

Property Matters



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This article reviews some warehouse operational issues for property insurers. We would be more than happy to help you think through these challenging questions and work with you to optimize your direct product and reinsurance coverages.

If you would like to start or continue a dialogue, please contact your Gen Re representative.

Logistics and 3PL

by Michael Guthrie, Gen Re, Charlotte

We've all seen TV ads that focus on "logistics," with people hurrying packages and cargo from one place to another—but what does logistics mean to a warehouse or cargo liability underwriter?

Public and bonded warehouses have existed for centuries, and property insurers have continually adapted to the evolving *physical risks*. During much of this evolution, the scope of responsibilities of the warehouse operation was simply storage.

Over the last 20 years, most warehouse operations and motor carriers now offer a broad array of cargo and inventory management services. This expansion of services results in increased *operational risks* and contractual liabilities. Most notably, logistics companies often enter into contractual arrangements that expand their liabilities as a bailee and, in some cases, expand their responsibility to provide direct damage property insurance, including for catastrophe perils.

How do the expanded operational risks of logistics affect our underwriting and risk assessment? In this article, we will help answer these questions and provide some resources for further investigation.

What Are Logistics and 3PL?

Basically, logistics is the integrated management of services involved with the transit and storage of goods between sellers and buyers. Inventory management and e-commerce services are key functions. Logistics is also a huge industry that generates approximately 9% of GDP in the United States. Companies that specialize in these services are referred to as “third-party logistics providers,” otherwise known as “3PL” or “TPL” providers.

The Council of Supply Chain Management Professionals defines a 3PL provider as “a firm [that] provides multiple logistics services for use by customers. Preferably, these services are integrated, or ‘bundled’ together, by the provider. Among the services 3PLs provide are transportation, warehousing, cross-docking, inventory management, packaging and freight forwarding.”¹

Another source goes into more depth, describing four categories of 3PL providers:²

- > **Standard 3PL provider:** The most basic form of a 3PL provider, performing such basic functions as pick-and-pack, warehousing and distribution. For a majority of these firms, the 3PL function is not their main activity.
- > **Service developer:** Offers advanced value-added services including tracking and tracing, cross docking, specific packaging or providing a unique security system. A solid IT foundation and a focus on economies of scale and scope enable this type of 3PL provider to perform such tasks.
- > **Customer adapter:** Comes in by request to take over complete control of the customer’s logistics activities. The 3PL provider improves the logistics dramatically but does not develop a new service. The customer base for this type of provider is typically quite small.
- > **Customer developer:** The highest 3PL provider level with respect to its processes and activities. The provider integrates itself with the customer and takes over their entire logistics function. These 3PL providers will have few customers, but perform extensive and detailed tasks for them.

The expanded services of logistics companies are a direct result of the need for improved supply chain efficiencies. Sellers that traditionally retained the expense and oversight of the transit and distribution of their goods have moved toward outsourcing these services. Logistics operations contract for all the steps in the movement of the seller’s goods, including transportation, warehousing, packaging and distribution. Each step in the above sequence can be tailored and scaled to the specific needs of the seller.

Large 3PL Providers

Warehouse and distribution centers are the center of the web for logistics providers. This is the point in the logistics chain where outsourcing and e-commerce have had the greatest impact. The management of these risks is an area dominated by large and familiar corporations, as shown in the table on this page.

Top U.S. 3PL Providers

Rank	Company	Space (million sq ft)
1	DHL & Exel Supply Chain	75
2	UPS Supply Chain Solutions	35
3	GENCO Distribution	30
4	Caterpillar Logistics Services	27
5	UTI Worldwide Inc.	26
5	CEVA Logistics, North America	26
7	Jacobson Companies	24
8	Americold Logistics, Inc.	23
9	Ozburn-Hessey Logistics	21.4
10	Kenco Logistic Services	21
11	MBX Logistics, LLC	20
12	Atlas/Versacold (Eimskip)	18.5
13	Ryder System, Inc.	18.3
14	Penske Logistics	15
14	Warehouse Specialists, Inc.	15
14	DSC Logistics	15
17	NFI Industries	14.5
18	Kuehne + Nagel	14.2
19	APL Logistics	14
20	Menlo Worldwide	13

Source: 3PLWarehousing.com, 12/13/10

3PL Services

A 3PL risk provider may offer many services in its warehouse or terminal. Examples include:

- > Cross Docking
- > Trans Loading
- > Labeling
- > Pick-and-Pack
- > Packaging & Re-Packaging
- > Sub-assembly
- > Pricing
- > Managing Expiration Date-Sensitive Inventories
- > Quality Control
- > Sampling
- > Product Inspection
- > Reporting
- > Catalog & Online Order Fulfillment
- > Direct-to-Home
- > Direct-to-Store
- > Import/Export/Customs
- > Expedited Transportation (including security)
- > Online Tracking & Tracing
- > Reverse Logistics

When logistics companies enter into service contracts for these services, they are more focused upon customer satisfaction than liabilities and product valuation. Product owners have leverage. It is therefore prudent for the insurance agent and underwriter to ascertain what the insured’s liabilities may be.

What Is U.C.C. Warehouse Liability?

Uniform Commercial Code §7-204 (Duty of Care; Contractual Limitation of Warehouseman’s Liability) defines warehouse operator liabilities and defenses. The code prescribes the nature of the warehouseman’s standard of care, and how that liability may be limited.

Per the code: “A warehouseman is liable for damages for loss of or injury to the goods caused by his failure to exercise such care in regard to them as a reasonably careful man would exercise under like circumstances, but unless otherwise agreed, he is not liable for damages which could not have been avoided by the exercise of such care.”

The code goes on to describe that liability may be limited to:

- > A specific liability per article or item;
- > A value per unit or weight;
- > A multiple of the base storage rate based upon an article; or
- > Unit of weight

While underwriters have been educated about these liability limitations, few are aware that the same code has always permitted broader liability. The code also states that “a warehouse operator may assume additional responsibility by contract or by advertising the undertaking of a responsibility beyond that imposed by law.”³

The 3PL business model means that fewer warehouse operators limit their liability as allowed under the U.C.C. An expert warehouse contract lawyer estimates that 75% of warehouse exposures today are either accepted under master contracts without any warehouse receipt, or the receipts are not written properly to preserve traditional U.C.C. warehouse defenses.

Bailment Liability

Bailment or bailee liability, without the previous liability limitations, normally applies when property has been entrusted to the warehouseman for processing or other services beyond simple storage. Although all liabilities would not fall to the property insurer, many additional liabilities arise from warehouse operators processing inventories. Here are examples of scenarios that may trigger claims for direct physical loss under the bailment coverage:

- > Acts of God
- > Failure to procure insurance required under contract
- > Failure to properly process goods (e.g., expiration dates infringed)
- > Negligent supervision or security
- > Seal integrity or breach of chain of custody
- > Adulterated products
- > Loss of warranty
- > Diminished value
- > Consequential damages
- > Products released due to false pretense and wrongful conversion

What do you think? What if your insured 3PL has accepted broad liability under a contract for inventory management of pharmaceuticals? Obviously, there is a climate control exposure and the inventory is subject to expiration dates. What does your form cover? Do you intend to cover changes in temperature, inherent vice, or loss of market if your insured is liable?

Intentionally Expanded Coverage

The insurance practice of broadening coverage to adequately address an insured’s interests continues to evolve. Many industry Warehouse Legal Liability forms and Warehouse and Logistics forms have amended coverage to include warehouse liability or bailee liability. For example, the Coverage clause may agree to “pay those sums you are legally obligated to pay **as a warehouseman or bailee**” (emphasis ours). Further, Covered Property is often defined as “tangible property of others which you have accepted as a warehouse operator **or bailee**” (emphasis ours). The differences in these two operational exposures can be substantial and warrant closer examination.

Many insurers also offer “Direct Damage” coverage endorsements—these remove the liability coverage test and provide broad coverage for risks of direct physical loss. Coverage for natural catastrophe perils may be assumed either by following the insured’s contractual liability, or by coverage under a Direct Damage endorsement. Exclusions for loss or damage resulting from processing are less common.

Warehouse insurance is a non-filed class that allows maximum flexibility to tailor coverage to specific risk needs. Other coverage enhancements may include:

- > Mysterious Disappearance, Inventory Shortage
- > Voluntary Parting—Trick or Device
- > Temperature Change
- > Infestation, Vermin, Atmosphere, Inherent Vice
- > Contamination, Co-mingling
- > Debris Removal
- > Voluntary Removal
- > Pollution Cleanup
- > Loss of Accrued Charges
- > Cost to Inventory After Covered Loss
- > Coverage on Vehicles
- > MTC—terminals

4PL and Non-Asset Based Companies

In both the motor carrier and warehouse trades, you will find “4PL” and non-asset based logistics providers. These “expertise” firms are primarily logistics consultants, providing guidance in many technical and communications areas such as accounting, billing, customer service, e-commerce and freight management. Some prominent providers include Accenture, BMT, Choice Logistics, Deloitte and DTS.

Since these companies don’t directly employ the warehouse workers, physically control the inventory or contract with the product owners, they usually have no direct insurable interest in the property. Requests from these entities to purchase “contingent” warehouse/bailment liability or to be added as additional insureds should be reviewed carefully.

Final Thoughts

The trend in today's warehousing business is toward logistics companies that provide a menu of services well beyond simply warehousing of a seller's goods while en route to buyers. This creates some challenges for an insurance company to accurately assess the scope of exposures, and to adjust claims that may be more complex than past history would indicate. It can also be a challenge to differentiate pricing for a traditional storage account versus a modern logistics service with a broad spectrum of operational exposures and contractual liabilities.

To successfully navigate through these challenges, it is important to have underwriting information that is current, comprehensive and accurate. Armed with quality information, underwriting discipline and appropriate insurance products, insurers will continue to evolve successfully along with the logistics industry.

If you have questions about this article or have risk opportunities you would like to discuss, contact your Gen Re representative who will gladly assemble our resources to help with your business. ■



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Endnotes

- ¹ The Council of Supply Chain Management, <http://cscmp.org/Default.asp>
- ² "Strategic development of third party logistics providers," Susanne Hertz and Monica Alfredsson, <http://www.sciencedirect.com/science/article/pii/S0019850102002286>
- ³ Uniform Commercial Code Section 7-24, as seen at <http://www.law.cornell.edu/ucc/7/7-204.html>

RECAP

- > Most warehouse operators have expanded their operational (logistics) services.
- > They are accepting broad bailee liability, and sometimes even agree to provide All Risks insurance coverage.
- > We are seeing a new generation of *combination* logistics policies that cover an insured's liability as a motor carrier, freight broker, warehouse operator and bailee.
- > Many insurers offer Direct Damage coverage endorsements. These endorsements remove the liability coverage test, and provide broad coverage for risks of direct physical loss.
- > Coverage for natural catastrophe perils may be assumed either by following the insured's contractual liability, or by coverage under a Direct Damage endorsement.
- > Exclusions for loss or damage resulting from processing are less common.
- > Warehouse insurance is a non-filed class that allows maximum flexibility to tailor coverage to specific risk needs.

Here are some recent Gen Re Research publications:

- > *UM/UIM Updated Law Survey for Third Quarter 2011—E-News Auto*, October 2011
- > *Dog Bite Liability—Insurers' Best Friend?—Insurance Issues*, September 2011
- > *The Regulatory Challenges Ahead—The Bulletin*, September 2011
- > *Wind and Solar Energy Time Element—More Than Meets the Eye—Facultative Matters*, August 2011
- > *Emerging Exposures and New Wordings—Are Your Forms Keeping Up?—Policy Wording Matters*, June 2011
- > *Workers' Compensation—Managing Through Tough Times (and Not Just Living Through Them)—Gen Re Viewpoint*, June 2011
- > *First Medicare Reimbursement Test—No Insurer Bad Faith Found—E-News Multiline*, June 2011

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