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THE LEGAL, INSURANCE, TECHNICAL, AND INVESTIGATIVE ASPECTS OF COMMERCIAL MOTOR TRUCK CARGO CLAIMS

I. Introduction

This panel will provide an overview of the myriad issues that can result from a commercial motor truck casualty involving damage to cargo; insurance coverage and exclusions; cause, nature, and extent of damage; and legal liability, including subrogation—all from the point of view of the claims adjuster, investigator, engineer, and lawyer, emphasizing the dependence of each on the other for the successful resolution of a cargo claim for the insurer, the insured motor carrier and cargo owner, and pursuit of subrogation. For purposes of this topic, the panel will focus on the hypothetical scenario of a high-valued, refrigerated cargo involved in either an accident or a reefer breakdown. While the hypothetical scenario is limited to one specific cargo, the way such a claim would be handled can be an exemplar for the handling of a claim involving damage to any cargo as the result of a commercial motor truck casualty.

II. Approaching a Claim from the Perspective of a Cargo Insurance Adjuster and a Motor Carrier Liability Insurance Adjuster

A. The Perspective of the Cargo Insurance Adjuster

Coverage, Exclusions, Valuation, Deductible Limits

Upon receipt of a new cargo claim, the cargo adjuster should verify the occurrence is within the policy period and the commodity is covered, and note the policy limits and deductible. Some import/export shipments have a certificate of insurance for the receiver which has this information. Most import/export shipments are valued on invoice value, plus freight, with a 10% uplift for unknown costs. Duty is typically included. Domestic shipments usually are valued at invoice or selling price, or can be based on a replacement cost basis. Typical cargo policies are based on "All Risk" coverage, with some exclusions. The adjuster should be aware of the specific exclusions contained in the policy and determine, initially, whether one or more of the exclusions may apply to possibly exclude coverage for the claim.

Brands and Labels

For the purpose of the hypothetical refrigerated cargo, there are two key coverages to look for in a cargo policy of insurance: "Brands & Labels" and "Control of Damaged Goods." These

coverages are important because they give the cargo owner/insured some say in the disposition of the damaged goods. The "Brands & Labels" coverage requires recognized corporate icons to be removed before salvage. The "Control of Damaged Goods" coverage may allow the cargo owner to determine when a commodity is damaged and/or the final disposition of any damaged goods. For liability concerns, some cargo owners may have the damaged goods destroyed, eliminating the possibility of any salvage as a setoff against the amount of the claim payment by the insurer. Such coverages may also significantly impact the ability of the insured to subrogate against the responsible motor carrier.

Inherent Vice

"Inherent Vice" is a common exclusion in the cargo policy and is an issue that commonly comes up in the case of refrigerated cargo. Inherent Vice is the natural ability of a product to change due to its makeup; e.g., fruit to mature and rot. If an Inherent Vice manifests itself with regard to refrigerated cargo, an insurer may have a defense to coverage.

Delay

"Delay" is normally not covered due to the uncertainty of when a commodity will arrive at its destination. Therefore, claims resulting from delay may also be excluded from coverage.

Subrogation

Once the adjuster has identified key coverages and exclusions, an investigation into the cause of the loss and nature of the claim is necessary. Typically, the cargo insurance adjuster will seek to collect the purchase invoice (or sales contract documents), bill of lading, delivery receipt (hopefully with exceptions by the cargo owner outlining any damages and shortages), a claim statement specifying the damages and value, and, finally, a "Notice of Claim" issued to the delivering motor carrier. If there is a transportation contract/agreement between the insured-cargo owner and the carrier, the cargo insurance adjuster will also want to obtain a copy. The Notice of Claim is important and required under all bills of lading or delivery receipts. Timely issuance of a Notice of Claim is important, both for asserting potential liability under the Carmack Amendment against the motor carrier, as well as compliance with contractual notice requirements. Such a notice will also preserve the opportunity to pursue a subrogation claim against the responsible carrier. A failure by the insured to preserve the subrogation rights of the insurer may allow a cargo insurer to deny a claim or deduct an estimated value of lost recovery from the claim. Retention of an independent investigator to determine the cause and origin of the loss and claim may also be required. This could assist the insured and insurer in a determination of damages, how the cargo was damaged, by whom, and also help in the pursuit of subrogation against the responsible motor carrier.

Notice and Suit Time

As mentioned above, the Notice of Claim is important and must be given in a timely fashion in order to protect the insurer's subrogation rights against the responsible motor carrier. The cargo insurance adjuster must also be knowledgeable as to applicable legal or contractual statutes

of limitations to make sure that subrogation lawsuits to recover for payments made to an insured are initiated before the expiration of suit time.

Salvage

The availability of a salvage recovery to offset payments made by the insurer is an important issue. The cargo insurance adjuster will want to determine, as early as possible in the claim process, whether the insurance policy permits salvage and who will control the salvage process. The investigator can also assist in determining if there is any salvage value of the cargo and work with the cargo owner on mitigating its overall loss. The investigator can also assist in determining if the cargo is a total loss or a constructive total loss with no salvage possible; in which case, arrangements for disposition can be made. Very often, salvage of such refrigerated cargos such as foodstuffs or pharmaceuticals are problematic because of the insured's concern for safety of the consumer, product liability, brand reputation, or contractual requirements of the insured's customer.

Cause of Loss

From the first presentation of a claim by the insured, the adjuster will be aware of the possible cause of the loss. However, very often, a final determination as to the cause of a loss will depend on the facts developed by the investigator and the opinions of other experts, as well as information provided by the insured with regard to the specific nature of the cargo. With the final determination of the cause of the loss from the investigator's report, the shipping documents, and any other relevant material collected during the handling of the claim, the adjuster should be able to finalize its coverage review, adjust the claim, settle the claim with the cargo owner (obtaining subrogation rights in the process), and then subrogate the claim against the responsible motor carrier.

B. The Perspective of the Motor Carrier Liability Insurance Adjuster

Coverage: Limits, Deductibles, Exclusions

The cargo insurance adjuster has completed the adjustment of the claim and now seeks subrogation against the responsible motor carrier. The responsible motor carrier receives a "Notice of Claim" and, hopefully, in a timely fashion, advises its motor truck cargo legal liability insurer. It is a common practice for the cargo insurer to issue a Notice of Claim to the motor carrier shortly after an occurrence for the purpose of putting it on notice of the incident early in the claim process so that the motor carrier's liability insurer will be able to conduct its own immediate investigation, or, better, a joint investigation with the cargo owner's investigator. This approach can prevent disagreements later in the claim process as to the nature and extent of the damages and the value of the claim. The motor carrier insurance adjuster should verify that the date of the incident occurred during the insurance policy effective dates and review the limits of liability and the applicability of any deductibles. If the alleged cargo damages exceed the policy limits, the adjuster should advise the insured motor carrier in writing of a claim in excess

of available limits. Finally, it should be verified that the commodity carried was an approved commodity under the insurance policy.

Negligence

Generally, it is difficult for a motor carrier involved in an accident to escape liability. The motor carrier has the obligation to demonstrate that it delivered the cargo in the same condition as received by it. Failing to do so, and unless it can avail itself of certain limited defenses to liability, the motor carrier liability adjuster will face a claim where the nature and extent of damages may be the only issue vis-à-vis the cargo insurer.

Bill-of-Lading Notations

Most important to the liability adjuster is the bill of lading. Does it contain a limit of liability or a time frame to provide notice of a claim? If the notice of a claim is not timely, liability to the cargo owner can be denied. Typically, under federal law, notice must be provided to the motor carrier within nine months of delivery or lack thereof. In response, the motor carrier and its liability adjuster need to deny or partially deny liability to start the time within which the cargo owner or its insurer must initiate a lawsuit. If there are limits of liability stated in the bill of lading, freight receipt, or published tariffs, the extent of liability of the motor carrier can be reduced.

"Exceptions" noted on a bill of lading are important. The driver of an insured motor carrier should/will monitor the loading of cargo into the trailer and participate in the sealing of the container. The driver is thus in a position to observe both the quantity and quality of the cargo and note "exceptions" on the bill of lading. Those exceptions could include the number of pieces actually loaded as compared to the shipping invoice, as well as damages to the packaging or the cargo itself. The driver is also in a position to reject a load. Notations on the bill of lading may be important if a claim is later made for shortage or damage and may even afford the motor carrier liability adjuster the opportunity to avoid liability.

Carmack Amendment

The main law governing motor carrier liability for cargo is the "CARMACK" Amendment, a federal statute with a long and storied history. The Carmack Amendment is a strict liability statute. However, a motor carrier may avoid liability for damages as a result of (1) an act of nature or God, (2) an act of the public enemy, (3) an act of the shipper, (4) an act of the public authority, and (5) the inherent nature or vice of the goods themselves, provided that the motor carrier can prove that it was also free from negligence.

Market Value of Cargo

The adjuster should review the documents provided. Any notations or "exceptions" on the delivery receipt should be reviewed. This is *prima facie* evidence against the trucker. However, the lack of or insufficient notations may benefit the trucker as to its liability exposure and allow for negotiation of the overall damages. The motor carrier is liable for market value of the cargo. Most motor truck legal liability policies provide coverage for what the trucker is "legally liable"

to pay to a cargo owner. However, the trucker is only responsible for the damages that it may have caused. Sometimes this is a challenge to determine, especially when a cargo owner alleges "Brands and Labels" or is an authority on the product. Thus, potential liability issues may develop if salvaged cargo is allowed on the market. Further, under certain state and federal laws, certain products may not be salvaged in the market if they are damaged or compromised. Under those circumstances, the motor carrier could still be liable for the full value of the loss.

Reefer Breakdown

Most reefer breakdown clauses in insurance policies provide coverage if the reefer unit is maintained and fails, other than for lack of fuel.

Spoilage

"Spoilage" claims are typically excluded, as they occur either due to inherent vice or delay, but may be recoverable under a Reefer Breakdown endorsement. The motor carrier can possibly deny liability to the cargo owner under certain circumstances.

An Outside Investigator/Engineer

The motor cargo liability adjuster may also seek the services and opinions of an independent investigator or an engineer if there are any questions regarding the nature and extent of damages, the liability of the responsible motor carrier, packaging and stowage, and salvage/mitigation of damages. Even in a case of clear liability on the part of the responsible motor carrier, securing the opinions of outside experts with regard to the nature and extent of the damages to a cargo can be useful in reducing any liability payments made to the cargo insurer.

C. Conclusion

The role of the cargo insurer adjuster and the motor carrier liability insurance adjuster are similar in many respects. Both determine available coverage under an insurance policy for a cargo loss claim; both determine if there are any exclusions to coverage; both are interested in the cause of the loss, as well as the nature and extent of the claimed damages; and both assess liability of their respective insureds—the cargo insurance adjuster—looking for the opportunity to seek liability against a responsible motor carrier for subrogation, and the motor carrier liability adjuster seeking to minimize or refute a cargo claim. Both may call upon the services of independent investigators/consulting engineers. Both may seek legal advice from counsel during the initial claim-handling process or for the purpose of filing or defending against a lawsuit.

III. Approaching a Claim from the Perspective of the Independent Investigator

Role of the Investigator: Who Does He/She Represent?; Ethical Obligations, Reporting Obligations

When undertaking the role of investigating cargo damage, an investigator must first know which party it will be representing. An investigator may represent cargo underwriters, the motor

carriers, or possibly even freight forwarders. However, regardless of who the investigator is representing, the investigator has an ethical duty to undertake his investigation "without prejudice," which is to say that he is to report only the cause, nature, and extent of damages, and not change, hide, or mischaracterize facts with regard to the cause, nature, and extent of a loss based on his representation. Thus, while an investigator is seeking to protect the interests of his client, he or she must do so within ethical boundaries.

The Investigation—Photographs/Documentation/Preservation of Evidence; Interviews of Witnesses/Drivers; Police Reports

The investigator will conduct his investigation with the objective of submitting a written report to his client. A large part of that report will be made up of the photographs at the scene of the accident and of the cargo itself, as well as documentation collected by the investigator. Photographs can go a very long way in showing the location of the accident, as well as the nature and extent of the damage to the cargo. However, while valuable, photographs are intended to augment the report of the investigator, and only form a part of the final report. The report will also include interviews of any witnesses, including the motor carrier driver, and/or obtaining reports or statements prepared by investigating police officers.

Preservation of Cargo/Minimize Loss; Control of Damaged Goods/Salvage

A critical part of the investigator's job is to assist in mitigating the loss in an incident. This entails removing potentially salvageable cargo from the scene of the accident into a stored area where it will be safe from further harm and can be accounted for and evaluated for damage. This needs to be done as soon as possible under the circumstances. Sometimes, removal can involve transloading cargo into a new conveyance. Sometimes, it can involve locating refrigerated space for storage. Often, such control of damaged goods presents numerous challenges. After the cargo has been secured, the surveyor should continue to assist with loss mitigation through salvage activities. Cargo will be advertised on the market for distressed cargo for the purpose of soliciting bids from interested buyers on an "as-is/where-is" basis. This process can be complicated by Brand-and-Label clauses. If there is a Brand-and-Labels clause, the investigator may not be allowed to salvage the cargo, and, in that case, it would need to determine what the cargo could have earned on a salvage basis and report the same to the insurance company.

Actual Damage/Cause of Loss

One of the most important jobs of the investigator is to determine the cause of the loss. Oftentimes, this can be linked back to the packaging of the cargo and, as such, was a preexisting condition. If the cargo is insufficiently packed and not suitable for the expected rigors of transit, then the insurer may have a basis for denying coverage. This issue is one of the major reasons why an investigator should always be present to inspect the damaged cargo. Additionally, the investigator can determine if the damage actually occurred in loading, and not during transit. If the loading was done by someone other than the motor carrier driver or the cargo owner, then the cargo insurer may seek subrogation against that responsible party.

Conclusion

The investigator is the "eyes and ears" for the insurance adjuster. He provides factual information about a loss, on a "without prejudice" basis, which can guide the adjuster in processing a claim and making decisions regarding coverage, liability, and claim payment.

IV. Approaching a Claim from the Perspective of the Engineering Expert

The work of the investigator in determining the nature, extent, and cause of a loss may, in fact, lead to the need for a more in-depth examination into the cause of the loss by way of accident reconstruction. In an accident reconstruction, a qualified engineering expert will attempt to determine time, distance, vehicle speeds, and ultimate root causes in order to further assist insurance adjusters and attorneys in the handling of a cargo damage claim. The purpose of this section is to familiarize the reader with the tools and methodologies associated with commercial motor vehicle accident reconstruction and illustrate how these can be used in evaluating cargo damage claims.

Federal Regulations Regarding Cargo Securement: 49 CFR§§ 393.100-393.136

Title 49 of the CFR, also known as the Federal Motor Carrier Safety Administration (FMCSA), Sections 393.100 through 393.136, details the requirements for cargo securement. The applicability and purpose of this code is as follows:

a) Applicability: The rules in this subpart are applicable to trucks, truck tractors, semitrailers, full trailers, and pole trailers.
b) Prevention against loss of load: Each commercial motor vehicle must, when transporting cargo on public roads, be loaded and equipped, and the cargo secured, in accordance with this subpart to prevent the cargo from leaking, spilling, blowing or falling from the motor vehicle.
c) Prevention against shifting of load: Cargo must be contained, immobilized or secured in accordance with this subpart to prevent shifting upon or within the vehicle to such an extent that the vehicle's stability or maneuverability is adversely affected.

The minimum performance requirements for cargo securement as defined by this standard are as follows:

a) Performance criteria—(1) Breaking strength. Tiedown assemblies (including chains, wire rope, steel strapping, synthetic webbing, and cordage) and other attachment or fastening devices used to secure articles of cargo to, or in, commercial motor vehicles must be designed, installed, and maintained to ensure that the maximum forces acting on the devices or systems do not exceed the manufacturer's breaking strength rating under the following conditions, applied separately:
    a. 0.8 g deceleration in the forward direction;
    b. 0.5 g acceleration in the rearward direction; and
    c. 0.5 g acceleration in a lateral direction.

b) (2) Working Load limit. Tiedown assemblies (including chains, wire rope, steel strapping, synthetic webbing, and cordage) and other attachment or fastening devices used to secure articles of cargo to, or in, commercial motor vehicles must be designed, installed, and maintained to ensure that the forces acting on the devices or systems do not exceed the working load limit for the devices under the following conditions, applied separately:
    a. 0.435 g deceleration in the forward direction;
    b. 0.5 g acceleration in the rearward direction; and
    c. 0.25 g acceleration in a lateral direction.

c) Performance criteria for devices to prevent vertical movement of loads that are not contained within the structure of the vehicle. Securement systems must provide a downward force equivalent to at least 20 percent of the weight of the article of cargo if the article is not fully contained within the structure of the vehicle. If the article is fully contained within the structure of the vehicle, it may be secured in accordance with § 393.106(b).

d) Equivalent means of securement. The means of securing articles of cargo are considered to meet the performance requirements of this section if the cargo is:
    a. (1) Immobilized, such so that it cannot shift or tip to the extent that the vehicle's stability or maneuverability is adversely affected; or
    b. (2) Transported in a sided vehicle that has walls of adequate strength, such that each article of cargo within the vehicle is in contact with, or sufficiently close to a wall or other articles, so that it cannot shift or tip to the extent that the vehicle's stability or maneuverability is adversely affected; or
    c. (3) Secured in accordance with the applicable requirements of §§ 393.104 through 393.136.

The code also provides additional requirements for specific cargo types, including, but not limited to: liquids, logs, dressed lumber, and steel coils. The standard also provides specific strength requirements for chains, straps, and front-end structures.

Commercial Motor Vehicle Reconstruction; an Overview

If cargo is damaged as the result of a motor carrier accident, it may be necessary to evaluate the securement of the said cargo. This is done via the above regulations. Specifically, an engineer is used to evaluate the components used and methodology by which the cargo was secured. This process may involve a field inspection of the motor carrier and cargo, and data collection via measurements and photographs. Additionally, laboratory analysis of failed components may be necessary to evaluate material properties.

Electronic Data Available on Commercial Motor Vehicles; ECMs

Modern commercial motor vehicle engines use an electronic system to control and monitor engine functionality and performance. These electronic control modules (ECM) are also capable of recording accident data. Specifically, some ECMs record crash-related data that includes

vehicle speed and braking. This data, in combination with site evidence and analytical computations, can be used to characterize the dynamics (accelerations) of a commercial motor vehicle in an accident scenario.

Electronic Data Available Through GPS

In addition to ECM data, larger companies often equip their commercial motor vehicles with global positioning satellite (gps) systems. These systems allow motor carriers to track the location of their fleet and, with some systems, the real-time speed of the commercial motor vehicle. These systems are generally known as vehicle telematics, and some common providers are Qualcomm and People Net. While this data tends to be less accurate than ECM data, it is still a valuable tool in commercial motor vehicle reconstruction and cargo securement assessment.

Government Reports

Other information may also be available through investigations conducted by investigating police authorities, the National Transportation Safety Board, or other governmental entities.

How This Data Can Be Used to Evaluate Potential Liability

However, it is often the case in a commercial motor vehicle accident that the cargo becomes unsecured despite conformance to the FMCSA requirements. This occurs because the acceleration (strength) thresholds given in the FMCSA are for the worst-case braking and corner accelerations of a commercial motor vehicle, not for the accelerations that could occur in an accident scenario. To this end, it can be valuable to know the accident dynamics in order to evaluate whether or not the cargo was properly secured.

An accident reconstruction can determine the peak accelerations experienced by a commercial motor vehicle during the pre-impact maneuvers, collision, and post-impact motion. These accelerations can then be compared to the cargo securement requirements of the FMCSA in order to evaluate compliance.

The commercial motor vehicle accident dynamics are evaluated using analytical calculations and electronic data; the later is addressed.

Reefer Units

An additional system that may be relevant when discussing commercial motor vehicle cargo is a refrigerated trailer or reefer unit. A reefer unit is a trailer with an integral cooling system that removes heat from the trailer cargo space, thus allowing the transportation of cargo with temperature requirements. The typical reefer cooling system is similar to that of a home air-conditioning system in that it has a compressor, condenser, expansion valve, and evaporator. The refrigeration cycle uses the thermodynamic properties of a refrigerant to remove heat from the trailer and expel it into the atmosphere. As with any mechanical system, the reefer refrigeration system must be properly maintained in order to avoid failures. Additionally, the potential

for a defective component or subcomponent is possible, which can result in a full system failure and ultimate loss of cargo. Engineering consultants can be used to inspect and evaluate reefer mechanical systems in the event of a failure.

Conclusion

The consulting engineer adds a more specialized, technical aspect to the investigation of a claim for cargo loss or damage in the event such expertise is warranted by the initial findings of the investigator. The work of the engineer both supplements and complements the work of the investigator and may be necessary to support a defense against a claim.

V. Approaching a Claim from the Perspective of the Lawyer

A claim for damage to cargo arising out of a commercial motor vehicle accident gives rise to potential coverage and liability issues for both the cargo insurer interests and the motor carrier legal liability insurer interests. It is not uncommon for a lawyer to be engaged early in the claims evaluation process to provide guidance with regard to coverage, salvage, and investigation issues that may arise. Once coverage has been determined, and a claim fully adjusted and paid, the possibility for subrogation against the motor carrier and the motor carrier's defense to that claim may be the next steps in the claim process.

A. Coverage Issues Under Cargo Policy

An insurance claims adjuster may have various reasons for challenging coverage for a claim for cargo loss or damage based upon the specific provisions of the insurance policy and the facts developed during the investigation of the loss. For this reason, a legal opinion may be sought with regard to coverage. For the hypothetical scenario posed by this paper, the reviewing attorney may encounter the following issues:

Defenses to Coverage—Requirement for a Direct Physical Loss

A typical cargo policy contains the following language:

COVERAGE

1. **Legal Liability Coverage** – "We" cover "your" legal liability for loss to covered property:

    a. while under "your" care, custody and control; and

    b. that "you" become legally obligated to pay as a common or contract carrier under a bill of lading, contract of carriage or shipping receipt that is issued by "you" to that is issued on "your behalf.

. . .

PROPERTY COVERED

"We" cover the following property unless the property is excluded or subject to limitations:

1. Property in Vehicles –

    a. Coverage – "We" cover **direct physical loss** caused by a covered peril to property of others described on the "schedule of coverages" when in due course of "transit" including loading and unloading.

. . .

2. "We" do not pay for loss or damage that is caused by or results from one or more of the following:

    c. Loss of Use – "We" do not pay for loss caused by or resulting from loss of use, delay, or loss of market.

The first issue is whether there is any coverage for the alleged damage to property. The policy limits coverage to a direct physical loss (here, there is no question that the peril was covered). A good example would be a refrigerated cargo of food products where there is no evidence of physical damage. Whether the mere condition that food products are potentially in violation of FDA regulations, without proof of actually physical loss or damage, constitutes a "direct physical loss" has been addressed by courts in various jurisdictions, with varying results, depending greatly on unique facts of each case.

Numerous courts have found that the phrase "physical loss" or "physical damage" requires a finding of actual material alteration of the product in some way. For instance, in *Source Food Technology, Inc. v. U.S. Fid. & Guar. Co.*, 465 F.3d 834 (8th Cir. 2006), the insured was prohibited from shipping beef product from Canada due to an embargo arising out of fears of mad cow disease. As a result of the embargo and failure to obtain beef product from its normal supplier, the insured suffered economic losses. The court found that a policy providing coverage for "direct physical loss to property" was not triggered, as the beef product suffered no actual physical contamination or damage. Similarly, in *Pentair, Inc. v. Am. Guar. & Liab. Ins. Co.*, 400 F.3d 613 (8th Cir. 2005), the insured made an insurance claim for business loss arising out of loss of power at two Taiwanese factories. The court found that the policy, which covered "all risks of direct physical loss," did not extend to such a loss where there was no physical damage as a result of the power outage. *See also Meridian Textiles Inc. v. Indemn. Ins. Co.*, 2008 U.S. Dist. LEXIS 91371 (C.D. Cal. 2008) (finding that yarn which had been stored in a warehouse that sustained a fire, but was not physically damaged by the fire, was not subject to coverage for diminution in value).

The Illinois Supreme Court has construed similar language as requiring an actual physical change to property, not just diminution in value or economic loss. In *Traveler's Ins. Co. v. Eljer*

Manufacturing, Inc., 197 Ill. 2d 278, 304 (Ill. 2001), the insured installed plumbing systems in new homes. Years later, some of the systems were found to be defective and caused damage to the homes in which they had been installed. The insured sought coverage under a CGL policy that was in effect at the time of the installation, but the insurer argued that there had been no "physical injury" as a result of the installation during the policy period. The court agreed, finding that the plain meaning of the term "physical injury" "unambiguously connotes damage to tangible property causing an alteration in appearance, shape, color or in other material dimension." *Id*. at 28. In *Ports of Indiana v. Lex. Ins. Co.*, 2011 U.S. Dist. LEXIS 130979 (S.D. Ind. 2011), the insurer claimed that only a small portion of a dock wall had sustained physical loss, whereas the insured claimed that a much larger section of the dock wall needed repairs. The court stated that the best way to assess whether the dock wall had been damaged was to determine "if there is a quantifiable loss in the property's usefulness or in its function for normal purposes." *Id.* at 28. The court held that the insured was not entitled to summary judgment because a question of fact existed as to whether the dock was actually damaged, and whether that damage was caused by a fortuitous loss.

On the other hand, courts have found coverage where there is some proof of physical effect impacting value or function. In *Ashland Hosp. Corp. v. Affiliated FM Ins. Co.*, 2013 U.S. Dist. LEXIS 114730 (E.D. Ky. 2013), the court found that a computer data storage network had sustained direct physical loss where it overheated and caused physical alteration of the components, even though that alteration did not render the network useless, but merely caused a loss of reliability. However, in that case, there was an actual physical effect or alteration.

General Mills, Inc. v. Gold Medal Ins. Co., 622 N.W.2d 147 (Minn. App. 2001), does suggest that mere impairment of function and value in the insured property is enough to support a finding of direct physical loss. In *General Mills*, a shipment of oats was treated with a pesticide that was not approved by the FDA for use on oats. While there was no indication that the pesticide would be harmful for consumption, the insured made the decision not to market the oats due to FDA regulations. The court found that the insured was not able to sell its product because of those regulations. "Whether or not the oats could be safely consumed, they legally could not be used in General Mill's business. The district court did not err in finding this to be an impairment of function and value sufficient to support a finding of physical damage." *Id.* at 152.

Although subsequent cases have distinguished *General Mills* on the basis that there was actual physical alteration to the oats, the *General Mills* court did not make that distinction in its opinion. In *United Sugars Corp. v. St. Paul Fire & Marine Ins. Co.*, 2007 Minn. App. Unpub. LEXIS 660 (Minn. App. 2007), USC was a producer of sugar. Its customer, Nestle, used the sugar to make cookie dough. While producing the cookie dough, it was determined that there were contaminants in the sugar in the form of bee parts and cigarette butts. Nestle determined that the cooked dough was adulterated and could not be sold, but there was never any testing to determine whether any bee parts or cigarette butts actually made their way into the cookie dough. USC's CGL policy provided for coverage for claims arising out of "property damage," which was defined as "physical damage to tangible property of others, including all resulting loss of use of that property." *Id.* at *3. The court interpreted *General Mills* as providing a definition of what can constitute property damage in the context of food production; i.e., "[t[hat mere expo-

sure of a food product to contaminants supports a finding of physical damage as that term is used in an insurance policy." *Id.* at *14. *See also Netherlands Ins. Co. v. Main Street Ingredients, LLC*, 2013 U.S. Dist. LEXIS 2685 (D. Minn. 2013) (finding insured's economic loss from recall of oatmeal made with instant milk which was the subject of a recall for possible salmonella contamination was a physical injury under CGL policy).

Courts in other jurisdictions have also held that impairment in function and merchantability is sufficient evidence of physical damage to trigger coverage. *See, e.g., PepsiCo. Inc. v. Winterthur Ins. Co.*, 24 A.D.3d 743 (finding coverage for drink products with poor taste caused by faulty raw materials, equating physical damage with impairment of function and value); *Dundee Mut. Ins. Co. v. Marifieren*, 587 N.W.2d 191 (N.D. 1998) (holding that storage facility which suffered power outage causing damage to crop of potatoes suffered physical damage because the facility's value or usefulness was impaired); *Am. Guar. & Liab. Ins. Co. v. Ingram Micro, Inc.*, 200 U.S. Dist. LEXIS 7299 (D. Az. 200) (finding that physical damage includes loss of use, functionality, access to computer circuitry).

At least one court has found coverage for damage to a food product where absolutely no physical damage existed. In *Customized Dist. Svcs. v. Zurich Ins. Co.*, 373 N.J. Super. 480 (N.J. Sup. Ct. 2004), the insured operated a warehouse which stored a beverage product. That product was misrotated, causing some product to become unsellable due to passed expiration dates. There was no allegation of any physical damage to the beverages. The court found that the misrotation caused a change in perception of the product equaling a physical change. In addition, the *Customized* court found that the loss of market exclusion did not apply. The court argued that the market for the beverage had not been lost, but, rather, the consumer's perception of the aged product changed, causing it to be unsellable in the market.

Control-of-Damaged-Goods Clause

A good example of a Control-of-Damaged-Goods clause can be found in *American Home Assurance Co. v. Merck & Co., Inc.*, 386 F. Supp. 2d 501, 506 (S.D.N.Y. 2005).

> The assured shall have full right to the possession of all goods involved in any loss under this policy and shall retain control of all damaged goods. The assured, exercising a reasonable discretion, shall be the sole judge as to whether the goods involved in any loss under this policy are fit for use as originally intended or in any other capacity, and no goods so deemed by unfit for use shall be sold or otherwise disposed of except by the assured or with the assured's consent, but the assured shall allow this company [insurer] any salvage obtained by the assured on any sale or other disposition of such goods. In addition, property insured by this policy shall be deemed to have suffered an insured loss if, as a result of a fortuitous event; said property is deemed unfit for use by any government regulatory body and/or agency, anywhere in the world, where as a result of reasonable interpretation of regulations promulgated by said bodies and/or agencies; or the only means of determining the existence or extent of damage is through "destructive testing."

The *American Home* case involved a challenge to insurance coverage for a loss to a shipment of vaccines during transportation by motor carrier from West Point, Pennsylvania, to Reno, Nevada, in a temperature-controlled truck. A TempTail3 temperature monitor was placed inside the truck to monitor the temperatures during the trip. The trailer had a ThermoKing refrigeration unit containing two gauges that recorded ambient temperatures with a Qualcomm Communications remote satellite data acquisition system recording the ambient temperatures within the truck and sending them via satellite to the motor carrier's office. The drivers of the truck allegedly recorded temperatures within the truck on a logbook using a readout on the ThermoKing refrigeration unit. Proper temperatures were not maintained, and Merck subsequently claimed the vaccines were unfit for use due to the possibility that they had been frozen in transport and could not be sold pursuant to its reasonable interpretation of FDA regulation 21 CFR § 211.208.[1] The court initially noted that it was its task to ascertain the intent of the parties as manifested by the terms used in the written insurance policy, construing any ambiguities against the insurer. The court also stated that Merck had the initial burden of providing that coverage existed under the Control-of-Damaged-Goods clause**;** at which point, the burden then shifted to the insurer, which could reduce or avoid liability by providing either that the manufacturer failed to mitigate damages or violated its obligations under the policy's sue-and-labor clause. The court ultimately determined that there were material issues of fact that precluded summary judgment as to whether the control-of-damaged-goods clause provided coverage for the shipments.

Brands-and-Labels Clause

The Brands-and-Labels clause defense usually comes up within the context of the obligation of the insured to mitigate damages. The insured will claim that the cargo was not salvageable because it contained brand-name labeling on the packaging, and selling the cargo into the market would damage the brand's reputation. The insurer, for its part, would argue the failure to mitigate was a breach of the insured's obligation under the policy. Such questions are normally fact questions requiring competent supporting testimony. *Dessert Service, Inc. v. M/V MSC Jamie/Rafaela*, 219 F. Supp. 2d 504 (S.D.N.Y. 2002).

Defense to Coverage—Inherent Vice

It is commonplace for cargos requiring refrigeration to also be cargos that may be susceptible to damage due to some inherent vice in the cargo itself (example, bananas which ripen as a matter of course). Trying to determine whether damage to cargo was the result of an inherent vice of the cargo itself, or whether it was the result of some negligence in failing to maintain the cargo at a proper temperature, is also a crucial task for the lawyer. It will also be important to the insured cargo owner because many cargo policies include an exclusion for loss due to "inherent vice."

An important case involving inherent vice is *Perzy v. Intercargo Corporation*, 827 F. Supp. 1365 (N.D. Ill. 1993).[2] *Perzy* involved a shipment of "snowball" paperweights consisting of a

[1]The case also involved claims for damages to two other non-refrigerated shipments.

[2]*Perzy* involved a cargo transported by ocean carrier; however, the court's analysis would be equally applicable to a cargo loss resulting from a commercial motor vehicle accident.

clear globe containing a miniature scene, filled with water and particulate that, when shaken, looks like falling snow. The paperweights were being returned to Vienna, Austria, arriving in a "frozen and damaged condition." The insurer of the cargo declined coverage for the freezing damage, claiming that it was excluded under the "inherent vice" exception found in both the certificate of insurance and the policy itself.

The court defined "inherent vice" as follows:

> Inherent vice is "a quality of the goods that causes damage to the goods during transport, even in the absence of negligence . . ." Properties with an inherent vice "carry within themselves the seeds of their own destruction." "Foods rot; iron rusts; some wines simply do not travel well . . ." Loss from inherent vice must be "inevitable, certain and non-fortuitous," even if the timing of the loss may not be calculable. [Citations omitted.]

After examining the facts, the court determined that the efficient cause of the freezing damage was the failure of a third party responsible for proper stowage to containerize or otherwise protect the snow globes from freezing, and, therefore, determined that the damage was not the result of inherent vice.[3]

The insurer has the burden of proof in establishing the applicability of inherent vice as an exclusion to coverage. Any determination will be fact-intensive. However, the finding of the applicability of the inherent-vice exclusion in a policy would defeat the claim of the insured cargo owner.

Salvage and Mitigation

See discussion in *Dessert Service, Inc. v. M/V MSC Jamie Rafaela*, 219 F. Supp. 2d 504 (S.D.N.Y. 2002). As stated above, salvage and mitigation, while obligations of the insured cargo owner, can also be complicated by a Brands-and-Label clause in the case of refrigerated cargos which are distinctively marked with a brand or label of the manufacturer/cargo owner.

B. Subrogation/Motor Carrier Liability

Assuming the cargo adjuster finds coverage under the insurance policy, has adjusted the loss and paid the insured, the next step will be to consider possible subrogation against the responsible motor carrier, which, if pursued, will involve the motor carrier legal liability insurer in the defense. In that event, the cargo adjuster and the motor carrier liability adjuster will be evaluating the potential liability and defenses to liability of the insured motor carrier.

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[3]The *Perzy* court also considered the improper-packaging defense raised by Intercargo, but determined that the evidence showed that the wording of that exclusion was not triggered by the facts of the case.

Carmack Amendment Liability

The primary source of liability for the motor carrier transporting cargo between states is the Carmack Amendment to the Interstate Commerce Act, first enacted in 1906. 49 U.S.C.A. § 14706. The Carmack Amendment creates a unity of responsibility in the transportation industry by requiring that the initial motor carrier of a shipment be responsible for the entire shipment, despite the number of connecting carriers involved. It applies only to surface transportation in the United States or from a place in the United States to a place in an adjacent foreign country when transported under a through bill of lading.[4] Under Carmack, the liability of the carrier is essentially strict liability.

The Carmack Amendment places the responsibility for the goods with the initial carrier and the delivering carrier, but provides that the bill of lading issued by the initial carrier controls the transaction. *Georgia, Florida & Alabama Railroad Co. v. Blish Milling Co.*, 241 U.S. 190, 194-195 (1916).

Tariffs/Terms and Conditions

A carrier may limit its liability if it establishes rates for the transportation of property under which liability is limited to a value established by written declaration of the shipper or by written agreement between the carrier and shipper if it would be reasonable under the circumstances. 49 U.S.C. § 14706(c)(1)(A). In this regard, both the cargo adjuster and the liability adjuster will want to determine if the carrier has issued a tariff and if, pursuant to that tariff, the carrier has given the shipper a fair opportunity to choose between two or more carrier liability levels, the shipper has chosen a liability level, and the carrier has issued a bill of lading reflecting the shipper's choice. The "fair opportunity" requirement is usually satisfied by issuing a bill of lading which contains space for the declaration of value for the payment of a higher freight weight. Tariffs no longer need to be filed with any governmental entity, but they must be available (and usually are through a Website posting) to the shipper.

The significance of a tariff is found in the limitation-of-liability provisions which can be asserted by the carrier as a defense to a claim. Such limitation will most likely substantially reduce any amount the cargo insurer can collect on its subrogated claim.

Contracts—Limitation of Liability

The cargo adjuster and the motor carrier liability adjuster will also want to determine if there are any separate transportation agreements between the insured cargo owner and the motor

[4]The Supreme Court recently ruled that Carmack does not apply to the inland portion of a shipment originating overseas under a through bill of lading. *Kawasaki Kisen Kaisha, Ltd. v. Regal-Beloit*, 130 S. Ct. 2433 (2010). While the Supreme Court in *Regal-Beloit* expressly declined whether Carmack applies to goods initially received in Canada or Mexico for import to the United States, a recent case held that the Carmack Amendment does apply to shipments originating in Canada and ending in the U. S. *Atlas Aerospace, LLC v. Advanced Transportation, Inc.*, 2013 U.S. Dist. LEXIS 157416 (D. Kan. 2012).

carrier which circumvent Carmack liability in exchange for contractual liability. That contractual liability may also limit liability of the motor carrier in significant ways, both for the dollar amount of the claim, as well as in other important aspects.

Damages/Salvage

Generally, the amount of damages (subject to any limitation liability) is the difference between the market value of the property and the condition in which it should have arrived at destination and its market value and the condition in which it did arrive. Recoverable damages against the motor carrier include damages for delay, lost profits, and all reasonably foreseeable consequential damages. *American National Fire Insurance Co. v. Yellow Freight System*, 325 F.2d 924, 931 (7th Cir. 2003).[5]

With regard to the damages for refrigerated cargo, it is commonplace for the cargo owners to rely on governmental regulations in asserting their claim for a total loss, even where the question of a total loss has never been adequately determined. The reasonableness of that position may be called into question by a court.

Defenses to Liability

As stated above, the liability of motor carriers is essentially strict liability. However, the motor carrier may successfully defend against a claim for cargo damage if it can show that the damage was caused by an act of God, a public enemy, the act of the shipper himself, public authority, or the inherent vice or nature of the goods (*Mo. Pac. R.R. Co. v. Elmore & Stahl*, 377 U.S. 134, 137 (1964)), provided that the motor carrier can also establish that it was free from negligence.

Notice of Claim and Suit Time

The requirements for a Notice of Claim and Suit Time under the Carmack Amendment are important issues for both the lawyer representing the cargo insurer interests, as well as the lawyer defending the motor carrier. A Notice of Claim must be issued by the cargo owner/insurer within nine months of the date of loss. A lawsuit against the motor carrier must be filed within two years and a day of any rejection of the claim. If transportation agreements are in force, different time requirements for a notice and filing suit may be specified.

VI. Summary and Conclusion

[5]However, to recover special or consequential damages, the shipper must show that the carrier had notice of the special circumstances from which such damages would flow. Some recent cases have held that damages under the Carmack Amendment can be demonstrated by the mere loss in market value. *Jessica Howard, Ltd. v. Norfolk Southern Railway Co.*, 316 F.3d 165, 169 (2nd Cir. 2003); *Atlantic Mutual Insurance Co. v. Napa Transportation, Inc.*, 2001 Fed. App. 19 (2nd Cir. 2006). Moreover, even in those cases, there is generally some amount of physical loss or damage to the cargo container or packaging, suggesting loss or contamination, rendering the goods unmarketable.

A claim for damage resulting from a commercial motor vehicle accident sets into motion a claims-handling process which may, at various times during the process, require the efforts and collaboration of the cargo insurer adjuster, the motor carrier liability insurance adjuster, an investigator, an independent engineering consultant, and a lawyer. Each participant has a very specific role to play in the claim process, but the work of each of those participants reinforces the work of the other participants in determining whether insurance coverage will be available to the cargo owner, the cause of loss, the nature and extent of loss, subrogation opportunities, and the legal liability of the responsible motor carrier. If an independent investigator is retained, that investigator becomes the eyes and ears for the insurance adjuster. The adjuster then takes that information to determine if a further engineering consultant is necessary for a more technical evaluation. The lawyer can serve both as an advisor during the claims process on issues related to coverage and liability and may subsequently be called upon to either prosecute a subrogation claim or defend against a subrogation claim by the cargo insurer. In his efforts, the lawyer will use the information developed by both the adjusters and the investigators and may call upon the engineering consultant for services as an opinion witness in litigation.

In conclusion, it can be said that the handling of a claim for cargo damage is a collaborative effort.