

Court Holds That Personal Profit Exclusion Bars Coverage for Claims of Interference with Contract and Violation of Consumer Protection Laws

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The United States District Court for the Northern District of California has held that the personal profit exclusion in a directors and officers and employment practices liability policy barred coverage for a judgment against the insureds on counts of interference with contractual relations and violation of Washington's consumer protection act. *Axis Reins. Co. v. Telekenex, Inc.*, 2012 WL 6632180 (N.D. Cal. Dec. 19, 2012). Ruling on the insurer's motion for partial summary judgment, the court held that coverage for the judgment in the underlying action also was barred by a California statute precluding insurance coverage for loss caused by an insured's willful acts. However, the court separately held that coverage for an award of sanctions for spoliation of evidence was not precluded by the personal profit exclusion or the statute.

In 2008, a telecommunications provider filed suit against the insured (a competing telecommunication provider) and the insured's CEO and president. The suit also named as defendants several employees of the insured who previously were employed by the claimant. Alleging that the insureds stole trade secrets and confidential information, the claimant brought numerous causes of action for, among other things, interference with contractual relations, misappropriation of trade secrets, Lanham Act violations and consumer protection act violations. The insurer provided a defense of the lawsuit subject to a reservation of rights. The jury returned a verdict for the plaintiff on the interference and consumer protection act counts. Following trial, the judge in the underlying action held that a former employee of the competitor, who allegedly funneled business to the insured, had altered and destroyed evidence. The court imposed sanctions against the employee as well as the insured company under a theory of *respondeat superior*. In coverage litigation brought after the underlying suit was resolved, the insurer filed a motion for summary judgment seeking a declaration that there was no coverage for the judgment or the sanctions.

First, ruling on the motion for summary judgment, the court held that coverage for the judgment was barred by the personal profit exclusion in the policy, which precluded coverage for losses involving "the gaining of any profit, remuneration, or advantage to which the Insured was not legally entitled . . . if evidenced by any judgment" The court rejected the insureds' argument that the court could look only to the verdict,

judgment and elements of the claim in evaluating the application of the exclusion. While the court held that these were “of primary importance,” it “decline[d] to look at the judgment and the [underlying] court’s findings in a vacuum.” According to the court, “[t]his approach would lead to absurd results, especially where the allegations and the judgment, taken together, clearly indicate that an insured gained a profit or an advantage from its wrongful acts, even though a finding of profit or advantage was not a necessary element of the claims asserted.” Specifically noting that, unlike some similar provisions, the exclusion at issue did not refer to a profit or advantage “in fact,” the court “look[ed] at the judgment in the context of the plaintiff’s allegations and evidence” and held that the exclusion applied. The court held, however, that the exclusion did not apply to the spoliation sanctions imposed against the insureds because there was no evidence that the insureds profited from the destruction of the evidence.

Second, the court held that coverage for the judgment was precluded by California Insurance Code section 533, which provides that “[a]n insurer is not liable for a loss caused by the wilful act of the insured” After first holding that California law applied, the court held that the insureds’ acts of interference with contractual relations were within the scope of “wilful acts” contemplated by the statute. Examining the underlying jury instructions, the court stated that “the jury necessarily found that [the insureds] acted intentionally with an improper purpose or by improper means and that their actions caused [the competitor] harm.” Because the statute does not apply where the insured is liable only vicariously, the statute did not preclude coverage for the spoliation sanctions imposed due to the actions of an uninsured individual.

The court also held that the insurer was not estopped from denying coverage for failing to inform the insureds of their right to independent counsel. The court held that there was no evidence of detrimental reliance by the insureds because the policy expressly provided the right to select independent counsel, and they did not object to the appointment of counsel, despite their awareness of the insurer’s reservation of rights and the opportunity to do so.