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Warehouse Legal Liability Trends

Joe Howard, Lockton Partner & Kevin M. Phillips, Scopelitis Partner

Warehouse Legal Liability Trends

- Developing Trends in the Insurance Marketplace
- Developing Trends in Claims

Current Warehouse Legal Liability Market

- Sustained soft cargo and stock throughput market for decades has led to unsustainable pricing in London market.
  Result: 4 years rate increases
- 2018 Lloyd's conducted reviews of individual business plans; led to closure of several Lloyd's syndicates. Others voluntarily withdrew writing Marine business.
- 2020 Lloyd's posted $900M major losses. Recently, cargo programs sustained significant losses resulting from misappropriation and fires.

Current Warehouse Legal Liability Market cont.

- Underperforming insurance industry sectors most impacted. Includes automotive, temperature sensitive goods, and soft commodities as well as pharmaceuticals.
- 3+ years of strict underwriting practices has increased market stabilization. Rate increases still expected, though not as significant as in past 3 years.
- Inflationary effect taking hold on valuations, limits and limitation of liability
- Customer property insurance cost and availability will continue to drive business to more highly protected warehouses

The Evolving Marketplace – Warehouse Legal
London Market Capacity and Movement

London cargo market can confidently offer increased capacity following significant investment in the segment over the past two years.

More recent entrants which all are now well established include:

Ocean Underwriting - Ascot backed, Lee Aspinall and Alasdair Butler
Arch - Steve O'Gorman moved from CNA and David Stallard who was previously at Markel joined recently
Tokio Marine HCC - Richard Golder and Jack Bryan previously at Hiscox
HDI - Steve Foreman recently secured Surplus Lines paper
IQUW - Scott Heely and Jonny Shannon joined from MS Amlin
Navium - Henry Maughan previously at Antaras
Starr - back writing cargo in London
Everest - Alastair Marriott left CNA and will start to write Cargo from 1st January
James Munn and Thomas Batterbury - Recently left Markel with James joining QBE. Tom started new "Freeboard Marine" MGA

London Market Outlook

- Sense of creativity to offer solutions for challenging risks, demonstrating strong capabilities and renewed optimism for the future.
- Face-to-face trading now back in London and, in conjunction with the utilisation of the electronic placing platform PPL, London can now confidently again claim to be the global lead market for complex risks.
- Rate rises still sought in some industry segments but with more balanced and pragmatic view.
- Cargo insurance buyers can expect stability and a general levelling of premiums.
- Significant market capacity available will ensure that buyers have options as competition provides favourable pricing conditions.
- Key priority for underwriters remains to reduce levels of exposure for any single loss. Achieved by deploying less capacity and reducing line size.

Despite the improved picture, we must remain vigilant due to economic forces arising from unknown consequences of the Ukraine-Russia conflict as well as extreme inflationary pressures and catastrophe costs which could apply a break to further price easing.

Expected Property Themes

HEADWINDS

1. Valuation
2. CATs
3. Unknowns of reinsurance

TAILWINDS

1. Book is well positioned
2. Competition is picking up

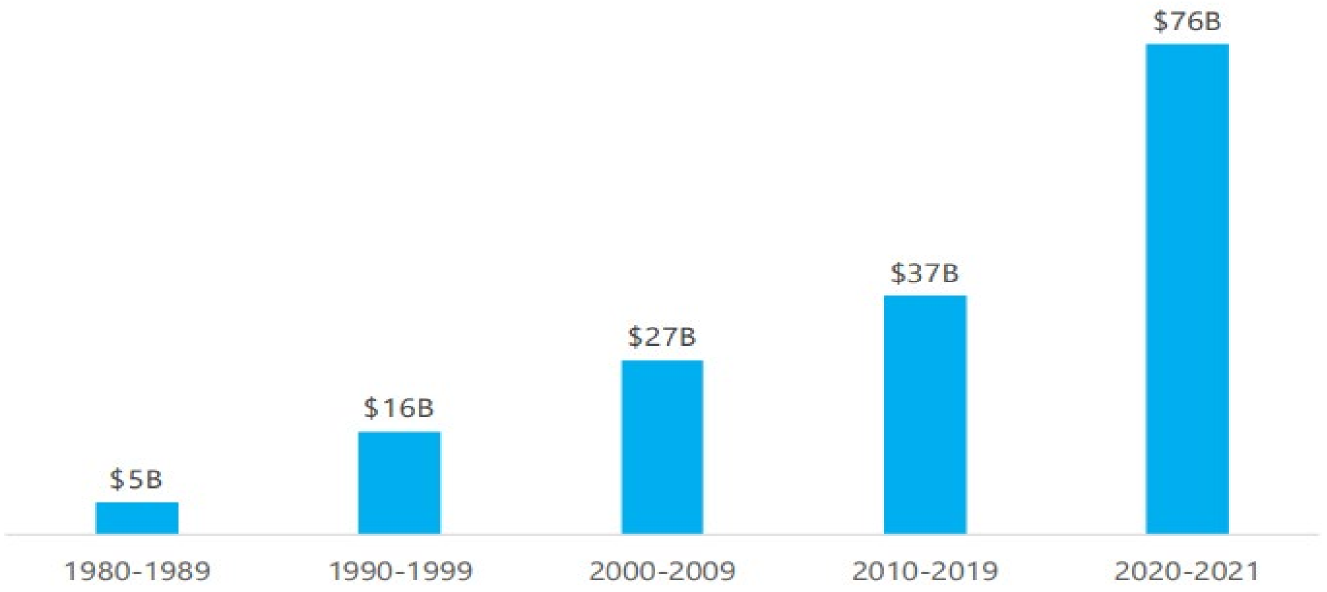
WHICH OF THESE FACTORS WILL PREVAIL?

Property Challenges

- Challenged occupancies include food & large warehouse risks. Continued price & terms pressure.
- Loss frequency & severity still a challenge for underwriters trying to grasp if this is a new normal.
- Market reinsurance agreements still create challenges on some deals. (Facultative/International)
- Loss costs continue to increase – loss activity, inflation, policy extensions, supply chain, infrastructure all contribute, while interest rates and reinsurance costs pressure combined ratios.
- Florida domestic market is challenged from poor carrier performance and numerous insolvencies over past few years. Hurricane Ian expected to apply further pressure.

Catastrophe Losses

FIGURE 4: SINCE THE 1980s, AVERAGE ANNUAL CATASTROPHE LOSSES IN THE U.S. HAVE RISEN AT AN EXPONENTIAL PACE.



Valuation and Exposures

Process Rigor is Key

If inflation factors for building and equipment are not in line with recognized industry figures, have a detailed story.

Good Data Wins!

Include sq. ft., construction type, owned or non-owned, triple net lease, etc.

What indexing tool is used?

Have you been consistently indexing values to present day dollars from the fixed asset register?

How are acquisitions handled in the fixed asset ledger?

Avoid reporting flat values year-over-year or missing information.

Appraisals from reputable firms on some frequency to validate process.

Utilize a forensic accountant for Business Interruption analysis and allocate values by location.

Liability Market

- Liability lines under significant pressure to achieve and maintain sustained profitability. – Despite some evidence of improved conditions for commercial auto insurers, concerns about continuing losses mean underwriting scrutiny will persist.

- Amid persistently high inflation, underwriters remain focused on reserve adequacy and expected future claim payouts. Recent umbrella/excess renewals reflect improved pricing stability.

- Growing loss severity is a concern across all lines and in many industries.

- In auto liability, inflation is driving up vehicle repair and replacement costs, while rising medical costs and distracted driving remain additional concerns.

- Insurers continue to watch severity trends closely as courts clear pandemic-related backlogs.

Fire Protection

FM Global has released their data sheet 4-13 – Oxygen Reduction Systems.
Key wording: Provide FM Approved systems, equipment, material, and services whenever they are applicable.
Today there are NO listed oxygen reduction systems in the public FM Approval Guide, this is developing

Zurich has released a "Risk Topics" guide for Fixed Fire Protection – Oxygen Reduction Systems
Key wording: Listed components means components approved, certified, or listed by a Zurich Recognized Testing Laboratory for their intended purpose.
Zurich Recognized Protection Principles apply to oxygen reduction system including:
VdS 3527. VdS-Guidelines for Oxygen Reduction Systems, Planning, and Installation

Both Zurich and FM suggest 11-13% as acceptable design oxygen concentration levels.

Cyber

- Ransomware activity was reported to be temporarily disrupted by Russia's conflict with Ukraine, but remains sizable long-term business threat.
- Developers of ransomware-as-a-service are shifting their focus to midsized companies, which they believe can generate more consistent returns than higher-profile targets, according to CoveWare.
- Robust cybersecurity controls remain a prerequisite for coverage, with underwriters seeking to verify that controls actually exist.
- Insurers carefully review policy applications to determine accuracy of representations about controls. We have seen coverage lost where the representations were incorrect.
- Contingent business interruption increasingly at the forefront of underwriters' minds. – Insurers particularly concerned about potential systemic risk, which they seek to contain by delineating policy limits for losses stemming from IT and non-IT providers.
- Pricing for cyber insurance coverage continues to rise, but the pace of increases is slowing. – Risk controls and other factors continue to drive individual insureds' outcomes.

Invasion of the…Bugs?

Case # 1

Damage From A Customer's Product

- Issue: A Customer's corrosive, sticky beverage begins leaking and causing extensive damage to your warehouse.
- Facts: You enter into a substantial storage contract with a beverage manufacturer. However, due to a manufacturing defect, the Customer's cans start leaking and releasing massive amounts of corrosive liquid. The corrosive nature of the beverage causes damage to everything it touches.
- Complicating Factors: Are other customers' products damaged? Who owns the actual building?
- Goal: Getting Customer to pay for all damages.

  Potential Legal Claims: Breach of Contract and Negligence.

Damage From A Customer's Product

IT WASN'T ME! Realizing the goal starts with your Contract:

- Goods were not packaged properly: "All Goods [are to] be delivered at the Facility properly...packaged for storage and handling."
- Customer must pay for all costs: "[Depositor shall] indemnify and hold Warehouse harmless from all loss, cost, penalty and expense...which Warehouse pays or incurs as a result of [the] Depositor failing to [provide accurate product information]."

Damage From A Customer's Product

- Damage to your site is the Customer's responsibility: "Where damage…occurs to…goods…the depositor shall be responsible for the cost of removing such goods and…site remediation resulting from the…damage to the goods."

- Damage was not caused by your negligence: "[W]arehouseman shall not be liable for any damage …however caused unless such damage…resulted from the failure [of] warehouseman to exercise…care as a reasonably carful man would…[W]arehouseman is not liable for damages which could not have been avoided by the exercise of such care."

A Good Contract Makes All The Difference

Damage From A Customer’s Product

Initial Steps:

- Document faulty product and all damages. Then, document again. You cannot have enough documentation.
- Alert Customer their product is defective and get quotes for repair.
- Call Scopelitis and let us demand payment for all your damages. This can save you from being the bad guy. In addition, we can make sure none of your rights are impaired.
- If any other customer’s product is damaged, alert them.
- If warehouse is owned by a third-party, alter them.

Other Considerations:

- Do you have insurance coverage for property damage? If so, getting the Customer to pay is preferred over making a claim. However, check time limits to make a claim with your insurer. It does not hurt to put your insurer on notice.
- How to tread if Customer is a big revenue generator and you want to maintain a positive relationship.
- Ultimately, in this type of situation, the law will almost certainly be on your side. Especially, if you have a good contract.

Other Considerations:

- Nevertheless, filing Suit should not be your first option. Amicable resolution is always a cost-saver. That being said, there will always be deadlines (like statute of limitations) to file Suit and preserve your Claim. You should be aware of any time limits which may lapse your claim.

Case # 2

TERMINATION DISPUTE

- Longtime customer
- Customer decides to leave for another WH provider (in coming months – WH and customer winding down operation)
- On the way out, customer stops paying bills
- Big $$$$ owed to WH
- WH sends demand letter - too much $$$ to ignore

"CLAIMS" AGAINST WAREHOUSE

- After WH demand letter, Customer asserts claims
- Product Loss/Damage/Shortage
- Overbilling for labor
- Management Fee
- Chargebacks
- Unauthorized purchases by WH
- End result: Customer says it is OWED $$$, despite not paying WH invoices

STRATEGY

- Isolate amounts owed to WH from everything else (what does your contract say about offsetting claims from invoices?)

- Be ready to go line by line through your charges if needed

- If loss/damage/shortage claims ultimately will be handled by insurance, get the process going and tell your customer that

STRATEGY

- You have insurance for a reason for product damage, but your business can't survive a customer not paying the bills
- Customers are always looking for reasons not to pay the bill – termination disputes happen

STRATEGY

- Your WH collections need to move faster than an insurance claim, so don't allow offsetting
- WH contract should provide protections for termination dispute, consequential damages, chargebacks
- Don't be afraid of meeting face to face to work through a termination dispute before litigation

Case # 3

WAREHOUSE FIRE

- A cold storage warehouse burned down in a massive fire.
- All goods were destroyed. Many customers incurred millions of damages due to their destroyed goods.
- Several customers had not fully paid their storage costs prior to the fire.
- Customers each signed warehouse receipts for all storage needs.
- **NO CAUSE OR ORIGIN WAS DETERMINED FOR THE FIRE.**

SIGNED RECEIPTS

The signed warehouse receipts contain:

- Damages limitations based on the weight of goods stored.
- Statute of limitations requiring claims to be brought in court within 9 months.
- A requirement for any claimant to show that the warehouse failed to use reasonable care.
- Provisions for the warehouse to collect outstanding storage charges and debris removal costs.

RESULTS

- Of the 31 customers at the warehouse, only 2 claims were filed on time within the contractual statute of limitations.
- Of those, each claimant will have a very difficult time proving that the warehouse did not use reasonable care without a **cause or origin** of the fire.

RESULTS

- Even if they prevail, the claimants will be significantly limited in damages due to the damages limitations present in the warehouse receipts.
- The warehouse is able to use owed debris removal costs and storage charges as leverage in the lawsuits.

TAKEAWAY

- A valid and signed warehouse receipt, or standard contract with a customer, can save a warehouse tens of millions of dollars in litigation and claims costs, and are a must when dealing with any customers.
- Many attorneys are not familiar with the 9 month contractual statute of limitations period in warehouse contracts.

Case # 4

AGV Integration in Customer's Facility

- Facts: Warehouse prepares proposal for Customer RFQ
- Customer has brand new "state-of-the-art" manufacturing plant and seeks warehouse service provider to provide long-term (7+ years) warehouse management services utilizing Customer's AGVs.
- Customer requires warehouse provider to purchase AGVs.
- Contract establishes a 6-month start-up period at hourly labor rates and transition to transactional pricing.

- Complicating Factors: Customer has already purchased the AGVs and contracted with other third-parties for initial design and technology integration at the Facility.

AGV Integration in Customer's Facility

Integration Efforts

- Parties meet several times per week during start-up period but have several disagreements:
  - How will the AGVs be integrated?
  - What technology will be used?
  - Who will be responsible for costs?
- During RFQ and Contract negotiation process, Warehouse relied on representations by Customer that Customer and AGVs were integration-ready.

AGV Integration in Customer's Facility

- After Contract was signed, Warehouse quickly discovered Customer was not able to properly integrate the AGVs for automated warehousing services at the Facility.
- Integration efforts continue beyond the originally conetemplated 6-month Start-Up period.
- Customer experiences continuous IT turnover during this time and integration efforts remain in a perpetual cycle of progress, stall, restart.
- The Parties mutually agree to extend 6-month Start-Up Period to continue integration efforts.

Contract Payment Dispute and Termination

- After 9-months Customer bottom-line lower than projections.
- Customer begins to complain about charges and services.
- Warehouse continues integration efforts, but no cooperation from Customer prevents AGVs from being deployed.
    - Consequently, Warehouse must continue to operate in manual mode and bill at the hourly rates.

Contract Payment Dispute and Termination

- Customer stops paying for any services demanding transition to transactional pricing.
- Warehouse sends notice of termination for unpaid charges and Customer kicks Warehouse out of Facility.

Litigation

- Warehouse files suit for breach of contract ($1.5M+)
- Customer files Counterclaim

- Potential Defenses:
  1. Counterclaim alleges lost profits
  - Contract prohibits recovery of consequential damages, including lost profits
  2. Election of Remedy
  - Termination as the exclusive Remedy for poor-performance
  - Customer cannot withhold undisputed charges (e.g., monthly/quarterly minimums), terminate the contract, <u>and</u> recover monetary damages.

Discussion