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Indemnification: Slow and Steady Wins the Race

According to the renowned Greek historian Herodotus, haste in every business brings failure. In today's environment, far too many carriers, shippers and third-party logistics providers casually sign service agreements containing indemnity provisions without ever taking the time to understand what these provisions actually mean. One significant risk that parties should avoid at all costs is an indemnity provision that may obligate an innocent party to defend and indemnify the other party to the contract for the other party's *own* negligence. A claim brought pursuant to such a provision can be devastating to your company.

Indemnification provisions often appear straightforward and innocuous at first glance. For instance, such a provision might read:

> [Party A] shall defend, indemnify and hold [Party B] harmless from and against any and all claims, liabilities, loss, cost or expense (including court costs and reasonable attorneys' fees) (collectively "Losses") including, but not limited to Losses for injury to or death of persons or damage to property arising out of the performance of this Agreement.

Whether such a provision requires one party to indemnify the other for the other's own negligence turns in large part on the law that governs the construction of the contract. What law governs the construction of the contract requires a consideration of a number of factors, including the actual jurisdiction in which the parties are contracting, the jurisdiction in which the contract will be performed and the contract's "choice of law" provision (another provision that is often given surprisingly little consideration by the parties). At the very least, parties must be aware that different jurisdictions have varying rules regarding the enforceability of such provisions.

States That Generally Enforce Indemnification of One's Own Negligence

In many jurisdictions, an indemnification provision like the one mentioned above could be construed to make Party A indemnify Party B for Party B's own negligence if that negligence "arises out of" (*i.e.*, relates to) the performance of the agreement. In other words, a 3PL who agreed to such a provision in a shipper-broker contract might find itself liable for the shipper's negligent loading of a container that subsequently causes a catastrophic traffic accident despite the fact that the 3PL is completely innocent of any wrongdoing. For instance, Ohio—though disfavoring such agreements—generally enforces such agreements even if they purport to indemnify a negligent party. The courts typically reason that Ohio's strong public policy in favor of freedom of contract trumps virtually all other considerations (except when the indemnification relates to intentional or illegal acts).

States That Expressly Prohibit Indemnification of One's Own Negligence

In recent years, a number of states have enacted legislation that expressly prohibits the enforcement of indemnification agreements in transportation contracts that purport to make an innocent party indemnify a culpable party for the culpable party's own negligence. For instance, South Carolina has enacted the following statute:

> Notwithstanding another provision of law, a provision, clause, covenant, or agreement contained in, collateral to, or affecting a

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> motor carrier transportation contract that purports to indemnify, defend, or hold harmless, or has the effect of indemnifying, defending, or holding harmless, the contract's promisee from or against any liability for loss or damage resulting from the negligence or intentional acts or omissions of the contract's promisee, or any agents, employees, servants or independent contracts who are directly responsible to the contract's promisee, is against the public policy of this State and is unenforceable.

In other words, South Carolina has attempted to adopt a public policy against enforcement of such a heavy-handed indemnification provision, at least in an intra-state transportation context. Other states have enacted similar legislation, and the American Trucking Association has drafted model legislation that states are free to adopt. Of course, parties may nonetheless quibble about the constitutionality of any given statute or its enforcement and applicability in certain circumstances.

Understanding indemnification requires not only reading the language carefully, but also taking into account the particular state's law that will govern the construction and enforcement of the provision.

States That Sometimes Permit Indemnification Of One's Own Negligence

A number of states attempt to find a middle ground between clear enforcement and categorical prohibition of these provisions. For instance, Texas generally enforces such indemnification agreements only if negligence is "expressly referenced" in the indemnification provision itself. Similarly, Delaware and Pennsylvania permit the enforcement of such indemnification if the provision authorizing indemnification of a party's negligence is "clear and unequivocal." In other words, in these jurisdictions, parties must be exceptionally obvious that they are agreeing that one party is going to indemnify the other party for that other party's own negligence. Simply put, the more express and precise the provision, the more likely that even an onerous provision will be enforced.

In summary, parties to all types of transportation and logistics contracts must take the time to understand indemnification clauses. Understanding indemnification requires not only reading the language carefully, but also taking into account the particular state's law that will govern the construction and enforcement of the provision.

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Due Diligence and Negligent Hiring in the Age of Puckrein and Schramm

Back in the day, before deregulation, a shipper or broker could hire a motor carrier and trust that the carrier had proper licenses and insurance and was responsible for its own actions. If the shipper or broker had deep pockets, it could be named in a lawsuit resulting from a vehicular accident, but a motion for summary judgment or a tender of defense to the carrier would usually suffice unless the shipper's or broker's negligence had caused the accident.

Since deregulation, if a shipper, broker, or (now) a 3PL was diligent in its selection of a motor carrier, entered into a carefully negotiated contract and required a copy of the carrier's operating authority and certificates of insurance, it probably felt confident it was protected. A shipper, a broker, or a 3PL reasonably felt it was responsible for the results of its own negligence, but not for the acts of the carrier or its driver.

Or so we thought.

Two recent cases illustrate how courts are expanding responsibility for carrier's actions to shippers, brokers and 3PLs. Shippers, brokers and 3PLs must now find ways to better protect themselves, not only by well-drafted contracts and careful selection of carriers, but by establishing methods to continually monitor the competency of their carriers.

The 3PL industry was awakened to the expanded risks involved in carrier selection when *Schramm v Foster* 341 F.Supp. 2d 536 (D.Md.2004), which involved a catastrophic accident and a violation of hours of service regulations, held that a 3PL had a duty of reasonable care in selection of carriers and could be subject to a claim for negligent selection of a carrier.

Before the industry could assimilate the fall out from Schramm, shippers were hit with *Puckrein vs ATI Transport, Inc*. 186 N.J. 563; 3897 A.2d 1034; 2006 N.J.

Lexis 656. *Puckrein* held that a shipper could be liable for negligent hiring of an incompetent motor carrier and that the shipper has a *continuing* duty to inquire as to the on-going competency of the motor carrier.

Puckrein, like *Schramm*, involved a catastrophic accident. Kevin Puckrein and Alecia Puckrein were killed and Alecia Puckrein's mother, Jean Graeves, was seriously injured when a tractor-trailer hauling a load for Browning-Ferris Industries of New York, Inc. ("BFI"), ran a red light and struck their automobile. The tractor was unregistered, uninsured and had seriously defective brakes.

[T]he shipper has a continuing duty to inquire as to the on-going competency of the motor carrier.

In the subsequent litigation, everyone except BFI and their associated companies defaulted. BFI had deep pockets and everyone else was judgment proof.

BFI had hired the motor carrier as an independent contractor. The general rule is that principals are not liable for the actions of independent contractors unless (1) the principal retains control of the manner and means of doing the work subject to the contract; (2) *the principal engages an incompetent contractor*, or (3) the activity constitutes a nuisance per se. The issue was whether BFI met its duty to continually inquire as to the competency of the motor carrier. At the time of the accident, the registration for the vehicle had been suspended, the vehicle was not insured, and the brakes were seriously defective. BFI had received a certificate of insurance from the carrier when the contract was signed, but the insurance had expired two months before the accident.

The court held that BFI could have known by exercise of reasonable care, that the motor carrier was no longer competent. The court further stated that a casual shipper of goods has a right to assume that the carrier is not conducting business in violation of the law. But a company such as BFI, whose core purpose is the collection and transportation of materials on the highways, has a duty to use reasonable care in the hiring of an independent trucker, including a duty to make an inquiry into that trucker's ability to travel legally on the highway. Even if BFI made reasonable inquiry at the time of its original hiring of the carrier, the duty did not end there. Despite its continuing duty to inquire as to licensing, registration, and competency, BFI apparently made no inquiry after the original contract was signed, although it continued to allow the carrier to transport materials for them.

What can a shipper, broker or 3PL do to protect itself in this age of Puckrein and Schramm?

1. Create a due diligence policy regarding retention of carriers and 3PLs and ensure all involved employees comply with the policy.
2. Carefully draft and negotiate contracts with all transportation providers.
3. Create and implement a carrier qualification checklist, including licensing and insurance requirements, and ensure all carriers meet and continue to meet its requirements.
4. Monitor, monitor and continue to monitor the competency of your carriers.

For more information, contact Martha Payne at (541) 764-2859 or mpayne@bfca.com.

The Edge of the Envelope: Freight Forwarder as Manufacturer Supplier?

As phenomena such as freight assembly warehouses, just in time inventory and RFID continue to grow and evolve, so do the categories into which plaintiffs may attempt to pigeonhole freight forwarders, carriers and warehousemen. This expansion is exemplified in the recent case of *Delgadillo v. Unitrons Consolidated, Inc.*, 191 Fed. Appx. 547; 2006 U.S. app. LEXIS 18331 (9th Cir. 2006). In that case, plaintiffs Alfredo Delgadillo and his wife filed a *product liability claim* against freight forwarder Unitrons Consolidated Inc. and freight forwarder Superspeed Transportation Inc.

Delgadillo sought to hold the forwarders liable under a provision of the Idaho Product Liability Act that holds: "[a] product seller, other than a manufacturer, is also subject to the liability of the manufacturer … if [t]he manufacturer is not subject to service of process under the laws of the claimant's domicile; or … [t]he claimant would be unable to enforce the judgment against the product manufacturer." The manufacturer in this instance was admitted to be unavailable under the Act. Consequently, the forwarders would be liable under Idaho's Act if they were determined to be "product sellers."

The Act defined "product seller" as: "any person or entity that is engaged in the business of selling products, whether the sale is for resale, or for use of consumption." The defendants contended that they were freight forwarders. They described themselves as "travel agents for cargo." They contended that their role was simply to "arrange for the shipment" of the subject

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machine to the United States, prepare the paperwork and collect and pay freight charges. These activities, the forwarders asserted, were insufficient to qualify them as "product sellers" under the Act.

In reviewing the District Court's summary judgment decision, the Appellate Court explained:

> The district court properly focused its attention on the nature of [the forwarder's] involvement in placing the product into the stream of commerce. Viewing the evidence in the light most favorable to the [forwarders], the district court determined that: (1) the lack of a freight forwarding license could lead a reasonable trier of fact to infer Appellees had sold the product; (2) the invoices demonstrating Appellees engaged in other transactions involving industrial equipment could lead a reasonable trier of fact to infer the Appellees have sold other products; (3) the Appellees' insurance policy could lead a reasonable trier of fact to infer Appellees feared liability for distribution of products and; (4) the Appellee's possession of a negotiable bill of lading could lead a reasonable trier of act to infer the appellees had title to the product.

Id., slip op. at 4.

The court agreed, however, with the district court that this evidence was insufficient to find that the forwarders were product sellers under the Act. There was no evidence that the sale of the product was the principal purpose of the transaction. The invoices and insurance policy only permitted a reasonable fact finder to infer that the forwarders may have been involved in the sale or distribution of other goods, not that they had sold or distributed the relevant product at issue.

If a freight forwarder or warehousing company plays a role in actual final assembly of products, it could very well metamorphosize into a "manufacturer supplier" under a state's product liability statute.

This holding draws a line in the sand as to the expansion of freight forwarder categorization. There are similar statutes in the product liability acts of most states, in light of the manufacture of many consumer products overseas. Consequently, such an attempt may be made in other jurisdictions. If a freight forwarder or warehousing company plays a role in actual final assembly of products, it could very well metamorphosize into a "manufacturer supplier" under a state's product liability statute. Another item of note, the fact that the freight forwarder was unlicensed, although not determinative, most certainly did not help the freight forwarder in the court's analysis.

There is a natural inclination by transportation entities, as they strive to provide greater, more seamless and more integrated services to their customers, to not only expand those services, but to proclaim the expansion of those services. Often, these representations, which many times merely constitute puffery or advertising, can lead courts to conclude that the intermediary's role in the shipment sequence has transcended, and thus subject the intermediary to a different and more expansive liability regime.

In light of this decision, all entities in the transportation sequence should be particularly careful to make sure that their role is defined as clearly as possible in any of the lading or contractual documents. Contractual disclaimers should also include an express clause, clearly stating that the transportation related entity is *not* a product manufacturer or supplier, nor in the business of resale of the goods. The contractual/lading documents should also include appropriate hold harmless and indemnity language to protect the transportation entity from any such claim.

For more information, contact Eric Zalud at (216) 363-4538 or ezalud@bfca.com.

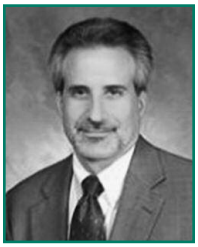
Benesch Opens Wilmington and Philadelphia Offices

East Coast Expansion!

Benesch has opened offices in Delaware and Pennsylvania with the addition of two new experienced bankruptcy partners, Raymond Lemisch and Bradford Sandler, as well as associate Jennifer Hoover and paralegal Sandi Van Dyk.

In light of the fact that many users and providers of transportation and logistics services are facing a difficult economic environment, the addition of new offices is particularly timely. For instance, according to the American Trucking Association, about 385 trucking companies with a minimum of five trucks went out of business during the first three months of 2007—a notable increase in fleet failures over 2006. "These offices were essential to our clients' needs in the bankruptcy area," said Will Kohn, Chair of the Business Reorganization Practice at Benesch. "The addition of Ray and Brad allow us to service both our Midwest and East Coast clients in a more efficient manner. They have excellent national reputations in the bankruptcy area, and our entire team is looking forward to working with them and their colleagues."

In any event, the Delaware and Pennsylvania offices will benefit even those users and providers of transportation and logistics services which are not financially distressed. Benesch's new offices give it a presence on the ground in and near some of the nation's most congested roadways and logistics centers. The addition of these offices expands Benesch's geographic footprint from the Pacific to the Atlantic and beyond, enhancing the firm's ability to serve its clients located around the country and throughout the world.



Mr. Lemisch, who is admitted in Delaware, Pennsylvania, New Jersey and Connecticut, has over 20 years of bankruptcy, litigation, and general business law experience. He represents unsecured creditors' committees, equity security holders' committees, debtors in Chapter 11 bankruptcy proceedings and Chapter 7 trustees. He also has an active transaction practice in which he represents both buyers and sellers of business and businesses seeking equity or debt financing. He is a member of the Turnaround Management Association and has chaired the Education Committee of its Delaware Valley Chapter. He is also a member of the American Bankruptcy Institute. Mr. Lemisch received his law degree from Boston University and his undergraduate degree from Haverford College.

Mr. Sandler is admitted in Delaware, Pennsylvania, New York and New Jersey and concentrates his practice in the areas of insolvency, commercial transactions and commercial litigation. Mr. Sandler has substantial experience representing businesses in out of court reorganizations as well as representing debtors, creditors' committees, secured and unsecured creditors, purchasers, landlords, Chapter 11 and Chapter 7 trustees and post-confirmation plan administrators in business bankruptcies. He also focuses on

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representing international and national businesses and entrepreneurs in corporate and commercial transactions. He is Co-Chair of the Asset Valuation and Disposition Subcommittee, and a member of the Preference and Avoidance Subcommittee, of the American Bar Association's Bankruptcy and Insolvency Litigation Committee. He is also Chair of the Bankruptcy Committee of the Business Law Section of the Philadelphia Bar Association. He received his law degree from Temple University School of Law and his undergraduate degree and M.B.A. from Drexel University.

"Over the last year we have made a concentrated effort to build some of our national practices, including core practice areas like Bankruptcy and Corporate," said Jim Hill, Benesch's Managing Partner. "These offices will be a great opportunity for us to build those practice areas, while Wilmington and Philadelphia will be key geographic regions for us."

On the Horizon

American Trucking Associations' Forum for General Counsel

Marc Blubaugh and Eric Zalud will be attending.
Eric Zalud will be speaking on High Dollar Freight Charge cases and how to prevent them.

July 29–August 1, 2007 | Dana Point, CA

Executive Committee of the Transportation Lawyers Association

Marc Blubaugh and Eric Zalud will be attending.

August 4, 2007 | Chicago, IL

The National Tank Truck Carriers, Inc. Board of Directors Meeting

Eric Zalud and Frank Reed will be speaking on rapid response to truck accidents.

August 10, 2007 | Colorado Springs, CO

Benesch's Transportation and Logistics Conference

The theme of this conference, at which members of Benesch's Transportation & Logistics group will be presenting, is "Maximizing Opportunities and Minimizing Risks in Transportation and Logistics: How the Law Can Help."

September 20, 2007 | Columbus, OH

SMC³ Contract Law Seminar

Bob Spira will be presenting.

September 26, 2007 | Location TBD

For further information and registration, please contact Megan Crossman at (216) 363-4174 or mcrossman@bfca.com.

For more information about the Transportation and Logistics Group, please contact one of the following:

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