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Mitigating Supply Chain Risk: Effective Transportation and Logistics Provider Diligence and Management Practices

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Every day, supply chain managers and logistics coordinators navigate a world of risk. Those risks include interruption due to delay, the damage, contamination, or loss of goods, customer service failures, and even regulatory compliance violations. Perhaps the greatest example is the 2016 bankruptcy of ocean carrier Hanjin that stranded $14 Billion USD in freight and shocked supply chains. Fortunately, both commercial shippers and service providers can implement practices to help avoid or mitigate risk as goods circle the globe in the hands of others.

Supply chain risk is an acute vulnerability for transportation and logistics. In today's market, these services contribute not only operational efficiency but also serve as the face to end-users and in some cases play a significant part of the enterprise value proposition. Some global supply chains aggressively mange providers while others do not. Other supply chains in-source many of these services while others do not. In either case, third parties are likely handling material inputs, finished products, and returns, in all jurisdictions to which the supply chain extends.

Transportation and logistics services are high-value and high-impact because they are essentially outsourced operations. Each functional element of the global supply chain operates within its own regulatory framework, contractual requirements, and accepted business practices. The "rules of the road" differ when dealing with direct carriers, forwarders and brokers, transportation management providers, customs brokers, export agents, warehousing and distribution companies. An effective plan to manage supply chain risk and resiliency will leverage each of these business realities during procurement and throughout operations management.

Service provider due diligence is a valuable part of any procurement and provider management strategy because it is both achievable and effective in the transportation and logistics sector. Most jurisdictions regulate transportation and logistics activates for public safety and convenience. Public records are often available from the respective regulatory agencies, which makes due diligence fast and inexpensive. Insurance and bonding information is also often available to the public due to the requirements imposed by law. Additionally, certifications and trade associations can serve as both badges of quality and evidence of market-standard practices and terms.

Taking brokers and third party logistics companies as an example, the range of services directly and indirectly offered will frame the impact of regulation and the areas for diligence. It is reasonable to inquire regarding a service provider's ability to perform, to require identification of its respective operating authorities and insurance, and to require representations and warranties to that effect

under contract. The starting point for this analysis often begins with the nature of the services, such as:

- **Surface Transportation** - Does the provider hold a broker or freight forwarder permit from the Federal Motor Carrier Safety Administration?
- **Air Transportation** - Does the provider operate pursuant to a security program approved by the Transportation Security Administration and does it hold certification from the International Air Transport Association?
- **Ocean Transportation** - Does the provider hold an ocean forwarder or non-vessel operating common carrier (”NVOCC”) license from the Federal Maritime Commission?
- **Customs Brokerage** - Does the provider hold a customs broker license from U.S. Customs and Border Protection?

To further the review, many of these regulated services also require bonds, trust funds, or other evidence of financial responsibility. It is not uncommon to request evidence of additional insurance based upon an internal Risk Management team’s tolerances. These requests often include commercial general liability coverage, workers compensation and employer’s liability coverage, contingent cargo coverage, warehouseman’s liability coverage, and even errors and omissions professional liability coverage. Sophisticated commercial shippers also require representations about the insurance requirements that the brokers and third party logistics providers impose on their portfolio of underlying carriers.

Certifications are another indicator of a provider’s experience in a particular service or jurisdiction and in some cases offer independent third-party verification. For example, it is not uncommon to require Customs-Trade Partnership Against Terrorism (“C-TPAT”) certification in the United States where the desired activities include cross-border traffic or other forms of trade. Among the North American Free Trade Agreement (“NAFTA”) countries, Partners in Protection (“PIP”) certification is available as an analog in Canada and Nuevo Esquema de Empresas Certificadas (“NEEC”) certification is available in Mexico. Trade association membership may also be representative of a provider’s commitment to professionalism. In the United States, many international forwarders are members of the National Customs Brokers and Forwarders Association of America (“NCBFAA”) and in the United Kingdom, as an example, British International Freight Association (“BIFA”) membership is available.

Active provider management strategies help to further manage supply chain risk and resiliency after qualified service providers are selected. As an initial matter, this involves negotiating appropriate contract terms and conditions applicable to the service, service provider, and country of operation. Developing agreement templates can facilitate the bidding process by comparing “apples to apples” while also gaining a view to which particular terms may be pain points for providers. Tailored agreement templates will also make contract administration and provider management easier following awards by clarifying expectations for renewals, updates to services and rates, and continuous improvement, and because similarly situated providers will be working from the same or nearly identical terms. Agreement templates will also help to manage the impact of incidents. For example, a transportation and logistics company can align with internal contingency plans by

addressing: (1) required data feeds and event notices; (2) business continuity and disaster recovery; (3) termination rights and post-termination assistance; (4) escalation procedures; and (5) dispute resolution requirements.

Service provider files age over time and require attention, such as updating operating authorities, insurance, and any other qualification that was raised during initial diligence. Operational characteristics and risk management tolerances may also change over time, and open and frequent communication offers an opportunity to problem-solve as well as to update any commercial or legal terms that may need adjusting. Contractual mechanisms are available to nurture these types of mutually beneficial relationship, including agreeing in advance to participate in periodic management meetings and continuous improvement discussions. The best-case-scenario is, of course, to develop a long and fruitful relationship throughout the supply chain that yields few surprises.

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