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All shook up

Are court decisions making cargo claims more difficult for shippers?

By Chris Dupin

David Maloof
attorney

"Deterrence is what it comes down to, particularly when you are dealing with cargo. The cargo can't speak for itself, it doesn't have a witness."

Attorney David Maloof said a series of court decisions over the past 16 years has made it difficult for shippers and their insurers to recover when carriers damage, destroy or lose their cargo.

At a recent seminar of the American Institute of Marine Underwriters, the Rye, N.Y.-based lawyer traced four "revolutions" in the courts that have reversed protections shippers formerly enjoyed, a trend he said is ongoing. He also suggested new strategies shippers and subrogated insurers — the cargo insurers who step into the shipper's shoes in court after paying their claims — can employ to recover their losses.

Maloof dates this trend to the Supreme Court's 1995 Sky Reefer decision where it ruled foreign forum selection clauses are enforceable for shipments to and from the United States. Before that decision, since at least 1936 when the Carriage of Goods by Sea Act (COGSA) was passed, lawsuits involving U.S cargo had to be filed in U.S. courts. But today, foreign shipping companies can require suits to be brought in their home jurisdictions.

If a dispute involving damage that occurred in the United States to an intermodal shipment can't be pursued here, but must be brought in a court in Japan, for example, Maloof said the costs may be prohibitive for a claim under $500,000 — not only are there attorney costs, but expenses such as translation, transporting and housing witnesses.

A second blow to cargo interests came with the 2004 Supreme Court decision in *Norfolk Southern Railway v. Kirby,* which held that a printed form on the back of a bill of lading could be treated "the same as if you signed it and had a team of lawyers who pored over it and crossed things out and changed it and said 'now it's a deal,'" Maloof said.

That was a big change from decisions such as Isthmian *S.S. Co. v. California Spray-Chemical,* a 9th Circuit decision in 1962 which said "the presence of this standardized clause in the contract does not represent an agreement between appellant and the shipper. It is simply a condition unilaterally imposed by the carrier upon the shipper" and held the law prevented "the use of just such false agreements which make 'freedom of contract' an illusion," he explained.

Maloof believes last year's 6-3 Supreme Court decision in *Kawasaki Kisen Kaisha v. Regal Beloit* spells more bad news for shippers. The court found COGSA applies to the inland portion of a shipment from overseas moving on a through bill of lading rather than the Carmack Amendment to the Interstate Commerce Act.

Further, he sees the decision as implying "for the first time that public policy arguments about bill of lading provisions being too draconian will not be supported.

"They didn't actually say that, but that is the message they gave: 'Don't come in and complain because the provisions are unfair,'" he said. "Railroads and other carriers are now moving to enforce clauses that say the only claim a shipper has is against the carrier that issued the bill of lading."

The good news for exporters is that Regal Beloit was about an import and Maloof said export intermodal shipments are not subject to the same limit.

In the wake of Regal Beloit, he said the 2nd Circuit *(St. Paul Travelers Ins. Co. Ltd. v. Wallenius Wilhelmsen Logistics)* and 9th Circuit *(Fed. Ins. Co. v. Union Pac. R. Co.)* have held this year that covenants not to sue are enforceable by subcontractors. Such covenants are common in bills of lading, he said, but historically were not enforced.

Maloof said this means, for example, that if cargo moving on a through bill of lading is damaged by a U.S. railroad, a shipper cannot sue the railroad in the United States. He added this amounts to "complete exoneration" and the shipper cannot even recover from the railroad under COGSA.

The subcontractor issue is also key in a case he is involved in at the U.S. District Court for the Southern District of New York *(Sompo Japan Ins. Co. v. Norfolk Southern Railway).*

An upshot of those cases, he said, is if a shipper that has a cargo loss under an intermodal bill of lading coming into the country, then it should file a "protective suit" against the ocean carrier within the one-year limitation period because it is possible that due to those decisions the shipper cannot sue the underlying carrier.

What Matters. But does any of this matter? Don't most shippers have cargo insurance that protect them, and shame on them if they're foolish enough not to buy it?

"I think it does," Maloof said. "On the surface its one insurance company against another. But there are always consequences to things that don't always appear on the surface. Premiums get affected by the outcome of these things and ultimately it's not the insurance company that would pay, it's the manufacturer, who will pay it with increased premiums."

Shippers also need to be able to recover from carriers to encourage care in handling cargo. Otherwise "why do we have a legal system at all? Why not just say, 'I damaged your cargo, I didn't mean to, I didn't do it on purpose, and I've handled a heck of a lot of other cargo much better than yours and I'm very sorry so let's shake hands and go our separate ways.' Why not do that?" he said.

"Deterrence is what it comes down to, particularly when you are dealing with cargo. The cargo can't speak for itself, it doesn't have a witness," he said. "Carriers have full control over it. And they have full access to the witnesses and the documents as to how that particular voyage went. And in those circumstances, you want to ensure cargo doesn't get damaged, that carriers are sufficiently deterred."

Maloof also noted that some shippers don't have insurance, and that very often losses exceed insurance. For example, he said if a component to a power plant is lost in an accident, it may put the project months behind schedule, resulting in costs for a company that will not be covered by cargo insurance.

Of course, the shipper could negotiate more aggressively with its carrier (and with a weak market, Maloof suggests this might be the time for shippers to drive a hard bargain), but he said "you have to understand that the carriers are in the business of carrying goods. So for them these contracts are everything."

But for manufacturers, shipping is "one tiny piece of their business. To expect them to put the same resources into that process of reviewing the bill of lading, as the ship-owner who is going to use it for every one of their shipments, is not practical."

He also sees elements of what's called the principal/agency dilemma, "meaning if they have cargo insurance the shipper's really negotiating for the cargo insurer. So they don't have as much of a stake in it if they have cargo insurance. What you need is a cargo insurer who has a sufficient relationship with the shipper to say 'we're going to negotiate this as a team because I'm going to get hurt at the end of the day' and effectively society is going to get hurt because of the lack of deterrence."

Maloof said there are a number of novel areas where recovery success has opened. These include, in some cases, pursuing litigation against ship managers who may have no COGSA limitation, suing truck stops that have not secured cargo if theft is foreseeable, and pursuing actions against truck brokers if they control or manage truckers.

Michael McDaniel
partner, Countryman and McDaniel

"I don't see any particular trend in the case law that is limiting the recoveries beyond the expectations of the parties as reflected in the contract."

He cautioned that with the rise of third party logistics services shippers often think they are doing business with a large company, but may find out after cargo is damaged that the firm is acting only as a broker and they have to pursue a subcontractor."It's a real gap between the expectations of shippers and reality when there is a loss" in these cases, he said.

Critic's View. Maloof, a leading attorney for shippers and cargo insurers, is not without his critics. Michael McDaniel, a partner in the Los Angeles firm of Countryman and McDaniel, said his firm "could not disagree with him more on this issue." Countryman frequently represents transportation intermediaries, including some of the biggest.

McDaniel said the view of cargo law depends on "how you frame the issue. Maloof looks at the issue as one of being more and more difficult to make a recovery."

In an interview with him and his colleagues Bruce Lindsay and Christoph Wahner, McDaniel said his firm views those same changes as the courts making it "more difficult for the subrogating insurance companies to avoid the consequences of the contracts that their assured made, because the goal, primarily, in these subrogation cases is to find ways to avoid the limits of liabilities that were agreed to prior to the shipping transactions.

"Those limitations of liability are long standing, and are based upon fundamental public policy," he said.

Lindsay explained that liability limitations were allowed because "in the beginning there were no liability limitations and freight rates were so incredibly high. It became evident that in order to reduce them, it was necessary to allow the carriers and those that were involved in the process to limit their liability."

For example, "no carrier wants to take a potential half-million-dollar hit" for a job that pays them only $1,500 in freight, he said. "That's what cargo insurance is for."

"That's one of the most interesting aspects of those that complain about not being able to make full recovery in these cases. Because on one hand where you had the limitation of liability, on the other hand, the cargo insurance itself is a commercial product that is viable and operates usually with a positive loss ratio," McDaniel said.

"So when a successful attempt is made to break the limit of liability, some might say this is a victory for the cargo interest, but it is just another example of how one uses a technicality to reach a result that was not the original expectation or the agreement of the parties," he added. "It's a windfall."

He said Maloof "likes to cast this issue in terms of the poor, luckless shipper, but we all know 95-plus percent of knowledgeable commercial shippers have cargo insurance and so the shipper is made whole as a matter of course, and I don't see any particular trend in the case law that is limiting the recoveries beyond the expectations of the parties as reflected in the contract."

Wahner sees more "creative advocacy" by plaintiff's attorneys to defeat limitations on technicalities or new theories such as applying to truckers the maritime doctrine that if a ship deviates from its planned route — goes to Greenland instead of the Canary Islands — then it loses its limitation on liability, or claiming the conduct of a carrier was "gross negligence" instead of negligence.

The Countryman lawyers note that the Montreal Convention for air cargo damage said there would be no exceptions to the limit of liability.

McDaniel is not persuaded by Maloof's concerns about shippers having to litigate claims overseas, stating that his firm litigates in some 87 countries working for both large and small intermediaries.

"The status of justice does vary, but in the major maritime nations, the case results have a striking similarity from one country to another in terms of upholding the limitations of liability. Sure, there are some differences, but generally you're going to have the same outcome in France or Korea."

He said "ma and pa" intermediaries operating on razor thin profits have been wiped out because they "banked their business and fortune on their contracts that they have a limited liability with a customer, and then some stranger on behalf of an insurance company steps up, and say 'we have some very interesting reasons why we are not going to abide by the contract, so please pay us $1 million.'"

"Every transportation mode, every legal regime will only enforce a liability limitation if there is an opportunity to declare a higher value for a higher freight charge," Wahner said, but most shippers chose not to do that because buying directly from a cargo insurance company is a better bargain.

McDaniel warned adding large numbers of exceptions to liability limits to shipping contracts leads to a "slippery slope, because you can reach the point where the limitations start to be meaningless. And I would argue that this is the most dangerous thing for the shipping public. You reach areas of commercial uncertainty where you cannot forecast losses, you can't forecast budget concerns and liabilities and that brings instability and higher freight prices." ■