STAY

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES—GENERAL

Case No. CV 17-9066-MWF (GJSx) **Date: March 6, 2018**
Title: Great American E&S Insurance Co. v. Ad.Com Interactive Media, Inc.

Present: The Honorable MICHAEL W. FITZGERALD, U.S. District Judge

Deputy Clerk:	Court Reporter:
Rita Sanchez	Not Reported
Attorneys Present for Plaintiff:	**Attorneys Present for Defendant:**
None Present	None Present

Proceedings (In Chambers): ORDER RE: DEFENDANTS' MOTION TO STAY OR, IN THE ALTERNATIVE, TO DISMISS [16]

Before the Court is the Motion to Stay or, in the Alternative, to Dismiss (the "Motion") (Docket No. 16) filed by Defendants Ad.Com Interactive Media, Inc. ("Ad.Com"), Cheap Stuff, Inc. ("Cheap Stuff"), Rate It, Inc. ("Rate It"), Local Pages, Inc. ("Local Pages"), Avi Bibi, and Danny Bibi on January 30, 2018. On February 14, 2018, Plaintiff Great American E&S Insurance Company ("Great American") filed, under seal, an Opposition. (Docket No. 30). On February 16, 2018, Defendants filed a Reply. (Docket No. 35). The Court has reviewed and considered the papers filed in connection with the Motion and held a hearing on **March 5, 2018.**

For the reasons discussed below, the Motion is **GRANTED** insofar as the case is hereby **STAYED** pending resolution of the *Yahoo* Action. The Motion is **DENIED *without prejudice*** insofar as it seeks dismissal of Great American's first, second, and sixth claims for relief pursuant to Rule 12(b)(6). Defendants may again move to dismiss after the stay is lifted.

In sum, there is sufficient overlap between the state court litigation and the present litigation to give rise to legitimate collateral estoppel concerns on Defendants' part, and the prejudice Defendants might face in the absence of a stay is far greater and less speculative than the prejudice Great American might face if this action is stayed.

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES—GENERAL

Case No. CV 17-9066-MWF (GJSx) **Date: March 6, 2018**
Title: Great American E&S Insurance Co. v. Ad.Com Interactive Media, Inc.

I. BACKGROUND

A. Cheap Stuff's and Rate It's Disputes with Yahoo

On March 23, 2009, Cheap Stuff and Yahoo!, Inc. ("Yahoo") entered an agreement pursuant to which "Cheap Stuff displayed and/or distributed keyword advertisements, also known as sponsored results, of third-party websites with relationships with Yahoo." (Complaint ¶ 10).

On December 1, 2009, Rate It and Yahoo entered an agreement pursuant to which "Yahoo agreed to deliver 'paid search results' to Rate It," "Rate It agreed to display such paid search results on its website," and Yahoo "agreed to pay Rate It 72% of gross revenue earned from paid search results shown on Rate It's 'offerings.'" (*Id.* ¶ 11).

In June 2012, Yahoo discovered "suspicious signals in click traffic provided through Cheap Stuff and Rate It's websites," and "ultimately determined that Cheap Stuff and Rate It had engaged in 'click fraud," generating traffic by 'automated or fraudulent means,' in violation of their agreements with Yahoo." (*Id.* ¶ 12).

On November 19, 2012, Yahoo terminated its agreements with Cheap Stuff and Rate It due to the alleged "click fraud." (*Id.* ¶ 18).

In June 2014, Cheap Stuff and Rate It sued Yahoo in Los Angeles Superior Court in actions captioned *Cheap Stuff, Inc. v. Yahoo!, Inc., et al.*, Case No. EC062557 (the "Cheap Stuff Action"), and *Rate It, Inc. v. Yahoo!, Inc.*, Case No. EC065931 (the "Rate It Action"). (*Id.* ¶ 19). Both Cheap Stuff and Rate It sought damages and recovery of unpaid invoices due to Yahoo's termination of the agreements. (*Id.*; Declaration of David Gauntlett in Support of Defendants' Motion to Stay or, in the Alternative, to Dismiss ("Gauntlett Decl.") (Docket No. 18), Ex. 3).

At some point in time the Cheap Stuff Action and the Rate It Action were consolidated; henceforth the Court will refer to both as the "*Yahoo* Action", as Defendants do. (Gauntlett Decl. ¶ 4).

Following consolidation, Yahoo filed a cross-complaint against all of the Defendants in this action. (Complaint ¶ 20; Gauntlett Decl. ¶ 7, Ex. 5). In its cross-complaint, Yahoo asserts breach of contract, fraudulent inducement, and breach of implied contract claims, and alleges, *inter alia*, that Defendants breached their obligations under their agreements with Yahoo "by, among other things … causing or permitting abuses of Yahoo's services …, including, but not limited to, queries or clicks generated by automated or fraudulent means." (Gauntlett Decl. Ex. 5 ¶ 27). Yahoo also alleges that Defendants "knowingly and intentionally misrepresented their identities to Yahoo … in order to induce Yahoo to enter into an agreement" with Defendants. (Gauntlett Decl. Ex. 5, ¶ 35).

Defendants deny Yahoo's allegations. (Gauntlett Decl. ¶ 7, Ex. 6).

B. Great American's Coverage Dispute with Defendants

In October 2012, Great American issued ThinkRisk Converging Risk Liability Policy No. THP1331748 (the "Policy"), covering the period October 10, 2012 to October 10, 2013, to Defendant Ad.Com. (Complaint ¶ 15, Ex. A). The Policy provides coverage for claims made against insureds during the policy period for "Professional or Technology Services Wrongful Acts committed on or after an August 2, 2012 Retroactive Date." (*Id.* ¶ 16). The Policy provides, in pertinent part:

> [T]he **Insurer** shall pay on behalf of the **Insured** all **Loss**, in excess of the Retention, arising from any **Claim** first made against such **Insured** during the **Policy Period** or Discovery Period for a **Professional or Technology Services Wrongful Act**, where such **Professional or Technology Services Wrongful Act** was committed on or after [August 2, 2012] … and before the expiration of the **Policy Period**.

(*Id.*) (bold text and alterations in original).

"Professional or Technology Services Wrongful Act" is defined as "an actual or alleged negligent act, error or omission actually or allegedly committed by or on behalf of the Insured in the performance of Professional or Technology Services," including services for third parties. (*Id.*). "Loss" is defined to include "payment of money as damages … and Costs of Defense …" (*Id.* ¶ 17). "Costs of Defense" is defined as, *inter alia*, "…reasonable and necessary fees, costs and expenses incurred by defense counsel in the investigation, defense or appeal of any **Claim**…" (*Id.*) (bold text in original; alteration omitted).

Great American alleges that, "[i]n or before September 2012," Defendants "became aware of Yahoo's claims of 'bad traffic,' and retained a consultant, Management Analytics, Inc. to evaluate Yahoo's claims." (*Id.* ¶ 13). "In an October 3, 2012 report, Management Analytics stated that Yahoo claimed to have identified 'inappropriate' or 'bad' traffic for a period of 60 days prior to an outage on July 20, 2012." (*Id.*). "According to the report, Yahoo claimed that 80% of traffic for the period of 60 days before July 19, 2012 was 'bad' traffic and asked for a charge-back of $4.5 million." (*Id.*).

On October 4, 2012, defendant Danny Bibi, the CEO of Ad.Com, executed an application for insurance with Great American. (*Id.* ¶ 14). "Despite his awareness of Yahoo's claims of 'bad traffic,' Danny Bibi deliberately answered 'No' to question 59 on the application, which stated: 'Is the Applicant, the individual signing this Application, or any of the Applicant's principals, officers or directors aware of any fact or circumstances reasonably likely to give [sic] to a claim arising out of the activities described in the Application?'" (*Id.*) (missing word noted in original). Great American issued the Policy in reliance on that representation. (*Id.* ¶ 15).

After Great American issued the Policy to Defendants, Defendants requested that Great American pay for their defense against Yahoo's cross-complaint in the *Yahoo* Action. (*Id.* ¶ 21). Great American agreed to defend Defendants "under a full and complete reservation of rights, including the right to seek reimbursement of

defense costs if it were to be determined that Great American had no duty to defend some or all of the claims in the Yahoo cross-complaints." (*Id.*). Great American permitted Defendants to utilize counsel of Defendants' choice. (*Id.*). "As new information became available, Great American amended and supplemented its reservation of rights to include other issues." (*Id.*).

On September 22, 2016, all Defendants apart from Rate It filed a lawsuit against Great American in this Court captioned *Ad.com Interactive Media, Inc., et al. v. Great American E&S Insurance Co.*, Case No. 2:16-cv-07150-MWF-GJS (the "*Ad.com v. Great American* Action"), asserting, *inter alia*, declaratory judgment and breach of contract claims relating to Great American's provision of a defense against Yahoo's cross-complaints. (*Id.* ¶ 22; Ad.com v. Great American Action Docket No. 1). On October 4, 2017, the *Ad.com v. Great American* Action was dismissed without prejudice pursuant to the parties' stipulation following entry of a settlement agreement. (Complaint ¶ 22; *Ad.com v. Great American Action* Docket No. 33).

On December 18, 2017, Great American initiated this action against Defendants, asserting seven claims for relief relating to the Policy and the funding of the Defendants' defense against Yahoo's claims in the *Yahoo* Action: (1) rescission; (2) fraud – unclean hands; (3) declaratory judgment – no duty to defend; (4) declaratory judgment – no duty to indemnify; (5) declaratory judgment – no pass through liability; (6) breach of contract; (7) reimbursement. (Complaint ¶¶ 23-62).

Through this Motion, Defendants first seek to stay this action pending the resolution of the *Yahoo* Action. Alternatively, Defendants seek dismissal of Great American's first, second, and sixth claims for relief pursuant to Rule 12(b)(6).

II. DISCUSSION

"A district court's discretion to stay proceedings 'is incidental to the power inherent in every court to control disposition of the cases on its docket with economy of time and effort for itself, for counsel, and for litigants.'" *Hanover Ins. Co. v. Mason Mcduffie Real Estate, Inc.*, No. 16-cv-01114-JST, 2016 WL 7230868, at *1 (N.D. Cal.

Dec. 14, 2016) (quoting *Landis v. N. Am. Co.*, 299 U.S. 248, 254 (1936)). "Whether to stay proceedings is entrusted to the discretion of the district court." *Id.* (citing *Landis*, 299 U.S. at 254-55).

"'To eliminate risk of inconsistent factual determinations that could prejudice the insured, a stay of the declaratory relief action pending resolution of the third party suit is appropriate when the coverage question turns on facts to be litigated in the underlying action.'" *Md. Cas. Co. v. Witherspoon*, 993 F. Supp. 2d 1178, 1186 (C.D. Cal. Jan. 22, 2014) (quoting *Montrose Chemical Corp. v. Superior Court*, 6 Cal. 4th 287, 301, 24 Cal. Rptr. 2d 467 (1993) ("*Montrose I*")); *accord Stonington Ins. Co. v. Adams*, No. 2:16-cv-02577-MCE-DB, 2017 WL 3009206, at *3 (E.D. Cal. July 14, 2017) (same). "'By contrast, when the coverage question is logically unrelated to the issues of consequence in the underlying case, the declaratory relief action may properly proceed to judgment.'" *Id.* (quoting *Montrose Chemical Corp. v. Superior Court*, 25 Cal. App. 4th 902, 908, 31 Cal. Rptr. 2d 38 (1994) ("*Montrose II*")). "'If the factual issues to be resolved in the declaratory relief action overlap with issues to be resolved in the underlying litigation, the trial court ***must*** stay the declaratory relief action.'" *Mason Mcduffie Real Estate*, 2016 WL 7230868, at *2 (quoting *Great Am. Ins. Co. v. Superior Court*, 178 Cal. App. 4th 221, 235-36, 100 Cal. Rptr. 3d 221 (2009)).

In addition to the level of overlap between the *Yahoo* Action and the present action, the Court considers the relative prejudice the parties might suffer in the event that this action is stayed or not stayed, and judicial economy. *See North River Ins. Co. v. Leffingwell Ag Sales Co., Inc.*, No. CV-F-10-2007 LJO MJS, 2011 WL 304579, at *5 (E.D. Cal. Jan. 27, 2011). The factors to be analyzed include "'(1) possible damage which may result from granting a stay, (2) the hardship or inequity which a party may suffer in being required to go forward, and (3) the orderly course of justice measured in terms of the simplifying or complicating of issues, proof, and questions of law which could be expected to result from a stay.'" *Id.* (quoting *CMAX, Inc. v. Hall*, 300 F.2d 265, 268 (9th Cir. 1962)).

***Overlap of issues*.** The parties focus primarily on the overlap of issues between the *Yahoo* Action and the present action. Defendants argue that there is "direct overlap between the facts underlying Great American's rescission claim and Yahoo's claims in the [*Yahoo* Action] as "[b]oth depend upon findings relating to Ad.com's knowledge of its obligations under its contracts with Yahoo, how those obligations related to traffic-related issues that arose during the course of performance under the contract, and when Ad.com became aware of Yahoo's claims that it later alleged in its Cross-Complaint." (Mot. at 7).

Defendants specifically point to "click fraud"-related allegations in both Great American's Complaint and Yahoo's cross-complaint. In support of its rescission claim, Great American alleges that, in June 2012, Yahoo developed suspicions that Cheap Stuff and Rate It had engaged in "click fraud" in violation of their contracts with Yahoo, that Defendants were aware of those "click fraud" and/or "bad traffic" suspicions in September 2012, and that, on October 4, 2012, Danny Bibi falsely answered "No" to the question of whether he or any other Defendants were "aware of any facts or circumstances reasonably likely to give [rise] to a claim arising out of the activities described in this Application" on Great American's insurance application form. (Complaint ¶¶ 12-14, 24-26). For its part, in connection with its breach of contract claim, Yahoo alleges that Defendants "caus[ed] or permit[ed] abuses of Yahoo's services as set forth in section 18 of the Cheap Stuff Agreement, including, but not limited to, queries or clicks generated by automated or fraudulent means." (Gauntlett Decl. Ex. 5 ¶ 27).

Great American argues, in essence, that there is not sufficient overlap between its rescission claim and Yahoo's breach of contract claim to warrant a stay because Yahoo seeks to prove that Defendants actually engaged in "click fraud" while Great American seeks to prove merely that Defendants were aware that Yahoo might bring a "click fraud"-related claim against them when Danny Bibi answered "No" to the relevant question on the Great American insurance application in October 2012. (Opp. at 4-8). According to Great American, "both the rescission claim and the 'prior knowledge' issue only turn on when the [Defendants] became aware that Yahoo had

raised an issue about the quality of the [Defendants'] search traffic." (*Id.* at 6). Conversely, in the *Yahoo* Action, Great American argues, "[t]he only thing Yahoo seeks to prove is click fraud, and its recovery does not depend on when the [Defendants] were alerted about Yahoo's concerns." (*Id.* at 8). Therefore, according to Great American, "there is no overlap here between the merits of Yahoo's case and defendants' knowledge of Yahoo's claims at the time they applied for the policy." (*Id.*).

The Court finds Defendants' position more convincing, as Great American takes too narrow a view of the "overlap" requirement. Again, a stay is appropriate when there is overlap between ***factual issues*** in the underlying action and the coverage action, and a stay is unnecessary "when the coverage question is ***logically unrelated*** to the issues of consequence in the underlying case." *Witherspoon*, 993 F. Supp. 2d at 1186 (internal quotation marks and citations omitted) (emphasis added). Great American's position begs the question of exactly how Great American will seek to establish that Defendants were aware that Yahoo might realistically bring "click fraud"-related claims against them when Danny Bibi answered "No" to the relevant question. Great American would no doubt have a stronger case to present at trial or on summary judgment if it were able to establish that Defendants had ***in fact*** engaged in "click fraud" before they applied for insurance, which is exactly what Yahoo seeks to prove in the *Yahoo* Action.

As Defendants' counsel correctly noted during the hearing, Defendants' innocence or guilt of the underlying "click fraud" bears upon Defendants' knowledge of Yahoo's potential claims at the time Danny Bibi filled out the insurance application. Specifically, Defendants could argue that their interpretation of Yahoo's questions or actions was not what Great American asserts, since anything Yahoo said or did was perceived from a background of innocence. Regardless of whether Great American intends to introduce evidence of underlying "click fraud" in this action, Defendants are entitled to argue that they are factually innocent of "click fraud" in defending themselves against Great American's coverage claims. There is thus sufficient factual

overlap between Yahoo's breach of contract claim and Great American's rescission claim to warrant a stay.

Of course it seems unfair for Great American to have to front defense costs, even with a reservation of rights, on a policy procured by fraud – if such is the case. But ultimately that was the issue raised and decided in *Montrose I* and *Montrose II*. As the Court and counsel discussed at the hearing, the case law about overlap simply does not support denial of a stay in this situation.

***Relative prejudice*.** Defendants cite three ways in which they will be prejudiced if this action proceeds forthwith: (1) Great American is giving "aid and comfort" to Yahoo by alleging factually similar "click fraud"-related claims; (2) Defendants will be forced to fight a "two-front war"; and (3) Defendants may be collaterally estopped from arguing certain issues in the *Yahoo* Action if overlapping factual issues (*e.g.*, that Defendants did engage in or promote click fraud) are first established in the present action. While the Court does not find the potential of Yahoo being "aided and comforted" by this lawsuit to be persuasive, it does find Defendants' latter two concerns to be legitimate. Being forced to engage in a "two front war 'effectively undercuts one of the primary reasons for purchasing liability insurance.'" *Adams*, 2017 WL 3009206, at *3 (quoting *Haskel, Inc. v. Superior Court*, 33 Cal. App. 4th 963, 979, 39 Cal. Rptr. 2d 520 (1995)). The potential for collateral estoppel is real and, from Defendants' perspective, problematic for obvious reasons. *See id.* (potential for collateral estoppel militated in favor of staying case).

Great American cites its continued expenditure of money on defending Defendants in the *Yahoo* Action as the prejudice it will face absent a stay. (Opp. at 9 ("Great American has expended enormous sums in the litigation of the Yahoo suits, and the burden will only become greater as trial approaches.")). Spending money to cover an insured's litigation costs is, of course, precisely what Great American is in business to do. Moreover, Great American acknowledges that it has agreed to fund Defendants' defense under a reservation of its rights. Even if this action were not stayed, Great American would presumably continue doing that unless and until this action was resolved in its favor.

Great American's espoused prejudice is thus speculative in two ways. First, it presumes that Great American will prevail in this action. Second, it presumes that Great American will prevail in this action before the *Yahoo* Action concludes. *See Mason Mcduffie Real Estate*, 2016 WL 7230868, at *3 ("It is true that Hanover might be forced to expend its own money and human resources defending McDuffie in the Underlying Action, even though this Court could ultimately determine that it has no legal obligation to do so. However, that prejudice depends on Hanover prevailing in the Instant Action, an issue the Court has not yet reached.").

On balance, Defendants face far greater prejudice in the absence of a stay than Great American faces if this action is stayed.

***Judicial economy*.** Resolution of Yahoo's "click fraud"-related claims in the *Yahoo* Action will necessarily lend some clarity to Great American's claims in this action. If it is ultimately determined that Defendants did engage in "click fraud," that would no doubt support to Great American's claim that Danny Bibi knowingly failed to disclose the possibility that Defendants might be sued for "click fraud" in the insurance application. A determination that Defendants did not engage in "click fraud," would support to Defendants in this action. Judicial economy is served, and a stay is warranted, where "the Underlying Action will make factual determinations upon which coverage may hinge." *Leffingwell*, 2011 WL 304579, at *7.

Moreover, Great American acknowledges that there are "breach of contract" and "fraudulent act" Policy exclusions upon which its "declaratory judgment – no duty to indemnify" claim depends that "cannot be determined until the underlying actions [*i.e.*, the *Yahoo* Action] are concluded," but predicts that "it will never be necessary to address those exclusions, as Great American will prevail on its other claims…" (Opp. at 8-9). While the Court appreciates that Great American is sanguine about its chances, the potential of engaging in piecemeal litigation – *i.e.*, forging ahead with Great American's rescission claim now and its declaratory relief claim after the conclusion of the *Yahoo* Action – would not be efficient for the Court or the parties.

Consideration of the Court's and the parties' time and resources militates in favor of a stay.

III. CONCLUSION

For the foregoing reasons, the Motion is **GRANTED** insofar as the case is hereby **STAYED** pending resolution of the *Yahoo* Action. The Motion is **DENIED** insofar as it seeks dismissal of Great American's first, second, and sixth claims for relief pursuant to Rule 12(b)(6), ***without prejudice*** to Defendants again moving for dismissal pursuant to Rule 12(b)(6) after the stay is lifted.

The parties shall file a joint status report every 90 days beginning on **April 30, 2018,** and shall notify the Court within 10 days of final resolution of the *Yahoo* Action.

IT IS SO ORDERED.