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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

U. K. ABBA PRODUCTS, INC.,

Plaintiff and Appellant,

v.

NORTHBROOK NATIONAL
INSURANCE COMPANY et al.,

Defendants and Respondents.

G028565

(Super. Ct. No. 818029)

OPINION

Appeal from a judgment of the Superior Court of Orange County, Eleanor M. Palk, Temporary Judge. (Pursuant to Cal. Const., art. VI, § 21.) Affirmed.

John A. Belcher for Plaintiff and Appellant.

Neumeyer & Boyd, Carol Boyd and Larry Nathenson for Defendant and Respondent Northbrook National Insurance Company.

Daniels, Fine, Israel & Schonbuch and Mark R. Israel for Defendant and Respondent Nationwide Indemnity Company.

Barbanel, Treuer & Dantzler and Alan H. Barbanel for Defendant and Respondent General Star Indemnity Company.

* * *

I. *Background*

In 1997 and 1998, a group of distributors of U. K. Abba Products brought claims against the shampoo maker on the theory that their distributorship agreements amounted to franchises under California law, and Abba was guilty of certain abuses in connection with the “sale” of those franchises. The most notable of those abuses were that it had failed to disclose it would sell its products at trade shows in competition with its own distributors, and that it would use its power to examine distributor books and records to confiscate customer lists to turn over to successor distributors.

Three sets of complaints were filed against Abba executives in Superior Court; Abba itself was the target of an arbitration action initiated with the Judicial Arbitration and Mediation Service. After the arbitration was completed in September 1998, Abba settled with the distributors for some \$2.1 million.

Abba notified the various commercial liability insurers that it had during the mid-to-late 1990’s of the claims against it relatively late in the process. Abba’s first notification to Northbrook National Insurance Company was by letter dated August 24, 1998, in the face of an arbitration slated to commence less than three weeks later, on September 9. The notification to General Star was on August 27, about two weeks prior to the start of the arbitration. Abba didn’t seek defense or indemnity from Nationwide Indemnity Company until October 1998, or from Wausau until early November 1998, which was after the arbitration had commenced and was in recess.

All insurers denied Abba’s requests for a “defense” (or, to be precise, denied the request for reimbursement of defense costs Abba had already incurred on its

own) and indemnification of the distributors' claims. This action against them was filed in June 2000.

In *U. K. Abba Products, Inc. v. Employers Insurance of Wausau* (Aug. 29, 2002, G028347) [nonpub. opn.], review granted Nov. 26, 2002), this court considered Abba's appeal after one of the insurers, Wausau, successfully sought summary judgment against it. In that opinion, we held that Abba faced no potential liability to its distributors for (1) misappropriating any advertising "ideas"; (2) misappropriating the distributors' style of doing business; or (3) wrongfully using a trademark. Accordingly, we upheld the trial court's judgment, because the distributors' claims had not raised any potential liability for "advertising injury" as defined by the policy, which included misappropriation of advertising ideas, style of doing business, and infringement of trademark.

The instant case does not come to us from a summary judgment, but, interestingly enough, from a court trial which resulted in a judgment in favor of the three other insurers in this appeal. To the degree that this appeal raises the same issues explored in the earlier opinion, the same analysis applies:

(1) The mere fact that Abba sold its products at the Long Beach Hair Show does not implicate coverage for misappropriation of advertising ideas because trade show selling is ordinarily understood to be a generic form or category of advertising, sans content of any "advertising ideas." As *Lebas Fashion Imports of USA, Inc. v. ITT Hartford Ins. Group* (1996) 50 Cal.App.4th 548, 560, footnote 7 points out, the word "idea" relates to a concept. There is nothing conceptual about merely going to a trade show and doing some selling. Indeed, the notion of going to a trade show and selling is not a concept capable of theft. That is particularly true here, in the context of the distributors' claims. It wasn't as if the distributors ever claimed that Abba stole the "idea" of going to a trade show from them. By their own account Abba had that idea first. Their beef against Abba was that it had no *right* to show up at the trade show at all.

(2) Likewise, the allegation that Abba had physically stolen the tangible customer lists worked up by the distributors does not implicate misappropriation of an advertising idea, because the claim was one for physical taking, not misappropriation of intellectual property. Again, the context shows the absence of any theft of ideas in the distributors' claims. What upset the distributors was that Abba had physically taken the lists so that they could be turned over to new distributors. But customer lists are ordinarily thought of as trade secrets, not ideas. Litigation typically arises when salespeople from one firm go to another firm and take a customer list with them. To say that the theft of the physical list is the misappropriation of advertising ideas is tantamount to saying that the theft of a book is plagiarism.

(3) Abba's selling its own products at a trade show (in competition with its distributors) did not implicate any claims for trademark infringement. Trademark infringement is about protecting consumers from becoming confused as to who made a particular product. But the distributors' claims against Abba had nothing to do with product confusion. Their claims had to do with Abba's legal right to sell its *own* product, not with any product protected by somebody else's (including their own) trademark.

II. *The Two New Theories*

The present appeal, however, presents two new twists in Abba's quest for coverage from its insurers. As mentioned above, the Wausau case was disposed of by way of summary judgment, but this appeal involves a judgment after a court trial. In the trial Abba came up with two new theories as to why there should be coverage:

(1) Abba faced claims for misappropriation of "proprietary marketing materials," not just the theft of a physical list of customers; and

(2) Abba faced claims for defamation and disparagement, not just selling at a trade show.

These theories are based on the testimony of the distributors' attorney at the *coverage* trial, held about two years after Abba had settled with its distributors.

A. "Proprietary Marketing Information"

The marketing materials theory is based on inferences from the testimony *in the coverage action* of John Adsit, the distributors' attorney. He testified that when Abba exercised its right under its distributorship contracts to examine the books and records of its distributors, it "gathered all the account information, gathered all the histories, gathered all the education, and gathered all this otherwise secret proprietary information that my clients knew . . . so that they could effectively hand over the territory to the successor distributors in such a way that it would not slow down or interrupt business for them or sales." Thus, he told the court "we were claiming proprietary information had been taken."

Preliminarily, we should note that the proprietary information theory relies on an inference, not well delineated in the briefs, that we might as well identify now. We have just quoted the strongest evidence, cited in Abba's brief, for it. One must infer from Adsit's coverage trial testimony that when Abba allegedly "gathered all the education," Adsit was referring to things like sales brochures (probably pictures of beautiful people with beautiful hair, that sort of thing) and perhaps statements as to how to train hair stylists in the use of the products.

Even with that inference (and given the fact the case comes to us from a court trial, Abba is not entitled to the inference), there are two reasons the new "proprietary information" twist still does not implicate any claim for misappropriation of advertising ideas. The first is that there was no nexus between the alleged theft of the educational materials and Abba's *own* advertising activities. (See *Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1277 ["we hold that 'advertising injury' must have a causal connection with the insured's 'advertising activities' before there can be coverage"].) By Adsit's own testimony, the theft of the "education[al] materials" from the distributors was to *turn over* those materials to successive distributors. Thus there really isn't any difference between the customer lists we have already discussed and the

“educational” or “proprietary” materials which are the slant of this particular appeal. The claims of the distributors were still based on the simple physical transfer of the physical embodiment of information.

Merely turning over stolen materials to successor distributors is not an advertising activity. Abba was not the target of claims by rivals for misappropriating *ideas*. Its sin was in misappropriating *materials*.

Furthermore, even if we assume that the theft of the “proprietary information” was an “advertising activity,” the fact is that there never was any claim for such a theft made against Abba by the distributors prior to the conclusion of the underlying cases.

The question of where the facts come from that can be used to establish an insurer’s duty to defend was considered by our Supreme Court in *Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal.4th 287, 295-304, though there, ironically enough, it arose in the context of whether *insurers* could use extrinsic facts outside of the complaint to *eliminate* the possibility of coverage. The beginning point, of course, is the facts in the underlying complaint. That has been the law since *Gray v. Zurich Insurance Co.* (1966) 65 Cal.2d 263, 276.

The universe of facts bearing on coverage, however, is not confined to those in the complaint. “Facts extrinsic to the complaint also give rise to a duty to defend when they reveal a possibility that the claim may be covered by the policy.” (*Montrose, supra*, 6 Cal.4th at p. 295.)

However, as shown in *Montrose*, those facts must at least be *known* to the insurer (see *Montrose, supra*, 6 Cal.4th at p. 296). We are aware of no case that has ever held that the duty to defend may be triggered by facts extrinsic to the underlying complaint but never brought to the attention of the insurer until *after* the underlying case was settled.

Abba responds to the problem of a lack of insurer knowledge by alluding to a duty to investigate: Somehow the insurers should have discovered that Abba might have been sued for theft of “proprietary information” though no such allegation was in the underlying complaints or brought to their attention by Abba itself.

The duty to investigate, however, necessarily turns on the type of claim which is to be investigated. For example, the two cases which Abba relies on for its duty of “thorough” investigation argument are first-party cases. *Egan v. Mutual of Omaha* (1979) 24 Cal.3d 809 was a disability insurance case where an independent adjuster decided that the insured was suffering from a “nonconfining” illness and on that basis tried to terminate further payments. (*Id.* at pp. 815-817.) The company did not adequately investigate whether *its* theory of nonconfining illness fit the actual facts. In *Egan*, there were facts extrinsic to a complaint because there was no complaint -- only the policyholder’s own claim.

Mariscal v. Old Republic Life Ins. Co. (1996) 42 Cal.App.4th 1617 fits the same pattern. It arose out of a first-party policy (for accidental death). After an auto accident, the insured, who had a history of heart disease, was taken to a hospital where he died. The treating doctor wrote on the proof of loss form that the cause of death was the auto accident, but the insurer denied the accidental death claim on the theory that the insured had died of a heart attack, without ever interviewing the treating doctor, anybody else involved in the accident, or even have its own doctor review certain records it did obtain. (See *id.* at pp. 1621-1622.)

There is a difference between first-party claims, where coverage may turn on a specific fact which can only be uncovered by a reasonably thorough job of gumshoeing (and usually that fact has to be uncovered by the insurer to sustain a position that would *otherwise* be contrary to the facts as given the insurer by the policyholder), and a

third-party claim, where facts which can create coverage must come from the underlying pleadings plus whatever facts the *insured* may bring to the insurer's attention.¹

The reason is this: The most likely source of extrinsic facts beyond the complaint against the insured is the third-party claimant, who is *suing* the insured. Unlike first-party claims, third-party claims entail possible liability on the part of the policyholder, and any contact between the insurer and the third-party claimant poses the serious risk of increasing the insured's own liability. It thus follows that the duty of a *liability* insurer to "investigate" a third-party claim cannot extend to the point of contacting the third-party claimant. (Cf. *Gunderson v. Fire Ins. Exchange* (1995) 37 Cal.App.4th 1106, 1114-1117 [extrinsic facts that surfaced in discovery in underlying proceeding but which were not ever incorporated as the bases for any claims could not be used to establish possibility of coverage on a duty to investigate theory].)

The salient fact in the case before us is that neither the underlying complaints nor Abba itself brought to the insurers' attentions any allegations concerning the theft of "proprietary information." Bringing out those facts in the coverage action was too late.

B. "Defamation and Disparagement"

What we have just said about extrinsic facts in the context of any claims for the theft of proprietary information goes all the more so for the defamation and disparagement theory. Any extrinsic facts which might have supported a defamation claim were plainly not in the complaint, or brought to any insurer's attention before the claim was unilaterally settled by Abba. There were, for example, no facts in the complaint to the effect that the distributors had alleged that Abba had made false

¹ Facts that the insurer learns outside of the complaint typically are discovered with an eye to denying coverage. (See *Montrose, supra*, 6 Cal.4th at pp. 295-300 (synopsis of Court of Appeal opinions relying on extrinsic facts to deny duty to defend).)

statements *about them* in some context such that the distributors might have later amended their complaint to allege a defamation cause of action.

That the distributors in their complaints alleged injury to their reputations was, in context, not a defamation claim, or a fact that might give rise to amended complaint containing a defamation claim. The damage that the distributors alleged was not the result of any allegedly false *statements* resulting in injury to a reputation, but was the result of the *fact* of termination of distributorships themselves. If Abba's theory of defamation were the law, any business act which resulted in someone losing a customer or reputation would be defamation.

To illustrate: Let us take an act which is the paradigm of something that isn't covered -- the delivery of nonconforming widgets to a customer, who uses the widgets to make its own product. Because the ordered widgets don't fit, the customer is delayed in meeting certain shipments, and suffers "injury to reputation." Does that mean there is potential liability for defamation? Of course not, and it would be sophistry to say so.

Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co. (1993) 14

Cal.App.4th 1595, 1604 is almost directly on point. There, a cleaning firm was sued for sexual harassment after its owner tried to rape a newly hired female employee. One of the firm's theories for coverage was that in falsely denying a sexual harassment claim, there was potential liability for defamation, which was covered under the policy. (*Ibid.*) The appellate court rejected that "sophistry," noting that "no such claim" had ever been made, nor did the facts alleged in the complaint "support the existence of such a claim." (*Ibid.*)

III. *Disposition*

The judgment in favor of the three insurers is affirmed. Respondents shall recover their costs on appeal.

SILLS, P.J.

WE CONCUR:

ARONSON, J.

FYBEL, J.