

QUALITY DISTRIBUTION INC  
Form 10-K  
March 16, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

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**FORM 10-K**

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x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

.. **TRANSITION REPORT PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from            to

COMMISSION FILE NUMBER 000-24180

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**Quality Distribution, Inc.**

(Exact name of registrant as specified in its charter)

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FLORIDA

59-3239073

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(State or other jurisdiction of  
incorporation or organization)

(IRS Employer  
Identification No.)

3802 Corporex Park Drive

Tampa, Florida 33619

(Address of principal executive offices) (zip code)

Registrant's telephone number, including area code:

813-630-5826

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**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:**

None

**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:**

Title of each class  
Common Stock (no par value per share)

Name of each exchange on which registered  
Nasdaq National Market

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Exchange Act Rule 12b-2). Yes  No

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes  No

Aggregate market value of voting stock held by non-affiliates as of June 30, 2005 was \$73.0 million (based on the closing sale price of \$8.85 per share).

As of February 28, 2006, the registrant had 19,053,988 outstanding shares of Common Stock, no par value, outstanding.

Documents Incorporated by Reference: Portions of the Proxy Statement for the registrant's 2006 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

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**INTRODUCTION**

In this annual report, unless the context otherwise indicates, (i) the terms the Company, Quality Distribution, QDI, we, us and our refer to Quality Distribution, Inc. and its consolidated subsidiaries and their predecessors and (ii) the terms Quality Distribution, LLC and QD LLC refer to our wholly owned subsidiary, Quality Distribution, LLC, a Delaware limited liability company, and its consolidated subsidiaries and their predecessors.

**FORWARD-LOOKING STATEMENTS AND CERTAIN CONSIDERATIONS**

This report along with other documents that are publicly disseminated by us contain or might contain forward-looking statements within the meaning of the Securities Exchange Act of 1934, as amended (the Exchange Act). All statements included in this report and in any subsequent filings made by us with the SEC other than statements of historical fact, that address activities, events or developments that we or our management expect, believe or anticipate will or may occur in the future are forward-looking statements. These statements represent our reasonable judgment on the future based on various factors and using numerous assumptions and are subject to known and unknown risks, uncertainties and other factors that could cause our actual results and financial position to differ materially. We claim the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act and Section 21E of the Exchange Act. Examples of forward-looking statements include: (i) projections of revenue, earnings, capital structure and other financial items, (ii) statements of our plans and objectives, (iii) statements of expected future economic performance, and (iv) assumptions underlying statements regarding us or our business. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as believes, expects, estimates, may, will, should, could, seeks, plans, intends, anticipates negatives of those terms, or other variations of those terms or comparable language, or by discussions of strategy or other intentions.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements. The forward-looking information is based on various factors and was derived using numerous assumptions. Important factors that could cause our actual results to be materially different from the forward-looking statements include the following risks and other factors discussed under the section 1A Risk Factors. These factors include:

general economic conditions,

the cyclical nature of the transportation industry due to various economic factors such as excess capacity in the industry, the availability of qualified drivers, changes in fuel and insurance prices, interest rate fluctuations, and downturns in customers business cycles and shipping requirements,

competitive rate fluctuations,

the availability of diesel fuel,

adverse weather conditions,

loss of qualified personnel, which could limit our growth and negatively affect operations,

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our dependence on affiliates and owner-operators and our ability to attract and retain owner-operators, affiliates and Company drivers, changes in, or our inability to comply with, governmental regulations and legislative changes affecting the transportation industry, increased unionization, which could increase our operating costs or constrain operating flexibility, our obligations under both historical and future environmental regulations and the increasing costs of environmental compliance,

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our substantial leverage and restrictions contained in our debt agreements, including our credit facility and our indentures,

our ability or inability to reduce our claims exposure through insurance due to changing conditions and pricing in the insurance marketplace,

the loss of one or more significant customers,

the cost of complying with existing and future anti-terrorism security measures enacted by federal, state and municipal authorities,

changes in senior management,

our ability to successfully integrate acquired businesses,

our ability to achieve anticipated operating results in fiscal 2006.

interests of Apollo Management, our largest shareholder, which may conflict with your interests, and

the potential loss of our ability to use net operating losses to offset future income due to a change of control.

In addition, there may be other factors that could cause our actual results to be materially different from the results referenced in the forward-looking statements.

All forward-looking statements contained in this Form 10-K are qualified in their entirety by this cautionary statement. Forward-looking statements speak only as of the date they are made, and we do not intend to update or otherwise revise the forward-looking statements to reflect events or circumstances after the date of this Form 10-K or to reflect the occurrence of unanticipated events.

**PART I**

**ITEM 1. BUSINESS**

**Overview**

We operate the largest dedicated bulk tank truck network in North America based on bulk service revenues reported by Bulk Transporter's 2004 Annual Gross Revenue Report. The bulk tank truck market in North America includes all items shipped by bulk tank truck carriers and consists primarily of the shipping of chemicals, gasoline and food-grade products. We transport a broad range of chemical products and provide our

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customers with value-added services and other logistics services. We are a core carrier for many of the Fortune 500 companies engaged in chemical processing, including The Dow Chemical Company, Procter & Gamble Company, E.I. duPont and PPG Industries, and we provide services to most of the top 100 chemical producers in the world with U.S. operations.

Our revenue is principally a function of the volume of shipments by the bulk chemical industry, our market share, and the allocation of shipments between tank truck transportation and other modes of transportation such as rail. The volume of shipments of chemical products are, in turn, affected by many other industries, including consumer and industrial products, automotive, paint and coatings, and paper, and tend to vary with changing economic conditions. Additionally, we provide leasing, tank cleaning, transloading and warehousing, which are presented as other service revenue. We also facilitate insurance products for drivers and affiliates through an independent third party. The principal components of our operating costs include purchased transportation, employee compensation, annual tractor and trailer maintenance, insurance, and technology infrastructure.

### **Our Industry**

We estimate, based on industry sources, that the for-hire North American bulk tank truck industry generated revenues of approximately \$9.0 billion in 2004. We operate in the highly fragmented for-hire segment of the



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chemical bulk transport market (estimated at \$6.5 billion) where we have achieved a leading market share. Our competition in the for-hire segment includes more than 200 smaller, primarily regional carriers. In addition to the for-hire segment, we also compete for the private fleet segment of the market by targeting private fleet operators who would benefit from outsourcing their transportation needs to us. Because we operate the largest dedicated bulk tank truck network in North America, we believe we are well-positioned to expand our business by converting private fleets.

Industry growth is generally dependent on volume growth in the industrial chemical industry and on the rate at which chemical companies outsource their transportation needs. As competitive pressures force chemical companies to reduce costs and focus on their core businesses, we believe that chemical companies will continue to consolidate their shipping relationships and seek to outsource a greater portion of their logistics needs to third-party carriers. We believe that large, national full-service carriers will benefit from this outsourcing trend and will be able to grow faster than the overall bulk tank truck industry.

Our industry is characterized by barriers to entry such as (i) the time and cost required to develop the capabilities necessary to handle sensitive chemical cargo, (ii) the financial and managerial resources required to recruit and train drivers, (iii) substantial industry regulatory requirements, and (iv) the significant capital investments required to build a fleet of equipment and establish a network of terminals. In addition, the industry continues to experience consolidation due to economic and competitive pressures, increasing operating costs for driver recruitment and insurance, and increasing capital investments for equipment and technology. As the cost and complexity of operating a bulk tank truck business increase and smaller competitors continue to exit the industry, we believe that large, well established carriers like ourselves will increase market share.

## **Development of Our Company**

Our Company was formed in 1994 as a holding company known as MTL, Inc. and consummated its initial public offering on June 17, 1994. On June 9, 1998, MTL, Inc. was recapitalized through a merger with a corporation controlled by Apollo Investment Fund III, L.P. As a result of the recapitalization, MTL, Inc. became a private company. On August 28, 1998, we completed our acquisition of Chemical Leaman Corporation and its subsidiaries ( CLC ). Through the 1998 acquisition, we combined two of the then-leading bulk transportation service providers, namely, Montgomery Tank Lines, Inc. and Chemical Leaman Tank Lines, Inc., under one operating company, Quality Carriers, Inc. ( QCI ). In 1999, we changed our name from MTL, Inc. to Quality Distribution, Inc. On November 13, 2003, we consummated the initial public offering of 7,875,000 shares of our common stock, no par value.

As of February 28, 2006, investment funds related to Apollo Management, L.P. owned approximately 54.5% of our common stock, and approximately 52.6% on a fully diluted basis after giving effect to stock options and warrants.

## **Services Provided**

### *Bulk Transportation Service*

We are primarily engaged in the business of bulk transportation of liquid and dry chemical products through our subsidiary, QCI and its Transplastics division ( TPI ). Business services are provided through Company-owned and affiliate terminals. As of December 31, 2005, 76 of 165 locations were Company operations and the remaining locations were affiliate operations. Owner-operators are heavily relied upon to fulfill

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driver and tractor needs at both Company and affiliate terminals. We believe the combination of the affiliate program and the emphasis on the use of owner-operators results in an efficient and flexible operating structure that provides superior customer service.

### *Affiliate Program*

Affiliates are established and maintained by their owners as independent companies with individualized, parochial profit incentives designed to stimulate and preserve the entrepreneurial motivation common to small

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business owners. Each affiliate enters into a comprehensive contract with QCI pursuant to which the affiliate is required to operate its bulk tank truck enterprise exclusively for and on behalf of QCI, subject to limited exceptions. Each affiliate is supported by our corporate staff and is linked via computer to central management's information systems located at the Tampa, Florida headquarters of QDI.

Affiliates gain multiple benefits from their relationship with QCI, such as improved equipment utilization through access to our network of operating terminals, access to, and enhancement of, our broad national and local customer relationships, national driver recruitment, standardized safety training (for drivers, tankwashers and mechanics) and expanded marketing and sales resources, combined with sophisticated marketplace/competitive research. Affiliates gain further value from QCI's management information systems, which provide essential operating and financial reports while simplifying daily operating situations with system-wide technology support (TMW Systems, Incorporated (TMW)) dispatch/billing platforms and en-route electronic linkage with each vehicle). Affiliates also derive significant financial benefit through our purchasing leverage on items such as insurance coverage, tractors, fuel and tires.

Affiliates predominantly operate under the marketing identity of QCI and typically receive a percentage of gross revenues from each shipment they transport. Affiliates are responsible for their own operating expenses such as licenses and workers' compensation insurance. We pay affiliates each week on the basis of completed billings to customers from the previous week. Our weekly settlement program deducts any amounts advanced to affiliates (and their individual drivers) for fuel, insurance, loans or other miscellaneous operating expenses, including rental charges for QCI's tank trailers. We reimburse affiliates for certain expenses billed back to customers, including fuel, tolls and scaling charges.

Our contracts with affiliates typically carry a one-year term and thereafter renew on an annual basis, unless terminated by either party. Affiliate contracts uniformly contain restrictive covenants prohibiting them from competing directly with QCI for a period of one year following termination of the contract. In addition, affiliates are required to meet all QCI standard operating procedures as well as being required to submit regular financial statements.

Affiliates engage and/or employ their own drivers and personnel. Affiliates also engage owner-operators as drivers. All affiliate personnel must meet QCI's operating standards/requirements.

Affiliates are required to pay for and provide evidence of their own workers' compensation coverage, which must meet both Company-established and statutory coverage levels. Affiliates are provided, as part of their contract, property damage and general liability insurance, subject to certain deductibles per incident. Expenses exceeding the prescribed deductible limits of the affiliate are the responsibility of QCI or its insurer.

### *Owner-Operators*

QCI terminals and affiliates extensively utilize owner-operators. Owner-operators are independent contractors who, through a contract with QCI, supply one or more tractors and drivers for QCI or affiliate use. QCI retains owner-operators under contracts generally terminable by either party upon short notice.

In exchange for the services rendered, owner-operators are normally paid a fixed percentage of the revenues generated for each load hauled or on a per mile rate. The owner-operator pays all tractor operating expenses such as fuel, physical damage insurance, tractor maintenance, fuel

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taxes and highway use taxes. However, we reimburse owner-operators for certain expenses passed through to our customers, such as fuel surcharges, tolls and scaling charges. QCI attempts to enhance the profitability of our owner-operators through purchasing programs offered by us directly or indirectly through outsourcing arrangements that take advantage of our significant purchasing power. These programs cover such operating expenses as tractors, fuel, tires, occupational,-accident and physical damage insurance.

Owner-operators utilized by QCI or an affiliate must meet specified guidelines for driving experience, safety records tank truck experience and examinations in accordance with U.S. Department of Transportation

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( DOT ) regulations. We emphasize safety to our independent contractors and their drivers and maintain driver safety inspection programs, safety awards, terminal safety meetings and stringent driver qualifications.

### *Tank Wash Operations*

To maximize equipment utilization and efficiency we rely on 32 tank wash facilities owned and operated by us in our subsidiary Quality Services, Inc. ( QSI ), and 15 affiliate-owned tank wash facilities located throughout our operating network. These facilities allow us to generate additional tank washing fees from non-affiliated carriers and shippers. Management believes that the availability of these facilities enables us to provide an integrated service package to our customers and minimize the risk of cost escalation associated with reliance on third-party tank wash vendors.

### *Driver Recruitment and Retention*

QCI and its affiliates dedicate significant resources to recruiting and retaining owner-operators and our own drivers. Company drivers and owner-operators are hired in accordance with specific guidelines regarding safety records, driving experience and a personal evaluation by our staff. We employ only qualified drivers who meet our standards. These drivers are required to attend a rigorous training program conducted at one of our six safety schools.

Driver recruitment and retention is a primary focus for all operations personnel. Each terminal manager has direct responsibility for hiring drivers. We use many of the traditional methods of driver recruitment as well as using many newer methods of driver recruitment, including the use of the Internet. QCI also has recruiting departments at the Tampa corporate office and the regional field offices.

From time to time, we facilitate driver recruitment by offering tractors through lease or purchase agreements. We also offer incentives to the owner-operators and affiliate drivers to purchase the specialized equipment needed to handle liquid chemicals.

### *Drivers and Owner-Operators*

At December 31, 2005, we utilized 3,244 drivers. Of this total, 1,798 were owner-operators, 1,167 were affiliate company drivers, and 279 were Company drivers.

### *Company Personnel*

At February 28, 2006, we employed 1,079 personnel, including 325 Company drivers.

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We provide our employees with health, dental, vision, life, and other insurance coverages subject to certain premium sharing and deductible provisions.

### *Union Labor*

At December 31, 2005, we had 191 employees (78 drivers) in trucking, maintenance or tank wash and approximately 133 employees at three affiliate terminals who were members of the International Brotherhood of Teamsters.

### *Tractors and Trailers*

As of December 31, 2005, we managed a fleet of approximately 3,500 trucks and 7,500 tank trailers. The majority of our tanks are single compartment, chemical-hauling trailers. The balance of the fleet is made up of multi-compartment trailers, dry bulk trailers, and special use equipment. The chemical transport units typically

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have a capacity between 5,000 and 7,000 gallons and are designed to meet DOT specifications for transporting hazardous materials. Each trailer is designed for a useful service life of 15 to 20 years, though this can be extended through upgrades and modifications. Each tractor is designed for a useful life of 5 to 7 years, though this can be extended through upgrades and modifications. We acquire new tractors for an initial utilization period of seven years.

Many of our terminals and our affiliate terminals perform preventative maintenance and receive computer-generated reports that indicate when inspection and servicing of units are required. Our maintenance facilities are registered with the DOT and are qualified to perform trailer inspections and repairs for our fleet and for equipment owned by third parties. We also rely on unaffiliated repair shops for many major repairs

The following table shows the age of trailers and tractors we managed as of December 31, 2005. All numbers are approximated as of such date:

<b>TRAILERS (1)</b>	<b>LESS THAN</b>	<b>3-5</b>	<b>6-10</b>	<b>11-15</b>	<b>16-20</b>	<b>GREATER THAN</b>	<b>TOTAL</b>
	<b>3 YEARS</b>	<b>YEARS</b>	<b>YEARS</b>	<b>YEARS</b>	<b>YEARS</b>	<b>20 YEARS</b>	
Company	134	159	1,796	814	1,718	1,191	5,812
Affiliate	87	173	461	189	130	230	1,270
Owner-Operator			5	7	5	2	19
Shipper Owned	115	60	36	47	53	49	360
<b>Total</b>	<b>336</b>	<b>392</b>	<b>2,298</b>	<b>1,057</b>	<b>1,906</b>	<b>1,472</b>	<b>7,461</b>

We also have 384 trailers that are held-for-sale.

<b>TRACTORS (1)</b>	<b>LESS THAN</b>	<b>3-5</b>	<b>6-10</b>	<b>11-15</b>	<b>GREATER THAN</b>	<b>TOTAL</b>
	<b>3 YEARS</b>	<b>YEARS</b>	<b>YEARS</b>	<b>YEARS</b>	<b>15 YEARS</b>	
Company	149	291	201	31	13	685
Affiliate	474	418	271	64	8	1,235
Owner-Operator	205	397	790	171	52	1,615
Shipper Owned	1	3				4
<b>Total</b>	<b>829</b>	<b>1,109</b>	<b>1,262</b>	<b>266</b>	<b>73</b>	<b>3,539</b>

(1) Age based upon original date of manufacture; tractor/trailer may be substantially refurbished or re-manufactured.

*Leasing*

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We lease tractors and trailers to affiliates and other third parties, including shippers. Tractor lease terms range from 6 to 60 months and normally include a purchase option. Trailer lease terms range from 1 to 84 months and do not include a purchase option. We derive a portion of our income from leasing these units to customers and affiliates.

### *Owner-Operator and Affiliate Services*

We offer purchasing programs that take advantage of our significant purchasing power for products and services such as fuel, tractors, and tires as well as physical damage, occupational-accident and workers compensation insurance. We believe that these programs strengthen our relationship with our owner-operators and improve driver recruitment.



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Through an outsourcing agreement with an unaffiliated insurance brokerage company and our subsidiary, PPI, we offer insurance products and other services to both our affiliates and to our owner-operators at favorable prices. In return, PPI receives a percentage of certain commissions, underwriting profits, administrative and other deferred revenues related to these outsourced insurance-related services.

## **MARKETING**

We conduct our marketing activities at both the national and local levels. We employ geographically dispersed sales managers who market our services primarily to regional accounts. These sales managers have extensive experience in marketing specialized tank truck transportation services. The national corporate sales staff concentrates on selling to a defined national account base. In addition, significant portions of our marketing activities are conducted by regional sales directors in conjunction with our terminal managers and dispatchers who act as local customer service representatives. These managers and dispatchers maintain regular contact with shippers and are well positioned to identify the changing transportation needs of customers in their respective geographic areas.

## **CUSTOMERS**

Our revenue base consists of customers located throughout North America, including many Fortune 500 companies such as The Dow Chemical Company, Procter & Gamble, PPG Industries, and E.I. duPont. During 2005, 2004 and 2003, Dow Chemical accounted for approximately 10.2%, 10.2%, and 11.3% of operating revenue, respectively. In 2005, our 10 largest customers accounted for 31.2% of operating revenues.

## **ADMINISTRATION**

As of December 31, 2005, we operated approximately 165 terminals (excluding transload facilities) throughout the United States as well as in Canada. Company-owned and affiliate terminals operate as separate profit centers and terminal managers are responsible and accountable for most operational decisions. Effective supervision requires maximum personal contact with customers and drivers. Therefore, to accomplish mutually defined operating objectives, the functions of customer service, dispatch and general administration typically rest within each terminal. Cooperation and coordination is further encouraged by our backhaul program.

From the corporate offices in Tampa, Florida, management monitors each terminal's operating and financial performance, safety and training record, accounts receivable and customer service efforts. Terminal managers ensure the terminals remain in compliance with safety, maintenance, customer service and other operating procedures. Senior corporate executives, safety department personnel and audit department personnel conduct unannounced visits to verify terminal compliance. We strive to achieve uniform service and safety at all Company-owned and affiliate terminals, while simultaneously affording terminal managers the freedom to focus on generating business in their regions.

## **COMPETITION**

The tank truck business is competitive and fragmented. We compete primarily with other tank truck carriers and dedicated private fleets in various states within the United States and Canada. With respect to certain aspects of our business, we also compete with intermodal

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transportation and railroads. Intermodal transportation has increased in recent years.

Competition for the freight transported by us is based primarily on rates and service. Management believes that we enjoy significant competitive advantages over other tank truck carriers because of our low fixed cost structure, overall fleet size, national terminal network and tank wash facilities.

Our largest competitors are Trimac Transportation Services Ltd., Schneider National, Inc. and Superior Carriers, Inc.; however, there are many other smaller recognized tank truck carriers, most of whom are primarily regional operators.

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We also compete with other motor carriers for the services of our drivers and owner-operators. Our overall size and our reputation for good relations with affiliates and owner-operators have enabled us to attract qualified professional drivers and owner-operators. We would like to expand our driver complement by 10% in 2006.

Competition from non-trucking modes of transportation and from intermodal transportation would likely increase if state or federal fuel taxes were to increase without a corresponding increase in taxes imposed upon other modes of transportation.

## **RISK MANAGEMENT, INSURANCE AND SAFETY**

The primary insurable risks associated with our business are bodily injury and property damage, workers' compensation and cargo loss and damage. We maintain insurance against these risks and are subject to liability as a self-insurer to the extent of the deductible under each policy. We currently maintain liability insurance for bodily injury and property damage with an aggregate limit on the coverage in the amount of \$40 million, with a \$5 million per incident deductible.

We currently maintain a \$1 million per incident deductible for workers' compensation insurance coverage. We are insured over our deductible up to the statutory requirement by state. We are self-insured for damage or loss to the equipment we own or lease, and for cargo losses.

We employ personnel to perform compliance checks and conduct safety tests throughout our operations. We conduct a number of safety programs designed to promote compliance with rules and regulations and to reduce accidents and cargo claims. These programs include training programs, driver recognition programs, safety awards, an ongoing Substance Abuse Prevention Program, driver safety meetings, distribution of safety bulletins to drivers and participation in national safety associations.

## **ENVIRONMENTAL MATTERS**

It is our policy and the policy of each of our subsidiaries to be in compliance with all applicable environmental, safety, and health laws. We also are committed to the principles of Responsible Care<sup>®</sup>, an international chemical industry initiative to enhance the industry's responsible management of chemicals.

Our activities involve the handling, transportation and storage of bulk chemicals, both liquid and dry, many of which are classified as hazardous materials or hazardous substances. Our tank wash and terminal operations engage in the creation, storage or discharge and proper disposal of wastewater that may contain hazardous substances, and the control and discharge of storm-water from industrial sites. In addition, we may store diesel fuel and other petroleum products at our terminals. As such, we and others who operate in our industry are subject to environmental, health and safety laws and regulation by U.S. federal, state and local agencies and Canadian federal and provincial governmental authorities. Environmental laws and regulations are complex, and address emissions to the air, discharge onto land or water, and the generation, handling, storage, transportation, treatment and disposal of waste materials. These laws change frequently and generally require us to obtain and maintain various licenses and permits. Environmental laws have tended to become more stringent over time, and most provide for substantial fines and potential criminal sanctions for violations. Some of these laws and regulations are subject to varying and conflicting interpretations.

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Facility managers are responsible for environmental compliance at each operating location. Audits conducted by our staff assess operations, safety training and procedures, equipment and grounds maintenance, emergency response capabilities and waste management. We may also, if circumstances warrant, contract with independent environmental consulting firms to conduct periodic, unscheduled, compliance assessments that focus on unsafe conditions with the potential to result in releases of hazardous substances or petroleum, and that also include screening for evidence of past spills or releases. Our staff includes environmental professionals who develop guidelines and procedures, including periodic audits of our terminals, tank cleaning facilities, and historical operations, in an effort to avoid circumstances that could lead to future environmental exposure.

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As a handler of hazardous substances, we are potentially subject to strict, joint and several liability for investigating and rectifying the consequences of spills and other environmental releases of such substances under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended ( CERCLA ), the Resource Conservation and Recovery Act of 1976 ( RCRA ), the Superfund Amendments and Reauthorization Act of 1986, and comparable state and Canadian laws. From time to time, we have incurred remedial costs and regulatory penalties with respect to chemical or wastewater spills and releases at our facilities and on the road, and, notwithstanding the existence of our environmental management program, we cannot assure that such obligations will not be incurred in the future, nor predict with certainty the extent of future liabilities and costs under environmental, health, and safety laws, nor that such liabilities will not result in a material adverse effect on our financial condition, results of operations or business reputation.

In addition, we may face liability for alleged personal injury or property damage due to exposure to chemicals and other hazardous substances at our facilities or as the result of accidents and spills. Although these types of claims have not historically had a material impact on our operations, a significant increase in these claims could have a material adverse effect on our business, financial condition, operating results or cash flow.

As the result of environmental studies conducted at our facilities or third party sites in conjunction with our environmental management program, we have identified environmental contamination at certain sites that will require remediation.

### *Reserves*

Our policy is to accrue remediation expenses when it is probable that such efforts will be required and the related expenses can be reasonably estimated. Estimates of costs for future environmental compliance and remediation are necessarily imprecise due to such factors as the continuing evolution of environmental laws and regulatory requirements, the availability and application of technology, the identification of currently unknown remediation sites and the allocation of costs among the potentially responsible parties under applicable statutes. As of December 31, 2005 and 2004, respectively, we had reserves in the amount of \$17.2 million and \$25.6 million, respectively for all environmental matters discussed below.

We are currently responsible for remediating and investigating five properties under federal and state Superfund programs where we are the only responsible party. Each of these five remediation projects relates to operations conducted by Chemical Leaman Corporation ( CLC ) prior to our acquisition of and merger with CLC in 1998. The two most significant Superfund sites are:

### *Bridgeport, New Jersey*

QDI is required under the terms of two federal consent decrees to perform remediation at this operating truck terminal and tank wash site. CLC entered into consent orders with USEPA in May 1991 for the treatment of groundwater (operable unit or OU1 ) and October 1998 for the removal of contamination in the wetlands (OU3). In addition, we were required to assess the removal of contaminated soils (OU2).

In connection with OU1, USEPA originally required us to construct a large treatment plant with discharge via a two mile pipeline to the Delaware River watershed with construction to be completed by the end of 2001. We have negotiated an alternative remedy with USEPA which would call for a significantly smaller treatment facility, in place treatment of groundwater contamination via in-situ treatment and a local discharge. The treatment facility has been approved and construction started in July 2005. USEPA has also approved an OU3 remedy for approximately 2.5 acres of affected wetland. This reflects a reduction from an approximate seven acre area that had been under negotiation. Site

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mobilization for the OU3 work took place in late May 2004 but was delayed due to weather-related issues. Field work was re-started in May 2005 and remediation work is on-going. Additional contamination has been identified. In regard to OU2, USEPA is now requiring a Feasibility Study for the limited areas that show contamination and warrant additional investigation or work. USEPA also wants to

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include in OU2 the in-situ treatment previously described as part of OU1. The environmental projections for OU1 and OU2 have been changed to reflect the reallocation of the in-situ costs to OU2 and the proposed contract amount for the OU1 work. We have estimated future expenditures to be in the range of \$8.6 million to \$11.4 million.

### *William Dick, Pennsylvania*

CLC entered into a consent order with the Pennsylvania DEP (PADEP) and USEPA in October 1995 obligating it to provide a replacement water supply to area residents (OU1), treat contaminated groundwater (OU2), and perform remediation of contaminated soils (OU3) at this former wastewater disposal site. OU1 is complete. PADEP and USEPA had previously been unable to agree on the final interim remedy design for OU2; specifically the discharge location for the treated groundwater. We have projected an interim remedy, which involves the construction of a treatment facility and discharge locally. A preliminary engineering design, which includes a discharge to a local tributary, was submitted in August 2004 to USEPA and PADEP for their review and comment. Agency comments have been received and a final design is being prepared that will be submitted to the agency. Based on recent data showing reduction in site groundwater contamination due to natural attenuation and the more extensive handling and removal of contaminated soils, we believe that the groundwater project can be completed over the five-year term of this interim remedy. The agencies have approved an OU3 remedy, which requires both thermal treatment of contaminated soils and treatment of residuals via soil vapor extraction (SVE). The OU3 remedy expanded in April 2004 to off-site shipment of contaminated soils because these soils were found to be incompatible with the thermal treatment unit, which started full-scale operation in May 2004. We determined in June 2004 that we would incur increased expense due to the off-site additional contaminated soil that was found to be incompatible with the thermal treatment unit, the increased volume of soil subject to thermal treatment based on an increase in the lateral extent of contamination, and the discovery of buried drums and associated contaminated material and soils, which required off-site disposal. In the third quarter of 2004, we determined that a latex liner waste material was present in the third pond, which needed to be excavated and removed for disposal offsite. This work was completed in early 2005. We also determined that the soils in pond three needed to be excavated to determine if they will be suitable for the originally planned SVE treatment. We excavated the pond's three soils into discrete piles and determined the best approach to treat each soil pile. It was determined that most of the soil piles could be treated on-site using SVE as originally planned. However, some modifications to the design will have to be made in order to treat a limited number of soil piles. The SVE phase of the remediation work will begin during the first quarter of 2006. We have estimated future expenditures to be in the range of \$2.5 million to \$3.1 million.

### *Other Owned Property*

*Scary Creek, West Virginia:* CLC received a clean up notice from the State authority in August 1994 requiring remediation of contaminated soils and groundwater at this former wastewater disposal facility. However, the State and we have agreed that remediation can be conducted under the State's voluntary clean-up program (instead of the state superfund enforcement program). We are currently completing the originally planned remedial investigation, but it appears that additional site investigation work will be required to completely delineate the extent of site contamination. Upon completion of the site investigation phase, a remedial feasibility study and design will be prepared to address contaminated soils, and, if applicable, groundwater. The expectation is that a remedy utilizing primarily in-situ treatment with limited soil removal will be conducted.

*Tonawanda, New York:* CLC entered into a consent order with the New York Department of Environmental Conservation on June 22, 1999 obligating it to perform soil and groundwater remediation at this former truck terminal and tank wash site. We have completed a remedial investigation and a feasibility study with the expectation that we will conduct a remedy that may include in-situ treatment, limited soil removal and monitored natural attenuation of the groundwater.

*Charleston, WV:* CLC completed a remediation of a former drum disposal area in 1995 at its active truck terminal and tank wash site under the terms of a State hazardous waste permit. The State has required





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supplemental groundwater monitoring in connection with the same permit and we are performing the same and believe that no additional remediation will be required.

*East Rutherford, NJ:* CLC entered into a Memorandum of Agreement with the State of New Jersey on June 11, 1996 obligating it to perform a Remedial Investigation and Remedial Action with respect to a subsurface loss of an estimated 7,000 gallons of fuel oil at this active truck terminal and tank wash site. We have completed the recovery of free product and conducted groundwater monitoring and are awaiting final approval of a plan to terminate further remedial action with some limited contamination left in place.

*ISRA NJ Facilities:* We are obliged to conduct investigations and remediation at three current or former New Jersey tank wash and terminal sites pursuant to the State's Industrial Sites Remediation Act, which requires such remediation following the sale of facilities after 1983. The former owner has agreed to take responsibility for one of the sites and the other two are in the process of remedial investigation with projections set in contemplation of limited soil remediation expense for contaminated areas.

We have estimated future expenditures for these other owned properties to be in the range of \$2.9 million to \$3.8 million.

### *Other Environmental Matters*

We have been named as a potentially responsible party ( PRP ) under CERCLA and similar state laws at 18 other multi-party sites.

We and our predecessors have been named in three civil actions seeking contribution for remediation at offsite treatment, storage and disposal facilities (TSDs) or privately owned properties. We have also received notices of potential liability at fifteen other TSDs and are negotiating with Federal, State and private parties on the scope of our obligations (if any) in connection with remedies at these sites. In addition, there are eight sites with respect to which we received information requests but have denied liability and there has been no demand for payment (considered inactive). Our financial projection is established with respect to those sites where a financial demand is made or an allocation of financial liability is reasonably ascertainable.

Recently, we were notified of potential liabilities involving the Lower Passaic River Study Area in New Jersey and the Malone Superfund Site in Texas. We will be participating in the studies of these two sites to determine site remediation objectives, goals and technologies. Since the overall liability cannot be estimated at this time, we have set reserves for only the remedial investigation phase at the two sites.

We were also recently notified of our potential liability for remedial measures to be undertaken by the EPA at the Mobile Tank Wash Facility Superfund Site in Mobile, Alabama. Liability cannot be estimated at this time. We have asserted claims against the site owner (currently in bankruptcy) and the owner's insurers but do not expect to receive any reimbursement at this time.

We have estimated future expenditures for these other environmental matters to be in the range of \$1.6 million to \$3.8 million.

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There can be no assurance that additional sites for which we are responsible will not be discovered, nor that violations by us of environmental laws or regulations will not be identified or occur in the future, or that environmental, health and safety laws and regulations will not change in a manner that could impose material costs on us.

### **MOTOR CARRIER REGULATION**

As a motor carrier, we are subject to regulation by the Federal Motor Carrier Safety Administration ( FMCSA ) and the Surface Transportation Board ( STB ), both of which are units of the U.S. Department of

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