

Lack of Occurrence, Knowing Violation of Rights Exclusion and Criminal Acts Exclusion Preclude Coverage for Judicial Kickback Scheme

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The United States District Court for the Middle District of Pennsylvania, applying Pennsylvania law, has held that an insurer has no duty to defend or indemnify a policyholder and two of its former officers in connection with participation in a judicial kickback scheme. *General Star Indem. Co. v. Mid-Atlantic Youth Svcs., Inc.*, No. 3:10-CV-0511 (M.D. Pa. Sept. 27, 2010). The court held that participation in the scheme did not constitute an occurrence and that knowing violation of rights and criminal acts exclusions barred coverage for suits brought by juvenile victims of the scheme. Wiley Rein LLP represented the insurer in this matter.

The insurer issued three consecutive Criminal Justice System Operations policies to the policyholder, an operator of juvenile detention centers. The policies each contained three relevant coverage parts: (1) Coverage A-Bodily Injury and Property Damage, (2) Coverage B—Personal and Advertising Injury and (3) Professional Liability. Both the bodily injury/property damage and professional liability coverage parts required that the damage arise out of an "occurrence," and the policies defined "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The policies excluded coverage under Coverage B for "[p]ersonal and advertising injury" caused by or at the direction of the Insured with the knowledge that the act would violate the rights of another and would inflict "personal and advertising injury." The policies also excluded coverage under all three coverage parts for "any 'occurrence', 'claim', including any injury, 'damages', legal liability, 'claims expense', loss, cost or expense, arising out of, resulting from, caused or contributed to by . . . [a]ny criminal, malicious, dishonest or fraudulent 'act, error or omission' committed by or at the direction of any Insured."

The policyholder and two of its former officers were sued by numerous juveniles who were incarcerated by two judges in Luzerne County, Pennsylvania. The judges allegedly took millions of dollars in bribes to direct juveniles to the policyholder's detention facilities. One of the former officers pled guilty to misprision of a felony for his participation in the asserted scheme.

In analyzing coverage under Coverage A and the Professional Liability Coverage Part, the court first held that the allegations in the underlying complaints did not state an occurrence within the definition of that term in the policies. Specifically, the court noted that the underlying complaints alleged only intentional, rather than negligent, acts. In so holding, the court rejected the insureds' arguments that the inclusion of stray verbiage regarding negligence in the underlying complaints triggered coverage.

With respect to the Knowing Violation of Rights Exclusion applicable to Coverage B, the court stated that "[i]n this case, the underlying complaints allege that the false imprisonment engaged in by [the policyholder and the former officers] was done with the knowledge that their actions were violating the constitutional rights of the underlying plaintiffs." Accordingly, the court held that the exclusion applied to preclude coverage.

Finally, the court held that the Criminal Acts Exclusion applied to preclude coverage under all three coverage parts for both the criminally liable insured who pled guilty and co-insureds who had not so pled. In this regard, the court reasoned that "[c]ourts in Pennsylvania have broadly applied these exclusions to both criminally liable and non-criminal co-insureds where the 'any insured' language has been found, as it is in the exclusion here."