Loss and Damage From a Shipper's Standpoint: A Provocative Assessment of Key Factors Requiring Analysis in the Deregulation Arena

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I. INTRODUCTION

Loss and damage, and the claims process ensuing from them, represent a large economic cost in the U.S. logistics system. The gross dollar

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amount of loss and damage events and the costs incurred to recover or minimize their effect is significant in the transportation network. Regulated for-hire motor and rail carriers alone, annually report over one billion dollars in net claims paid.[1] Not included in this figure are costs incurred by users (shipping and receiving parties) for claims processing, arbitration, lost value opportunity costs, claims not settled, and loss and damage not claimed at all.

Loss and damage obligations are defined by an intricate pattern of relationships between shippers, receivers and carriers as discussed below. The deregulation movement will no doubt affect this pattern. An analysis is needed concerning the possible regulatory changes, directly or indirectly bearing on the loss and damage area, so that they can be weighed within the overall perspective of the major thrusts of entry and rate policy changes being proposed. The effects of deregulation or reregulation in the carrier obligations and claims area are largely economic. The effects lend themselves to logical analysis and some quantifiable measurement.

The obligations and legal relationships surrounding rail and motor common carrier loss and damage occurrences stem from a framework of Congressional legislation, administrative rulemaking, institutional arrangements in the form of tariffs, and precedents (both judicial and commercial).[2] Loss and damage is a critical, highly visible and often identifiable cost to carriers, shippers, and receivers. It is a cost and a time factor that receives constant attention by all parties. Based upon the present structure of responsibilities and relationships, efforts to reduce its incidence and/or its cost of payout continue. The Association of American Railroads and The American Trucking Association study improved packaging and handling techniques and often publish the results in the form of "shipper's advisories." These efforts will continue despite the outcome of the regulation debate, but regulatory changes might cause the penalties and burdens of various responsibilities to shift from one party to the other. Many forms of liability limitation by carriers have been attempted throughout the past period of regulation.[3] In a profit maximizing endeavor, it can be expected carriers would increase these efforts especially following the lifting of present regulations. An analysis from a shipper's point of view can be used to highlight some of the expected loss and damage practice changes that might arise in a deregulated environment.

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1. *See* ASS'N OF AM. RAILROADS, YEARBOOK OF RAILROAD FACTS (1979); AM. TRUCKING ASS'N, AMERICAN TRUCKING TRENDS (1979).

2. The primary requirements for these obligations and relationships are in the Interstate Commerce Act, 49 U.S.C. § 11707 (1978); and 49 C.F.R. § 1005 (1978).

3. *See, e.g.*, Principles and Practices for the Investigation and Voluntary Disposition of Loss and Damage Claims and Processing Salvage. 340 I.C.C. 515 (1972), also referred to as *Ex Parte 263*.

II. Loss and Damage in Carrier Selection and the Total Costs of Transportation

Loss, damage and the promptness of claims settlement are cited as factors in shippers' mode and carrier selection decisions and are a major part of the total costs of transportation.[4]

A. *Loss and Damage as a Carrier Selection Factor*

A review of the literature that attempts to capture shipper modal and carrier selection behavior substantiates loss and damage as a major shipping variable.[5] Table 1 shows that loss and damage factors range from medium in importance (middle ranking) to fairly high in importance. The Stock and LaLonde study additionally presents the ranking of factors that might cause a firm to alter modal choice in the future.[6] Unsatisfactory loss and damage experience ranked 8th out of 19 factors, indicating it could influence shippers to switch modes, a major investment and strategic undertaking.

B. *Role of Loss and Damage in Total Costs of Transportation*

The total costs of transporting a firm's goods includes the most visible factors of freight charges, packaging, loading and unloading, and dunnage and bracing. Many peripheral, indirect, and overhead costs are built into the traffic function as well. The importance of these additional costs depends upon the firm's loss and damage experience with carriers, and/or the freight-on-board (F.O.B.) or selling terms contracted with the other shipping party. For example, the size and related operational cost of a firm's traffic department will tend to be large, if it purchases goods on F.O.B. origin and sells them on F.O.B. destination bases.[7] Other costs of loss and damage that are part of the total traffic management overhead are claims processing, settlement time costs, replacement goods movement, and related production and inventory costs. Table 2 lists and analyzes transportation cost factors which are affected by the incidence of loss and damage.[8]

4. *See* Joseph L. Cavinato, Analysis of Loss and Damage in a Procurement Distribution System Using a Shrinkage Approach (1975) (Ph.D. dissertation, The Pennsylvania State University).

5. *See* Edward J. Bardi, Analysis of Noncost Factors in the Carrier Selection Decision: A Study of Household Goods Movement by Industrial Firms (1971) (Ph.D. dissertation, The Pennsylvania State University).

6. Stock and LaLonde, *The Transportation Mode Decision Revisited*, 17 Transp. J. 51 (Winter 1977).

7. *See* K. Flood, *supra* at Chap. I.

8. *See* Cavinato, *supra* at Chap. II.

TABLE 1

Research Indicating Loss and Damage Factors in Mode/Carrier Selection

Researcher(s)	Factor	Basis of Measuring each Factor	Loss and Damage Factor Ranking with Other Factors
Bardi[7]	Frequency of Damage	Ranking of 21 transportation selection factors	3rd out of 21
	Ease of claim settlement		4th out of 21
Flood[8]	Loss and Damage Experience	Ranking of 17 transportation selection factors	8th out of 17
	Promptness of claim settlement		12th out of 17
Jerman, Anderson and Constantin[9]	Freight damage and damage experience	5 point scale (1 or "no importance"; 5 "extremely important")	4.03 on scale of 5
Stock and LaLonde[10]	Loss and/or damage history	Ranking of 23 transportation selection factors	6th out of 23
	Prompt claim service		10th out of 23

9. *See* BARDI, *supra*.
10. K. FLOOD, TRAFFIC MANAGEMENT 19 (1975).
11. Jerman, Anderson, and Constantin, *How Traffic Managers Select Carriers*, 77 DISTRIBUTION WORLDWIDE 21-24 (Sep. 1978).
12. Stock and LaLonde, *The Transportation Mode Decision Revisited*, 17 TRANSP. J. 51-59 (Winter 1977).

TABLE 2

Shipping, Receiving and Transportation Factors in Relation to Loss and Damage Costs—From Shipper's Point of View

Element of Transportation	Loss and Damage Related Cost within the Transportation Element
1. Freight Rate	L&D or carrier payout on claims reflected in the rate
2. Transit Time	Significant loss and damage factor with perishable goods and with others receiving special damages
3. Variability of Transit Time	Same
4. Equipment Availability	Affects dunnage and bracing expenses according to type of equipment used to reduce loss and damage during shipment
5. Equipment Condition	Affects dunnage and bracing expenses plus expenses of cleaning, patching and possibly disinfecting the equipment
6. Bracing and Dunnage	An inverse relationship (the greater amount used by shipper, the less occurrence of L&D)
7. Packaging	An inverse relationship
8. Inspection by Consignee in Claim Process	Clerical costs, time in processing, photographs, etc.
9. Claim Settlement Time	Represents a lost opportunity cost on capital invested in the lost or damaged goods
10. Cooperage	Necessary for salvaging goods, cases, lot shipments
11. Claim Settlement	If paid in entirety, full cost loss is at minimum; if partial settlement paid, balance increases monetary impact on L&D incident to shipper/receiver; if disallowed, monetary impact fully borne by shipper/receiver
12. Shipper/Receiver Insurance Coverage	An added cost to shipper/receiver that does not necessarily reduce the freight rate or L&D experience, but does reduce claim settlement processing and time costs for the policy holder
13. Replacement Goods Shipment	Presently a measure of damages covered in claim settlement if claim is allowed. If not, the extra cost of LTL (when original shipment may have been TL) is borne directly by shipper/receiver May have to ship via premium cost mode of transportation to maintain customer relations or product supply in production
14. Production and Inventory Costs	Many firms adjust inventories upward to provide a "cushion" in event of loss and damage to normal lot sizes or shipments. Research of three firms' distribution systems revealed L&D was responsible for between 1% and 6.5% of extra upward purchase and manufactured product units that never were sold[13]

III. The Problem

The cost of loss and damage is shared by the shipper/receiver and the carrier. The burden of minimizing them or of placing their effects, however, can be shifted from one party to the other. Packaging and loading rules in carrier tariffs place much of the loss and damage prevention cost responsi-

13. *Id.* at Chap. IV.

bility onto the shipper.[14] Carriers, on the other hand, are responsible for mishandling, etc.[15]

If the responsibilities of current laws and regulations are lifted, carriers might seek new opportunities to limit this presently significant cost. The ways in which carrier loss and damage related cost minimization efforts could conceivably be attempted are discussed below. The effects of possible repeal, liberalization or altered loss and damage laws, and regulations should be analyzed and possibly quantified.

This article will examine and analyze present laws, regulations, institutional practices and decisions that pertain to transportation obligations and claims. Particular attention will be paid to those loss and damage areas and proposed practices which have been attempted and adjudicated in the past, and/or have come under regulation. It could be expected that such proposals, which are currently limited or not permitted, might come into use when regulations that prohibit or restrain their use are lifted. This article will provide a framework for an economic evaluation of this possibility.

The areas of investigation and analysis include, (1) Revised Interstate Commerce Act,[16] (2) regulations in the Code of Federal Regulations,[17] and (3) Interstate Commerce Commission Rulings.[18] All may affect or allow greater freedom in carrier tariff provisions and practices.

IV. Analysis

Potential areas for alteration of loss and damage obligations and practices by deregulation fall into four groups:

A. Extent of obligations and exposure to liability,
B. Measures of damages,
C. Means of settling claims, and
D. General loss and damage policies and practices.

A. Extent of Obligations and Exposure to Liability

Several alternatives are possible in this realm.

1. Repeal of Revised Interstate Commerce Act (RICA) Sections Dealing with Loss and Damage: Section 11707 of the RICA states the explicit

14. *See* packaging rules in Uniform Freight Classification Comm., Uniform Freight Classification; Nat'l Motor Freight Classification Comm., Nat'l Motor Freight Classification; Cavinto, *supra* Chap. II (for discussion).

15. Bill of lading holds rail and motor carriers liable for all loss and damage except that caused by Acts of God, shipper negligence, public enemy, public authority, and inherent nature of the goods. *See also* 49 U.S.C. § 11707 (1978); 49 C.F.R. Part 1005 (1978).

16. 49 U.S.C. § 11707 (1978), also referred to as the Revised Interstate Commerce Act (RICA).

17. Particularly, 49 C.F.R. Part 1000 *et seq.* (1978).

18. I.C.C. Reports and I.C.C. Motor Carrier Reports.

powers Congress granted the ICC in dealing with loss and damage. This section requires that a receipt be given the shipper, that a liability be created by the receipt, that one is entitled to recovery, that liability limitations or exemptions are not allowed without ICC authorization, and that minimum time limit restrictions on claims filing be provided. Repeal of this section would revert control of the shipping transaction to state contract law which varies to some degree from state to state. This situation was the primary reason for originally enacting uniform claim legislation. Repeal of this section could further diminish the use of, or completely eliminate reliance upon, the provisions presently embodied in the bill of lading. The document, as a contract and a receipt from which claims arise, might conceivably lose its legal significance, thereby reducing the standing and protection now provided the shipper.

The provisions dealing with time limitations on claims and the call for inspections on concealed loss and damage that lead up to the *Ex Parte 263* rulemaking proceeding in 1972 are an example of past carrier efforts of this type.

2. Repeal of RICA Sections That Affect Rules and Practices Concerning Packaging and Loading: A major area of concern to the shipping community is the rules dealing with packaging for shipment tendering. Sections 10701 and 10702 require that rules and practices be reasonable, section 10708 provides ICC authority to determine their lawfulness, and section 10704 allows the ICC to prescribe reasonable rules.

A requirement of extremely strong packaging favors carriers by unilaterally shifting a major cost of loss and damage prevention onto the shipper. Shippers now have the recourse of petitioning the ICC in a complaint or protest should a loading rule or tariff require unreasonably stringent packaging. Shipping firms might also have some ability to alter or prevent the use of such rules by alternative carrier selection, but this is not always feasible.

3. Repeal of the Claim Period Regulation, Section 11707(e): Currently, the RICA does not allow for any claim rule time limitation of less than nine months from the date of the cause of action. One effective means of liability limitation would be for carriers to shorten that period. This was attempted in the concealed loss and damage areas by the Association of American Railroads in 1970.[19]

Though there is some merit to shortening the time period (due to freshness of memory, the exposure to subsequent damage, etc.), the alternative carrier limits could be made so short that concealed loss and damage discovery, the feasible filing of a claim, and the call for inspection would be impossible. Further, repeal of this time limit would no doubt cause a multi-

19. 340 I.C.C. 515 (1972).
20. *See* 49 U.S.C. § 10101 (1978).

tude of time limits being implemented in the field, thereby reducing the efficiency and uniformity called for by National Transportation Policy.[20]

4. Repeal of Interline Obligations, Section 11707(a)(1): Congress specifically provided a party with damaged goods could file a claim against any of the line haul movement carriers. Repeal of this section could require an injured shipper/receiver to first determine which carrier is responsible for the loss and damage. The total costs of shipping would rise and shippers would send single line shipments only. Single line selection by a majority of shippers would lend impetus to mergers and carrier expansions, both of which would require separate analysis to determine their national effect. This situation might also cause firms to enter into private carriage commitments to alleviate liability problems and to protect customer service factors, rather than to minimize costs. Repealing the present interline claim system, which provides a seemingly insignificant remedy, would create additional administrative burdens and costs for shippers.

B. *Measures of Damages*

Motor carrier loss and damage practices might also change with respect to the measure of damages.

1. Repeal or Administrative Relaxation of Section 10730, Rates and Liability Based on Value: The ICC has traditionally applied a basic set of guidelines in its decision process to determine whether a commodity's rates could be published under the released rate system. Because of past tendencies of carriers to avoid obligations and liabilities by seeking greater use of released value rates, this practice is limited by the requirement for ICC review and approval.

Carrier shifts in this area might take the form of: (1) a rate reduction on released rates not commensurate with the reduced liability, and/or (2) reduced liability on released rates with extremely high rates for full liability moves.

Given repeal of Section 10730, this would represent a fruitful profit maximization area for carriers. A major danger in the form of reduced carrier security and handling diligence arises with released rate liability. This was evidenced in the air cargo security proceedings before the U.S. Senate in the early 1970's.

General commodity motor carriers have recently offered a defense of the released rate system of extra charges for full coverage. Such charges would be subject to rate competition from alternative protection coverage by insurance firms, other carriers, and shippers' self insurance.[21] Be that

21. Middle Atlantic Conference, Middle Atlantic Conference, Initial Statement, Proposed Rulemaking on Released Rates in Conjunction with a Small Shipments Tariff (1978).

as it may, the simplicity of dealing with one firm (the carrier) for transportation and insurance, and the relatively low administrative cost of such full service, cause shippers at present to choose the more convenient alternative.

2. Repeal or Administrative Relaxation of Section 10730, Altered Measures of Damages: The application of the measures of damages might be altered to further limit dollar liabilities. Several means of settling released rate claims are possible.

The key components of released liability are (1) the dollar (or cents) amount stated, (2) the poundage basis for applying the dollars or cents, and (3) the unit(s) comprising the maximum liability limit per shipment. The third component can be a problem. The maximum liability limit, for example fifty cents per pound, might be applied against the weight of the entire shipment, the pallet load in which damage occurred, or the case or unit in which damage took place. At present, the ICC's policy is to apply the released rate to the entire shipment. Thus, if a $100, ten-pound item carried at a released rate of fifty cents per pound in a shipment of 1,000 items is damaged, its loss is fully covered. If liability were calculated on the basis of each item, however, the shipper would only be protected to a maximum of five dollars. Without the Commission's ability or willingness to apply a rule basing the maximum liability upon *per shipment* weight, carriers could retain the rate and pound basis but create more restrictive maximum liability unit bases.

3. Repeal or Administrative Relaxation of Section 10730, Wider Application of Released Rates in Certain Forms of Traffic: The ICC has allowed released value rates only on specific commodities. The Middle Atlantic Conference proposed a tariff with released rates in 1978 for small shipments regardless of the commodity.[22] If allowed to go into effect, this precedent would open the way for carriers to broaden the use of released rates from specific commodities to traffic types (such as class rates, interline moves, residential deliveries, etc.) which would effectively reduce their liability exposure.

4. Repeal or Administrative Relaxation of Section 10701, The Use of a Claim "Tolerance:" Liability limitation could conceivably be applied in terms of allowances or tolerances for certain percentages of the shipment damaged or lost. One such landmark attempt was in Special Regulation, Eggs, whereby carriers sought to eliminate liability unless damages exceeded a specified percentage of the shipment.[23]

5. Repeal or Administrative Relaxation of Section 10701, The Use of

22. *Id.*

23. Special Regulations, Eggs, 284 I.C.C. 377 (1952); Secretary of Agriculture v. United States, 350 U.S. 162 (1956).

a Claim "Deductible:" A further liability limitation might arise in the form of a claim deductible clause. With this approach, a deductible, similar to that found in automobile insurance policies, might be applied. Carriers would only be liable for loss in excess of the deductible amount.

Both the tolerance and deductible approaches would relieve carriers of a large number of claims, and could conceivably lead to a relaxation of their effective cargo handling and security practices. Furthermore, once this principle of rate and liability application is accepted, slight adjustments in the tolerance or deductibles could be made, thereby impacting total shipping costs (with possibly large increases). The use of these liability approaches would make the determination of full transportation costs more complex.

6. Changed Interpretation of Damaged Value of Replacement Goods and Shipments: Current claim settlement conventions provide for the damaged party to be made "whole." As the conventions are applied, a truckload shipper experiencing a loss of a small number of units can claim a replacement cost for those units based on the higher LTL rate since the LTL rate will be charged to ship the replacement units. If conventions are narrowly interpreted under relaxed standards, carriers might only settle at the unit TL rate originally paid.

7. Changed Interpretation of Damaged Value, Special Damages: Carriers are often held liable for special damages in actual or constructive notice situations. Current practice holds a carrier liable, when appropriate, for the difference between market values on the date and in the condition of actual arrival, and on the date and in the condition of arranged or normal transit time arrival. Possible carrier reactions to a relaxed regulatory environment in this situation might include decreasing special damages as a matter of policy, or increasing the transit time from a reasonable dispatch time to the worst transit time experienced to date.

8. Stringent Application of Concealed Loss and Damage Settlement Practices: The *Ex Parte 263* proceedings were originally conducted in response to the Association of American Railroads proposed rule which would limit carrier liability to 50% of the net monetary loss in concealed loss and damage situations.[24] While this rule would reduce the costs of claims settlement and litigation, the rationale for such a practice may not be placing actual responsibility on the party causing the economic loss.

C. Means of Settling Claims

The manner in which carriers settle loss and damage claims is generally covered in "Rules, Regulations, and Practices of Regulated Carriers with Respect to the Processing of Loss and Damage Claims."[25]

24. 340 I.C.C. 515 (1972).
25. 49 C.F.R. Part 1005 (1978).

1. Repeal of Section 10704 (ICC Power to Prescribe Reasonable Rules) or Administrative Relaxation or Revocation of *Ex Parte 263*: Part 1005 of 49 C.F.R. provides a uniform loss and damage claim disposition process for use by all regulated carriers.[26] By providing for, (1) an acknowledgement of each claim, (2) a statement of remaining filing needs, (3) prompt investigation, and (4) prompt settlement or notification of outstanding claims, the process reduces the number of methods previously employed by the industry. Thus, while indirectly enforcing a time limit on settling claims, it tends to reduce some of the indirect costs of shippers' claims.

This regulation attempted to remove many of the technical bases for avoiding claim settlement while providing for some objectivity in settlement. The claim acknowledgement and statement of any remaining documentation required reduces claim avoidance through confirmation of the claim filing within the required time limits, and by reducing the ability to delay settlement of incomplete claims that would otherwise require constant claimant followup. Objectivity in the claim process is enhanced by the requirement to investigate each claim. This reduces indiscriminate claims by shippers and fosters corrective actions by both parties. Without the requirements set for in *Ex Parte 263*, many of the previously existing practices that were rectified or reduced by it would no doubt return.

2. Changed Form of Settlement: Carriers now settle claims by actual payment to the claiming party. Without restriction, a carrier could conceivably issue only a credit to be applied against future shipment freight invoices. This is a practice used widely in the retail sector, and it would be used in transportation if section 11707 of *The Revised Interstate Commerce Act* otherwise prohibiting it were repealed. The credit approach would bind the shipper to the carrier for future carrier selection decisions in a way that would tend to be anticompetitive in nature.

D. General Loss and Damage Policies and Practices

Rate bureaus and the tariff publishing requirement are two regulatory elements presently in force that affect the loss and damage area

1. Repeal of Section 10706, Antitrust Immunity of Rate Bureaus: Rate bureaus function primarily as collective rate making forums, but they also act on non-rate matters as well. Rate bureaus act as a forum for discussion to assure some uniformity in creating loss and damage related tariff rules and shipping practices (packaging, etc.). Without such immunity, carriers might tend to develop divergent loss and damage related rules, thereby further complicating the overall shipping process.

26. *Id.*

2. Repeal of Section 10761 and 10762, Tariff Publishing Requirement: Abolishment of tariff publishing and filing requirements has been mentioned in the current deregulation atmosphere. In the event of the repeal of the Reed Bulwinkle Act, the ICC would probably be forced to request the repeal of tariff filing requirements due to its practical inability to maintain such a tariff library. Without filed tariffs, each carrier would utilize, at most, an internal rate book which could be changed at will, or which could possibly contain different rates and loss and damage rules for different shippers or classes of shippers. This situation is beginning to appear in the deregulated air freight industry.

When the rules and practices must be published as tariffs, shippers may depend on the application of specific rules to future shipments. Without published loss and damage rules, the complexity of shipping would greatly increase, and shippers might tend to use fewer carriers due to the need to reduce the interfacing of variable operating practices of each carrier. Thus, inconsistent loss and damage practices might become a factor in decreasing the competitive choice now available to shippers.

V. Conclusions

The existing framework of legal responsibilities and relationships surrounding transportation loss and damage has evolved from a number of direct and indirect provisions. Common law, court decisions, Interstate Commerce Act provisions, as well as administrative regulations affect loss and damage events and shipping practices. Deregulation or reregulation will no doubt entail the modification or repeal of legal principles upon which the existing loss and damage legal framework is directly or indirectly based.

This loss and damage framework defines and maintains one major cost factor used by shippers to make distribution system design, modal and carrier selection choices. Loss and damage responsibilities may presently be perceived as minor cost factors, but when these responsibilities are easily alterable, they might cause major impacts. The current framework of loss and damage relations now provides a relatively stable, consistent, analytical medium for a shipper's total transportation costs analysis.

The debate in the collective rate making area may have a profound effect upon loss and damage as well. The push for a totally competitive pricing system, without collective rate making immunity, but with individually created loss and damage rules by each carrier, may comport with the economic competitive model promising lower rates. However, that model also requires that individuals have full knowledge of all buying/selling elements. Determination of all carriers' rates *and* loss and damage factors might not be possible nor economically feasible for even large shippers. Furthermore, a carrier "competitive" from a rate standpoint might not be so

when total costs, especially individual loss and damage regulations, are considered, provided it is possible to consider them at all! Thus, competitive individual pricing and full knowledge (of full costs) might not be attainable, but instead they might be inversely related to each other.

The essential point is that regardless of what regulatory changes are made, they should be done so on rational and practical grounds after all direct and indirect factors and impacts are carefully evaluated. Loss and damage, often incorrectly perceived as a minor transportation factor, warrants such an analysis.

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