

United States District Court  
For the Northern District of California

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IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA

AXIS REINSURANCE COMPANY,	)	Case No. 12-2979 SC
	)	
Plaintiff,	)	ORDER GRANTING IN PART AND
	)	DENYING IN PART MOTION FOR
v.	)	<u>PARTIAL SUMMARY JUDGMENT</u>
	)	
TELEKENEX, INC.; ANTHONY ZABIT;	)	
KAREN SALAZAR; BRANDON CHANEY;	)	
DEANNA CHANEY; MARK PRUDELL; JOY	)	
PRUDELL; MARK RADFORD; NIKKI	)	
RADFORD; JOSHUA SUMMERS; JULIA	)	
SUMMERS; IXC HOLDINGS, INC.;	)	
STRAITSHOT COMMUNICATIONS, INC.;	)	
and STRAITSHOT RC, LLC,	)	
	)	
Defendants.	)	
	)	

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**I. INTRODUCTION**

Axis Reinsurance Company ("Axis") brings this action against Telekenex, Inc. ("Telekenex"), Anthony Zabit, Karen Salazar, Brandon Chaney, Deanna Chaney, IXC Holdings, Inc. ("IXCH"), (collectively, the "Telekenex Defendants"), Straitshot Communications, Inc., and Straitshot RC, LLC (collectively, "Straitshot"). Axis seeks a judicial declaration that the insurance policy it issued to Telekenex (the "Policy") does not cover any amounts awarded in an underlying action captioned

1 Straitshot Communications, Inc. v. Telekenex, Inc., et al., No.  
2 C10-268 TSZ (W.D. Wash) (the "Straitshot action"). ECF No. 15  
3 ("Am. Compl."). Axis now moves for partial summary judgment  
4 against all defendants on three of its five causes of action  
5 pursuant to Federal Rule of Civil Procedure 56.<sup>1</sup> ECF No. 37  
6 ("MSJ"). The Telekenex Defendants have opposed Axis's motion for  
7 partial summary judgment, ECF No. 40 ("MSJ Opp'n"), but Straitshot  
8 has not. Axis has also filed a reply brief in support of its  
9 motion. ECF No. 46 ("MSJ Reply"). The Court finds this matter  
10 appropriate for resolution without oral argument. For the reasons  
11 set forth below, the motion is GRANTED in part and DENIED in part.

12  
13 **II. BACKGROUND**

14 **A. The Policy**

15 Sometime in 2008, Telekenex, a telecommunications provider,  
16 applied for insurance coverage with Axis. Smith Decl. ¶ 3; Odalen  
17 Decl. Ex. 2 ("Ins. App.").<sup>2</sup> The application indicates that  
18 Telekenex operates out of San Francisco, California and that all of

19 \_\_\_\_\_  
20 <sup>1</sup> Axis has also sued Mark and Nikki Radford, Joshua and Julia  
21 Summers, and Mark and Joy Prudell. To the extent that Axis intends  
22 to move for summary judgment against these defendants, and it  
23 appears that it does, its motion is inappropriate. The Clerk has  
24 already entered default against the Summerses and the Radfords, ECF  
25 No. 26, and the Prudells were not served until well after Axis  
26 moved for summary judgment, see ECF Nos. 66, 67. If Axis wishes  
27 the Court to enter judgment against the Radfords and the Summerses,  
28 then it should move for default judgment. If it wishes for a  
judgment against the Prudells, then it should provide them with  
adequate time to respond.

<sup>2</sup> Ross Smith, Axis's attorney, and Matthew Odelen, a senior claims  
specialist at Axis who handled Telekenex's claim, filed  
declarations in support of Axis's motion for partial summary  
judgment. ECF No. 38 ("Smith Decl."); ECF No. 39 ("Odelen Decl.").  
Mr. Chaney, one of the named Defendants, filed a declaration in  
opposition to Axis's motion for partial summary judgment. ECF No.  
41 ("Chaney Decl.").

1 its 113 employees work in California. Ins. App. at 2, 10. Axis  
2 ultimately approved Telekenex's application and issued the Policy  
3 to Telekenex on May 27, 2008. Odalen Decl. Ex. 1 ("Policy").  
4 According to Mr. Odalen, who handled Axis's claims, the Policy was  
5 issued in San Francisco, California. Id. ¶ 2. The Policy includes  
6 several endorsements which amend the policy in a number of ways.  
7 One of these endorsements, entitled "California Amendatory  
8 Endorsement," concerns the cancellation and nonrenewal of the  
9 Policy. Policy at 10.

10 The Policy provides coverage for claims against directors and  
11 officers (a.k.a., "D&O liability"), employment practices liability,  
12 fiduciary liability, and outside executive liability, among other  
13 things. Policy § I. The Policy carves out a number of exclusions,  
14 including an "Unlawful Advantage Exclusion" for losses

15 based upon, arising out of, directly or indirectly  
16 resulting from, in consequence of or in any way  
17 involving: the gaining of any profit, remuneration, or  
18 advantage to which the Insured was not legally  
19 entitled . . . if evidenced by any judgment, final  
adjudication, alternate dispute resolution proceeding  
or a document or written statement by an Insured.

20 Id. § IV.A.5.

21 The Policy covers "Insured Individual[s]," who are defined as  
22 "natural persons" who are "duly elected or appointed director[s],  
23 officer[s], trustee[s] of Manager[s] of the Policyholder," as well  
24 as "individuals compensated by the Policyholder through wages,  
25 salary, and/or commission." Id. § III.C.7. The Policy also  
26 provides coverage for an insured's spouse where that spouse is sued  
27 solely by reason of his or her status as a spouse of the insured.

28 Id. § II.A.

1           **B. The Straitshot Action**

2           In 2008, one of Telekenex's Washington-based competitors,  
3 Straitshot, sued Telekenex and the other Telekenex Defendants in  
4 the Western District of Washington. Smith Decl. Ex. 3 ("Straitshot  
5 5AC") ¶ 2. Straitshot alleged that the Telekenex Defendants stole  
6 its trade secrets and confidential customer information and covered  
7 up this theft through the destruction of evidence. Id. ¶ 1. In  
8 addition to Telekenex, Straitshot sued Mr. Zabit, Telekenex's  
9 president, Mr. Chaney, Telekenex's Chief Executive Officer ("CEO"),  
10 and Messrs. Prudell, Radford, and Summers, former Straitshot  
11 employees who allegedly funneled business opportunities to  
12 Telekenex before resigning from Straitshot. Am. Compl. ¶¶ 4-8;  
13 Straitshot 5AC. Straitshot also sued the individual defendants'  
14 spouses, Mss. Chaney, Prudell, Radford, Salazar,<sup>3</sup> and Summers, on  
15 the ground that the other individual defendants' unlawful acts were  
16 taken on behalf of the marital community. Straitshot 5AC.

17           Straitshot asserted fourteen causes of action. Id. ¶¶ 325-  
18 415. Among other things, Straitshot asserted that Messrs. Prudell,  
19 Radford, and Summers breached their employment contracts with and  
20 their duty of loyalty to Straitshot by divulging Straitshot's  
21 confidential and proprietary information to Telekenex; that all  
22 defendants interfered with Straitshot's contractual relations with  
23 its customers; and that a number of the defendants violated the  
24 Lanham Act, the Consumer Protection Act, the Washington Criminal  
25 Profiteering Act, and the federal RICO statute. Id.

26           Sometime after the Straitshot action was filed, Telekenex  
27 tendered a claim to Axis under the Policy. Odalen Decl. ¶ 3.

28 <sup>3</sup> Ms. Salazar is Mr. Zabit's wife. Straitshot named her as Jane Doe Zabit.

1 Telekenex indicated that it intended to assume the legal defense of  
2 the claim using its own independent counsel. Odalen Decl. ¶ 3, Ex.  
3 4. Axis responded to the claim in letters dated September 28, 2010  
4 and October 4, 2010, where it indicated that a number of claims  
5 asserted in the Straitshot action were not covered under the Policy  
6 and that Axis reserved its rights to deny coverage for the matter.  
7 See id. Ex. 3; Chaney Decl. Ex. B. Sometime in or around the fall  
8 of 2010, Telekenex informed Axis that its chosen defense counsel  
9 had withdrawn pursuant to a court order because of a conflict of  
10 interest. Id. Ex. 4. Axis agreed to accept the duty to defend and  
11 retained the law firm of Littler Mendelson to defend the Straitshot  
12 action. Id.

13 The Straitshot action ultimately went to trial. The jury  
14 returned a \$6.49 million verdict in favor of Straitshot, finding  
15 for Straitshot on its claims for: (1) breach of contract against  
16 Messrs. Prudell and Radford; (2) breach of the duty of loyalty  
17 against Messrs. Prudell and Summers; (3) interference with  
18 contractual relations against Telekenex and Messrs. Prudell,  
19 Radford, Summers, Zabit, and Chaney; and (4) violation of the  
20 Consumer Protection Act against Telekenex and Messrs. Zabit,  
21 Chaney, Prudell, and Radford. Smith Decl. Ex. 7 ("Straitshot  
22 Verdict"). The jury found against Straitshot on its claims for  
23 misappropriation of trade secrets and false statements in violation  
24 of the Lanham Act. Id. The Court entered a judgment against all  
25 defendants. Smith Decl. Ex. 9 ("Straitshot Judgment").

26 Following the trial, the court issued Findings of Fact and  
27 Conclusions of Law that rejected the defendants' affirmative  
28 defenses of estoppel and unclean hands. Smith Decl. Ex. 8

1 ("FFCL"). As part of its findings, the Court concluded that  
2 "Straitshot expressly authorized Telekenex, Summers, and other  
3 Telekenex network engineers to 'access its systems' in order to  
4 provide assistance to Straitshot customers," but "the Telekenex  
5 Defendants' conduct went well beyond what was authorized by  
6 Straitshot, including using its access to Straitshot's systems to  
7 encourage Straitshot customers to move to Telekenex." Id. ¶ 14.  
8 The Court issued additional Findings of Fact and Conclusions of Law  
9 awarding Straitshot sanctions for Mr. Summers's spoliation of  
10 evidence and failure to produce documents during discovery. Smith  
11 Decl. Ex. 10 ("Spoliation FFCL"). In connection with these  
12 findings, the Court concluded that Mr. Summers intentionally and  
13 wrongfully used a Straitshot laptop and, in bad faith, made  
14 substantial alterations and deletions to that laptop in violation  
15 of multiple temporary restraining orders. Id. ¶ 24. The Court  
16 also found that Straitshot was entitled to sanctions from Telekenex  
17 for the spoliation under the doctrine of respondeat superior. Id.  
18 ¶ 31.

19 **C. The Instant Action**

20 On June 8, 2012, Axis filed the instant action against the  
21 Telekenex Defendants and Straitshot. ECF No. 1. In its Amended  
22 Complaint, Axis asserts eight causes of action, three of which are  
23 relevant to the instant motion. In Count I, Axis asserts that the  
24 amounts awarded in the Straitshot action are not covered under the  
25 Policy because they fall under the Policy's Unlawful Advantage  
26 Exclusion. In Count II, Axis asserts that California Insurance  
27 Code § 533 also bars recovery for the amounts awarded in the  
28 Straitshot action. In Count V, Axis asserts that IXCH is not

1 entitled to coverage under the Policy. Axis now moves for summary  
2 judgment on Counts I, II, and V.

3  
4 **III. LEGAL STANDARD**

5 Entry of summary judgment is proper "if the movant shows that  
6 there is no genuine dispute as to any material fact and the movant  
7 is entitled to judgment as a matter of law." Fed. R. Civ. P.  
8 56(a). Summary judgment should be granted if the evidence would  
9 require a directed verdict for the moving party. Anderson v.  
10 Liberty Lobby, Inc., 477 U.S. 242, 251 (1986). "A moving party  
11 without the ultimate burden of persuasion at trial -- usually, but  
12 not always, a defendant -- has both the initial burden of  
13 production and the ultimate burden of persuasion on a motion for  
14 summary judgment." Nissan Fire & Marine Ins. Co., Ltd. v. Fritz  
15 Cos., Inc., 210 F.3d 1099, 1102 (9th Cir. 2000). "In order to  
16 carry its burden of production, the moving party must either  
17 produce evidence negating an essential element of the nonmoving  
18 party's claim or defense or show that the nonmoving party does not  
19 have enough evidence of an essential element to carry its ultimate  
20 burden of persuasion at trial." Id. "In order to carry its  
21 ultimate burden of persuasion on the motion, the moving party must  
22 persuade the court that there is no genuine issue of material  
23 fact." Id.

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1 **IV. DISCUSSION**

2 **A. Unlawful Advantage Exclusion**

3 Axis moves for summary judgment on Count I on the ground that  
4 the Policy's Unlawful Advantage Exclusion bars coverage for losses  
5 arising out of the Straitshot action, specifically, the \$6.49  
6 million judgment and spoliation sanctions. Before turning to the  
7 substantive law on this issue, the Court first addresses the  
8 parties' arguments concerning what law to apply.<sup>4</sup>

9 As Axis argues, California Civil Code section 1646 governs the  
10 choice-of-law analysis for disputes over contract interpretation  
11 such as this one. See Frontier Oil Corp. v. RLI Ins. Co., 153 Cal.  
12 App. 4th 1436, 1454 (2007). However, courts need not engage in a  
13 section 1646 choice-of-law analysis where there is no material  
14 conflict between the laws of the states involved. See id. at 1453;  
15 Gitano Grp., Inc. v. Kemper Grp., 26 Cal. App. 4th 49, 57 (1994).  
16 Such is the case here. Under Washington law, "[a] court considers  
17 the [insurance] policy as a whole, and gives it a fair, reasonable,  
18 and sensible construction . . . . If the policy language is clear  
19 and unambiguous, the court must enforce it as written and may not

20 \_\_\_\_\_  
21 <sup>4</sup> The parties rely, in part, on choice-of-law arguments raised in  
22 earlier briefing. On September 5, 2012, the Telekenex Defendants  
23 moved to dismiss this action in favor of a parallel action pending  
24 in a Washington court. ECF No. 21 ("MTD"). They argued that a  
25 Washington venue was more appropriate because, among other things,  
26 Washington law applied to the coverage dispute at issue. Id. at 7.  
27 After Axis moved for partial summary judgment, the Telekenex  
28 Defendants requested that the Court defer consideration because the  
issues of venue, jurisdiction, and applicable law had not yet been  
resolved. ECF No. 45. On November 27, 2012, the Court denied both  
motions. ECF No. 63. The motion to dismiss was denied on the  
ground that the Washington action had since been dismissed in  
deference to the case pending before this Court. Id. at 3. The  
motion to defer was denied on the ground that courts "frequently  
settle[] choice-of-law issues during summary judgment proceedings,  
and the parties have briefed those issues here." Id.

1 modify it or create ambiguity where none exists." Black v. Nat'l  
2 Merit Ins. Co., 154 Wash. App. 674, 679 (2010) (internal quotation  
3 marks omitted). Likewise, California courts give the terms of an  
4 insurance policy "[their] ordinary and popular sense, unless used  
5 by the parties in a technical sense" and construe terms as  
6 ambiguous "only if [they are] susceptible to two or more reasonable  
7 constructions despite the plain meaning of [the] terms within the  
8 context of the policy as a whole." Palmer v. Truck Ins. Exch., 21  
9 Cal. 4th 1109, 1115 (1999) (emphasis in original) (internal  
10 quotation marks omitted). Additionally, both Washington and  
11 California courts construe ambiguities against the insurer, id.;  
12 Quadrant Corp. v. Am. States Ins. Co., 154 Wash. 2d 165, 172  
13 (2005), and narrowly interpret exclusionary clauses, such as the  
14 one at issue here, Villa Los Alamos Homeowners Assn. v. State Farm  
15 Gen. Ins. Co., 198 Cal. App. 4th 522, 534 (2011); Phil Schroeder,  
16 Inc. v. Royal Globe Ins. Co., 99 Wash. 2d 65, 68 (1983).  
17 Accordingly, the Court need not and, therefore, does not reach the  
18 choice-of-law question here and applies California law.

19 The Court now turns to the substantive dispute concerning the  
20 Unlawful Advantage Exclusion. The exclusion bars recovery for  
21 losses arising from claims "based upon, arising out of, directly or  
22 indirectly resulting from, in consequence of or in any way  
23 involving: the gaining of any profit, remuneration, or advantage to  
24 which the Insured was not legally entitled . . . if evidenced by  
25 any judgment [or] final adjudication . . . ." Policy § IV.A.5.  
26 Axis argues that the exclusion applies here since the Telekenex  
27 Defendants' loss stems from their unlawful procurement of  
28 Straitshot's customers and confidential information. MSJ at 16.

1 Axis responds that the exclusion only applies where there is an  
2 illegal profit evidenced by a judgment or final adjudication and  
3 that, here, neither the jury's verdict, the court's judgment, nor  
4 the court's spoliation award contains a determination that the  
5 Telekenex Defendants gained any profit or advantage. MSJ Opp'n at  
6 7.

7 Axis primarily relies on the Fifth Circuit's decision in  
8 Jarvis Christian College v. National Union Fire Insurance Co. of  
9 Pittsburgh, 197 F.3d 742 (5th Cir. 1999). MSJ at 16-17. That case  
10 dealt with a similarly worded policy exclusion, which precluded  
11 insurance coverage for "any claim arising out of the gaining in  
12 fact of any personal profit or advantage to which the Insured is  
13 not legally entitled." Jarvis, 197 F.3d at 747 (emphasis added).  
14 The district court found that the exclusion applied where a member  
15 of Jarvis's board had transferred \$2 million of Jarvis's endowment  
16 funds to a business that the board member owned. Id. On appeal,  
17 Jarvis argued that the board member did not gain "in fact" a  
18 personal profit or advantage from the transfer. The Fifth Circuit  
19 disagreed, finding that, as the owner of a third-party business,  
20 the board member expected to personally make over \$360,000 from the  
21 fund transfer. Id. at 748. Further, even if the board member did  
22 not gain a balance-sheet profit, "[he] did gain in fact a personal  
23 advantage." Id. (emphasis in original). Based on Jarvis, Axis  
24 argues that the Policy's Unlawful Advantage Exclusion should apply  
25 here, reasoning that "the acts of the Telekenex [D]efendants  
26 created the ultimate advantage in giving Telekenex an opportunity  
27 to shift . . . Straitshot's entire customer base over to Telekenex  
28 . . . . And as owners, officers and/or employees, [the individual

1 defendants] all stood to personally gain and shared in the  
2 advantage gained by Telekenex." MSJ at 17.

3 The Telekenex Defendants respond that, under another Fifth  
4 Circuit case, Tig Specialty Insurance Co. v. PinkMonkey.com, Inc.,  
5 375 F.3d 365 (5th Cir. 2004), the Unlawful Advantage Exclusion only  
6 applies where an illegal profit or advantage is evidenced by a  
7 judgment or final adjudication. MSJ Opp'n at 7-8. Tig involved a  
8 policy exclusion practically identical to the one at issue in  
9 Jarvis, requiring a profit or advantage in fact. Tig, 375 F.3d at  
10 371. The Court found that a statutory stock fraud conviction  
11 triggered the exclusion because, in order to convict, the jury was  
12 required to find that the defendant "benefited from [a] false  
13 representation or promise" and "[b]enefit is synonymous with  
14 advantage or profit." Id. at 370. In contrast, the Telekenex  
15 Defendants argue, the jury in the Straitshot action only found  
16 against Telekenex and its officers on two causes of action,  
17 interference with contractual relations and violation of  
18 Washington's Consumer Protection Act, neither of which require a  
19 finding of profit or advantage. MSJ Opp'n at 9.

20 The Telekenex Defendants also cite to this Court's opinion in  
21 PMI Mortgage Insurance Co. v. American International Specialty  
22 Lines Insurance Co., No. C. 02-1774 PJH, 2006 WL 825266 (N.D. Cal.  
23 Mar. 29, 2006), for the same proposition. The exclusion at issue  
24 in PMI, like the exclusions in Jarvis and Tig, required a showing  
25 of profit or advantage "in fact." PMI, 2006 WL 825266, at \*2. The  
26 court declined to apply the exclusion on the basis of the  
27 allegations in the underlying complaint alone. Id. at \*6.  
28 Instead, the Court held that, in order for the exclusion to apply,

1 the insurer must demonstrate, "through proof of either evidentiary  
2 facts or a final adjudication, that the underlying . . . complaint  
3 arose out of an unlawful profit or advantage to which [the insured]  
4 was not legally entitled." Id. at \*7. The Court reasoned that  
5 "requir[ing] an actual adjudication or determination of fact prior  
6 to application of the profit or advantage exclusion[] more  
7 appropriately effectuate[s] the goal of giving the phrase 'in fact'  
8 its ordinary and popular meaning." Id. at \*5.

9 The dispute between Axis and the Telekenex Defendants boils  
10 down to whether the Court may look to the allegations and evidence  
11 presented in the Straitshot action to determine whether the  
12 Policy's Unlawful Advantage Exclusion applies. Axis argues that  
13 allegations and evidence are relevant to the inquiry. The  
14 Telekenex Defendants argue that the Court may look only to the  
15 verdict, the judgment, and the elements of the claims on which the  
16 jury found for Straitshot. The Court finds that the appropriate  
17 course is somewhere in between.

18 Unlike the exclusions in Jarvis, Tig, and PMI, the Policy's  
19 Unlawful Advantage Exclusion does not refer to a profit or  
20 advantage "in fact." Instead, it refers to a profit or advantage  
21 "evidenced by [a] judgment [or] final adjudication." Accordingly,  
22 the verdict, judgment, and findings of fact in the Straitshot  
23 action are of primary importance in determining whether the  
24 Unlawful Advantage Exclusion applies. The Court could not look at  
25 Straitshot's allegations and evidence alone without doing injustice  
26 to the plain meaning of the exclusion. However, the Court declines  
27 to look at the judgment and the Washington court's findings in a  
28 vacuum. This approach would lead to absurd results, especially

1 where the allegations and the judgment, taken together, clearly  
2 indicate that an insured gained a profit or an advantage from its  
3 wrongful acts, even though a finding of profit or advantage was not  
4 a necessary element of the claims asserted. Accordingly, the Court  
5 finds that the better approach is to look at the judgment in the  
6 context of the plaintiff's allegations and evidence. This approach  
7 is consistent with the approaches set forth in Jarvis, Tig, and  
8 PMI. In all three of these cases, the courts considered the  
9 underlying facts or allegations to some extent. Jarvis, 197 F.3d  
10 at 748; Tig, 375 F.3d at 370; PMI, 2006 WL 25266, at \*6.

11 In this case, the plaintiffs in the Straitshot action alleged  
12 that the Telekenex Defendants misappropriated Straitshot's  
13 customers and confidential information and presented evidence to  
14 that effect. See Straitshot 5AC, Smith Decl. Exs. 11-20 ("Trial  
15 Transcripts"). The jury ultimately found against the Telekenex  
16 Defendants on Straitshot's claims for interference with contractual  
17 relations and violation of the Washington Consumer Protection Act.  
18 In doing so, the jury necessarily found, among other things, that:  
19 Straitshot had a valid business relationship with a third party  
20 that had the probability of future economic benefit; Telekenex  
21 intentionally induced a breach of that relationship; Telekenex used  
22 wrongful means to compete; and Telekenex engaged in an unfair or  
23 deceptive act or practice by making false statements about  
24 Straitshot and its customers in the conduct of its trade or  
25 commerce. Smith Decl. Ex. 6 ("Jury Instructions"). Further, as  
26 part of its findings of fact, the Court concluded that Telekenex  
27 improperly "us[ed] its access to Straitshot's systems to encourage  
28 Straitshot customers to move to Telekenex." FFCL ¶ 14. Taken

1 together, these findings constitute clear evidence that Telekenex  
2 misappropriated Straitshot's confidential information and customers  
3 in an effort to improve its own business. Accordingly, the \$6.49  
4 million judgment against the Telekenex Defendants amounts to "a  
5 loss . . . arising out of . . . the gaining of a[] profit . . . or  
6 advantage to which [the Telekenex Defendants] w[ere] not legally  
7 entitled." The Telekenex Defendants' contention that they did not  
8 profit or gain an advantage from the misappropriation of a  
9 competitor's customers is simply not plausible.

10 The Court reaches a different conclusion with respect to the  
11 spoliation sanctions. The court in the Straitshot action awarded  
12 these sanctions after it found that Mr. Summers had intentionally  
13 and wrongfully used a Straitshot laptop and then destroyed  
14 information on that laptop. See Spoliation FFCLL ¶¶ 24, 30-31.  
15 The Court found that Straitshot was entitled to sanctions from both  
16 Telekenex and Mr. and Ms. Summers because Mr. Summers was a  
17 Telekenex employee during the relevant period and his actions were  
18 within the scope of his employment. Id. ¶ 31. The Unlawful  
19 Advantage Exclusion does not apply here because there is no  
20 indication Telekenex or any of the other Telekenex Defendants  
21 profited or otherwise gained a business advantage from Mr.  
22 Summers's destruction of evidence. They may have profited from  
23 unlawful appropriation of the confidential information on the  
24 laptop, but that was not the basis for the sanctions. The  
25 Telekenex Defendants may have also gained a potential litigation  
26 advantage from the destruction of evidence, but the language of the  
27 exclusion, which refers to "profit, remuneration, or advantage,"  
28 does not appear to encompass such an advantage, and the Court is

1 obliged to construe the exclusion narrowly. See Villa Los Alamos,  
2 198 Cal. App. 4th at 534.

3 **B. Estoppel**

4 The Telekenex Defendants argue that summary judgment should be  
5 denied on Count I for the independent reason that Axis is estopped  
6 from denying coverage because it failed to inform the Telekenex  
7 Defendants of their right to independent counsel in the Straitshot  
8 action. This argument is predicated on California Civil Code  
9 section 2860, which provides: "if . . . a conflict of interest  
10 arises which creates a duty on the part of the insurer to provide  
11 independent counsel . . . , the insurer shall provide independent  
12 counsel . . . unless" the insured is informed of the conflict and  
13 then "expressly waives, in writing, the right to independent  
14 counsel." Cal. Civ. Code § 2860(a). Section 2860 also provides:  
15 "when an insurer reserves its rights on a given issue and the  
16 outcome of that coverage issue can be controlled by counsel first  
17 retained by the insurer for the defense of the claim, a conflict  
18 may exist." Id. § 2860(b).

19 Pursuant to section 2860, an insurer must pay the reasonable  
20 cost for hiring independent counsel by the insured where there are  
21 divergent interests of the insured and the insurer brought about by  
22 the insurer's reservation of rights. Scottsdale Ins. Co. v.  
23 Housing Group, No. C 94-3864 TEH, 1995 U.S. Dist. LEXIS 8791, at  
24 \*5-6 (N.D. Cal. June 21, 1995). "[N]ot every reservation of rights  
25 creates a conflict of interest requiring appointment of independent  
26 counsel." Blanchard v. State Farm Fire & Cas. Co., 2 Cal. App. 4th  
27 345, 350 (1991). "If the issue on which coverage turns is  
28 independent of the issues in the underlying case, [independent]

1 counsel is not required. A conflict of interest does not arise  
2 unless the outcome of the coverage issue can be controlled by  
3 counsel first retained by the insurer for the defense of the  
4 underlying claim." Id. (internal citations omitted). Thus, "where  
5 the insurer's asserted nonliability has a purely legal basis which  
6 is unaffected by the factual determinations made at the liability  
7 stage, counsel retained by the insurer faces no conflict of  
8 interest in defending the underlying action . . . ." Scottsdale  
9 Ins., 1995 U.S. Dist. LEXIS 8791, at \*19. The reason is that "none

10 of the developments in the underlying action 'matter' for purposes  
11 of the coverage defenses the insurer plans to assert later." Id.

12 The Telekenex Defendants argue that Axis's appointed counsel  
13 had the ability to control the development of various factual  
14 matters central to the instant coverage dispute. MSJ Opp'n at 13.  
15 For example, the Telekenex Defendants argue that "Axis plainly had  
16 an interest in establishing liability based on a claim involving  
17 willful acts or profit" since Straitshot's success on such claims  
18 could trigger the policy's Unlawful Advantage Exclusion and  
19 California Insurance Code section 533, which bars insurance claims  
20 for losses caused by the willful acts of the insured. Id.

21 The Telekenex Defendants contend that Axis ran afoul of  
22 section 2860 since it agreed to defend the Straitshot action  
23 subject to a reservation of rights and then appointed its own  
24 counsel to represent the Telekenex Defendants without informing  
25 them of a potential conflict or obtaining their consent. Id. at  
26 13-14. They further argue that because Axis failed to inform the  
27 Telekenex Defendants of their right to independent counsel, Axis is  
28 estopped from denying coverage. Id. at 14 (citing Clarendon Nat'l

1 Ins. Co. v. Ins. Co. of the W., 442 F. Supp. 2d 914, 941-43 (E.D.  
2 Cal. 2006)).

3       The Court finds that Axis is not estopped from denying  
4 coverage. In this context, "[e]stoppel requires proof by the  
5 insured of detrimental reliance, as well as proof of a reasonable  
6 belief that the insurer would provide coverage." Clarendon, 442 F.  
7 Supp. 2d at 942 (internal citations omitted). California courts  
8 have found detrimental reliance where there is a conflict of  
9 interest and the insurer deprives the insured of separate counsel  
10 or an opportunity to request such counsel until it was too late,  
11 e.g., on the eve of trial. See id. (citing Stonewall Ins. Co. v.  
12 City of Palos Verdes Estates, 46 Cal. App. 4th 1810, 1838-39  
13 (1996)). The Telekenex Defendants have failed to show such  
14 detrimental reliance here. The Policy expressly provided Telekenex  
15 with the right to select independent counsel, regardless of  
16 concerns about conflicts of interest. Policy § V.C, as amended by  
17 Endorsement No. 1 ("[T]he Insureds shall have the right to assume  
18 the defense of any claim."). The Telekenex Defendants initially  
19 exercised that right by selecting independent counsel to defend the  
20 Straitshot action. Odalen Decl. Ex. 4. That counsel later  
21 withdrew pursuant to a court order because of a conflict of  
22 interest and, sometime thereafter, Axis agreed to accept the duty  
23 to defend and appoint other counsel. Id. There is no indication  
24 that the Telekenex Defendants objected to the appointment of new  
25 counsel, even though, at the time the counsel was appointed,  
26 Telekenex was fully aware that Axis had reserved its rights under  
27 the Policy. See Odalen Decl. Ex. 3, Chaney Decl. Ex. B.

28       In sum, the Telekenex Defendants should have been aware of any

1 conflicts associated with Axis's appointed counsel and they had  
2 ample opportunity to appoint their own counsel. Accordingly, there  
3 is no evidence that the Telekenex Defendants detrimentally relied  
4 on Axis's counsel and, thus, no ground for finding that Axis is  
5 estopped from denying coverage. For these reasons, as well as the  
6 reasons set forth in Section IV.A supra, Axis's motion for summary  
7 judgment on Count I is GRANTED in part and DENIED in part. The  
8 Court finds that the Unlawful Advantage Exclusion applies to the  
9 \$6.49 million judgment against the Telekenex Defendants but not to  
10 the spoliation sanctions.

11 **C. California Insurance Code Section 533**

12 Axis also moves for summary judgment on Count II on the ground  
13 that California Insurance Code section 533 precludes coverage. MSJ  
14 at 18. The Telekenex Defendants respond that Washington law, not  
15 California law, applies here, and, even if California law did  
16 apply, section 533 does not bar coverage. MSJ Opp'n at 15-16.

17 The Court first addresses the threshold question of choice of  
18 law. In cases such as this, California courts employ the so-called  
19 governmental-interest approach to determine which law governs. See  
20 Frontier, Cal. App. 4th at 1442-43. Under this approach, the Court  
21 must first determine whether the applicable law of California and  
22 Washington materially differ. See id. at 1454. The parties appear  
23 to agree that there is nothing comparable to California Insurance  
24 Code section 533 in Washington law. Accordingly, the Court  
25 proceeds to the next step of the analysis to determine whether both  
26 California and Washington have an interest in applying their own  
27 law. The Court concludes that they do. The underlying Straitshot  
28 action was adjudicated in Washington under Washington law,

1 Telekenex is based out of California, and the other Telekenex  
2 Defendants reside in both California and Washington. Accordingly,  
3 the Court turns to the final and most complex step of the  
4 governmental interest analysis to determine which state's interest  
5 would be more impaired if its law were not applied. See id. at  
6 1454-55.

7 In evaluating the respective interests of the parties and the  
8 states in this context, California courts often consider the  
9 language of the insurance policy. See Stonewall Surplus Lines Ins.  
10 Co. v. Johnson Controls, Inc., 14 Cal. App. 4th 637, 645 (1993).  
11 For example, choice-of-law provisions are generally enforced. Id.  
12 Where, as here, the policy contains no such choice-of-law  
13 provision, California courts will consider the place of  
14 contracting, the place of negotiation of the contract, the place of  
15 performance, the location of the subject matter of the contract,  
16 and the residence or location of the parties. Id. at 646.  
17 "[P]articular importance is placed on the location of the subject  
18 matter of the contract, i.e. the location of the insured risk."  
19 Id. Where a policy insures against risks located in several  
20 states, e.g., where the policy contains amendatory endorsements for  
21 multiple states, courts will often apply the law of the state of  
22 the principal location of the particular risk involved. Id. at  
23 646-47. However, in the absence of multiple state-specific  
24 endorsements or other references to multiple states, courts have  
25 declined to find that the laws of multiple states govern a policy.  
26 See Costco Wholesale Corp. v. Liberty Mut. Ins. Co., 472 F. Supp.  
27 2d 1183, 1206 (S.D. Cal. 2007).

28 In this case, the facts suggest that the parties contemplated

1 California as the location of the insured risk when they executed  
2 the Policy. When it applied for the Policy, Telekenex represented  
3 that 100 percent of its 113 employees were located in California.  
4 Application at A-4. Further, the Policy itself identifies San  
5 Francisco, California as Telekenex's address. Policy at 1. The  
6 Policy includes only one state-specific amendatory endorsement, and  
7 that endorsement refers to California. Id. at 10. Contrary to the  
8 Telekenex Defendant's argument, MTD Reply at 2, there is no  
9 indication that the parties intended for the Policy to be treated  
10 as multiple, separate policies, each insuring an individual risk in  
11 a different state. "The Policy's explicit reference to  
12 [California] (and no other state) supports the application of  
13 [California] law." Costco, 472 F. Supp. 2d at 1206. The  
14 respective residences of the individual defendants also support the  
15 application of California law. Messrs. Zabit and Chaney,  
16 Telekenex's former president and CEO, respectively, are residents  
17 of California. Am. Compl. ¶¶ 4-5. While Messrs. Prudell, Radford,  
18 and Summers are residents of Washington, they were not employed by  
19 Telekenex when it executed the Policy. See id. ¶¶ 6-7.

20 Further, the Court finds that the impairment analysis  
21 otherwise favors the application of California law. The Telekenex  
22 Defendants argue that Washington has the greatest interest in this  
23 dispute because it arises out of the Straitshot action, which was  
24 litigated in Washington, based on acts and omissions by Washington  
25 residents in Washington state, and concerned harm to Straitshot,  
26 which is based out of Washington. However, "applying [California]  
27 law will not materially impair [Washington]'s interest because the  
28 parties are disputing coverage, rather than compensation." Costco,

1 472 F. Supp. 2d at 1206. Washington's primary concern is  
2 compensation for Straitshot, a Washington corporation. See id.  
3 Who cuts the check, the Telekenex Defendants or Axis, is  
4 considerably less important. See id. On the other hand,  
5 California has a considerable interest in the Policy because it was  
6 executed in this state and the facts suggest that the parties  
7 intended for California law to govern its application. See id.

8 Accordingly, the Court finds that California law governs. The  
9 next step is to determine whether California Insurance Code section  
10 533 is applicable. Section 533 provides: "An insurer is not liable  
11 for a loss caused by the wilful act of the insured; but he is not  
12 exonerated by the negligence of the insured, or of the insured's  
13 agents or others." Cal. Ins. Code § 533. "The statute reflects a  
14 fundamental public policy of denying coverage for willful wrongs  
15 and discouraging willful torts." Shell Oil Co. v. Winterthur Swiss  
16 Ins. Co., 12 Cal. App. 4th 715, 739 (1993). For the purposes of  
17 section 533, a willful act includes "an act deliberately done for  
18 the express purpose of causing damage or intentionally performed  
19 with knowledge that damage is highly probable or substantially  
20 certain to result." Id. at 742. It also includes an intentional  
21 and wrongful act "in which the harm is inherent in the act  
22 itself."<sup>5</sup> Mez Indus., Inc. v. Pac. Nat. Ins. Co., 76 Cal. App. 4th  
23 856, 875-76 (1999) (internal quotations omitted). Section 533 does

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25 <sup>5</sup> The Telekenex Defendants cite authority indicating that section  
26 533 also requires a "preconceived design to inflict injury." MSJ  
27 Opp'n at 2 (citing Clemmer v. Hartford Ins. Co., 22 Cal. 3d 865,  
28 887 (1978)). However, since that authority was decided, the  
California Supreme Court has held that a showing of specific intent  
is unnecessary "if the harm was inherent in the act itself."  
Trailer Marine Transp. Corp. v. Chicago Ins. Co., 791 F. Supp. 809,  
811 (N.D. Cal. 1992) (citing J.C. Penney Casualty Ins. Co. v. M.K.,  
52 Cal. 3d 1009 (1991)).

1 not bar indemnification for a principal where it is held  
2 vicariously liable for the willful acts of its agent. See  
3 Fireman's Fund Ins. Co. v. City of Turlock, 170 Cal. App. 3d 988,  
4 1001 (1985).

5 In this case, the Telekenex Defendants' actions come within  
6 the scope of "wilful acts," as that term has been defined in the  
7 context of section 533. The jury found each and every Telekenex  
8 Defendant liable for interference with contractual relations. As  
9 set forth by the court in the Straitshot action, the elements of  
10 interference are: (1) a valid contractual or business relationship,  
11 (2) the defendant knew of the existence of that relationship, (3)  
12 the defendant intentionally caused the termination of that  
13 relationship, (4) the defendant's conduct was for an improper  
14 purpose or by improper means, and (5) the defendant's conduct was a  
15 proximate cause of plaintiff's damages. Jury Instructions at 27.  
16 Accordingly, in finding the Telekenex Defendants liable, the jury  
17 necessarily found that they acted intentionally with an improper  
18 purpose or by improper means and that their actions caused  
19 Straitshot harm. As the Telekenex Defendants' conduct involved  
20 misappropriating Straitshot's customers, Straitshot's damages were  
21 highly probable or substantially certain.

22 The Telekenex Defendants argue that the jury expressly found  
23 that the Telekenex Defendants did not act willfully. MSJ Opp'n at  
24 19. This argument is unavailing because it relies on the portion  
25 of the verdict dealing with Straitshot's claim for misappropriation  
26 of trade secrets (rather than the contractual interference claim).  
27 The special verdict form in the Straitshot action asked the jury to  
28 decide whether the defendants were liable for misappropriation of

1 trade secrets and, if so, whether that misappropriation was "wilful  
2 and malicious." Straitshot Verdict Questions 5, 5a. The jury  
3 ultimately found that defendants were not liable for  
4 misappropriation for trade secrets, so it never reached the  
5 question of willfulness. See id. Contrary to the Telekenex  
6 Defendants' argument, this does not suggest that the jury found  
7 that the defendants' interference with Straitshot's contractual  
8 relations was not willful.

9 The Telekenex Defendants also argue that section 533 is  
10 inapplicable because the named insured, Telekenex, did not commit  
11 any willful acts -- it was found liable because of the acts of its  
12 employees. MSJ Opp'n at 18. They again point to the Straitshot  
13 Verdict, id., which establishes that the jury held each defendant  
14 liable for interference with contractual relations "solely on the  
15 basis that he or it acted in concert with one or more other  
16 defendants." Straitshot Verdict Question No. 4a. The Telekenex  
17 Defendants reason that "[s]ince all Axis's insureds are only  
18 vicariously liable according to the special verdict form," section  
19 533 does not preclude coverage. MSJ Opp'n at 19 (citing Fireman's,  
20 170 Cal. App. 3d at 1001). This argument lacks merit as it applies  
21 to coverage for damages flowing from Straitshot's claim for  
22 interference with contractual relations. Nothing in the Straitshot  
23 verdict suggests that the jury found Telekenex liable under some  
24 theory of vicarious liability. Rather, the verdict indicates that  
25 Telekenex was acting "in concert" with the other defendants to  
26 carry out the scheme to misappropriate Straitshot's customers. In  
27 finding that the defendants acted in concert, the jury necessarily  
28 found that they "consciously act[ed] together in an unlawful

1 manner." Kottler v. State, 136 Wash. 2d 437, 448 (1998).

2       However, the Telekenex Defendants' argument regarding  
3 vicarious liability does have merit with respect to the spoliation  
4 sanctions issued against Mr. Summers and Telekenex. While Mr.  
5 Summers' actions in destroying evidence may have been willful,  
6 there is no indication that he qualified as an insured under the  
7 Policy. Indeed, Axis appears to suggest that Mr. Summers was not  
8 an insured under the Policy. See MSJ Reply at 12. Telekenex is an  
9 insured under the Policy, but it was only held liable under the  
10 doctrine of respondeat superior. Spoliation FFCL ¶ 31.  
11 Accordingly, section 533 does not preclude coverage. See  
12 Fireman's, 170 Cal. App. 3d at 1001. Axis argues that, "[b]ecause  
13 the conduct underlying the spoliation of evidence adjudication is  
14 intertwined with the unlawful schemes underlying the judgment for  
15 which Telekenex was held directly liable, . . . the Willful Acts  
16 exclusion applies." MSJ Reply at 12. However, Axis has offered no  
17 evidence showing how the two schemes were intertwined. Nothing in  
18 the Spoliation Findings of Fact and Conclusions of Law suggests  
19 that Telekenex or any of its principals directed or expected Mr.  
20 Summers to destroy evidence as part of the scheme to interfere with  
21 Straitshot's contractual relations.

22       For these reasons, Axis's motion for summary judgment on Count  
23 II is GRANTED in part and DENIED in part. The Court finds that  
24 section 533 bars coverage for damages flowing from Straitshot's  
25 claim for interference with contractual relations but not for the  
26 spoliation sanctions.

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1           **D.    Coverage for IXCH**

2           Axis also moves for summary judgment on Count III, arguing  
3 that IXCH is not entitled to coverage under the Policy. IXCH and  
4 Telekenex executed an asset purchase agreement in August 2010,  
5 through which IXCH agreed to purchase Telekenex's assets and assume  
6 its liabilities. Chaney Decl. ¶ 4. It is undisputed that IXCH is  
7 not an insured under the Policy's terms; that, under the Policy's  
8 terms, Telekenex could not unilaterally assign its rights under the  
9 Policy; and that Axis never agreed to allow Telekenex to assign its  
10 rights under the Policy to IXCH. However, the Telekenex Defendants  
11 argue that, regardless of the Policy language, the right to  
12 coverage, defense, and indemnity, transferred to IXCH by operation  
13 of law when it purchased Telekenex's assets and agreed to assume  
14 its liabilities. MSJ Opp'n at at 21.

15           The Telekenex Defendants rely on the Ninth Circuit's decision  
16 in Northern Insurance Co. of New York v. Allied Mutual Insurance  
17 Co., 955 F.2d 1353 (9th Cir. 1992). In Northern, as here, the  
18 question presented was whether the right to indemnity under an  
19 insurance policy transferred to a successor that had assumed its  
20 predecessor's liabilities, even though the insurance policy  
21 contained a no-assignment clause. 955 F.2d at 1357. The Ninth  
22 Circuit concluded that the policy benefits were transferred by  
23 operation of California law, reasoning that "the rationale for  
24 honoring 'no assignment' clauses vanishes when liability arises  
25 from presale activity." Id. at 1357-58.

26           While Northern clearly favors the Telekenex Defendants on  
27 Count V, it appears that Northern is no longer good law. After the  
28 case was decided, a number of California courts, including the

1 California Supreme Court, rejected the principle that the finding  
2 of successor liability entitles a successor, by operation of law,  
3 to the insurance coverage of its predecessor. See Henkel Corp. v.  
4 Hartford Accident & Indem. Co., 29 Cal. 4th 934, 943 (2003)  
5 ("Whether or not [predecessor] assigned any benefits under the  
6 liability policies to [successor], any such assignment would be  
7 invalid because it lacked the insurer's consent."); Gen. Accident  
8 Ins. Co. v. Super. Ct., 55 Cal. App. 4th 1444, 1454 (1997)  
9 ("finding of successor liability in tort does not entitle the  
10 successor corporation, by operation of law, to the insurance  
11 coverage of its corporate predecessor").

12 As IXCH is not an insured under the Policy and there is no  
13 indication that Axis consented to an assignment of the Policy  
14 benefits to IXCH, the Court GRANTS Axis's motion for summary  
15 judgment with respect to Count III.

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**V. CONCLUSION**

For the foregoing reasons, Plaintiff Axis Reinsurance Company's motion for partial summary judgment is GRANTED in part and DENIED in part. With respect to Count I, the Court finds that the Policy's Unlawful Advantage Exclusion Code bars coverage for the \$6.49 million judgment against the Telekenex Defendants but not coverage for the spoliation sanctions. With respect to Count II, the Court finds that California Insurance Code section 533 precludes coverage for damages flowing from Straitshot's claims for interference with contractual relations but not for damages flowing from the spoliation sanctions. With respect to Count V, the Court finds that IXC Holdings, Inc. is not an insured under the Policy as a matter of law.

IT IS SO ORDERED.

Dated: December 19, 2012



UNITED STATES DISTRICT JUDGE