

## Chapter 22

# Key Contractual Issues with Logistics Outsourcing

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### ABSTRACT

*Whilst there have been many papers on logistics outsourcing there is very limited commentary on the contractual issues with logistics outsourcing. Most of the literature can be generally categorized according to different focus area. Some of these focus areas include logistics practices, usage of 3PL logistics services, current state and future trends, strategies, and performance measurements. The chapter attempts to address this “gap.” The chapter will focus on some of the key contractual issues with logistics outsourcing contracts currently troubling customers, service providers, and advisers, such as (a) scope of the services; (b) change control; (c) service levels and service credits; (d) risk allocation – limitations and exclusions of liability; and (e) benchmarking.*

### INTRODUCTION

The outsourcing of logistics and third-party logistics appears to have originated in the 1980s as an important means for improving supply chain effectiveness (Maloni and Carter, 2006). Like other outsourcing arrangements, third-party logistics continues to grow. Estimations indicate that the proportion of companies in the United States that

have implemented third-party logistics (TPL) has increased by 5-8 per cent annually (Ashenbaum et al., 2005). According to a 2004 survey no less than 80% of the Fortune 500 Companies said they rely on TPL, and two-thirds of these companies had been involved in TPL for more than five years (Lieb & Bentz, 2005). As these contracts come up for renewal it is useful to reflect on what has worked and what has not. This chapter focuses on some of the issues currently troubling customers,

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service providers and advisers with their logistics outsourcing contracts. These issues include:

- Scope of the services;
- Change control;
- Service levels and service credits;
- Risk allocation – limitations and exclusions of liability; and
- Benchmarking.

## **BACKGROUND**

It is perhaps worth noting that the term “outsourcing” is used to embrace an extremely wide collection of different arrangements. However, at their heart they have one thing in common – the transfer to a third party of responsibility for performance of a particular service or function with a resultant loss of direct control. Because of this loss of direct control, coupled with the often critical importance of the subject matter and the long term nature of many arrangements, the logistics outsourcing contract itself becomes of vital importance in maintaining the balance of power between the customer and the service provider (De Silva & Golding, 2005).

Logistics is defined by the Council of Supply Chain Management Professionals as “The process of planning, implementing, and controlling procedures for the efficient and effective transportation and storage of goods including services, and related information from the point of origin to the point of consumption for the purpose of conforming to customer requirements. This definition includes inbound, outbound, internal, and external movements.” (CSCMP, 2006). Logistics outsourcing, therefore, refers to the procurement of any of these activities from a logistics service provider (the “service provider”). The use of the term “customer” in this chapter refers to the organisation which is outsourcing its logistics function.

This chapter is based on the law as of 1 November 2011.

## **LOGISTICS OUTSOURCING**

### **Existing Research**

There appears to be no published research and writing on the topic of contractual issues with logistics outsourcing. However, there are a number of papers on logistics outsourcing and Razzaque and Chang did a comprehensive review on the outsourcing of the logistics function. This literature can be generally categorised according to different focus area. Some of these focus areas include logistics practices, usage of 3PL logistics services, current state and future trends, strategies and performance measurements. In addition, there are a few studies which deal with the concerns and general risks related to this logistics outsourcing (Damme & Amstel 1996, Sink & Langley 1997, Laarhoven et al. 2000). However these studies do not appear to discuss contractual risks with logistics outsourcing.

### **Scope of the Services**

An important area of concern to both customer and service provider is the scope of the services. The functions performed by service providers in respect of logistics outsourcing vary considerably. According to a survey conducted by Lieb and Schwarz (2004), service providers supply a wide variety of services including:

- Direct transportation services;
- Warehouse management / operations;
- Shipment consolidation services;
- Freight forwarding;
- Carrier selection;
- Inventory replenishment
- Customs brokerage; and
- Carrier performance management.

It is almost impossible to properly price a logistics outsourcing contract until the scope of the services to be provided is defined. Also the

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