Risk Bytes
Contractual risk management

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Introduction

This Risk Byte provides an introduction to contractual risk management for transport operators. Whether you are using a house bill of lading (HBL), standard trading conditions (STCs), or are being presented with a new contract for your consideration by a customer, this document aims to explain how you should contract with your customers and subcontractors to minimise risk.

Key issues:

- The difference between contracting with your customer as a principal and as an agent
- How compulsorily applicable national laws and/or international conventions affect your limits of liability
- The importance of back-to-back contractual terms with your subcontractors

Common terminology

Principal
A person or company who contracts to perform the contractual obligations itself, but who may subcontract performance to another. In practice, a freight forwarder acting as principal would assume responsibility for the entire carriage, even if it does not itself take possession of the cargo being shipped, and the operation is performed entirely by its subcontractor.

Agent
A person or company who contracts on behalf of its customer to find a third party to perform the contractual obligations, thereby bringing its customer into a direct contractual relationship with a third party. In practice, a freight forwarder acting as an agent would not be liable to the customer for how the third party performs the contractual obligations. It would typically charge a flat agency fee for the introduction and nothing beyond.

Transport operator
A person or company that offers logistics and/or freight forwarding services.

Law and jurisdiction clause
A clause that defines an agreed law applicable to the contract and the jurisdiction of the courts that will hear any disputes arising out of the contract. It is important to bear in mind that a compulsorily applicable national law or international convention may take priority over a law and jurisdiction clause.

Merchant clause
A clause in a contract that extends obligations and liabilities beyond the shipper and carrier concerning the shipment of goods. Such clauses are often wide in their scope and may include charterers, receivers, freight forwarders and beyond.

Himalaya clause
A contractual provision that gives the benefit of any limits and defences that are set out in the contract to a class of third parties who are not otherwise a party to the contract.

Time bar
A clause in a contract that provides for a period of time within which the customer must commence legal proceedings against the transport operator. These clauses seek to “bar” the customer from bringing a claim if it fails to comply with the specified time limits.

Notification requirements
Contracts may also contain notification requirements that outline the time within which a notice of loss, damage or delay must be given to the other party. For example, the customer must notify of any external cargo damage upon delivery. The contract might say that failure to provide notice of loss within the specified time bars recovery completely. Similarly, failure to give timely notice of any damage would mean that cargo is deemed to have been delivered undamaged and would become more difficult to prove the opposite.

What is contractual risk management?

Contractual risk management refers to the steps you take to protect your business when entering into contracts with your customers or subcontractors. You achieve this by negotiating contracts that are fair, reasonable and which describe clearly the duties, responsibilities and liabilities of each party.

When appointing subcontractors, it also means ensuring they are reputable and suitably qualified to undertake the services you need. You should endeavour to contract with them on the same terms as those that apply between yourself and your customer, ensuring "back-to-back" liability. Check too that they have adequate insurance to recover losses should your customer suffer a loss because of the subcontractor's negligence.

Why is it important?

Contractual risk management is part of your overall business risk management and gives your business certainty, for example if the cargo is lost or damaged when in your care or when performance expectations are not met.

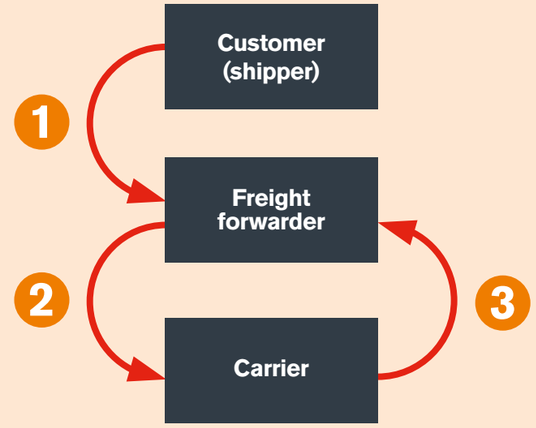
Benefits:

- ✓ Defines clear responsibilities, avoiding potentially commercially damaging disputes
- ✓ Provides certainty in defining and limiting your liability in the event of a loss
- ✓ Maximises the potential for recovery from your subcontractor if they are at fault
- ✓ Facilitates fair and prompt payment
- ✓ A clear and unambiguous contract will assist avoiding disputes and expensive legal costs

Contracting as a principal

A transport operator can act either as a principal or as an agent (see below). A principal contracts itself to undertake the physical movement of cargo on its customer's behalf. When doing so, it will issue its own transport document, evidencing the contract of carriage with its customer and setting out or referring to applicable contract terms, for example, an HBL. The transport operator acting as a principal can, however, elect to subcontract all or part of the cargo movement to another carrier. In this case a second contract of carriage will exist between the principal transport operator and the subcontracted carrier. The subcontracted carrier may issue its own transport document to evidence the subcontract and the applicable terms, for example, a master bill of lading (MBL). The transport operator acting as principal remains responsible to its customer for the acts or omissions of its subcontractor, as if those acts or omissions were its own.

The contractual chain of a principal/carrier



1 Customer and freight forwarder enter into contract for carriage services and the freight forwarder issues an HBL

2 Freight forwarder enters into contract with carrier on its own behalf

3 Carrier issues master bill of lading to the freight forwarder creating a direct contract between the carrier and the freight forwarder

Contracting as an agent

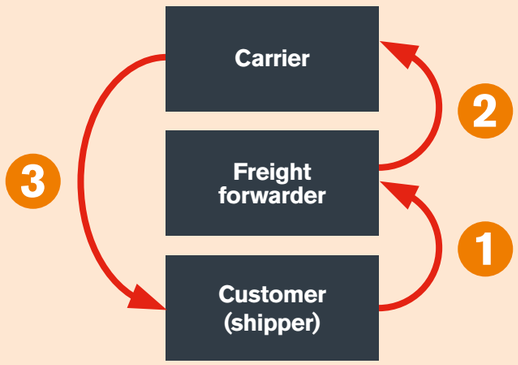
If a transport operator does not intend to contract itself to perform the physical movement of the cargo, but instead contracts with its customer simply to procure a third party to perform the services for them, then it will be acting as an agent of the customer. As an appointed agent, the transport operator will take responsibility for selecting a suitably qualified and experienced third-party carrier and will assist its customer in entering into the contract of carriage with them. In this scenario, only one transport document is likely to be created, for example, an MBL. This document will evidence the contract and the applicable terms between the transport operator's customer and the third-party carrier.

When acting in this capacity, the transport operator generally does not have any liability towards its customer for the acts or omissions of the appointed carrier. The transport operator could be liable, however, if it is shown that they had failed to exercise reasonable care and skill in the selection of the third-party carrier and that this has caused the customer to suffer a loss. Accordingly, it remains important for the transport operator to incorporate appropriate STCs into its contract with the customer. A true agent is entitled only to charge an agency fee rather than a freight fee or a mark-up on a freight fee. This means that revenue for a particular movement is likely to be less when contracting as an agent than as a principal. As such, a transport operator acting as an agent may wish to apply lower limits of liability than would be applicable were it acting as a principal. This could be a multiple of the agency fee earned, for example.

It is important to understand that if you are acting as agent only, you are contracting as agent for your customer, not the carrier.

The STCs should make clear that the transport operator does not accept liability for the negligent actions of carriers or any other suppliers appointed on its customer's behalf.

Contractual chain when acting as agent



1 The customer enters into contract for freight forwarding services

2 Freight forwarder contracts with carrier on behalf of customer

3 Carrier issues bill of lading to customer naming customer as shipper creating a direct contract between carrier and customer

Whether you are reviewing an existing HBL or STCs, or drafting a new one, you should get an experienced lawyer to ensure it is enforceable in the country stated in the law and jurisdiction clause (see page 8). Some jurisdictions, for example, will not recognise the difference between an agent and principal. In others you may need your customer to formally acknowledge their acceptance of the terms of the contract, including limitation provisions.

Are you the agent?

Following a loss that gives rise to a claim, there are many instances where the transport operator believes it has been acting as agent only and has no liability. These can be challenging cases to defend, because whilst a transport operator may think it has contracted as agent only, a court may find that it has contracted as a principal and is liable. There are many factors that a court may take into account when determining this question. For example, if a transport operator charges a mark-up on the carrier's freight without communicating this to its customer, this may well support the view that the transport operator contracted as principal and not as agent. This is because in many countries agents are not allowed to make a secret profit. A transport operator who wishes to contract as agent only should take independent legal advice to ensure that its contractual arrangements support this analysis.

"A company might act as principal at certain times or through certain divisions in its business and as agent at others, sometimes even for the same customer. This can lead to confusion if it is not clearly set out when they are acting in each capacity and which liability regimes apply".

Watch out for the merchant clause

The merchant clause under many MBLs is typically worded to capture a wide range of stakeholders, whether they are a direct party to the contract of carriage or not. Its purpose is to make such parties responsible directly to the performing carrier. As a booking party, acting in the capacity of agent, the transport operator may be liable to the carrier in the event of a loss if, for example, the transport operator's customer, named as shipper or consignee, does not provide the carrier with an attractive point of recovery. These circumstances are common in cases of abandoned cargo where the transport operator's customer or the named consignee, if different, fails to collect and clear the cargo leaving it in the care of the carrier. It is important to ensure that the applicable STCs between the transport operator and its customer give a right of recovery for the transport operator where it has incurred a liability to the carrier under the merchant clause (or otherwise).

As a freight forwarder acting as principal or agent, conducting thorough due diligence is critical to mitigate this risk.

Making the contract right for you

Key considerations

Scope of work
A transport operator must ensure the contract sets out exactly the services to be provided. It might also be important to clearly define what services are not being provided and the point at which the services start and cease. This will help the legal defence in the event of a claim. It is prudent to clarify, where appropriate, that cargo insurance is not automatically included and that it is the obligation of the customer to purchase cargo insurance for the shipment of goods. A transport operator might be able to provide its customer with access to such cover, but this is something worth clarifying with the customer to avoid unnecessary disputes in the event of a loss.

Burden of proof
Which party has the legal burden to prove that the loss, damage, or delay was caused by the transport operator? The answer might vary from one jurisdiction to another. It is important, therefore, that the applicable contract terms deal with this. From the transport operator's perspective, the contract terms should make it clear that the burden of proving the claim rests with the customer.

Force majeure
An unplanned or unexpected event can prevent your business from being able to fulfil its contractual obligations. Typically, these events include wars, riots, fires, floods, hurricanes, typhoons, earthquakes, lightning, explosions and labour strikes. More recently, it has become common also to include pandemics, endemics and epidemics. A properly drafted force majeure clause might be able to protect the transport operator by excluding or limiting liability for any claims that arise or by excusing the transport operator from having to perform the contract going forward, or both. In the event of a loss, a force majeure clause is likely to be challenged by the customer, so when drafting such a clause, care needs to be taken to ensure it deals with all potential issues and scenarios. Whilst not exhaustive these may include:

- a detailed definition of a force majeure event
- a description of what happens when an event occurs
- details of who can suspend performance
- details of what happens if the force majeure event continues for more than a specified period.

Limiting your liability
When entering into any contract relating to carriage of cargo, a transport operator should seek – as a minimum – to limit its liability to the limits set out in any compulsorily applicable national law or international convention. These limits can vary significantly (see example).

Example:

A cargo of four machines weighing a total of 2,850kg and valued at USD80,000 is lost during transit due to a freight forwarder's negligence. The forwarder's liability will be determined by what conventions it incorporated in its house bill of lading and what mode of transport was being used when the loss occurred (see table). It ranges from USD104,082 if being carried on a plane under the Montreal convention to just USD532 if carried on a ship under the Hague Rules.

Convention	Hague Visby	Hague	US COGSA
Mode of transport	Sea	Sea	Sea
Limitation of liability calculation	2 SDR/kg Or 666.67 SDR/package (whichever is greatest)	GBP100/package or unit	USD500/package
Total liability	5,700 SDR	GBP400	USD2,000
USD liability	USD9,462	USD532	USD2,000

Convention	CMR	Rotterdam	Montreal	CIM
Mode of transport	Road	Multimodal	Air	Rail
Limitation of liability calculation	8.33 SDR/kg	3 SDR/kg Or 875 SDR/package (whichever is greatest)	22 SDR/kg	17 SDR/kg
Total liability	23,741 SDR	8,550 SDR	62,700 SDR	48,450 SDR
USD liability	USD39,409	USD14,193	USD104,082*	USD80,427*

*No limitation available, the forwarder would be liable for the full value of the cargo (USD80,000).

These calculations use the following conversion rates as at January 2024: 1 SDR = USD1.66, GBP1 = USD1.33, and figures are subject to rounding.

Including a well-defined limitation provision in your contracts with customers is therefore of the utmost importance so that in the event of a claim, there can be no doubt as to the extent of your liability to your customer. If you fail to do this, you risk facing unlimited liability.

You should seek local legal advice to ensure the enforceability of those terms in the country stated in the law and jurisdiction clause. If they are not legally enforceable and the terms are challenged in court, you may end up being exposed to the full value of the loss.

Full and enhanced liability contracts
Avoid accepting any contract clause that exposes your business to a level of liability beyond compulsorily applicable national laws or international conventions. If your business does accept such contracts, the amount beyond your legal liability is unlikely to be recoverable from your liability insurance policy (unless your insurer had formally agreed the terms).

Himalaya clauses
Make sure you know whether there is a "Himalaya clause" incorporated into the contractual terms and if not, whether it would be appropriate to include one. This clause could serve to provide a third party engaged by you with the same protection afforded to your business in the event of a loss or protect them from an elevated claim directly from the claimant. Himalaya clauses are most commonly found in maritime bills of lading but are theoretically applicable to any contract.

Liquidated damages
Sometimes called "punitive damages", these are typically fixed contractual penalties for failure or delay in performing your services (e.g., USD500 a day for a late delivery). Such losses are unlikely to be recoverable from your liability insurance policy, so you should try to avoid them at all costs.

Indirect and consequential losses
Avoid accepting liability for losses other than those directly related to loss or damage to a cargo, such as loss of profit or delay. Failure to exclude indirect and consequential losses could expose you to an uninsured claim, particularly if the losses claimed are too remote from the cargo loss.

Time bar
A time bar of nine months to one year for commencing legal proceedings arising out of a claim against your business is likely to be considered fair, reasonable and enforceable in many jurisdictions. But you will need to check that the clause is enforceable in the law and jurisdiction stated in the contract.

This is a vital clause when contracting and will provide your business with a degree of certainty by minimising the length of time your business is exposed to claims.

Law and jurisdiction
Some local laws and the relevant local courts tend to be cargo and customer friendly and some adopt the opposite approach of being carrier friendly. From the transport operator's perspective the ideal scenario is to apply a law that is considered to be carrier friendly and to have any disputes resolved by carrier friendly courts. Very often a transport operator might prefer to select the law of its country of domicile and the jurisdiction of its home courts. If this is not acceptable to the customer, legal advice should be sought as to an appropriate law and jurisdiction, as it can be very costly for a transport operator, or its insurers, to have claims dealt with unfamiliar jurisdictions. Often, a good compromise is to use a neutral territory that has recognised legal expertise in handling transport and logistics related claims.

Contracting on back-to-back terms

"Back-to-back" means you are contracting with your subcontractor on the same terms as you have contracted with your customer. A transport operator acting as principal should ensure it contracts with its subcontractor on back-to-back terms to avoid a gap in liability between what is legally owed to their customer and what is recoverable from their subcontractor (see case studies).

Circular indemnity clause
This type of clause protects the agents, servants, and subcontractors of the transport operator by stipulating that the customer will not bring direct claims against those entities. If, contrary to that promise, such a claim is made, it requires the customer to indemnify the transport operator against all the consequences. Instead, the clause would generally stipulate that claims would only be brought against the transport operator, which would then be dealt with per the terms of the contract.

Case Study 1

Water ingress into a container at sea caused a total loss of eight 750kg pallets of coffee. The transport operator acting as principal had contracted with the shipper under Hague Visby Rules but had in turn contracted with their subcontractor under Hague Rules.

The limitation calculations (see table) showed that the forwarder's liability to the shipper was USD19,920, but the forwarder could only recover USD1,064 from the carrier, a shortfall of USD18,856.

Failure to contract on "back-to-back" terms

	Freight forwarders T&C's with customer	Freight forwarders terms with their subcontractor
	Hague Visby	**Hague**
Mode of transport	Sea	Sea
Limitation of liability calculation	2 SDR/kg Or 666.67 SDR/package (whichever is the greatest)	GBP100/package or unit
Total liability	12,000 SDR	GBP800
USD liability	USD19,920	USD1,064

These calculations use the following conversion rates as at January 2024: 1 SDR = USD1.66, GBP1 = USD1.33, and figures are subject to rounding.

Case Study 2

A transport operator in Australia shipped a high-value cargo of electronics for its key customer. The cargo weighed 1,000kg and had a value of USD150,000. The transport operator's sales director had signed a contract providing an enhanced liability in the event of loss or damage in transit, providing full-value protection to the customer.

The transport operator's operations department subcontracted the final delivery by road to a trucking company it had used many times without incident. During the road carriage, the truck driver stopped for a statutory rest break and thieves stole the truck along with its trailer and cargo.

The customer filed a claim against the transport operator under the contract, demanding settlement at full value for the stolen goods. When the claim and contract was reviewed by the transport operator, it became clear this was a valid demand.

The transport operator made a back-to-back claim against the subcontracted trucking company, which immediately rejected the claim. The trucking company provided a copy of its STCs, stating its liability was restricted to a fraction of the claimed amount based on a calculation relating to the weight of the cargo.

Having not ensured it was contracting with the trucking company on back-to-back terms, the transport operator was required to settle the claim at full value and was able to claim only a fraction of this back from the trucking company. Furthermore, as the transport operator had not declared the enhanced liability contract to its liability insurer, it was unable to recover the difference.

"Having not ensured it was contracting with the trucking company on back-to-back terms, the transport operator was required to settle the claim at full value and was able to claim only a fraction of this back from the trucking company."

Case Study 3

A NVOCC transport operator issued an HBL for a shipment of 1,000 cartons on 10 pallets in a single 20ft container. On its HBL, the goods were described as 1,000 cartons. During carriage, the entire container is stolen and a claim arises for the full amount of the stolen goods. On investigation, it was noticed that the MBL issued by the actual carrier describes the cargo as 10 pallets only. In this instance, the difference in description of the cargo created a gap in back-to-back recovery, meaning that the transport operator had to pay the claim based on the limitation relating to the 1,000 carton enumeration, whereas it could only recover against the actual carrier based upon the limitation for the 10 pallet enumeration. It is vital to make sure that the cargo descriptions and the package/unit enumerations mentioned in different transport documents are identical. Any discrepancy could leave the transport operator out of pocket and may also prejudice its liability insurance cover.

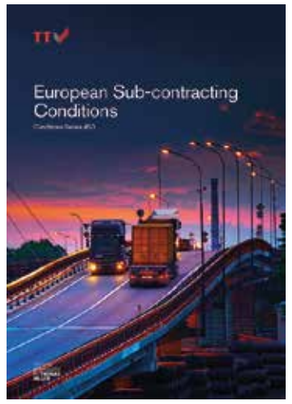
Summary and checklist

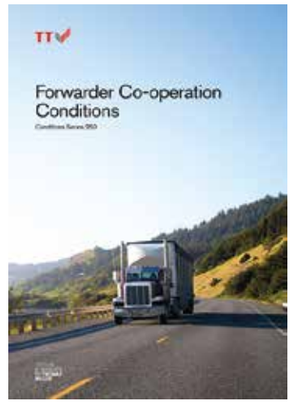
Before entering any contract relating to the shipment of cargo, you should consider the following:

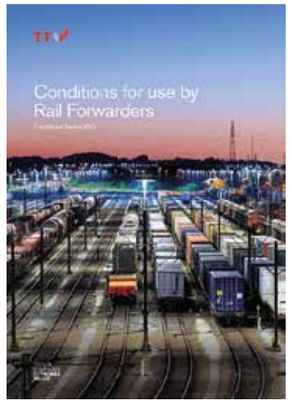
- [ ] What services are to be provided under this agreement?
- [ ] Will we be acting as agent or principal/carrier?
- [ ] Will we be incorporating our house bill of lading terms and conditions or standard trading conditions (collectively “standard terms”) into this agreement?
- [ ] If not, how do our liabilities differ between this contract and our standard terms?
- [ ] Are we permitted under the contract to appoint subcontractors?
- [ ] If we are using a subcontractor, will we be subcontracting on back-to-back terms?
- [ ] If we are using a subcontractor, has their liability insurance been checked?
- [ ] Are there financial penalties or liquidated damages incorporated into the contract?
- [ ] Are our liabilities under the contract fault/negligence based? Are indirect and consequential losses for delay and loss of market excluded?
- [ ] Has a force majeure clause been included that excludes liability for anything not related to fault or negligence?
- [ ] Has a time bar been included?
- [ ] Does the contract discuss the terms of renumeration and the burden of responsibility insofar as import/export duties and taxes are concerned?
- [ ] Does the contract specify the insurance requirements of the service provided and do these go beyond the current insurance arrangements?
- [ ] Are the indemnity provisions of the contract fair and reasonable?
- [ ] Has a lawyer reviewed the contract? If so, have they confirmed that the limitation provisions within the contract are enforceable as per the applicable law and jurisdiction clause?

TT standard contracts

If you are a TT Club Member, the Club can provide you with a template house bill of lading and standard trading conditions that can be adapted to your needs. However, you will need to seek legal guidance to ensure that they are enforceable in the law and jurisdiction selected in the contract.







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