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May 24, 2017

VIA EMAIL AND CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Jason A. Sullivan
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> Re: **Insurer: Darwin National Assurance Company**
> **Insured: Xi3, Inc.**
> **Policy No.:   0309-3034 (the "Allied World Policy")**
> **Policy Period: November 18, 2014 to November 18, 2015**
> **Limits: $1 million**
> **Retention: $25,000**
> **Matter: *Demand from D. Ray Strong, as the Court Appointed***
> ***Receiver for Xi3, Inc.* (the "Receiver Demand")**
> **WW Ref No.   32597-291**

Dear Messrs. Sullivan and Roswell:

Our firm represents Darwin National Assurance Company, a member of the Allied World group of insurance companies ("Allied World") as coverage counsel in connection with the Receiver Demand referenced above.[1]

We are in receipt of a letter dated April 21, 2017, in which counsel for Xi3's court-appointed Receiver "provid[es] additional supporting facts" in connection with the receiver's November 17, 2015 demand letter. In its April 21, 2017 letter, the Receiver offered to "resolve this matter in exchange for payment of the full [Allied World Policy] limits."

As detailed below, based on new information that the Receiver provided in its April 21, 2017 letter, there is no coverage for the Receiver Demand under the Allied World Policy. Allied

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[1] This letter supplements and incorporates by reference the positions set forth in Allied World's May 3, 2016 letters. Allied World continues to reserve all rights.

World therefore rejects the Receiver's offer to "resolve this matter in exchange for payment of the full [Allied World Policy] limits."

In its April 21, 2017 letter, the Receiver alleges that Mr. Sullivan and Mr. Roswell failed to disclose the fact that in December 2007, a lawsuit (the "Computive Litigation") was filed against ISYS Technologies, Inc. ("ISYS"), Coded Instruction Security Corporation ("CISC") and Mr. Sullivan in which the court entered an order requiring Mr. Sullivan and ISYS to turn over certain intellectual property owned by Mr. Sullivan (the "Sullivan Patents").

As discussed below, the Pending or Prior Litigation Exclusion in the Allied World Policy bars coverage for the Receiver Demand because the Receiver Demand is a Claim "alleging, arising out of, based upon or attributable to, as of [November 18, 2013]" the Computive Litigation and/or is a Claim "alleging or derived from the same or essentially the same facts, or the same or related Wrongful Acts, as alleged in" the Computive Litigation. In addition, there is no coverage for the Receiver Demand because the Insured failed to disclose the Computive Litigation and/or any issues with the Sullivan Patents in Xi3's September 18, 2013 policy application.

I.   The Receiver's April 21, 2017 Letter

On April 21, 2017, counsel for the Receiver "provide[d] additional supporting facts to the Company's claims" and offered to "settle the existing claims for the full [Allied World Policy] limits." In its April 21, 2017 letter, the Receiver alleges that in December 2007, the Computive Litigation was filed against ISYS, CISC and Mr. Sullivan in the Third Judicial District Court, Salt Lake County, Utah. According to the Receiver, in 2010, "after orders were entered in favor of the Computive Parties, and while the Computive Litigation was still pending, [Mr. Sullivan and Mr. Roswell] formed Xi3." Through Xi3, the Receiver alleges that Mr. Sullivan and Mr. Roswell "continued the same business operations previously conducted by ISYS, CISC, and Sullivan," and that Xi3's business operations "required the use of [the Sullivan Patents]."

In the April 21, 2017 letter, counsel for the Receiver enclosed "Findings of Fact and Conclusions of Law" dated July 10, 2012, in which the court "ordered that Sullivan assign and deliver to the Computive Parties the Sullivan Patents." The Receiver alleges that after the July 10, 2012 order, "Xi3, under the direction of [Mr. Sullivan and Mr. Roswell], solicited millions of dollars in funds from investors through the use of misstatements and/or misleading statements." Specifically, in January 2013, "[Mr. Sullivan and Mr. Roswell] prepared and submitted a Note Subscription Agreement (the "NSA") to solicit a series of investors referred to as the Axiom investors." The Receiver alleges that during each round of investor solicitation, "Sullivan signed an Officer's Certificate representing that" the representations and warranties in the NSA were "true in all respects. . ." On August 13, 2013, the court entered a judgment against ISYS, CISC and Sullivan in the Computive Litigation.

The Receiver alleges that "[t]hrough the NSA and the officer certificates, [Mr. Roswell and Mr. Sullivan] made misrepresentations and/or misleading statements to potential investors

by, at a minimum, failing to disclose (1) the Computive Litigation and the entry of the [Findings of Fact and Conclusions of Law] which ordered Sullivan and ISYS to turn over the Sullivan Patents to the Computive Parties and (2) existing encumbrances against the Sullivan Patents."

II. Coverage Discussion

1. The Prior or Pending Litigation Exclusion Bars Coverage for the Receiver Demand.

Exclusion E. of the Allied World Policy (the "Pending or Prior Litigation Exclusion") excludes coverage for Loss in connection with any Claim:

> [A]lleging, arising out of, based upon or attributable to, as of [November 18, 2013], any pending or prior: (1) litigation; or (2) administrative or regulatory proceeding or investigation, of which an **Insured**[2] had notice, including any **Claim** alleging or derived from the same or essentially the same facts, or the same or related **Wrongful Acts**, as alleged in such pending or prior litigation or administrative or regulatory proceeding or investigation[;]

As discussed above, the Computive Litigation was filed against ISYS, CISC and Mr. Sullivan in December 2007, almost six years before the Prior or Pending Litigation date in the Allied World Policy. On July 10, 2012, the court in the Computive Litigation "ordered that Sullivan assign and deliver to the Computive Parties the Sullivan Patents." The Receiver now alleges that your "failure to disclose the Computive Litigation and the encumbrances to the Sullivan Patents" constituted a breach of your fiduciary duties. Accordingly, the Prior or Pending Litigation Exclusion bars coverage for the Receiver Demand because the Receiver Demand is: (1) a Claim "alleging, arising out of, based upon or attributable to, as of [November 18, 2013], any pending or prior litigation," i.e., the Computive Litigation; and/or (2) a Claim that is "alleging or derives from the same or essentially the same facts, or the same or related Wrongful Acts, as alleged in" the Computive Litigation.

2. The Insured Failed to Disclose the Computive Litigation and the Sullivan Patents in the Policy Application.

In addition to the Prior or Pending Litigation Exclusion, coverage is barred for the Receiver Demand because the Insured failed to disclose the Computive Litigation and/or issues with the Sullivan Patents in its policy application.

The Allied World Policy was written "in consideration of the payment of the premium and in reliance upon the **Application**, which shall be deemed to be attached to, incorporated into, and made a part of this Policy . . ." "Application" is defined in the Allied World Policy as "all applications, including any attachments and other materials provided therewith or incorporated

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[2] Terms in **bold** are defined in the Allied World Policy.

therein, submitted in connection with the underwriting of this Policy ***or for any other policy of which this Policy is a renewal, replacement or which it succeeds in time*** [emphasis added]. The 2013 RLA Policy Application (defined below) is therefore deemed incorporated into the Allied World Policy.

On September 18, 2013, the Insured completed a "Directors and Officers Liability – Private Company Application" with RLA Insurance (the "2013 RLA Policy Application"). The 2013 RLA Policy Application was submitted by Aaron Roswell and signed by Jason Sullivan. In Section III. of the 2013 RLA Policy Application ("Prior Knowledge Section"), Mr. Sullivan marked "No" next to the following question:

> Does any person proposed for this insurance have knowledge of any fact, circumstance or situation involving the Organization, its Subsidiaries or the Directors, Officers or Employee of the Organization or its Subsidiaries which he/she has reason to believe might result in any future claim(s) which might fall within the scope of proposed insurance?

The 2013 RLA Policy Application provides that "the Insureds understand and agree that if such fact, circumstance or situation exists, whether or not disclosed in response to question 2 in Section III Prior Knowledge above, any claim or action arising from such fact, circumstance, or situation is excluded from coverage under any policy issued by the insurer."

As discussed, on July 10, 2012, the court in the Computive Litigation "ordered that Sullivan assign and deliver to the Computive Parties the Sullivan Patents." The court in the Computive Litigation entered a judgment on August 13, 2013, approximately <u>one month before</u> Mr. Sullivan signed the 2013 RLA Application. However, Mr. Sullivan failed to disclose the Computive Litigation or any issues with the Sullivan Patents as a "fact, circumstance, or situation" that "might result in any future claim(s)." Because the Receiver Demand is a claim or action arising from the same facts, circumstances, or situations as the Computive Litigation, the Receiver Demand is excluded from coverage under the Allied World Policy.[3]

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Allied World's position with respect to this matter is based on the information provided to date, and is subject to further evaluation should additional information become available. If you possess any additional information that you believe would bear on coverage in this matter, please forward that information to us at your earliest convenience. Allied World reserves the right to amend, alter and/or supplement this letter based upon receipt of any additional information discovered or provided. Nothing in this letter is intended to, nor should be interpreted to, modify, abridge or otherwise restrict any of Allied World's rights under the Allied

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[3] On October 27, 2014, the Insured completed the "Liberty Private Advantage Policy Renewal Application for Insurance" (the "2014 Liberty Renewal Application"). Allied World reserves all rights with respect to the 2014 Liberty Renewal Application, including, but not limited to, Allied World's right to deny coverage for the Receiver Demand based on misrepresentations or omissions in the 2014 Liberty Renewal Application.

World Policy. Allied World continues to reserve all rights and defense under the Allied World Policy and at law.

Please feel free to contact the undersigned with any questions or concerns you may have regarding this letter or Allied World's coverage position.

Very truly yours,

WHITE AND WILLIAMS LLP

Maurice Pesso

Maurice Pesso

cc: Via Email

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