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KD Alert: No Insurance for Sandusky Sex Abuse

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When a director, officer, or employee of an insured entity is sued, liability insurers often face the question of whether the person was sued in an "insured capacity." Naturally, liability insurance products, such as D&O and E&O policies, should extend to executives and employees of an insured only to the extent they are sued individually with respect to their position with the company.Often, however, the lines are blurred where an individual is alleged to have committed malfeasance and there is an issue as to whether the individual was acting in a purely personal capacity or acting under the color of their corporate position. The recent court decision involving the lamentable Jerry Sandusky/Penn State child sex abuse scandal demonstrates the challenges a court may face in addressing capacity issues surrounding an individual's alleged malfeasance.

In Federal Insurance Co. v. Sandusky, No. 4:11-cv-2375, 2013 U.S. Dist. LEXIS 29740 (M.D. Pa. Mar. 1, 2013), the Philadelphia federal court was asked to determine whether an insurance carrier had a duty to defend Sandusky against criminal and civil charges related to the alleged sexual abuse of minors. A blended D&O and EPL policy had been issued by Federal Insurance Company to "The Second Mile," a non-profit organization founded by Sandusky with a mission related to Pennsylvania's youth. Sandusky was an insured party under the policy due to his executive/employee status. Allegedly, Sandusky met some of his victims through The Second Mile and even sexually abused victims during activities at The Second Mile, and the Court had to determine if his wanton conduct arose in Sandusky's capacity as an employee or executive. Ultimately, the Court held the insurer had no obligation to provide any coverage, including a duty to defend.

There are several interesting aspects of this decision. First, while adamant the sexual abuse and molestation was performed in an uninsured personal capacity, the Court seemed to struggle to differentiate violent sex crimes from less egregious misconduct that could be characterized as an insured acting in a personal capacity for his or her own benefit. While the Court cited prior decisions involving similar sexual assaults to support its view, the reasoning behind the Court's decision simply explained the conduct as personal in nature and without a purpose to serve The Second Mile. Therefore, the basis for the Court's finding potentially could be applied to situations beyond the realm of sex abuse and other violent crimes. However, the Court specifically avoided the question as to whether any criminal conduct can be committed in an insured capacity even though this and many other D&O policies are intended to cover criminal defense costs. Although briefly mentioned in the opinion, the Court also did not reconcile Sandusky's uninsured sex abuse with the EPL policy's coverage for loss arising from "sexual harassment, including unwelcome sexual advances . . . or other conduct of a sexual nature against a Third Party."

Significantly, the Court emphasized Sandusky "did not engage in this wrongful conduct in furtherance of his duties for The Second Mile." Such a standard may provide useful guidance to both insurers and insureds assessing whether a director, officer, or employee is alleged to have engaged in misconduct to benefit him or herself—allegations not uncommon in D&O claims, although undoubtedly, issues may arise where the question is raised as to whether non-duty related conduct must rise to the level of child sex abuse.

At the same time, the Court mentioned a potential exception where conduct personal in nature is "inextricably intertwined" with the insured's role as an executive or employee. However, the Court left application of this exception to another day and another case.

Interestingly, the capacity issue allowed the Court to deny coverage without addressing whether public policy grounds should be expanded to treat defense costs as uninsurable as a matter of law in the event of a criminal conviction. The Court specifically declined to address this question after it ruled on the capacity issue.

It will also be interesting to see how the reasoning of the Court will interact with coverage disputes arising out of policies offered by some carriers specifically insuring sexual misconduct and molestation liability. Some of these policies are intended to provide defense costs to alleged perpetrators until the sexual misconduct is admitted or judicially determined. However, since these policies also require the misconduct to be within the alleged perpetrator's scope of employment, there may be difficulty reconciling the intent of such policies with the Court's decision to deny a duty to defend even for sexual abuse that is only alleged.

Finally, we note many readers of this decision familiar with D&O insurance may wonder why there is no mention of the fraudulent/criminal act exclusion, which is a standard provision in D&O policies often triggered in the event of a criminal conviction. Apparently, the exclusion in this D&O policy required a non-appealable judgment, and Sandusky appealed his conviction maintaining his innocence.

For more information on this matter, please contact Kevin M. Mattessich or Daniel H. Brody of KD's New York City office, or one of the attorneys in KD's Insurance Coverage & Monitoring practice group.