

Insurance — What Your Customer Needs to Know

By Ann Christopher

INSURANCE is one of the most significant issues impacting a third party business relationship. Unfortunately, insurance as it pertains to the warehouse industry is often subject to misunderstanding by the depositor, the warehouse operator and even the insurance provider. As such, it is important to understand the following regarding insurance and the warehouse industry.



(1) Although the warehouse has entered into a bailee/bailor relationship with the depositor, the depositor often assumes (inappropriately) that it is outsourcing all risk associated with its goods;

(2) The Uniform Commercial Code identifies the duty of care imposed upon the warehouse operator. The warehouse cannot reduce its duty of care beyond that specified under the Code. Conversely, a warehouse that increases its liability beyond that specified under the Code may jeopardize its warehouse legal liability insurance; and

(3) Depending on circumstances, the warehouse should consider obtaining several diverse and distinct types of insurance, including: warehouse legal liability, business interruption, comprehensive general liability, completed operations, auto, motor truck cargo and pollution contamination/remediation.

In the third party relationship, the depositor does not relinquish title to the goods. Therefore, the depositor retains the risk of loss and/or damage to his goods while such goods are in the warehouse's possession. The bailee, i.e., the warehouse operator, is only responsible to the bailor, i.e., the depositor, for such loss or damage to the property as results from negligence on the part of the bailee. In other words, the warehouse operator's liability is limited to loss or damage to the depositor's goods attributable to warehouse negligence. This concept is reflected in the Standard Contract Terms and Conditions for Merchandise Warehouses which states in section 11(b): GOODS ARE NOT INSURED BY THE WAREHOUSE AGAINST LOSS OR INJURY HOWEVER CAUSED. The warehouse operator's legal liability insurance is not coverage on the depositor's goods. Rather, warehouse legal liability insurance provides coverage when warehouse negligence results in damage or loss to the depositor's goods. The Uniform Commercial Code specifies the warehouse operator's liability and the subsequent duty of care imposed upon him. Section 7-204(1) of the Code states:

The warehouse operator's liability is limited to loss or damage to the depositor's goods attributable to warehouse negligence.



(1) A warehouse is liable for damages for loss of or injury to the goods caused by its failure to exercise care with regard to the goods that a reasonably careful man would exercise under like circumstances. However, unless otherwise agreed, the warehouse is not liable for damages which could not have been avoided by the exercise of that care.

The Code states that the warehouse operator cannot reduce this duty of care. As such, the warehouse cannot state that it will be liable only for ‘willful negligence’. Although the warehouse operator cannot reduce this standard of care, he is allowed to limit the damages for which he will be liable. Section 7-204(2) of the Uniform Commercial Code states:

(2) Damages may be limited by a term in the warehouse receipt or storage agreement limiting the amount of liability in case of loss or damage beyond which the warehouse is not liable. Such a limitation is not effective with respect to the warehouse’s liability for conversion to his own use. The warehouse’s liability, on request of the bailor in a record at the time of signing such storage agreement or within a reasonable time after receipt of the warehouse receipt, may be increased on part or all of the goods covered by the storage agreement or the warehouse receipt. In this event, increased rates may be

charged based on an increased valuation of the goods.

Conversely, a warehouse operator may be asked to increase his liability beyond the negligence standard; however, the consequence may be a loss of warehouse legal liability protection. Thus, one should not agree to contract language that might be construed as elevating the warehouse’s duty of care, i.e., ‘warehouse operator shall guarantee the safety of the goods in storage’ or ‘warehouse operator will prevent any and all damage to goods’. Most warehouse legal liability policies will not respond if the warehouse operator has increased his duty of care. A depositor’s demand that the warehouse operator elevate his duty of care beyond that required by law will most certainly negate the warehouse’s legal liability insurance. This obviously will have a detrimental impact on both parties.

Section 11 of the Standard Contract Terms and Conditions for Merchandise Warehouses specifically addresses the issue of liability as between the warehouse and the depositor:

Liability and Limitation of Damages – Section 11

(a) Warehouse shall not be liable for any loss or injury to goods stored however caused unless such loss or injury resulted from the failure by the warehouse to exercise

such care in regard to them as a reasonably careful person would exercise under like circumstances and warehouse is not liable for damages which could not have been avoided by the exercise of such care.

(b) Goods are not insured by the warehouse against loss or injury however caused.

(c) The Depositor declares that damages are limited To _____ per _____, provided, however, that such liability may at the time of acceptance of this contract as provided in Section 1 be increased upon Depositor’s written request on part or all of the goods hereunder in which event an additional monthly charge will be made based upon such increased valuation.

Where loss or injury occurs to tendered, stored or handled goods, for which the warehouse is not liable the Depositor shall be responsible for the cost of removing and disposing of such goods and the cost of any environmental clean up and site remediation resulting from the loss or injury to the goods.

In accordance with Section 7-204(2) of the Uniform Commercial Code, the limitation of damages is to be identified in the storage agreement. Prior to the redraft of Article 7 of the Uniform Commercial Code, the Code specified that damages must be specified by ‘a specific liability per article or item, or value per unit of weight.’ Examples of this are \$100 per drum or ten cents per pound. In those states that have ratified the revised Article 7 of the Uniform Commercial Code (which represents the vast majority of the states at this time), there is much more flexibility defining damages. However, those subject to jurisdiction in states that have not adopted the revised Article 7 must exercise caution – and continue to define damages by ‘a specific liability per article or item, or value per unit of weight.’

It is important that Section 11(c) of the Standard Contract Terms and Conditions be completed or there is no limitation of damages. In other

words, Section 11(c) must not be left blank. Failure to specify a limitation may jeopardize the warehouse operator's warehouse legal liability insurance. Furthermore, it is important that the depositor understands the significance of the limitation of damages as defined in Section 11(c).

One frequently asked question is, what constitutes an appropriate limitation of damages, i.e., how should Section 11(c) be completed? There is no standard limitation in the United States as to do so might be construed as an antitrust issue. Interestingly, the Canadian Standard Contract Terms and Conditions does specify the limitation of damages as the lesser of the monetary amount of the damage incurred or 100 times the monthly storage rate on any one package or stored unit with the contents (or, in cases where the warehouseman's charges are calculated for other than actual storage, maximum \$50.00 per unit). Both countries recognize the depositor's legal right to request that the limitation be increased. However, the warehouse operator retains the right to assess an additional charge for the increased limitation under such circumstances.

The limitation should be based on the total exposure and the limits of the warehouse legal liability insurance carried by the warehouse operator. It is important that the warehouse works closely with its insurance provider to ensure adequate coverage capable of responding to claims submitted on behalf of multiple accounts if necessary. In defining a limitation of damages, it is important that the depositor understands that the goods are not insured for full value by the warehouse operator. Therefore, it is in the best interest of the depositor to retain insurance on the goods while such goods are under the care, custody and control of the warehouse.

Some customer contracts require that calculation at the time of loss be based on the selling price of the goods. However, warehouse legal liability policies may not provide settlement at this valuation as the warehouse can only be held liable for the manufactured landed costs of the goods. Typically, warehouse legal liability policies exclude additional assumed liability on the part of the warehouse operator. Warehouse legal liability insurance will NOT cover the depositor's lost profits.

Contracts often contain insurance clauses requiring that the depositor be identified as an additional insured on the warehouse operator's comprehensive general liability, workers compensation, warehouse legal liability insurance policies. It is important that the warehouse discuss this issue with its insurance carrier before committing to adding the depositor as an additional insured on the various types of policies. Although there may not be a problem with adding the depositor as an additional insured on the general liability policy, to do so on the warehouse legal liability policy does not provide the same third-party protection to the depositor. Warehouse legal liability is a negligence based liability policy; it will pay for loss or damage to property of others while in the warehouse operator's care, custody and control when

the loss/damage is attributable to warehouse negligence. Adding the customer to the warehouse legal liability policy serves no purpose since the depositor cannot be liable to itself.

The warehouse operator may need to consider other types of insurance options. If he is providing value-added services for the customer, any exposure associated with that service is beyond the scope of warehouse legal liability coverage. Completed operations insurance should be considered under such circumstances. Warehouse operators, especially those that store chemical products, should consider pollution contamination remediation insurance. Business interruption insurance is extremely valuable in the event that the warehouse ceases operation for a limited time, i.e., fire or other disaster situation.

It is crucial that the depositor understands that it cannot outsource all risk and liability associated with its product simply by outsourcing its logistics needs. The International Warehouse Logistics Association's non-negotiable warehouse receipt specifically states, 'the property covered by this receipt has not been insured by this Company for the benefit of the depositor against fire or any other casualty.' As such, it is important that the depositor retain adequate insurance on its product while it is in the possession of the warehouse operator.

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