Other Relevant Facts," and "Facts of Little Relevance" categories. The critical factor in the classification test was determined to be whether the operator had "the potential to realize a profit or loss" and that the threshold criterion in determining this issue was whether the operator had "a substantial investment in equipment."[92] If not, the individual would be considered an employee.[93]

Seven requirements were set forth to make a determination of the equipment issue and each were discussed each in some detail. Initially, the IRS indicated that "[t]he parties must intend that the Van Operator have a substantial investment in the power equipment unit and must treat the transaction consistently with that purpose."[94] In setting forth the above-referenced requirement, the IRS indicated that "[t]he parties must document the transaction appropriately (that is, a title in the Van Operator's name in the case of a purchase and a note or other evidence of indebtedness if the purchase is financed, or a lease agreement in the case of a lease)."[95] The IRS indicated that "[t]he transaction will be examined considering the terms in light of all the facts and circumstances, including the overall relationship between the parties."[96]

A further requirement mandated that "[t]he purchase price or the valuation used to determine payments, in the case of a lease, must reflect a reasonable valuation for the power unit" and must be personally liable for the power unit.[97] Also,

> "[t]he Van Operator must be personally liable for payments if a purchase is

91. *See* I.R.S., EMPLOYMENT TAX GUIDELINES: CLASSIFYING CERTAIN VAN OPERATORS IN THE MOVING INDUSTRY 11-31 (1998), *available at* www.irs.gov/pub/irs-utl/van-ops.pdf (hereinafter "MSU"). The document was produced as part of the IRS' Market Segment Understanding Program [MSU] which the IRS initiated as an "innovative approach to resolving some longstanding disagreements with various industries on administrative or technical tax issues. An MSU identifies a particular area where the facts, law, or both are unclear, or noncompliance is widespread, within an independent market segment." *Id.* at 1. The program is similar to the Market Segment Specialization Program [MSSP] which produced a document covering the trucking industry *See* I.R.S., MARKET SEGMENT SPECIALIZATION PROGRAM, TRUCKING INDUSTRY 5-4–5-6, *available at* http://www.unclefed.com/SurviveIRS/MSSP/ truck.pdf. The Trucking Industry MSSP focuses on general audit techniques and basically does little more in terms of the classification issue than sets out the "Twenty Factor" Classification Test. *Id.* While the MSU refers to "Van Operators in the Moving Industry," it is submitted that the test essentially applies to all trucking. *See* I.R.S., EMPLOYMENT TAX GUIDELINES: CLASSIFYING CERTAIN VAN OPERATORS IN THE MOVING INDUSTRY 1 (1998).

92. MSU, *supra* note 91, at 9.

93. *Id.*

94. *Id.* at 13.

95. *Id.*

96. *Id.*

97. *Id.*

> financed or for lease payments in the case of a lease. If the purchase is financed, the amount of the payments must reflect a reasonable interest rate and reasonable amortization. In the case of a lease, the amount of the payments must reflect a reasonable interest rate."[98]

In expanding upon the issue of the of reasonable valuation, the IRS noticed that the amount of the purchase price or the valuation used to determine payments, in the case of a lease, would have to reflect a reasonable valuation for the tractor or truck. A reasonable valuation would be assumed if it is consistent with that derived from the *N.A.D.A. Official Commercial Truck Guide*, *The Truck Blue Book*, or similar source, adjusted for condition, mileage, bulk discounts, or other factors relevant to the individual power unit.[99]

In respect to personal liability for payments, the IRS specifically noted that "except in cases where the Van Operator pays the entire purchase price in a single payment, the Van Operator must be personally liable to make fixed periodic payments consistent with the form of the transaction."[100] The IRS specifically recognized that the payment may occur through deduction from the payments due the Van Operator from the carrier.[101]

In the case of a lease, the IRS' guidelines require fixed minimum payments. "If, however, there is a fixed minimum rental at fair rental value, the fact that a Van Operator may pay a higher rental based upon fees collected does not suggest the absence of a substantial investment."[102]

In the case of a financed purchase and in the case of a lease, the amount of the payments would have to reflect a reasonable interest rate. An interest rate would be considered reasonable if it was equivalent to rates charged by independent lenders or lessors providing financing for power units of similar type and quality or if it is at least equal to the applicable federal rate under section 1274(d) of the Internal Revenue Code.[103] "In the case of a variable interest rate, the rate is reasonable if, on the effective date of the loan and on any date the interest rate changes, the rate at least equals the applicable federal rate then in effect under section 1274(d)."[104]

If the purchase is financed, the IRS would require that the amount of the payments must reflect a reasonable amortization. Thus,

> [a]mortization of principal is reasonable if the amortization schedule is (1) similar

98. *Id.*

99. *See generally* N.A.D.A.**,** 2008 Official Commercial Truck Guide (2008); The Truck Blue Book, *available at* http://www.truckbluebook.com/.

100. MSU, *supra* note 91, at 14.

101. *See id.*

102. *Id.*

103. 26 U.S.C. § 1274(d) (2008).

104. MSU, *supra* note 91, at 14.

> to that offered by other financial institutions to comparable borrowers for a power unit of similar type and quality, or (2) at least sufficient to amortize the indebtedness over the greater of five years or the useful life of the power unit, if the taxpayer [Van Operator] can demonstrate a useful life greater than five years.[105]

The following example was set forth by the IRS to illustrate the requirement that the amount of the payment reflect a reasonable valuation of the power unit, a reasonable interest rate, and reasonable amortization:

> Example: The Van Operator and the Company enter into an agreement under which the Van Operator obtains from the Company a power unit for a term of five years. The power unit has a value of $50,000, according to the Truck Blue Book. The power unit is expected to have a residual value of $10,000 after five years. At the time the Van Operator and the Company enter into the agreement, the applicable federal rate under section 1274(d) is 7 percent. The agreement calls for monthly payments by the Van Operator.[106]

To calculate the minimum amount that would be considered a reasonable monthly payment under circumstances in the above example, two factors are relevant: (1) the amount of interest the Company would receive on the $50,000 value of the truck over five years (using the applicable federal rate on a declining monthly balance), and (2) the amount the Company would receive for the power unit's deprecation over five years.[107] The first computation shows that total interest payments of $10,617 would be required.[108] The second computation shows that total payments for depreciation of $40,000 would be required since only $10,000 of the power unit's original $50,000 value would remain after five years.[109] The total, $50,617, divided by sixty payments, yields a monthly payment of $844.[110] Thus, a substantial investment would be found only if the agreement required monthly payment of at least $844.[111]

The IRS also indicated that "the Van Operator must be free to select the entity from which the Van Operator obtains the power unit."[112] The IRS also indicated that "the Van Operator must be responsible for the vehicle, including maintenance, fuel, liability insurance, and risk of loss from damage or destruction."[113] If the lessor performs standard maintenance, the cost of maintenance must be included in determining the Van Operator's periodic

105. *Id.*
106. *Id.* at 15.
107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.*
111. *Id.*
112. *Id.*
113. *Id.*

payments and must be clearly shown as a separate cost item in determining the payment amount.[114]

In the case of a lease, the IRS would require that the arrangement must generally have duration of at least one year. [115]

The IRS also indicated that the agreement must provide for financial remedies against the Van Operator in the event of default.[116] A default may include the Van Operator's termination of association with the Company,[117] but the Company must demonstrate that it acted in a commercially reasonable manner to enforce the obligation.[118]

While the foregoing requirements evidence the seven basic requirements, the IRS also noted two other considerations in resolving the "bona fide" test. Initially, the IRS indicated that terms of the lease-purchase arrangement "must not undercut or diminish the substantial nature of the Van Operator's investment."[119] The arrangement has to "be considered in light of all the facts and circumstances, including the overall relationship between the parties."[120] The following example was given to illustrate a possible factual situation:

> <u>Example</u>: A Company decides to convert its employee-drivers to independent contractors. It tells its drivers that from now on, they must lease a power unit from the Company for $1,000 a month and the Company will lease it back from them at the same rate, plus an amount to reimburse the drivers for expenses such as fuel and oil changes, for which they will be responsible. Nothing else about the relationship between the parties will change. In this example, the overall relationship between the parties remains that of employer-employee; the Company controls the financial aspects of the drivers' work. The drivers do not have the opportunity for profit or loss.[121]

The IRS also indicated that an examiner must review all ancillary contracts, including the Federally-regulated lease, riders, and other side agreements and interview both the Company and Van Operator with respect to those agreements.[122] The IRS noted that companies often use multiple agreements, which may or may not be consistent.[123] If the documents are

114. *Id.*

115. *Id.* (the IRS did recognize the moving industry as seasonal and that the entire business relationship between the carrier and van operator may last for a shorter period, for example, May through September and that in such a case the leasing arrangement must have the same duration of the Van Operator's service or hauling agreement).

116. *Id.* at 16.

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.*

consistent with the characterization of the transaction by the parties, this supports, but is not conclusive of, a finding that the arrangement should be respected.[124] If the documents are inconsistent, further analysis would be needed.[125] Occasionally, the terms of a transaction in the opinion of the IRS are so altered by another agreement that the transaction is devoid of economic substance and should be disregarded.[126] In sum, the IRS indicated that an examiner must look to the true substance of the transaction.[127]

The following example was given by the IRS its concern:

> Example: A Van Operator leases a power unit from the Company for $1,000 a month. The lease agreement states that the Company will perform all maintenance and that the portion of the lease payment attributable to maintain is $250. The Van Operator also has an FHWA-regulated lease agreement to provide driving services and a power unit to the Company. The FHWA-regulated lease agreement provides that the Company will pay the Van Operator $1,000 a month for the sublease of the power unit and $8 an hour for hours worked. Under the FHWA-regulated lease, if the Van Operator stops driving for the Company, the power unit is returned to the Company, neither party is liable for its lease payments, and the Company pays the Van Operator the hourly rate for hours worked. In this example, the Van Operator does not have a substantial investment in the power unit or the risk of loss because the FHWA-regulated lease agreement relieves the Van Operator of liability to make the lease payments and guarantees the Van Operator $8 an hour for hours worked.[128]

This pronouncement of the IRS is extremely important in establishing lease-purchase plans, administering, valuating, and defending them in the context of a "bona fide" test. Equally important is the use of the Guidelines in the lobbying of states and other federal agencies to adopt statutes and/or regulations to recognize that any equipment requirement not only include an owned vehicle, but those held under a bona fide equipment lease.

VIII. REFLECTIONS UPON THE MARKET SEGMENT UNDERSTANDING

The Market Segment Understanding "MSU"[129] reflects a sage recognition that the employment classification should be determined in the context of a specific industry or portion thereof. It provides significant guidance in terms of motor carrier equipment acquisition programs as well as addressing the employment classification issue in general. At the same time, the MSU should not be considered an absolute answer to the propriety of a particular program or programs in general. Initially, concerns must be expressed that some basic

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124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.*
128. *Id.* at 16-17.
129. MSU, *supra* note 91, at 16.

misconceptions were made. It is felt that the IRS may have overlooked the fact that motor carriers and affiliated companies are not in the business of financing and leasing for the same reasons as third party financiers. The latter's rewards come from maximizing profits generated by their financing businesses. The larger and more successful motor carriers and their related companies seek profits generated by their financing and leasing of equipment, but the margin of such profits sought is tempered by the benefits flowing to the related, but prime, motor carrier business.

A general principle in the insurance industry is that premiums are related to the degree of risk involved. Financing and leasing embrace the same concept of the risks undertaken in the determination of finance terms and/or lease terms. If a motor carrier is able and willing to take a greater risk than the public financing companies, for the reasons previously discussed, and if the carrier is willing to accept a lower profit margin on leasing operations because of the advantages to its prime business, it does not appear logical to require the motor carrier to charge lease fees or finance charges comparable to those of independent financing companies.

The real issue is whether the individual purchaser or lessee is undertaking an obligation which will bear on his ability to make a profit or incur a loss. If the terms of the purchase or lease, coupled with contract terms covering the motor carrier service, are such as to guarantee the purchaser or lessee a profit, obviously the purchase agreement or lease is not bona fide. This was recognized in the MSU[130] and there is no dispute that a lease and motor carrier agreement involving circular payments is not a bona fide arrangement. The essential point should be whether a risk of making a profit or loss utilizing the equipment is present.

Some concern exists because the MSU has taken the position that the purchaser or lessee should have the unrestricted use of the equipment.[131] This should not be a requirement. Initially, it should be noted that if this were, in fact, a bona fide requirement, the motor carrier or affiliated company would be placed in a position where they could be financing equipment for use in their competitor's business or be creating new competitors by the purchasers or lessees.

The motor carriers and their affiliates would be facing the same risk as independent financing companies without any compensating benefits in their motor carrier business. Their programs would be nothing more or less than those of an independent financing company. While some motor carriers and affiliates may find the profit potentials attractive enough to accept such status, this is really not the intent or reasons why such programs are created and have

130. MSU, *supra* note 91, at 18. Where a Company prohibits a Van Operator from accepting jobs from other firms or individuals, right to control by the Company is indicated.

131. *Id.* at 18-19.

flourished. Further, many individuals would be precluded from their dreams of having their own vehicles and operate it as an independent businessperson.

Further, most tying arrangements which have been reviewed recognized that there may be occasions where the relationship must, because of law or otherwise, be terminated and provide that the tying provision may be renegotiated or resolved by some of the following methods:

(a) the individual making a security deposit to cover the increased risk of the vehicle being contracted to another carrier or if a security deposit was required initially to increase the amount of such deposit;

(b) the individual being able to refinance the vehicle by independent sources within a reasonable period of time;

(c) the individual being able to exercise a premature purchase of a leased vehicle at the higher of fair market value or what it would cost the lessor to secure a clear title;

(d) the individual agreeing to contract with a motor carrier approved by the seller or lessor.[132]

An individual should be able to agree to commit the equipment to one carrier for a set period of time to achieve his/her goal of acquiring ownership of equipment as long as it is being done voluntarily. The only possible bearing a tying arrangement should have on the employment classification issue is if the motor carrier uses the tying clause to exercise inappropriate direction and control over the individual business operations under the motor carrier contract. However, if the motor carrier's contract terms and practices involving individuals leasing or buying equipment are the same as for all independent contractors including those not in the equipment acquisition program, a tying arrangement should be a moot issue.

It is also felt that if the parties are faced with a default or merely want individually or jointly to terminate the lease of the equipment, the parties shall be able to provide alternatives to resolve these problems. The above-cited provisions, which have been used by drafters makes sense in a business setting being considered as "commercial reasonable steps" under the IRS standard,[133] are not deviate attempts to circumvent the substantial investment test or undertaking personal risks in the relationship.

The MSU position is that a bona fide lease must be for a minimum period of one year unless the lease is for the duration of the operating contract with

132. The MSU did not address the tying arrangement in the context of the termination of an Agreement and the examples cited are merely some drafters' attempts to resolve the issue in a "commercial reasonable manner.

133. The MSU merely talks of financial remedies in terms of the "Default Provision" whereas contract reformation might be a more sensible remedy. MSU, *supra* note 91, at 16.

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the motor carrier is less than one year.[134] The requirement of such a period does not appear to be sensible. If a lessee, for example, desires a six-month lease anticipating that he would purchase another vehicle from an independent company or the motor carrier when a new model is available, why should this raise an issue of whether the six-month lease is a bona fide one? A month lease for example, may be appropriate if the lessee's prime vehicle is undergoing major repairs and a second substitute vehicle is desired for use in meeting the lessee's operating contract with the motor carrier.

Private non-trucking independent businesspersons in other industries lease photocopy machines or computers on a month-to-month basis. Companies will lease a motor vehicle on a daily basis to meet peak delivery commitments. The period of the lease is not significantly relevant and material. The question is whether the individual Van Operator is providing equipment normally not furnished by an employee at his/her own expense and, based on its usage, whether the individual could stand to achieve a profit or suffer a loss. While a longer term lease agreement might tend to indicate a "more" significant investment, a specific term length as a gauge of being bona fide should not be dictated or controlling.

The above is particularly true since the requirement would not only apply if the lease is made through the motor carrier or an affiliated company. Why would a lease for a period of less than one year with an independent leasing company not raise the same bona fide issue that it is raised in respect to the motor carrier or affiliated company?

The requirement that the Van Operator must be free to select the entity for whom it obtains the vehicle[135] is also of concern except if this means Van Operator may not be forced to enter into a purchase agreement or lease with a person or entity not of his/her own choosing. If this requirement means that Van Operator must have the right to determine the franchised equipment dealer who sells or leases the vehicle to the entity sponsoring the purchase or lease program to the Van Operator, an objection exists.

It is not clear how this bears on the issue of substantial investment or employment classification. The program terms and success may and usually will be dependent upon the sponsor's source of equipment and the deal negotiated with that source in securing the equipment. The vehicle or vehicles which are available to the independent contractor are made known to the potential lessee who has the choice of choosing to accept the available vehicle or not before any acquisition is consummated. An equipment acquisition program cannot exist if each potential lessee were allowed to select the franchised dealer from which to secure the vehicle having it custom

134. MSU, *supra* note 91, at 15; *see also* note 115 for additional information.

135. *Id.*

specifications desired by an individual.[136] As previously discussed, such programs involve offer mass purchases of standard special equipment from a single source as means of being able to offer such equipment at advantageous terms.

Finally, franchised dealers or independent finance companies frequently charge four percent more interest on their deals as opposed to a motor carrier sponsored programs because their risks are greater and, in most instances, their overhead is higher.[137] Why should the motor carrier or affiliated company be forced to raise its rates merely to protect an independent contractor relationship?

While the federal interest rate is offered as a fall-back position, why should a motor carrier or affiliated company even be forced to charge this rate? The parties should be free to make this determination and if the motor carrier's program is seeking a greater interest rate than third party financiers, potential lessee should and will use other sources.

Economic common sense will keep motor carrier's from not seeking a reasonable profit on such programs. Even if the motor carrier or affiliated company were willing to break-even on the program, which is probably not realistic, it is difficult to conceive how this bears on the employment classification issue. The fact of the matter is that the independent contractors, in the context of his/her own situation, has made a substantial investment, abet a bargain one, to become an independent businessperson.

Thus, it is suggested that the question of a specific test the relationship of a payment to value is not a significant. The real issue, as stated before, is whether the independent contractor has taken on an obligation to acquire equipment not usually furnished by an employee and whether he/she has entered into a contract where the use of such equipment in a business involves a question of earning a profit or sustaining a loss.

IX. CONCLUSION

How can body politics justify legislation or regulations which effectively precludes are an individual's desire and dream to become an independent businessperson from becoming a reality? Many individuals want to be their own boss and be an independent businessperson. They recognize in doing so they are undertaking financial risks. How body politics justify effectively precludes an individual desire and dream to become an independent businessperson. These individuals should have the freedom to acquire equipment from a source they choose.

No governmental entity should undertake the task of determining what is

136. Interview with John Siebel, *supra* note 18.
137. *Id.*

good or bad for individuals in establishing or operating their business as long as no laws are violated. Penalizing motor carriers and individuals for choosing to participate in carrier sponsored programs is clearly a step in the wrong direction. Such bona fide programs are economically sound and advantageous to lessees. It is time that the crimping of such program by body politics is stopped.

TABLE II: HOW GOVERNMENT ENCOURAGES THE USE OF INDEPENDENT CONTRACTORS[138]

Burdens and Benefits	**Independent Contractor**	**Employee**
Tax Collection and Reporting	Employer withholds no taxes, reports to IRS annually with a single form.	Employer calculates, withholds, pays, and reports to several state agencies and IRS on monthly or quarterly basis.
Layoff or Firing	Employer pays no penalty unless termination involves a breach of contract.	Employer's unemployment Insurance tax rate increases when employees are terminated.
Wage Garnishment	Employer cannot be required to garnish checks.	Employer can be required to garnish wages for child support or other causes.
Civil Rights Suits	Difficult to prove discrimination by employers against independent contractors. Set-aside programs encourage independent contracting.	Discrimination relatively easy to prove. Affirmative Action programs are costly to administer and make firing difficult.
Americans with Disabilities Act	Independent contractors are not	"Reasonable accommodation"

138. John Enright and William Dole, *Entrepreneurial Independent Contractors vs. The State*, Heartland Policy Study No. 56 (The Heartland Institute) Apr. 30, 1993 at 7.

	covered.	requirements will take time and money to implement; lawsuits for noncompliance will be expensive.
Employee Benefits	Independent contractors provide their own benefits.	Tax benefits available to employers who provide employee benefit plans, but strings attached can make plan costly, "one-size-fits-all" plans rarely meet the needs of individual employees.
Immigration Law	Independent contractors are not covered.	Employee must verify employees' citizenship status and be prepared at all times for INS audit.
Overtime Provisions	Independent contractors are not covered.	Flextime discouraged by requirements that overtime be paid at time-and-a-half; part-time employees cannot work 40-hour weeks; salaried employees cannot be docked for partial days.
Business Expense Deductions	Independent contractors find it relatively easy to deduct personal investments in computer equipment, skills upgrading, etc.	Employees generally cannot deduct business expenses unless they can show the expense was required by their employer as a condition of keeping their job.