Risk Transfer Issues in Motor Transport Agreements

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Indemnity. The oldest and most widely used method of shifting risk of loss to another party; it is commonly used today under terms of a written agreement. All insurance agreements, even as far back as Roman traders, are based upon the theory of indemnification: If you pay me X, I will pay you Y if the agreed upon loss occurs. "Y" payments have bankrupted and continue to plague the best and brightest.

For purposes of this report, we will first tackle risk shifting between and among motor carriers, logistic providers and shippers or beneficial owners of cargo.[1] Later on we'll address what's on the horizon as to new strategies to consider as shippers approach problems created by the recent flurry of anti-indemnity laws now observed by a majority of states.

Indemnification: hold harmless, defense, indemnity clauses in transportation
An enforceable indemnity clause has been the most dependable method for shippers or owners of freight to facilitate the avoidance of their own negligence and place it with transport companies. Since deregulation, but more so in the last decade, shippers have gone a bit over-board in shifting all responsibility to the carriers, well, just because they could and can.

Recently, following a trend in oil fields and general construction, and with the urging of state transport associations, a large number of state legislatures have passed bills outlawing certain types of indemnity in transportation agreements.

Indemnity Clauses in transportation contracts have become burdensome to transporters and a safety issue for the public:

1. As an outgrowth of generally accepted risk financing techniques, theoretically at least, the parties to a transport contract enter into the agreement on equal footing and are free to accept or reject terms that are deemed unfair or too risky. Shippers argue that the price for risk shifting is "built in" the transport pricing, an argument that no one takes seriously in an industry with hundreds of thousands of capacity providers and servicers.

2. While insurance principles are broad-based and spread risk among many insureds, indemnity clauses in transport contracts are targeted devices; and most often, the weaker party holds its nose and hopes that their personnel – and their capital - are not lost in the fulfillment of the task.

3. Shippers having this leverage evaluate the manner in which they can off-load risk in the most efficient fashion as they move cargo. Shippers look at factors deciding whether:

[1] The laws and contract terms discussed herein relate to all the many additional entity types in the transportation industry. For purposes of simplicity, we refer mostly to shippers and transporters. There are, of course, many exceptions and exemptions in the laws and contracts.

a) to retain the risk of loss of an occurrence that its operation may cause;
b) transfer the risk to an insurer in exchange for some amount of premium;

c) transfer the risk to the counter-party transporter via contract using strong indemnity language.

Each of the above scenarios has a degree of cost uncertainty, but the last one – shifting the risk to an unequal counter-party, can be the least expensive and more certain. Well-crafted indemnity language is more than just risk shifting; it's a method of obtaining additional insurance that can relieve the shipper of premium, legal and administrative costs.

Reasons Raised Against Unfair Indemnity Terms:

- It creates a "moral hazard" because such terms encourage the shipper to be careless and abandon its responsibility to protect persons and property on its own premises or those in transit due to negligence in loading / rigging / and unloading. Indemnity can transfer risk associated with strangers to the agreement, to the public, and in many instances, agents or employees of the transporter. This last scenario is worsened by the fact that the employer may be obligated under both liability and Workers' Comp to compensate its own personnel, even when the shipper was solely or mainly at fault.

- It hides the potential loss exposure by shifting the risk to one who is unable to take precautionary measures of preventing loss created by the shipper – e.g. in the truckload industry "shipper load and count," or pre-loaded and sealed trailers. It creates exposure for all in warehouse, dock and retail locations.

- And lastly, shifting the hidden risks to the motor carrier and /or its insurer prevents carriers and brokers from pricing freight charges properly and prevents insurers of transporters from underwriting correctly. Transporters can't predict who will sue them if they are indemnitors for premises liability claims only because their trucks and personnel are on site. Transport insurers are asked to underwrite transport risks and never know what agreements the transporters might sign or what risks they are actually underwriting.

Indemnity Clauses:

- force transporters to price uncertainty into rates; and force them to incur exposure to unknown and unanticipated risks. Paying for losses arising from an indemnity agreement may persist for years in risk and insurance costs.

- force transporters to compete with peers who are domiciled in states with anti-indemnity laws.

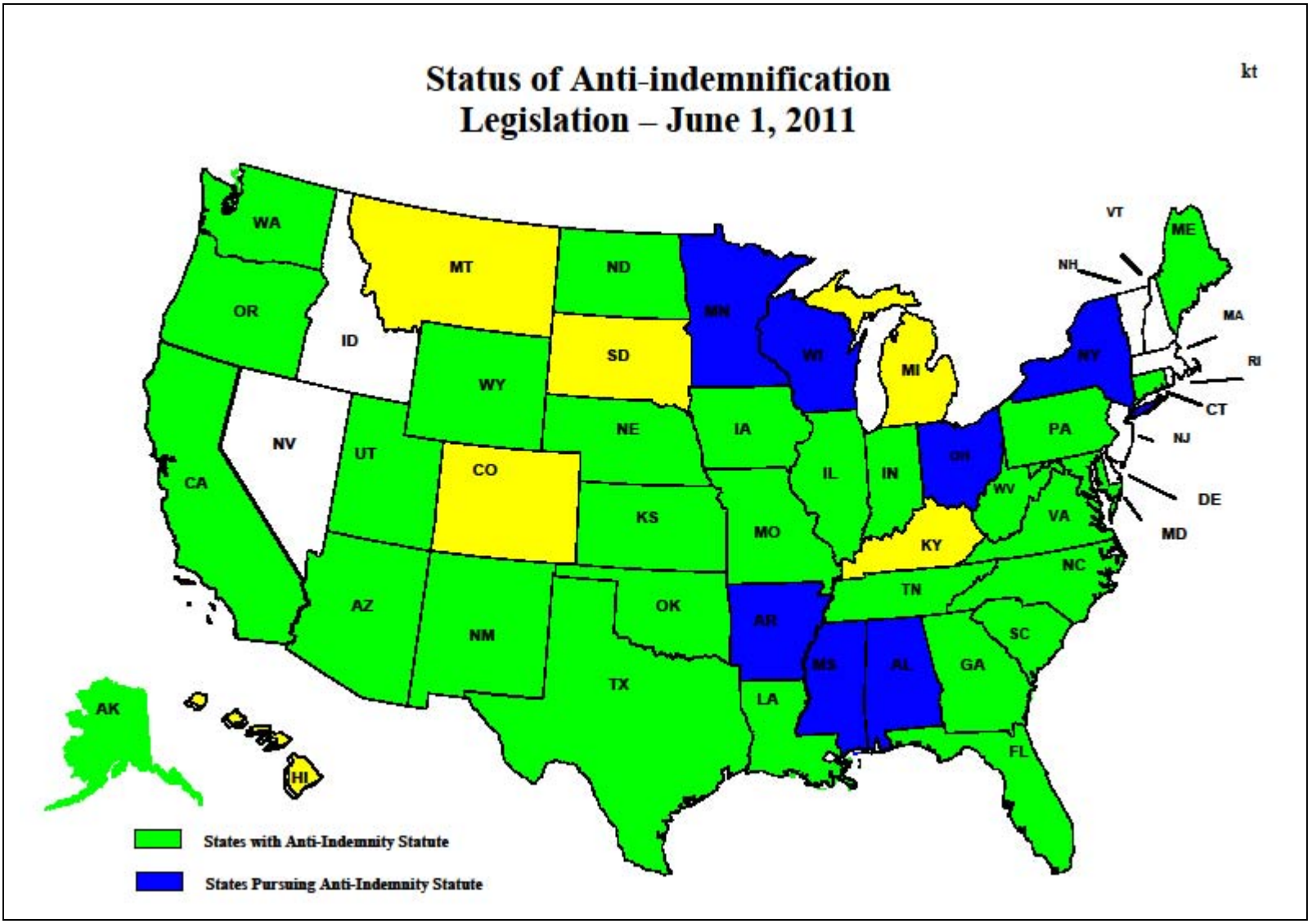
Variables facing Transporters who agree to Indemnity:

- no certainty about the safe operations of entities unrelated to customers, many of whom are foreign or out-of-state and who load or unload in and around – or even just near- transport equipment;
- absolute inability to forecast total "cost of risk" of the contract; thus, inability to calculate return on lanes or customers;

- a decision to blindly sign risk shifting contracts just to stay in business;

- Indemnity clauses alter existing law of apportioning fault among negligent parties, forcing the counter-party to assume risk regardless of the fault of the shipper – or of a stranger to the contract – who actually caused the loss. Most state laws apportion fault under comparative fault among responsible parties. Indemnity clauses supersede existing, well-functioning law to the detriment of transporter companies.

The map that follows illustrates the states with enacted and proposed anti-indemnity laws. Although there are repeating patterns in some laws, and a model law was proposed by the ATA, an analysis of each contract lined up against each statute is absolutely necessary in order to determine rights, exit strategies and fully voidable indemnity terms.



Compounding the effort to interpret and avoid oppressive terms are the myriad supplemental addenda to contracts so often found in long-term relations among shippers and transporters.[2]

The states' rationale for voiding onerous – or in some instances, all - indemnity clauses include:

- although courts and all Constitutions uphold the sanctity of contract, the public disfavors indemnifying a party for its own negligence;
- anti-indemnity laws are thought to deter careless conduct and promote public safety;
- anti-indemnity laws prevent the inequity of one-sided cost shifting; inequities that are ultimately borne by the public in higher transportation expense;
- anti-indemnity laws protect against uninsured and uninsurable claims involving loss of life, injury, property damage and environmental impairment;
- anti-indemnity laws maintain order in the insurance industry, which underpins free commerce and better promotes safety with insurance market pricing.

Types of Indemnity Agreements:

Broad Form: The transporter assumes an unqualified obligation to defend and hold harmless the shipper (along with its agents, customers, lumpers, etc) for all risk and liability associated with (e.g., "arising out of" or "caused in whole or in part, by") the performance or breach of the contract regardless of who may be negligent or at fault.

Intermediate Form – The transporter assumes all risk and liability as above, except as may be determined to be caused by the sole negligence of the shipper. Thus, the transporter must defend claims and lawsuits until such time as "sole negligence" is determined, perhaps as a matter of law – either by the court or jury. [3]

Limited Form – a/k/a "comparative fault model." The transporter and shipper assume apportioned risk and liability, to the extent of each one's fault.[4]

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[2] If I had enough fingers and toes, I could estimate the number of unsigned contracts, unanswered emails, or contract addenda in someone's top drawer that alter contract terms, including indemnity terms. If necessary, courts will interpret contracts by reviewing course of conduct and/or silence in response to changed terms. With the cost of risk eroding already-thin OR's at transporters, and with so much more freight moving internationally, rationale behind not examining, ascertaining and re-negotiating exposures is intriguing, to say the least. Nothing less than the full contract and all addenda should be reviewed. Even some lawyers inexplicably send just single pages and expect answers.

[3] The immediacy of defending claims and lawsuits as a hidden expense cannot be overstated. Very often defense costs exceed the value of the claim, but the transporters must start paying immediately, and, by experience, will never get reimbursed even if the shipper is ultimately found negligent. Overlooking the actual terms of an indemnity clause can be very costly for several years. It will, often, increase insurance costs.

[4] See footnote 3, however.

Indemnity Clauses – Broad Form Samples

Sample One

Indemnification. Transporter will indemnify and hold harmless Shipper from all claims arising from or in connection with the transport of cargo, management of the pickup or delivery process, or any work or activity in furtherance of this Agreement; any act, omission or negligence of Transporter or any of Transporter's employees, agents, licensees, officers, directors, sub-agents, invitees or contractors of Transporter; any accident, injury or damage whatsoever occurring in the performance of work hereunder. Transporter hereby expressly indemnifies Shipper, its agents, servants or contractors, for the consequences of any act or omission, unless such act or omission constitutes gross negligence or intentional conduct. [5]

Sample Two

Indemnification. Promisor will defend, indemnify and hold harmless Shipper and its officers, directors, shareholders, agents, customers and employees from and against all loss, liability, damage, claim, fine, cost or expense, including reasonable attorney fees, arising out of or in any way related to the performance or breach of this Agreement by Promisor, its employees, Subcontractors or independent contractors, including, but not limited to Claims for or related to personal injury (including death) and property damage related in any way to Promisee's possession, use, maintenance, custody or operation of the Equipment or provision of Services, including operations upon the premises of Shipper; and provided further that Promisee's indemnification obligations under this paragraph will apply to any Claim, including those caused by or resulting from the negligence of Shipper. The parties agree that Promisee's indemnification obligations will survive the termination of this Agreement.

Sample Three

Indemnity. Motor Carrier shall at all times (both during and after the term hereof) indemnify, defend and hold harmless ABC Company, its agents and employees against and from any and all settlements, losses, damages, costs, counsel fees and all other expenses relating to or arising from any and all claims of every nature or character (including, but without limitations, claims for personal injury, death and damage to property, improper or inadequate packaging or loading, clean-up costs from commodity spills and damage to the environment) asserted against ABC: (a) by any agent or employee of Carrier or (b) by any other person; arising out of the Carrier's service, except for those claims and causes of action arising out of the gross negligence or intentional acts of ABC Manufacturing employees.

[5] Gross negligence, intentional acts, willful or purposeful conduct are terms of art and require a higher, more difficult level of proof. In the interim of attempting to prove such conduct, the transporter will continue to pay for separate counsel for the Shipper because of the obvious conflict of interests between them.

Indemnity Clauses – Intermediate Form Samples

Sample One

Indemnification. Motor Carrier agrees to, and shall, indemnify, defend and hold harmless, at no cost to the Indemnitees (defined as Shipper, XYZ Imports, any affiliated or subsidiary corporations, and their respective directors, officers, employees, agents, shareholders, partners and members and other representatives, collectively, " Indemnitees ") from and against any and all claims, allegations, actions, demands, liabilities, losses, damages, injuries, illnesses, judgments, settlements, costs and expenses (including reasonable attorneys' fees) that are caused in whole or in part [*emphasis added*]or otherwise arise from or relate to the Equipment, any act or omission of Carrier or its personnel, or any breach of this Agreement by Shipper, whether or not it is caused in part by a party indemnified hereunder. [*emphasis added]*. In the event a claim is filed against any Indemnitee that is subject to Indemnification, the Indemnitor has the right to control the defense in any undertaking under this paragraph, including the costs and defense fees, but agrees Indemnitee may participate by cooperating in the investigation, resolution and defense of this undertaking. This indemnification is one of first defense and payment, not of reimbursement or surety, and shall survive the expiration or termination of this Agreement.[6]

Sample Two

Except as otherwise provided below, Promisee agrees that it will protect, defend, hold harmless, and indemnify DEF Imports, Shipper, customers of Shipper and their respective directors, officers, employees, and agents (hereinafter collectively referred to as "Indemnitees") from and against: All claims, demands, actions or causes of action which may at any time be brought against any Indemnitee because of death or injury to persons including Promisee's employees, agents or subcontractors or damage to property (including but not limited to cargo being transported hereunder[7]) which may arise from or in connection with: (i) the maintenance, use or operation (including loading and unloading) by Promisee, Promisee's agents or subcontractors of any motor vehicle or allied equipment in performance of services under this Agreement; and/or (ii) any and all acts or omissions of Promisee, its agents, employees or subcontractors in providing the transportation services to be provided under this Agreement;

Notwithstanding any provision in this Agreement stating or implying to the contrary, Promisee shall defend, protect, indemnify, and hold harmless any Indemnitee from or against any such penalty, fine, claim, action, or cause of action even to the extent that same partially was caused by or results from, arises out of, or occurs in connection with the negligence of such Promisee.

[6] This clause requires a consideration of separate legal counsel and loss of control of Transporter's own defense since Shipper can have other counsel "participate" in the defense and resolution. "Full employment for the legal profession" clause.

[7] This clause can defeat or supplement cargo loss clauses elsewhere in the Agreement that reflect typical Carmack Amendment claims with its carrier defenses. While conflicting, contracts will often refute and make certain terms superior to extraneous law or conflicting terms within the contract itself.

Sample Three

MOTOR CARRIER shall defend, indemnify and hold harmless 123 Logistics, Shipper, against any and all claims and liabilities and all expenses including attorney fees relating to or arising from the transportation services rendered hereunder; provided, however, that nothing in this section shall require Carrier to indemnify Shipper against that portion of any claim or liability which is proven [*emphasis added*] to have resulted solely from any negligent or willful act or omission on the part of Shipper, its agents or employees.[8]

Indemnity Clauses – Limited Form Sample

Sample One

(a) Motor Carrier shall defend indemnify, and hold QBC Distributors and its employees and agents harmless from and against all claims, liabilities, losses, damages, fines, penalties, payments, costs, and expenses, including, but not limited to attorney fees and costs of suit caused by and resulting from: (i) the negligence or intentional misconduct of Motor Carrier or its employees or agents, or (ii) Motor Carrier's or its employee's or agent's violation of applicable laws or regulations.[9]

(b) QBC shall defend indemnify, and hold Motor Carrier and its employees or agents harmless from and against all claims, liabilities, losses, damages, fines, penalties, payments, costs, and expenses, including but not limited to attorney fees and costs of suit caused by and resulting from (i) the negligence or intentional misconduct of QBC, or its employees, or agents, or (ii) QBC's or its employees' or agents' violation of applicable laws or regulations.

(c) In the event such claims, liabilities, losses, damages, fines, penalties, payments, costs, and expenses are caused by the joint and concurrent negligence of the Parties, the defense and indemnity obligations shall be borne by each Party in proportion to its degree of fault as determined by prompt pre-indemnity mediation or arbitration.

Strategies of Shippers and Owners In Circumventing New Anti-Indemnity Statutes

Most transportation contracts are drawn in their entirety by shippers, owners, logistic companies, and brokers (true brokers). The home states of the company – or of their lawyers – are most often the desired laws of contract interpretation.

[8] Deceptively, "proven" means proven in a court, not settled, mediated or dismissed.

[9] Use of the term "regulation" is quite vague and broad enough that mere technical violation can be held against the Motor Carrier (e.g., driver HOS logging "form and manner" errors can be misconstrued to be violations of applicable law or regulation).

Of course, if the home state happens to have an anti-indemnity statute relating to transportation agreements, the contract could be written so as to be interpreted under the laws of another, more friendly state.[10]

However, another possible technique is to require the transporter to obtain insurance coverage against the loss for the benefit of the shipper. Most frequently the shipper will require that it be identified as an additional insured on the transporter's commercial truck and general liability policies.

As we know, losses covered by insurance are paid to or on behalf of an "insured." Almost any entity can be added as an insured in these type policies, subject only to the approval of the unwitting insurer.

Demanding additional insured status – which most states' anti-indemnity laws do not address in voiding onerous risk transfer – offers shippers the best possible strategy for dealing with a number of contract difficulties:

- additional insured status, in most states, will allow even the onerous type of risk shifting, i.e., even for the shipper's "sole negligence;"[11]

- additional insured status provides a direct right to the legal defense supplied by the insurer, the same right the transporter has; the transporter has no say in who the lawyer would be. However, that lawyer will seek facts to blame the transporter;

- additional insured status provides a safe harbor to shippers against subrogation by the transporter's insurer;

- additional insured requests can expand the shipper's coverage to include claims for false arrest, malicious prosecution, slander, invasion of privacy, if the insurance clause of the contract is crafted carefully. This can provide coverage to shippers that they may not be able to buy themselves, or that would be prohibitively expensive, as with environmental remediation. Transporters unwittingly commit to supply such coverage and pay now – or later.

In summary, the reasons that shippers demand additional insured coverage in the transportation contracts are powerful:

1. protecting its own policy and limits of insurance;

2. guaranteeing a defense by the transporter's insurer;

3. provide back-up for a potentially unenforceable indemnity agreement;

[10] With certain legal restrictions, i.e., there must be some relationship to the state of choice.

[11] See Broad form examples, *supra*.

4. obtain coverage unavailable in its own insurance program; and

5. avoiding subrogation.

AVOIDING THE DIFFICULT INSURANCE TERMS:

- Agree to provide coverage only for "bodily injury, property damage caused by" not "all claims arising out of the work or operations of the named insured performed for the additional insured."

- Do not agree to insure against losses resulting from breach of contract; to insure parties outside the contract; or for coverage for types of occurrences that are not already covered by the policy already in your name.

- Choice of Law – try to choose carefully the choice of law clause. Some states address contractual insurance requirements – and requests for additional insured status specifically – as forms of indemnification.[12] These states have voided additional insurance requirements as within the scope of their anti-indemnity laws.

- Negotiate out of being required to supply additional insured status. Argue that often the shipper's "other insurance" clause will clash with the transporter's coverage, causing an apportionment of the loss that actually lessens available coverage.

- With the prevalence of limited liability companies, additional insured status requires careful coordination with the underlying policy definition of an insured. There may not be coverage for shippers with an LLC designation.

- If the transporter is self-insured (generally a true retention rather than a deductible) courts will not honor additional insured claims because there is no separate entity – no true insurer – accepting the risk. The transporter would be paying, which can be a violation of the anti-indemnity legislation.

Regards,

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[12] This is evolving still, so it must be reviewed at the time of contract.