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"WRONGFUL ACTS" AND THE JERRY SANDUSKY SCANDAL *By Michael R. Kelley*

It has been said that "Hard cases make bad law."

On March 1, the Federal District Court for the Middle District of Pennsylvania ruled that Jerry Sandusky is NOT entitled to insurance coverage under the Second Mile's policies for defense costs and attorneys' fees for both the criminal case and the civil cases either filed or to be filed. The Court ruled last summer that the Second Mile's insurer had no duty to pay any settlement or judgment on Sandusky's behalf because such coverage was void as against public policy.

So, Jerry Sandusky is not entitled to insurance coverage. No reason for any of us to lose sleep over this decision, right? But, did the court make the right decision? If the court got it wrong, should we care?

"The Second Mile's insurance policy covers claims of wrongful acts, which includes amounts that an insured becomes obligated to pay arising from 'sexual harassment, including unwelcome sexual advances, requests for sexual favors or other conduct of a sexual nature against a Third Party, committed, attempted, or allegedly committed or attempted . . . by an Insured Person in his or her capacity as such." Under the policy, "Insured Person" is defined broadly to include any employee, volunteer, director, officer, trustee, committee member, or independent contractor of The Second Mile, "while acting in his or her capacity as such."

The Court acknowledged that Sandusky 1) was an insured under the policy, as he had been an officer, director, and volunteer of the Second Mile; 2) had been accused of wrongful acts covered by the policy; and, 3) that both the criminal and civil complaints alleged that he used his position with the Second Mile to carry out his crimes. But, the Court found that Sandusky committed his heinous acts in his personal capacity and not "while acting in his capacity" as a volunteer or executive with the Second Mile. In other words, Sandusky's molestation of children was not carried out in any way to further the interests of the Second Mile organization. They were his own sinister acts carried out solely for his own purposes. Therefore, the Court concluded, there was no coverage under the policy.

That seems a reasonable enough conclusion.

But consider this: The wrongful conduct covered by the policy is all illegal or at least unlawful conduct that would be considered outside the scope of any legitimate employment or volunteer work. If such conduct is always outside the scope of legitimate work or volunteerism, what good is this insurance coverage in the first place? Is such coverage essentially illusory, in that there are no circumstances in which coverage could ever be triggered? The Court's response to this argument was underwhelming:

> This Court need not reach the question of whether some conduct, although criminal, may be performed by an insured person in furtherance of his or her duties to an insured entity, and thus entitled to coverage under the criminal defense provision. In this case, because Defendant Sandusky's conduct was clearly personal in nature and not in furtherance of his duties for The Second Mile, he is owed no . . . defense under the policy.

Perhaps the Sandusky situation is so unique and despicable that this decision will have little effect on other cases. But consider whether insurance companies will use this decision to argue that those accused of sexual harassment in the workplace – one of the primary purposes of the type of policy at issue in Sandusky – are no longer entitled to coverage for defense fees and costs because, obviously, sexual harassment is not within the accused employee's job description. Or, when an insurer offers coverage for mechanical breakdown, for example, but then proceeds to exclude every circumstance that could lead to a mechanical breakdown, will insurance companies rely on the Sandusky decision to argue that its coverage was not illusory?

In my view, the Court could have denied coverage here for the same reason as in the first decision, namely, that the coverage was void on public policy grounds. That would have made it clear that the decision was based on the unique facts of the case and that insurers should not try to use the case to further deny coverage in other matters. Instead, the Court has given insurance companies further ammunition to deny legitimate claims of coverage in the future.

Hard cases make bad law. Sandusky – Part II is the latest example of this old adage. ■

INSURANCE SPOTLIGHT:

MANAGEMENT LIABILITY INSURANCE *By Michael R. Kelley*

If a company files for bankruptcy, allegedly as a result of mismanagement, are claims brought by the bankruptcy trustee against the former management of the company covered by insurance?

The answer is yes, if the company maintained Management Liability insurance.

On May 31, 2013, it was announced that XL Insurance had agreed to pay $19 million to the bankruptcy trustee of the now defunct law firm of Dewey & LeBoeuf. Amid a Manhattan district attorney's probe into the alleged financial improprieties of the firm's chairman, the firm's bankruptcy filing left creditors seeking more than $100 million in claims. Dewey & LeBoeuf maintained a $25 million Management Liability policy with XL. The bankruptcy trustee reportedly agreed to accept $6 million less than the policy limits because the defense of the claim was expected to cost millions of dollars, and, under the policy, defense costs reduced the total amount of available coverage. ■

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