



## TT Live – Series 1: episode 4 – 02/12/2020

### Due diligence

#### Mitigating the risks

In this episode, Mike Yarwood, Managing Director Loss Prevention, talks with Andrea Gentile, Senior Claims Executive for the TT Club around the topic of due diligence.

**Mike:** “Welcome to this edition of TT Club’s Podcast “TT Live”. In this session, we are going to focus on the subject of due diligence and I am joined by my colleague Andrea Gentile, Senior Claims Executive at TT Club.

Due diligence is effectively a risk management control, a process by which businesses can protect themselves from a number of potential exposures. It is a subject that can be considered in a wide variety of contexts. Whether choosing a haulage contractor, a service provider or considering risks associated with doing business for a new customer, due diligence should be an embedded part of the process.

International trade and the global nature of the supply chain involve stakeholders frequently interacting with other parts of the world. Effective due diligence is increasingly important, whether providing a service or relying on another party to fulfil your obligations.

In the context of protection, it can serve to assist in the selection process of contractors, are they able to meet your requirements, are they a financially viable company, are they trained/qualified to perform the task you require? It can also serve to consider risks associated with undertaking business for a new customer, are they able to pay for the services you provide, what level of credit is it appropriate to extend.

Fundamentally, as a management control, due diligence exists to minimise risk. While as mentioned, the scope of due diligence is far reaching, for the purposes of this session we will focus on the selection of haulage contractors and how a due diligence process can assist.

Andrea, welcome and thank you for joining us for this session. This is a topic that will likely affect many freight forwarders, NVOCC’s and other stakeholders in the supply chain. In particular cargo theft remains one of the top five heads of claims cost for TT Members, I can recall many cases where the integrity of a subcontracted haulier has been brought in to question during the post incident investigations.”

**Andrea:** “Thank you Mike for giving me the opportunity to offer some input on this delicate topic. As you have just said, due diligence is a very wide area but essentially comes down to, so to speak, be a good student and do the homework in order to make an informed decision and thus ultimately in order to reduce the risk of financial losses.

One single inaccurate decision can indeed bear serious consequences. Quick example: let’s imagine you are a freight forwarder and you are paid to move a valuable cargo of pharma products from A to B. Let’s also assume you do not have the assets to move the cargo and therefore you have to pay a Haulier to do so. If you choose your Haulier exclusively on the basis of the rate applied, that is, the cheapest you find in the market, it is highly probable that you are not making an informed decision. Why? Because Hauliers offering very low rates are also making small profits, therefore, are more inclined to save costs whenever possible.

Parking costs are significant in the UK and a Haulier who is keen to keep costs low may be very tempted to park its truck at a lay-by rather than a secure truck parking with the consequence to expose the cargo to criminal actions and ultimately you, as freight



forwarder, to a huge loss. But let me stop right there - Mike this is something you want to expand on?"

**Mike:** "Thank you... many of our Members are primarily freight forwarders and therefore sub-contracting various elements of each movement is fundamental to their business model.

While our focus here is security, there are clearly other areas of risk that due diligence could assist with. From a safety perspective, is your contractor suitably trained to handle, pack and secure the goods you are entrusting to them?

Where regulations are concerned, is your contractor qualified to handle and carry the goods, does the driver have an ADR licence to carry dangerous goods for example.

Concerning security however, experience suggests that the final mile delivery of goods by road in the destination country is most frequently where theft losses occur, so due diligence where haulage contractors are concerned should be high on the list of priorities."

**Andrea:** "Yes, along the lines of what we just said earlier on, many of the cargo theft claims we handle involve sub-contracted haulage companies often domiciled in unfamiliar jurisdictions. This can make the claims handling and particularly the recovery process challenging. Regardless of the services being tendered and whether contracting with a supplier on the other side of the world or in the same city, it is fundamental to know who you are contracting with, that they are a reputable company, that they are able to represent your interests appropriately, and importantly that they are a genuine, financially viable entity. These are all crucial aspects that you need considering very carefully before deciding to whom you entrust your cargo with. These decisions are directly interconnected to your potential liability towards your Customer."

**Mike:** "Of course the international nature of the supply chain adds complexity. While you may be based in the UK or Germany, the haulage contractor may be based in an entirely different country. Where due diligence is concerned, what are the first steps and how can you undertake checks on a would be haulage contractor from an unfamiliar country?"

**Andrea:** "Due diligence really is a process driven activity. The starting point is often identifying the services you require of your sub-contractor and understanding any particular expertise required. From a security perspective, this may be as simple as identifying the value and theft attractiveness of the cargo to be shipped and the likely route to be taken. Ideally stakeholders would have established an approved haulier list through experience over many years and will have had the opportunity to meet with the contractor personally and develop a good and trusted relationship with them. Of course, where this is the case and an approved haulier can be appointed, the risk diminishes. Risk is heightened where an approved haulier is not available and this is where a robust due diligence process pays off."

**Mike:** "So what are the primary areas of concern? Are there maybe two or three areas of particular importance?"

**Andrea:** "From TT's experience one of the primary checks should be to verify the contractors identity. Who is the company you are entrusting the cargo and your reputation with. Are they legitimate? There are many occasions where criminals use the smoke screens provided through electronic exchanges to falsify information and deceive legitimate carriers. We shouldn't lose sight of the fact that where criminals are able to deceive and are able to access cargo, this is a very lucrative business for them, so they are well motivated. Some red flags might be that the only correspondence is by mobile phone or a free mail account, the lack of an established land line telephone, a business email address or a website, should heighten your focus."



**Mike:** “Identity as you say is absolutely key, in terms of documentation and other checks, what should a stakeholder be looking for to satisfy themselves?”

**Andrea:** “100% verification is difficult to achieve and would in any event likely not be cost effective or operationally possible. The focus should be to check and obtain documentary evidence that the contractor is legitimate. Relevant documents such as their full legal name and trading address, insurance policies (stating in clear terms the contractual framework in place between contractor and its Insurer, limits of liabilities, obligations and warranties), trade references, standard terms and conditions and compliance certificates could all reasonably be requested and provided by a legitimate contractor. The key focus here is to make it as difficult as possible for illegitimate contractors to deceive. If for example you have initial suspicions because the contractor has no website and is communicating only by mobile phone, then requesting further documents may serve to verify your suspicions, in the event that they are unable to provide a satisfactory response. Bottom line, if you are not fully persuaded that the contractor is legitimate business, you should investigate thoroughly.”

**Mike:** “The trading address is an interesting and in hindsight an obvious point. I recall a case several years ago where through investigations we were able to establish that the trucking company’s trading address was actually in a residential apartment block in a residential area of the city. Through the booking stage, nobody had even thought to question this.”

**Andrea:** “Yes, we do see cases like this. With freely available mapping software, it can be a reasonably easy check to make remotely. If for example the contractor purports to be a trucking company with 20 vehicles, if their trading address illustrates that they operate from an apartment block, you should infer right away that that sounds suspicious.”

**Mike:** “The prevalence of digital solutions and platforms, freight exchange sites in particular, has arguably reduced the available time to undertake due diligence. There is an increasing expectation for speed of service and delivery. How should stakeholders in the supply chain approach balancing these challenges?”

**Andrea:** “I don’t think it is correct to suggest that in the past, shipments were less time sensitive, however I agree that the digital environment we now work in provides the opportunity for far less formal arrangements to be made very quickly. This does place additional pressures on stakeholders, especially when they are already under time pressure from their customer. Having a well-established and communicated due diligence process with identified key minimum criteria will assist in protecting your business. Despite the apparent urgency, it is important to find the time to undertake checks. May I suggest a take home lesson here: always remember, it’s your liability towards your Customer but more importantly your reputation in the market at stake.”

**Mike:** “Control over who is actually carrying your cargo is another consideration. I have seen many occasions whereby the haulage movement has been further subcontracted several times, creating a potentially complex contractual chain.”

**Andrea:** “Yes indeed, as you mention, generally speaking under international laws there are no statutory restrictions on further contracting. Performing excellent due diligence on the company you sub-contract to risks becoming null and void if they then sub-contract the movement to another haulier and that haulier to another haulier. All of the direct controls risk being lost or at least diluted. This can be particularly problematic for CMR movements, where as a freight forwarder you may be considered the first CMR carrier and therefore liable for the actions of all subsequent carriers – whether you have directly appointed them or not!

Yes, this may happen when you are involved in a movement seeing a number of carriers contractually involved. To exemplify, if there are 6 carriers involved and you are the first, under the CMR Convention the cargo claimant can pursue its claim

against you or alternatively the last/actual carrier performing the movement. Which effectively means two things. Number one, you are an easier target for the Claimant because you will likely be financially speaking more capable than the last/actual carrier. Number two, like it or not you become responsible for actions and omissions of last/actual carrier.

How to minimise the risk here? Stakeholders could in this context consider building service level agreements with their direct contractors which could include provisions to not further contract or in the event that they do, they assume back to back liability with you.”

**Mike:** “We mentioned freight exchange sites earlier, there have been a number of cases in the last couple of years whereby thieves have been able to disguise themselves, infiltrate these platforms and steal cargo. Are there any additional steps that stakeholders should be mindful of when using this type of platform to sub-contract haulage movements?”

**Andrea:** “The due diligence process should remain constant. Consistency should drive resilience and afford your business the greatest protection. Where freight exchange sites are concerned, yes there are risks, you are potentially advertising your cargo to an illegitimate contractor. The counter argument however, would be that a diligent freight exchange site operator should have protection measures in place too, preventing easy access for such contractors. I think the message here really should be not to rely on the site operator to have performed full due diligence and to follow your own established process checks on all occasions. The freight exchange site operator will at no point become an entity in the contractual chain!”

**Mike:** “We have considered what due diligence is and discussed some potential elements of the process. Within a business, whose responsibility is due diligence and who should be undertaking it?”

**Andrea:** “I think that the support and messaging should absolutely come from the senior management team. Support is required where a member of staff for instance has to delay a shipment to ensure that checks are properly completed. Having a proportionate, consistent process thereafter is important to ensure operator compliance. In terms of who should undertake and who is responsible for due diligence, it is really an organisation wide process. Anybody who is dealing with customers or contractors should be trained in the process and importantly aware of the potential risks.”

**Mike:** “So if this is a process that a wide range of staff are performing, then stakeholders also need to consider monitoring compliance as you say and having an established escalation process.”

**Andrea:** “Yes absolutely, there is the need to primarily ensure that people are following the process. Thereafter, while there will be cases at each extreme (obviously legitimate or not) there will inevitably be cases whereby a contractor is able to supply only partially satisfactory answers or documents. There is an importance in those instances to ensure that there is an internal escalation process whereby the final decision is made by somebody with sufficient authority in the business, this will obviously be different from business to business but should be clearly documented in the process.”

**Mike:** “Where due diligence activities are concerned, the internet can be viewed as a great enabler, providing remote access to many key metrics under consideration here.”

**Andrea:** “Correct, yes. We already mentioned the mapping software, other publically available sites would include national company registers, VAT number registers and verification of Membership of trade organisations. I think the message where the internet is concerned is that care should be taken. Recognising that internet pages may not be

fully accurate (whether by omission or deliberately fraudulent); always think about what is presented and seek to cross-check information from trusted sources. Wherever possible, obtain original documents, conduct pre-contract negotiations over known landline phone numbers and verify email addresses. Thorough checks frequently pay dividends, do not take everything obtained from the internet at face value. Google may be a starting point but may also not be enough.”

**Mike:** “Due diligence is clearly a wide reaching subject. When stakeholders are considering their own due diligence process, inevitably in running a business, cost will be a factor as well as designing a process that is proportional and sustainable. A question that they might ask themselves is “what are the risks of getting this wrong?”

**Andrea:** “This is a good point. The potential exposures in the context of haulage contractors are many, the most profound however is likely to be the negative impact on the commercial relationship with your customer. This might stem from a theft of cargo (or a series of thefts), damage to cargo which has not been handled with the required expertise, or even being brought into disrepute in the event that a haulage contractor is found by authorities not to have the correct licence, qualifications or equipment to safely carry the cargo. All of these individual examples will attract varying levels of both insured and uninsured cost, that will have a financial impact on your business. One cost however that is difficult to quantify and has the potential to existentially affect your business is that of damaging commercial relationships. Whether it be a poor reputation in the market or actually losing a contract, these are the potential costs that should motivate the senior management team to dedicate focus to the businesses due diligence process.”

**Mike:** “Andrea, thank you for sharing your expertise, do you have any final thoughts or considerations that freight forwarders/NVOCC’s should be mindful of when considering their due diligence process?”

**Andrea:** “Firstly, do take your time....The potential risks and exposures are generally heightened when actors face time restrictions and where one-off business transactions are in contemplation. I would always advise to think in terms advantages versus disadvantages, what you win and what you may lose.

Secondly, consider carrying out some due diligence on who is your contractor and the contractual frameworks and insurance policies in place. This does involve your contractor primarily but might involve also your contractor’s subcontractor. You may want to use some legal advice to this end.

Final point, consider what the impact would be on your commercial relationship with your customer if the contractor you are about to appoint was to fail. While easy in hindsight, it is often the case that the commercial impact of failing to deliver a particular shipment on time is far less than sub-contracting that shipment to an unverified contractor who steals or damages the cargo. As we said earlier, it’s your reputation and ultimately your business at stake!”

**Mike:** “In conclusion, implementing well considered due diligence and management controls, focused on early identification and verification of contractors can prove critical in avoiding losses and protecting your business. While the recommendations in this discussion hopefully provide some useful general guidance, each business will need to consider a proportional approach. The key message is to be consistent and have an established escalation process in the event of discrepancy in order to control risks as they are identified.

Thank you once again to our guest speaker, Andrea Gentile and thank you for tuning in. Please do join us next week when Kate Andrews will join me to consider contract review risks.”