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Follow the Leader: Possible Lessons for Ohio Policyholders from Oklahoma's Oil and Gas Insurance Experience

By Matthew K. Grashoff
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Some people enjoy being trailblazers — boldly going where no one has gone before, to borrow a phrase. When it comes to insurance coverage, however, sometimes it pays, literally and figuratively, to let others go before you and learn from their mistakes. Ohio policyholders facing losses from fracking-related earthquakes currently have the option of doing just that, thanks to ongoing litigation in Oklahoma.

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Crime Insurance Coverage: Determining When a Loss is a "Direct Loss" Covered Under the Policy

By Gabrielle T. Kelly
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Most people understand the basic concept underlying crime insurance — that it is a form of fidelity insurance that insures commercial entities against the risk of loss by crime — though they are less clear on the type of losses that are covered by the policies. Crime policies typically exclude losses that are "indirectly" suffered by the policyholder. An example of the language in these policies follows:

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As activity in the oil and gas industry has grown in the past few years, the risks associated with the industry have grown as well. In particular, one emerging risk involves the occurrence of earthquakes in energy-producing areas that were not previously prone to seismic activity. Certain scientists argue that oil and gas activities, in particular the underground disposal of byproducts from the hydraulic fracturing or "fracking" process, could arguably be responsible for these earthquakes.

The insurance industry has already begun to feel the effects of this rise in "induced seismicity," the term for earthquake activity allegedly caused by oil and gas activities. According to a May 2015 article on the American Oil & Gas Reporter website, around 50 lawsuits related to alleged induced seismicity have been filed across the country, and that number is sure to rise in the future. In the Fall 2013 issue of Your Coverage Advisor, Brouse McDowell noted the need for policyholders to understand how their policies may or may not respond to claims for induced seismicity. Oil and gas producers have also begun reviewing their insurance coverage programs to ensure that they are covered in case of induced-seismicity lawsuits.

Oklahoma is currently at the forefront of addressing induced-seismicity lawsuits. The state has been hit hard by alleged induced seismicity: in 2014 alone, the state experienced more earthquakes of magnitude 3.0 or higher — i.e. strong enough to be felt indoors — than in the previous 30 years combined. Surveys from the Oklahoma Insurance Department indicate that the percentage of Oklahomans with earthquake insurance has correspondingly increased as well, from approximately 2% in 2011 to between 15% and 23% in 2014.

Despite the growing popularity of earthquake insurance in Oklahoma, few claims are being paid. According to a March 2015 bulletin by Oklahoma's Insurance Commissioner, of the approximately 100 earthquake claims that were filed by Oklahoma policyholders in 2014, only eight were paid. The Commissioner's office apparently believes that the insurers are denying claims based on a common exclusion of losses due to "man-made" causes, including "oil and gas exploration and production." The bulletin cautioned insurers not to rely on the "unsupported belief that these earthquakes were the result of fracking or injection well activity" as the basis for denying claims.

The ongoing story of Sandra Ladra provides an interesting case study. Ladra, a resident of Prague, Oklahoma, was injured in November 2011 during one of the strongest earthquakes in state history. Ladra sued two energy companies which operated nearby injection wells where fracking byproducts were disposed, arguing that their operation of the wells was the cause of her injuries. The trial court dismissed the action on jurisdictional grounds, reasoning that only the state agency charged with regulating the oil and gas industry had authority over cases relating to oil and gas operations. In a recent ruling that received national media attention, the Oklahoma Supreme Court reversed that decision, holding that Ladra's right to seek a remedy for violation of her rights was not trumped by the agency's authority to regulate the industry.

Ladra's case is now back in the hands of the trial court, but she still faces major hurdles. One of the most significant hurdles will be the issue of causation: who, or what, caused the earthquake that injured her? Since she is suing the oil and gas producers, Ladra must prove

that their conduct caused the earthquakes — in effect, that the earthquakes were "man-made." Ladra's complaint cites three scientific studies which she claims link the defendants' injection wells to the induced seismicity, but the defendants will certainly produce other evidence showing that there is no proof of a connection between the two.

If Ladra were seeking coverage under an earthquake policy, however, she would be faced with another set of problems: the same evidence she relied on to show that the induced seismicity was a "man-made" event caused by the defendants would be fatal to her claim because the earthquake policy would not cover man-made events. Although Ladra does not actually face the logical riddle described above, it is not difficult to imagine that a future plaintiff might. Courts will eventually have to confront the complex causation issues raised by induced-seismicity cases, and policyholders will have to learn how to best pursue the multiple available methods of recovery. Policyholders may be forced to choose a sole avenue of recovery: a suit against the entity that "caused" the earthquake, or a suit seeking coverage under an earthquake policy that posits the earthquake was caused by natural forces.

Ohio policyholders should be mindful of developments surrounding these issues in Oklahoma so that they can learn the shape the debate will likely take in Ohio. After all, no one likes to be the first person to arrive at a party — sometimes it's safer to be fashionably late and follow someone else's lead. ■

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> *[This Policy excludes] Loss that is an indirect result of any act or occurrence covered by this Policy including, but not limited to, loss resulting from *** payment of damages of any type for which the Insured is legally liable; But, this Company will pay compensatory damages arising directly from a loss covered under this Policy.*

Courts agree that the language in crime policies restricts coverage to direct losses, and that an organization suffers a direct loss when the organization has ownership rights as to the money or property that was taken. Jurisdictions differ, however, on the applicable standard for determining whether the policyholder suffered a direct loss when the policyholder does not have ownership rights, but is holding property owned by others. There is no controlling Ohio authority directly addressing what constitutes a direct or indirect loss under a crime policy, but the Sixth Circuit Court of Appeals has addressed the issue. In **First Defiance Fin. Corp. v. Progressive Cas. Ins. Co.**, the court held that a policyholder incurred a direct loss resulting from the theft of customer funds held by the employer. In that case, the policyholder reimbursed customers that were the victims of fraud perpetrated by a former employee. The insurer denied coverage and asserted that the policy covered only losses incurred by the insured in the first instance. The court rejected the insurer's argument and ruled that loss of assets for which the insured was responsible constituted a direct loss covered by the policy, regardless of whether the stolen items belonged to a third party.

Conversely, in **Lynch Properties, Inc. v. Potomac Ins. Co.**, the Fifth Circuit Court of Appeals rejected a policyholder's assertion that it suffered a direct loss where the company's losses resulted from its reimbursement of funds stolen by its employee from the personal bank accounts of the policyholder's President. The Court held that crime policies were not intended to serve as liability insurance to protect employers against tortious acts committed against third parties by their employees. The loss suffered by the policyholder arose solely from its reimbursement of funds belonging to others, and was not the result of employee theft of the policyholder's own property. Accordingly, the court found the loss too tenuous for coverage under the crime policy.

Several jurisdictions have adopted the conventional proximate-cause test in determining whether an insured suffered a direct loss under a crime policy. For example, in **Scirex Corp. v. Fed. Ins. Co.**, the Third Circuit Court of Appeals held that a policyholder suffered a "direct loss" within the meaning of an employee dishonesty policy when the insured was required to expend funds to repeat clinical drug trials for its clients due to its nurses' falsification of records and failure to follow protocol. In ruling for the policyholder, the court noted that "direct loss" is a nebulous concept and that the proximate-cause analysis should be employed in determining whether the insured suffered a direct loss.

When an insured's loss is based on the theft of property belonging to a third party or other unusual circumstances, the policy must be read very carefully. An insurer may seek to deny a claim because the loss was not "direct." Coverage for the loss will depend on the policy language and the law applicable to the interpretation of the policy. Thus, if confronted with such an issue, it is advisable to contact coverage counsel to discuss coverage for the claim. ■

Attorney Profile:

Amanda M. Leffler

Amanda M. Leffler, co-chair of Brouse McDowell's Litigation Practice Group, has substantial experience in insurance coverage matters. She frequently assists clients in negotiating payment of their insurance claims prior to litigation and, where necessary, prosecutes coverage cases against insurers who have denied claims. Amanda takes a practical, business-minded approach to coverage matters, and has expertise in numerous types of disputes, including general liability, construction, directors & officers, property, asbestos, and environmental liability. She also has diverse commercial litigation expertise including employment matters on behalf of employers, shareholder disputes, breach of contract, business torts, and zoning issues.

Amanda is one of five Brouse attorneys certified as a Specialist in Insurance Coverage Law by the Ohio State Bar Association and is AV® Preeminent Peer Review Rated through Martindale- Hubbell. She has been recognized as either a Rising Star or an Ohio Super Lawyer since 2009, through a peer- and achievement-based review. Amanda was also selected as one of the top 25 Women Cleveland Super Lawyers in 2015 and was recognized as one of the top 50 Women Ohio Super Lawyers in 2015.

Active in the Akron and legal communities, Amanda is currently a member of the Board of Trustees of United Disability Services, and serves as Vice President of Membership and Secretary of the Akron Bar Association. She has been active in the American Bar Association Insurance Coverage Litigation Committee, and currently serves as a co-chair of the Employment Sub-Committee. Amanda is also a recent graduate of Leadership Akron, Class 31. When not advocating on behalf of her clients, Amanda is an avid reader, and enjoys spending time with her husband, Dan, and her daughters, Abigail (5) and Avery (3). ■

Baseball, Ballparks, and Broker Liability

By Kerri L. Keller
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Recently, the Sixth Circuit Court of Appeals upheld a trial court's dismissal of a case against an insurance broker for allegedly failing to procure the proper liability insurance to cover an outdoor baseball event. In **Johnson v. Doodson Ins. Brokerage, et al.**, the Sixth Circuit was asked to consider whether a broker could be held liable for negligence or breach of contract arising out of the broker's procurement of an insurance policy that did not fully cover the events for which it was purportedly obtained.

In **Johnson**, the Cleveland Indians hired National Pastime Sports to produce a "Kids Fun Day" of events at the Indians games. The event featured children's attractions and included an inflatable castle and an inflatable slide. The contract between the Indians and National Pastime required National Pastime to obtain a five-million-dollar comprehensive liability policy. National Pastime used defendant Doodson Insurance Brokerage to obtain an insurance policy with New Hampshire Insurance. Although Doodson stated on the application that the events would include "inflatable attractions," the policy specifically excluded coverage for injuries caused by "inflatable slides."

In an unfortunate turn of events, the decedent Douglas Johnson attended an Indians game in June of 2010. While he was looking at a display, an inflatable slide collapsed and crushed him. He died from

his injuries just a few days later. When National Pastime informed Doodson of the accident, it was informed that accidents caused by inflatables were not covered under the policy.

Multiple lawsuits ensued between all of the parties involved – National Pastime, the Indians, New Hampshire Insurance, Johnson's estate, and Doodson. In one of the lawsuits, Johnson's estate obtained a default judgment against National Pastime for $3.5 million dollars. The remaining suits between National Pastime, the Indians, Doodson, and New Hampshire Insurance all eventually settled. Johnson's estate, however, was unable to collect upon its judgment against National Pastime and eventually sued Doodson in Michigan federal court for negligence and breach of contract resulting from Doodson's failure to obtain a policy for National Pastime that covered injury from inflatable slides.

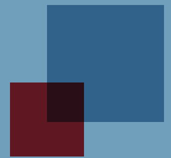
Analyzing the matter under the laws of the states of Michigan and Texas, the appellate court came to the following conclusion – Doodson could not be held liable to Johnson's estate under either negligence or breach of contract for its failure to obtain an insurance policy for National Pastime that would have covered Johnson's injuries. According to the Sixth Circuit, Doodson owed no independent legal "duty" to Johnson. The court noted that one's negligence in carrying out a contractual obligation may result in liability to a third-party, such as Johnson, but usually only where the defendant's negligence increases a risk of harm to the third-party. According to the court, "[Doodson's failure] to perform a contractual obligation to procure insurance against suits by injured parties does not implicate a risk of harm that [Doodson] had any common law duty to prevent."

The court also found that Johnson was not an "intended third-party beneficiary" of the insurance policy because "neither [he] nor a class of which he was a member was directly referred to in the contract....." Rather, as the court noted, Johnson was merely a member of the "public at large," a class that the Michigan Supreme Court had already determined was "too broad" of a class to qualify as an intended third-party beneficiary of a contract.

As the court noted, Doodson's liability in this case was really to the Indians and National Pastime – not to Johnson or his estate. While Johnson's death was a tragedy, and his estate unable to collect on its judgment against National Pastime, Doodson was not legally responsible to Johnson in either tort or contract for its failure to ensure that National Pastime obtained proper liability coverage.

> "...while brokers are clearly not insulated from liability... [third-parties] may face insurmountable hurdles when trying to hold a broker liable for failing to obtain sufficient insurance coverage for its client."

The take-away from Johnson is that while brokers are clearly not insulated from liability – either to those with whom they are liable in contract or in tort, or those with whom they are not – third parties may face insurmountable hurdles when trying to hold a broker liable for failing to obtain sufficient insurance coverage for its client. As this case establishes, Doodson did not owe a duty to Johnson where it did not take any actions that increased the risk of harm to Johnson or where he was not a named or intended beneficiary of the contract between National Pastime and the Indians. ■



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Amanda P. Parker
Charles D. Price
Paul A. Rose

Attorney Highlights

Matthew K. Grashoff was selected as Counsel to the Appellate Rules Committee of the Supreme Court Commission on the Rules of Practice and Procedure.

Matthew K. Grashoff was selected for the Akron Bar Association Leadership Academy.

Kerri L. Keller spoke at the National Business Institute Seminar — The Rules of Evidence: A Practical Toolkit — Ethical Considerations in April 2015.

Kerri L. Keller was appointed as a member of the Advisory Group of the U.S. District Court, Northern District of Ohio in July 2015.

Gabrielle T. Kelly spoke on bad faith and the tripartite relationship at the NBI seminar "Personal Injury Claims: the Insurance Defense Perspective" on Friday, August 14, 2015.

Amanda M. Leffler was elected Vice President of Membership and Secretary of the Akron Bar Association.

Save the date!

Insurance Coverage Conference

October 1, 2015 | 1:30 P.M. to 5:30 P.M.

Location:
Embassy Suites Independence
5800 Rockside Woods Blvd.
Independence, OH 44131