

Trade Secrets Exclusion Bars Coverage for Company but Not for Officers If They Could Show "Financial Hardship"

June 2007

In an unreported decision, a California appellate court has held that a D&O policy did not cover allegations that a company used confidential information to co-opt a business opportunity because of an exclusion in its D&O policy for misappropriation of trade secrets. *Parallax Design & Constr. v. Certain Underwriters at Lloyd's London*, 2007 WL 1227687 (Cal. Ct. App. Apr. 26, 2007). However, the court held that the insurer was not entitled to judgment on the pleadings against the officers since the exclusion did not apply to them and the company's payment of the settlement on their behalf did not foreclose the possibility that they suffered "financial hardship."

This case arose out of a decision by an employee of a construction company to quit working for his employer and start his own, competing construction company. The former employee won the right to have his construction company do work at a location that had previously used his old employer's services. Subsequently, the old employer sued the former employee, his company, and other officers of the company for allegedly stealing a business opportunity. The insurer denied coverage for the company based on an exclusion for misappropriation of trade secrets. That exclusion barred coverage for claims against the company for "any actual or alleged infringement, misappropriation, or violation of . . . trade secrets."

Shortly after the lawsuit was tendered, the company and its officers settled the case. Although they were jointly obligated to make the payment, the company paid the entire sum. The court held that the trade secrets exclusion unambiguously precluded coverage for the claim of misappropriation of trade secrets brought against the insured former employee and his company. The court found that all 10 causes of action against the former employee and his new company were barred from coverage because they were all predicated on the company's alleged misappropriation of trade secrets.

However, the court held that the insurer was not entitled to judgment on the pleadings as to the officers. The insured argued that they could not establish damages on a breach of contract claim since the company had funded the defense and settlement of the case. The court held that resolution of the factual issue could not be made at the pleadings stage since the company might be seeking reimbursement from them or they may

have suffered a financial loss as a result of the company funding the settlement. In addition to finding that an issue of fact precluded judgment on the pleadings, the appellate court stated that it was "bad policy to permit an insurance carrier to escape liability simply because the company rather than the officers paid the settlement." Instead, it held that the officers should be given an opportunity to show that they had suffered, or would suffer "financial hardship or harm."