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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION ONE

STATE FARM FIRE & CASUALTY
COMPANY,

Plaintiff and Respondent,

v.

JOHN WIER et al.,

Defendants and Appellants.

A127243

(Sonoma County

Super. Ct. No. SCV 234700)

JOHN WIER et al.,

Cross-Complainants and
Respondents,

v.

STATE FARM FIRE & CASUALTY
COMPANY et al.,

Cross-Defendants and Appellants.

A125563, A127551

(Sonoma County

Super. Ct. No. SCV 234700)

I. INTRODUCTION

This case, part of a litigation saga now spanning 13 years, involves an insurance coverage dispute between State Farm Fire & Casualty Company (State Farm) and two of its insureds, John Wier (Wier) and Richard Pyorre (Pyorre). Both Wier and Pyorre were also former State Farm agents (the agents). State Farm sued the agents, alleging they took trade secret customer information in anticipation of their termination and used it to solicit customers to switch insurance companies. The agents, who had procured a number of State Farm policies for themselves, tendered their defense, and State Farm provided one under a reservation of rights pursuant to the “advertising injury” provision

of their commercial general liability (CGL) policies. Following the California Supreme Court’s grant of review in *Hameid v. National Fire Insurance of Hartford*¹—on the issue of whether an insured’s use of a competitor’s customer list to solicit the customers gave rise to a duty to defend under the “advertising injury” provision of a CGL policy—State Farm sent the agents a supplemental reservation of rights letter. State Farm therein reserved the right to also seek recovery of defense costs if the Supreme Court reversed the appellate court decision, held there was no duty to defend, and thus changed the existing law.

The Supreme Court eventually did so hold. At that point, State Farm stopped providing a defense and brought the instant lawsuit against the agents for recoupment of defense costs, but only those expended after the date of the supplemental reservation of rights letter. The agents cross-complained for breach of contract and bad faith. Following a bifurcated trial, judgment was entered declaring State Farm had had no duty to defend the agents, but barring it from recouping any defense costs. All parties appealed.

We agree State Farm never had a duty to defend the agents in the trade secrets case. We also conclude, as a matter of law, the agents did not prove any of their equitable defenses to State Farm’s recoupment claim. We therefore reverse the judgment against State Farm and remand the case for determination of the amount of recoupment to which it is entitled.

II. PROCEDURAL AND FACTUAL BACKGROUND

The genesis of this recoupment action is State Farm’s trade secrets lawsuit against Wier and Pyorre in federal court in October 1999. State Farm sued the two when, following their termination as State Farm agents, they used State Farm policyholder lists to solicit these policyholders to purchase insurance from their new employer. State Farm sought injunctive relief, disgorgement of profits, and compensatory and punitive damages.

¹ *Hameid v. National Fire Insurance of Hartford* (2003) 31 Cal.4th 16 (*Hameid*).

During their tenure with State Farm, the agents had purchased a variety of State Farm insurance policies, including business liability, homeowner's, residential dwelling and umbrella insurance policies containing professional liability endorsements, and they tendered their defense of the federal court action to State Farm. State Farm agreed to provide a defense under a reservation of rights under the "advertising injury" clause of their business liability policies. The federal case was then dismissed for lack of diversity jurisdiction.

In February 2000, State Farm filed suit against the agents in Mendocino County Superior Court, alleging three causes of action: misappropriation of trade secrets, conversion and breach of contract. State Farm again sought injunctive relief and disgorgement of profits, but only compensatory damages for breach of contract. The agents again tendered their defense, and State Farm again agreed to provide a defense under a reservation of rights based on the "advertising injury" clause of their business liability policies. State Farm specifically reserved the right to "deny coverage at any time or to further defend the proceedings." The agents then filed cross-complaints alleging breach of their agent agreements, bad faith, intentional interference with contract, unfair competition, and unjust enrichment or alternatively a violation of public policy.

Three months later, in May 2000, State Farm sent Wier a letter stating there was no coverage for the claims in the Mendocino action under his personal liability umbrella policy, noting the umbrella policy contained an exclusion for "any loss caused by your business pursuits or arising out of business property." State Farm reiterated, however, it had "determined . . . we owe a duty to defend subject to a Reservation of Rights under your Business Policy"

In October 2000, State Farm sent a letter to Pyorre stating there was no coverage for the claims in the Mendocino action under his homeowners and personal liability umbrella policies. It also stated, however, it would continue to provide a defense, subject to a reservation of rights, under his business liability policy. It noted its prior reservation of rights, and specified it did "not intend to waive any of our rights based upon this letter."

Approximately a year and a half later, on April 10, 2002, the California Supreme Court granted review in *Hameid* on the issue of whether taking a competitor's customer list and soliciting customers from it gives rise to a duty to defend under a CGL policy's "advertising injury" provisions. (*Hameid, supra*, 31 Cal.4th at p. 19.) This precipitated a discussion between State Farm and its attorneys as to whether it should issue additional letters reserving the right to recoup defense costs given that the court might hold, contrary to the Court of Appeal, that there was no duty to defend, let alone to provide indemnity. State Farm concluded it should issue such letters and did so on June 19, 2002. State Farm advised the agents it continued to reserve the right to indemnify and, referencing *Hameid*, now also reserved the right to recoup defense costs incurred after the date of the letter. It further stated, "Should we seek such reimbursement, it would be after this action has been concluded or our participation in the action has been terminated." Trial in the trade secrets case was scheduled to start in five days. The agents did not respond to the letters, nor did they seek a continuance of the trial date.

While the jury found the information and documents taken by the agents were trade secrets, it further found State Farm was not the owner of those trade secrets. The jury also found the agents had breached their contractual obligation not to solicit former State Farm clients, but their breach was excused because State Farm had breached the covenant of good faith and fair dealing. Lastly, the jury found for the agents on their cross-claims for intentional interference with contract, awarding them \$600,000 in economic damages, \$3 million each in emotional distress damages, and \$6 million in punitive damages. (*State Farm Mutual Automobile Insurance Co. v. Wier* (Dec. 27, 2004, A101791) [nonpub. opn.].) The court granted State Farm's motion for new trial, but denied its motion for judgment notwithstanding the verdict even though it concluded the jury's verdict against State Farm was "in all respects unsupported by the evidence." (*State Farm Mutual Automobile Insurance Co. v. Wier, supra*, [nonpub. opn.] at p. 3)

On appeal, this court affirmed the order granting State Farm a new trial, reversed the order denying JNOV and ordered that judgment be entered in favor of State Farm on its ownership of the trade secret materials and the agents' defense of breach of the

covenant of good faith and fair dealing. (*State Farm Mutual Automobile Insurance Co. v. Wier, supra*, [nonpub. opn.] at p. 18.) We also affirmed an order granting a nonsuit on the agents' claims for breach of contract and breach of the covenant of good faith and fair dealing, and remanded the case. (*Ibid.*) The parties represent the trial court subsequently granted the agents' motion to dismiss and entered a judgment of dismissal on May 21, 2010.

In the meantime, in July 2003, while the judgment in the trade secret case was on appeal, the California Supreme Court issued its decision in *Hameid*. (*Hameid, supra*, 31 Cal.4th 16.) The court reversed the court of appeal and held using a competitor's customer list to solicit those customers did not give rise to a duty to defend under a CGL policy's "advertising injury" provisions. Rather, the term "advertising injury" in insurance contracts requires "widespread promotion to the public," rather than individual solicitation. (*Hameid, supra*, 31 Cal.4th at p. 19.)

In light of the *Hameid* decision, State Farm withdrew its defense of the trade secrets case and notified the agents it intended to seek reimbursement of defense costs paid after the date of the supplemental reservation of rights letter. State Farm demanded Pyorre reimburse it \$387,403.30, and Wier reimburse it \$361,644.26.

In April 2004, State Farm filed the instant action in Sonoma County Superior Court against the agents, seeking recoupment of defense costs it had paid after its supplemental reservation of rights letter. The agents cross-complained for breach of contract, unfair business practices, bad faith and declaratory relief, and also interposed various equitable defenses to State Farm's claims for recoupment.

One year later, in May 2005, State Farm filed a motion in its capacity as the plaintiff for summary adjudication of the duty to defend under the agents' rental dwelling, homeowner's, business liability and umbrella policies. In June, it filed a "companion motion" in its capacity as cross-defendant for summary adjudication of the first, third and fourth causes of action alleged in the agents' cross-complaints. The trial court partially granted State Farm's motion as cross-defendant, ruling it had no duty to defend under Wier or Pyorre's homeowner's policies, or under Pyorre's residential

dwelling policies. The court denied the remainder of the motion as to whether State Farm had a duty to defend Wier under his residential dwelling policies, Pyorre and Wier under their umbrella policies, and Pyorre and Wier under their business owners' policies. State Farm, as cross-defendant, filed a second motion for summary adjudication on the issue of its duty to defend, which the trial court again denied.

The recoupment case proceeded to trial in two phases. Phase one was a court trial on whether State Farm had a duty to defend the agents in the trade secrets case. The court ruled State Farm had no duty to defend. Phase two was a jury trial on the agents' equitable defenses to recoupment, and on their cross-claims. The jury denied any recoupment and found for Wier on his cause of action for bad faith and for Pyorre on his cause of action for declaratory relief. All parties appealed.

III. DISCUSSION

The Agents' Appeal

The Duty to Defend

The Agents maintain the trial court erred in holding State Farm had no duty to defend them in the Mendocino trade secrets action. They claim there was a potential for coverage under the advertising injury, property damage and personal injury provisions of their State Farm business liability policies (also known as comprehensive general liability, or CGL, policies), as well as under the professional liability endorsement to their umbrella policies.

To provide context for analysis of the agents' claims, we summarize the principles pertaining to an insurer's duty of defense. "An insurer must defend its insured against claims that create a potential for indemnity under the policy. [Citations.] The duty to defend is broader than the duty to indemnify, and it may apply even in an action where no damages are ultimately awarded. [Citation.] Determination of the duty to defend depends, in the first instance, on a comparison between the allegations of the complaint and the terms of the policy. [Citation.] But the duty also exists where extrinsic facts known to the insurer suggest that the claim may be covered. [Citation.] Moreover, that the precise causes of action pled by the third party complaint may fall outside policy

coverage does not excuse the duty to defend where, under the facts alleged, reasonably inferable, or otherwise known, the complaint could fairly be amended to state a covered liability. [Citations.] [¶] The defense duty arises upon tender of a potentially covered claim and lasts until the underlying lawsuit is concluded, or until it has been shown that there is no potential for coverage.” (*Scottsdale Ins. Co. v. MV Transportation* (2005) 36 Cal.4th 643, 654-655, italics omitted (*Scottsdale*).

“On the other hand, ‘in an action wherein none of the claims is even potentially covered because it does not even possibly embrace any triggering harm of the specified sort within the policy period caused by an included occurrence, the insurer does not have a duty to defend. [Citation.] “This freedom is implied in the policy’s language. It rests on the fact that the insurer has not been paid premiums by the insured for [such] a defense. . . . [T]he duty to defend is contractual. ‘The insurer has not contracted to pay defense costs’ for claims that are not even potentially covered.” [Citation.]’ [Citations.]” (*Scottsdale, supra*, 36 Cal.4th at p. 654.)

There may be “no potential for coverage” and thus no duty to defend on either a factual or a legal basis. An unresolved factual dispute, which, if resolved in a particular way will result in coverage, gives rise to a duty to defend even if ultimately the resolution of the factual dispute results in no duty to indemnify. “If any facts stated or fairly inferable in the complaint, or otherwise known or discovered by the insurer, suggest a claim potentially covered by the policy, the insurer’s duty to defend arises and is not extinguished until the insurer negates all facts suggesting potential coverage.” (*Scottsdale, supra*, 36 Cal.4th at p. 655.) The insurer “may owe a duty to defend its insured in an action in which no damages ultimately are awarded.” (*Horace Mann Ins. Co. v. Barbara B.* (1993) 4 Cal.4th 1076, 1081.) “If there is a dispute as to the existence of . . . facts, a potential for coverage exists until the factual dispute is resolved so as to establish either actual coverage or the absence of coverage. [Citations.] Thus, any factual dispute affecting the existence of coverage creates a potential for coverage and a duty to defend.” (*State Farm General Ins. Co. v. Mintarsih* (2009) 175 Cal.App.4th 274, 284, fn. 6 (*Mintarsih*).

In contrast, “[t]here is no ‘potential for coverage’ and no duty to defend . . . if the existence of coverage depends solely on the resolution of a legal question (e.g., the interpretation or application of policy terms). [Citations.] In those circumstances, coverage either exists or does not exist. [Citation.] A duty to defend arises if coverage exists under the law, and no duty to defend arises if coverage does not exist. [Citation.] If the legal question is decided in favor of coverage, a duty to defend existed as of the time that the insurer first became aware of facts alleged in the complaint, or extrinsic facts, establishing a basis for coverage. *The resolution of a legal question against coverage, on the other hand, establishes in hindsight that no duty to defend ever existed and that there was never any potential for coverage.*”² (*Mintarsih, supra*, 175 Cal.App.4th at p. 284, fn. 6, italics added.)

Effect of Summary Judgment Denials

The agents initially claim the trial court erred in “failing to adhere to prior rulings” denying State Farm’s summary adjudication motions regarding coverage. They maintain these denials established a “factual” potential for coverage under their policies and consequently, a duty to defend. (See *American Cyanamid Co. v. American Home Assurance Co.* (1994) 30 Cal.App.4th 969, 975 [“if the parties dispute whether the insured’s alleged misconduct is potentially within the policy coverage, and if the evidence submitted does not permit the court to eliminate either party’s view, then factual issues exist precluding summary judgment in the insurer’s favor. Indeed, ‘the duty to defend is then established, absent additional evidence bearing on the issue.’ ”], quoting *Horace Mann Ins. Co. v. Barbara B., supra*, 4 Cal.4th at p. 1085, italics omitted.)

In this case, however, the question of coverage was made uncertain by an issue of law—generally the legal meaning of “advertising injury” in the policies—not an issue of fact. The resolution of a legal question against coverage “establishes in hindsight that no duty to defend ever existed and that there was never any potential for coverage.” (*Mintarsih, supra*, 175 Cal.App.4th at p. 284, fn. 6.) Thus, the denial of State Farm’s

² Interpretation of insurance policy provisions presents issues of law we review de novo. (*Waller v. Truck Insurance Exchange, Inc.* (1995) 11 Cal.4th 1, 18.)

motions for summary adjudication did not establish there was a duty to defend the agents as a matter of law.

Advertising Injury Coverage

The agents acknowledge the holding in *Hameid*, but assert their “mass mailings” to State Farm customers were advertising, not direct solicitation, and thus there was a potential for coverage under their policies. They also maintain the allegations in the Mendocino case embraced “misappropriation of advertising ideas or style of doing business” and copyright infringement, and characterized as such, potentially triggered coverage for advertising injury.

The advertising injury provision of the agents’ CGL policies applies to acts “committed in the course of advertising your goods, products or services.” “Advertising injury” is defined in the policies as “injury arising out of one or more of the following offenses: [¶] (a) oral or written publication of material that slanders or libels a person or organization or disparages a person’s or organization’s goods, products or services; [¶] (b) oral or written publication of material that violates a person’s right of privacy; [¶] (c) misappropriation of advertising ideas or style of doing business; or [¶] (d) infringement of copyright, title or slogan.”

In considering coverage under such “advertising injury” insurance policy provisions, the California Supreme Court has distinguished between claims based on advertising, which may be covered, and claims arising from direct solicitation of customers, which are not. In *Hameid*, the court addressed whether taking “a competitor’s customer list and solicit[ing] customers from it” gives rise to a duty to defend under the advertising injury provision of a CGL policy. (*Hameid, supra*, 31 Cal.4th at p. 19.) *Hameid* was a beauty salon owner who had purchased a CGL policy that included coverage for “advertising injury” arising out of the “ ‘misappropriation of advertising ideas or style of doing business.’ ” (*Ibid.*) Shortly after the salon opened, two hairdressers from a nearby competitor rented work stations from him, bringing most of their customers from the competing salon. (*Ibid.*) *Hameid*’s only advertising was “a flyer in a ValPak that was sent in a mass mailing to local residents.” (*Id.* at p. 20.) The

competing salon sued Hameid, not for claims relating to the flyer, but for “stealing its customer list and soliciting its customers,” as well as misappropriating its trade secrets, allegedly consisting of its “confidential price list and pricing policies.” (*Ibid.*) Hameid tendered the defense of the action to his insurance company, which refused to defend him. (*Ibid.*)

The Supreme Court, reversing the Court of Appeal, held “the term ‘advertising injury’ as used in the CGL policy requires widespread promotion to the public such that one-on-one solicitation of a few customers does not give rise to the insurer’s duty to defend the underlying lawsuit.” (*Hameid, supra*, 31 Cal.4th at p. 19.) It concluded “personal solicitations” were excluded “from the definition of ‘advertising’ in the CGL insurance policy” (*Id.* at p. 29.) Thus, the court held Hameid failed to show the competing salon “alleged any cause of action amounting to a potentially covered offense.” (*Id.* at p. 30.)

The agents assert *Hameid* is “not on point.” They claim the “parties being sued in *Hameid* did no advertising,” while they “undertook extensive broadcast and print advertising in various media, including thousands of direct mail advertisements” They also claim “[t]he solicitations made by the insured in *Hameid* were personal telephone calls,” while those alleged here were via a mass mailing of “form letters” and “advertising packets.” The agents conclude “[t]here is nothing in the *Hameid* decision that holds or implies that a mass mailing is not ‘advertising.’ ”

We note first the agents have misstated the facts in *Hameid*. *Hameid* *did* conduct advertising, via “ValPak flyers” sent to local residents. (*Hameid, supra*, 31 Cal.4th at p. 20.) The solicitations in *Hameid* also were not limited to telephone calls, but included “mailers to [the competitor’s] customers advising them of their new location and of Hameid’s lower prices.” (*Id.* at p. 29.)

The agents have also misframed the pertinent legal issue. It is not the “mass mailing” that removed their actions from the advertising injury coverage, but the individualized solicitation of State Farm customers. While there may be circumstances in which a general mass mailing would constitute advertising under the terms of an

insurance policy, nothing in *Hameid* suggests direct, individualized solicitations of customers are transformed into advertising because of their numerosity. The trial court found the agents “copied many pages of computerized records containing confidential policyholder data[, and] . . . used this information to target solicitations made to thousands of State Farm customers.” “The solicitation[s] came near the customers’ renewal dates and contained accurate information about their insurance coverage and premiums.” Though the agents effected a mass mailing to thousands of State Farm policyholders, it was composed of individual solicitations personalized based on the confidential information the agents took from State Farm, including State Farm customer names, automobile information, renewal dates, coverage and premiums. And, the mailings were not to the public at large, but to State Farm policyholders whose information had been taken by the agents.

The agents maintain solicitation and advertising are not mutually exclusive. However, cases since *Hameid* have reinforced the solicitation/advertising dichotomy. In *We Do Graphics, Inc. v. Mercury Casualty Co.* (2004) 124 Cal.App.4th 131, We Do Graphics (WDG) was sued by a competitor after the competitor’s former employee took customer files and used them to solicit business on behalf of WDG. (*Id.* at p. 135.) WDG argued it “ ‘routinely advertised its services and products . . . and called upon [the competitor’s former employee] to offer his input and comments on marketing and advertising strategies.’ ” (*Id.* at p. 138.) The court held “the facts alleged . . . relate to a defecting employee who allegedly stole trade secrets and attempted to solicit his former employer’s customers. . . . The . . . complaint alleges no facts relating to any ‘advertising injury’ as defined by the policy” (*Ibid.*)

In *Rombe Corp. v. Allied Insurance Co.* (2005) 128 Cal.App.4th 482, Rombe Corporation, while still a franchisee of TRC Staffing Services, invited customers of its franchise to a breakfast meeting at a hotel. Rombe announced it was terminating its franchise with TRC and starting its own employment agency, and “asked those in attendance to become customers . . . of the new agency.” (*Id.* at pp. 485-486.) The breakfast meeting and Rombe’s plans for a new agency were later reported in an Internet

newsletter. (*Id.* at p. 486.) Rombe’s insurance policy defined “advertisements” as “notices ‘published or broadcast’ either to the general public or specific market segments.” (*Id.* at p. 492.) The court rejected Rombe’s contention that the customers at the breakfast meeting were a “ ‘specific market segment’ ” such that their solicitation was advertising under the policy—such “an expansion would provide coverage for almost all commercial disputes between competitors.” (*Ibid.*)

In *S.B.C.C., Inc. v. St. Paul Fire & Marine Insurance Co.* (2010) 186 Cal.App.4th 383, the plaintiff contended “the policy definition of ‘advertising’ [was] expansive enough to include personal solicitations of a competitor’s customers.” (*Id.* at p. 393.) Despite the fact the policy definition of advertising was “broader” than that in *Hameid*, the court held the solicitations were not “advertising.” (*S.B.C.C., Inc., supra*, at p. 393.) It also rejected the plaintiff’s claim that its use of a competitor’s customer lists and contact information was “ ‘unauthorized use . . . [of] an[y] ‘advertising idea.’ ” (*Ibid.*)

Nonetheless, the agents claim *Hameid* did not establish that “solicitation is never advertising.” To the contrary, under *Hameid* “advertising” and “solicitation” have become mutually exclusive terms. (*Rombe, supra*, 128 Cal.App.4th at p. 485.) In fact, *Hameid* rejected a case-by-case analysis of whether certain activities constitute “advertising,” and established, instead, that solicitation of a competitor’s customers does not constitute “advertising” under CGL policies. (*Hameid, supra*, 31 Cal.4th at pp. 23-24.) *Hameid* specifically rejected the notion that advertising includes soliciting “ ‘all or a significant number of a competitor’s client base,’ ” (*id.* at p. 23, disagreeing with *New Hampshire Ins. Co. v. Foxfire* (N.D. Cal. 1993) 820 F.Supp. 489, 494) or “courting a competitor’s customers with a personal solicitation that caused many of them to defect.” (*Hameid*, at p. 25, disagreeing with *Monumental Life Ins. Co. v. United States Fidelity & Guaranty Co.* (1993) 94 Md.App. 505.) *Hameid* explained “ ‘If the act of contacting potential customers is advertising for the purposes of the policy, then any dispute related to economic competition among business is covered by the policy provision for advertising injury.’ ” (*Hameid*, at p. 24, quoting *Select Design v. Union Mutual Fire Ins. Co.* (1996) 165 Vt. 69, 77.)

The agents additionally claim the advertising injury provisions were implicated because they misappropriated State Farm’s advertising ideas and style of doing business. The “advertising ideas” allegedly misappropriated included sending out renewal notices, sponsoring youth sports teams, newspaper and radio ads, advertisements on billboards and shopping carts, and “ ‘pretty much any kind of media you could think of’ ” As the trial court found, there is nothing unique about this type of business promotion. “The insurer has no proprietary rights to this small town marketing scheme. This is a smart, but common approach to reaching potential customers.” We agree utilizing “pretty much any kind of media” is hardly a proprietary advertising idea that could be misappropriated.

Moreover, any “ ‘advertising injury’ must have a causal connection with ‘advertising activities.’ ” (*Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1276.) The agents’ policies specified advertising injury applies only to acts “committed in the course of advertising your goods, products or services.” The agents, however, were sued for misappropriating proprietary information—customer lists and coverage information—not for causing injury in the course of their advertising.

The Professional Liability Provisions

The agents maintain the trial court also erred in finding no duty to defend under the professional liability coverage provided by their personal liability umbrella policies.

Both Wier and Pyorre’s State Farm umbrella policies contained a professional liability endorsement which provided in part: “If you are legally obligated to pay damages for a loss, we will pay your net loss in excess of the limit of your underlying Professional Liability coverage listed in the Declarations arising out of a claim against you for: [¶] 1. [Y]our malpractice, error or mistake or that of a person for whose acts or omissions you are legally responsible in rendering or failing to render professional services, while this endorsement is in effect, in the practice of your profession listed on the Declarations. . . .” The policies also provided “The coverage under this endorsement does not apply to any loss for which coverage is not afforded by your underlying Professional Liability coverage” The underlying American Home professional liability policy provided coverage for “Any negligent act, error or omission in rendering

or failing to render professional services *for others* in the Insured's capacity as an Insurance Agent for the Insurance Company . . . named in the Declarations . . . and caused by the Insured" (Italics added.)

Business disputes between members of a firm or between employers and employees are generally not covered under professional liability insurance. In *Transamerica Ins. Co. v. Sayble* (1987) 193 Cal.App.3d 1562 (*Transamerica*), the court considered whether the insurers were required, "under their professional liability policies issued to [an attorney], to defend law suits based on business conflicts between members of a law firm, without any allegation of professional malpractice." (*Id.* at p. 1564.) The policy provided coverage for " 'any act, error or omission in professional services rendered or that should have been rendered . . . ' . . . for 'others.' " (*Id.* at pp. 1566-1567.) The court held there was no coverage, adopting the analysis in *Blumberg v. Guarantee Ins. Co.* (1987) 192 Cal.App.3d 1286 (*Blumberg*). *Blumberg* involved a dispute between two former law partners. Following the dissolution of their partnership, Blumberg's former partner sued him for breach of the partnership agreement, misrepresentation and fraud, and breach of fiduciary duty. (*Id.* at p. 1290.) Blumberg tendered his defense to his insurer under his lawyer's professional liability policy, which, as in *Transamerica*, covered professional services rendered "for others." (*Blumberg*, at p. 1290.) The court concluded there was no coverage because Blumberg's alleged actions were not "in his 'capacity as a lawyer,' " nor was he "rendering professional services 'for others.' " (*Id.* at pp. 1292-1293.) Similarly, in *Inglewood Radiology Medical Group, Inc. v. Hospital Shared Services, Inc.* (1989) 217 Cal.App.3d 1366 (*Inglewood*), the court held professional liability insurance did not provide coverage for a physician's termination of an employee, even though the decision to terminate required medical expertise. (*Id.* at p. 1370.)

The agents maintain *Transamerica* and *Blumberg* are distinguishable because the policies at issue in those cases "were limited to professional services 'for others' in their capacities as lawyers," and their State Farm umbrella policies do not include the "for others" limitation. The umbrella policies, however, exclude coverage for "any loss for

which coverage is not afforded by your underlying Professional Liability coverage.” The underlying policy includes the “for others” requirement. Thus, the policies at issue in this case also limit coverage to professional services “for others.”

Moreover, the causes of action against the agents in the Mendocino trade secrets action were not based on “rendering or failing to render professional services” as insurance agents. Just as in *Inglewood*, in committing the acts alleged in the complaint, the agents were acting in their capacity as professionals (here, insurance agents), but were not rendering professional services. The causes of action were for misappropriation of trade secrets, conversion and breach of contract; more akin to the business disputes which *Transamerica* and *Blumberg* held were not covered under professional liability policy provisions.

Personal Injury Coverage

The agents next contend the trial court erred in finding no duty to defend under the “personal injury” provisions of their CGL policies. They assert the claims State Farm pursued in the Mendocino case embraced potential claims for disparagement and “privacy offenses,” both of which they maintain are covered under the policies.

The CGL policies defined personal injury as “injury, other than bodily injury, arising out of one or more of the following offenses: [¶] . . . [¶] d. oral or written publication of material that slanders or libels a person or organization or disparages a person’s or organization’s goods, products or services; or [¶] e. oral or written publication of material that violates a person’s right of privacy.” “Trade libel is defined as an intentional disparagement of the quality of property, which results in pecuniary damage to plaintiff. . . . “Injurious falsehood, or disparagement, then, may consist of the publication of matter derogatory to the plaintiff’s title to his property, or its quality, or to his business in general [T]he plaintiff must prove in all cases that the publication has played a material and substantial part inducing others not to deal with him, and that as a result he has suffered special damages. . . . Usually, . . . the damages claimed have consisted of loss of prospective contracts with the plaintiff’s customers.” ’ [Citation.] . . . [I]t is not absolutely necessary that the disparaging publication be intentionally

designed to injure. If the statement was understood in its disparaging sense and if the understanding is a reasonable construction of the language used or the acts done by the publisher, it is not material that the publisher did not intend the disparaging statement to be so understood.” (*Nichols v. Great American Ins. Companies* (1985) 169 Cal.App.3d 766, 773 (*Nichols*.)

The agents assert coverage for “disparagement” was implicated because the evidence adduced during the Mendocino case showed that, after receiving the agents’ solicitations, “some [State Farm] policyholders were confused or irate, believing that their State Farm policies had been cancelled.” At oral argument, the agents expounded the solicitation letters could constitute disparagement by implication, relying on *Travelers Property Casualty Company of America v. Charlotte Russe Holding, Inc.* (2012) 207 Cal.App.4th 969. In that case, Versatile, a clothing manufacturer, sued Charlotte Russe, a retail store with which Versatile had contracted to become the exclusive sales agent for one of its brands. Versatile alleged Charlotte Russe’s practice of offering Versatile apparel at “close-out” prices, and advertising that fact via in-store signs, disparaged their product because the discount prices suggested their product was of inferior quality. (*Id.* at p. 973.) The court held “we cannot rule out the possibility that Versatile’s pleadings could be understood to charge that the dramatic discounts at which the [brand’s] products were being sold communicated to potential customers the implication—false, according to Versatile—that the products were not (or that Charlotte Russe . . . did not believe them to be) premium, high-end goods.” (*Id.* at p. 980.) Thus, the court found the allegations “were sufficient to raise reasonable inferences” that Charlotte Russe “disparaged the . . . products and brand.” (*Ibid.*) Here, in contrast, the agents’ solicitation letters suggest nothing about the quality of State Farm’s insurance products.

The agents also rely on two federal cases applying California law, neither of which is factually apposite. In *Career Systems Development Corp. v. American Home Assurance Co.* (N.D. Cal. 2011) 2011 WL 4344578), the plaintiffs alleged Career Systems had “ ‘made false and damaging statements . . . ’ such as accusing [one] of sexual

misconduct” and telling another’s coworker she was having a nervous breakdown. (*Id.* at p. *1.) Given that the alleged defamation was direct rather than by “reasonable inference,” the court found the allegations triggered the duty to defend. In *Burgett, Inc. v. American Zurich Ins. Co.* (E.D. Cal. 2011) 830 F.Supp.2d 953, Persis International sued Burgett, alleging it “made false statements to another company, Samick, about its ownership of the ‘SOHMER’ trademark, a trademark Persis allege[d] it owned.” (*Id.* at p. 957.) Burgett represented to Samick it had valid rights to the SOHMER trademark, and entered into a purported licensing agreement allowing Samick to sell pianos with the SOHMER trademark. (*Ibid.*) Persis alleged that Burgett implied “ ‘to the marketplace that Burgett had the superior right to use the SOHMER trademark,’ ” and thus, by implication, represented that Persis did not have the rights to the SOHMER trademark. (*Id.* at p. 963.) The court held there was a duty to defend because the allegations were sufficient to potentially establish a claim for disparagement by implication. (*Id.* at p. 962.)

The solicitation letters at issue here included letters from Mercury to State Farm customers stating “Thank you for choosing Mercury Insurance Group for your insurance needs,” and enclosing a Mercury “Notice of Premium Due” with the customers’ personal information, such as type and license number of vehicles. The letters did not, however, suggest anything negative about State Farm. Unlike the assertions of exclusive right to use a trademark in *Burgett*, the solicitation letters did not suggest Mercury had any greater right than State Farm to sell insurance products. At most, the solicitation letters lead some customers to mistakenly conclude their State Farm policies were no longer in effect. As in *Nichols*, the “complaint cannot be tortured to state a cause of action for trade libel. The necessary element of a defamatory publication or utterance is missing from the complaint and cannot be supplied by reference to reports in which the

defamatory innuendo appears only inferentially.” (*Nichols, supra*, 169 Cal.App.3d at p. 775.)³

Property Damage Coverage

The agents further contend the trial court erred in finding no duty to defend under the property damage provisions of their CGL policies. They assert State Farm’s cause of action for conversion in the Mendocino case triggered coverage under the “loss of use of tangible documents” policy provisions.

“Property damage” is defined in the agents’ CGL policies as: “physical injury to or destruction of tangible property, including all resulting loss of use of that property . . . [¶] . . . [and] loss of use of tangible property that is not physically injured or destroyed, provided such loss of use is caused by physical injury to or destruction of other tangible property. All such loss of use will be considered to occur at the time of the occurrence that caused it.” The policies define “occurrence” as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions which result in bodily injury or property damage.” The policies further provide: “We insure for accidental direct physical loss to property covered under this policy,” subject to certain limitations and exclusions.

The agents’ claims founder on the “accident” requirement. “It is fundamental that allegations of intentional wrongdoing do not allege an ‘accident.’ [Citations.]” “‘[I]ntentional or fraudulent acts are deemed purposeful rather than accidental and, therefore, are not covered under a CGL policy.’ ” (*Collin v. American Empire Ins. Co.*

³ Wier contends there also was a potential for coverage under the “personal injury” provisions of his rental dwelling policy. This policy provided: “[p]ersonal injury” means injury arising out of one or more of the following offenses: [¶] . . . [¶] b. libel, slander or defamation of character; or [¶] c. invasion of privacy, wrongful eviction or wrongful entry.” To be covered, the “personal injury” must be caused by an “occurrence,” which is defined as “an accident, including exposure to conditions, which results in [¶] . . . [¶] c. personal injury.” Because the actions of Wier and Pyorre that State Farm complained about in the Mendocino case were intentional rather than accidental, there was no potential for coverage under the personal injury provisions of Wier’s rental dwelling policy.

(1994) 21 Cal.App.4th 787, 806, 810.) Here, any loss of use was allegedly caused by the agents' intentional acts, not by an accident. Further, we are hard pressed to view the agents' use of State Farm's trade secret policy holder information, the conduct of which State Farm complained, as "physical injury to [or destruction of] tangible property." While the agents claim when "a party is alleged to have retained physical documents and prevented another party from accessing them, this falls within the scope of property damage coverage," their only legal support for this assertion is an unpublished case from Ohio, which we decline to consider.⁴ The property damage provisions in the policies simply did not create a potential for coverage giving rise to a duty to defend.⁵

State-Farm's Cross-Appeal

Having determined that the trial court correctly ruled there was no duty to defend the agents in the Mendocino trade secrets case, we turn to State Farm's appeal from the judgment in this case denying its claims for recoupment of defense costs under *Buss v. Superior Ct.* (1997) 16 Cal.4th 35 (*Buss*). As we have set forth, the agents interposed a number of equitable defenses to State Farm's recoupment claims, including waiver, estoppel, forfeiture and unclean hands. The jury was instructed on each, and returned a general verdict against State Farm on its recoupment claims. State Farm maintains it acted properly in reserving its right to recoup defense costs (i.e., its "*Buss*" rights) shortly after the Supreme Court granted review in *Hameid* and, thus, the agents' equitable defenses fail as a matter of law. We conclude the agents did not, and cannot, establish

⁴ The agents note Wier testified he stored the State Farm documents in an unheated area that was "mildewy and damp." However, Wier did not testify the documents were thereby damaged, nor do the agents claim on appeal that this resulted in "property damage" under the policies.

⁵ The agents' assertion that there was an issue of fact regarding whether State Farm was seeking "damages" in the Mendocino action—one of the requirements for coverage under the CGL policies, whether for advertising injury, personal injury or property damage—does not affect the fundamental coverage analyses. Whether or not some form of monetary compensation was sought, does not alter the fact that the challenged conduct engaged in by the agents—taking and using State Farm's trade secret customer information to solicit those customers to purchase insurance from the agents' new company—was not covered under the provisions of those policies.

each of the requisite elements of these defenses and that State Farm is not precluded from recovering defense costs expended after the date of its June 19, 2002, reservation of rights letter.

“Buss” Rights

In *Buss*, the California Supreme Court held “ ‘California law clearly allows insurers to be reimbursed for attorneys fees’ ” and other expenses “ ‘paid in defending insureds against claims for which there was no obligation to defend.’ ” (*Buss, supra*, 16 Cal.4th at p. 50, citing *Omaha Indem. Ins. Co. v. Cardon Oil Co.* (N.D.Cal. 1988) 687 F.Supp. 502, 504.) “As to claims that are not even potentially covered . . . the insured may indeed seek reimbursement for defense costs.” (*Buss*, at p. 50.)

If the law regarding coverage of a claim changes in the insurer’s favor, the insurer *never* had a duty to defend, and it is entitled to seek recoupment of any defense costs it paid, as long as it has reserved its right to do so. “[W]here [the] only potential for liability turns on resolution of [a] legal question, there is no duty to defend.” (*Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 25-26.) “In those circumstances, coverage either exists or does not exist. [Citation.] A duty to defend arises if coverage exists under the law, and no duty to defend arises if coverage does not exist.” (*Mintarsih, supra*, 175 Cal.App.4th at p. 284, fn. 6.) “[W]here the third party suit never presented any potential for policy coverage, the duty to defend does not arise in the first instance, and the insurer may properly deny a defense. Moreover, the law governing the insurer’s duty to defend need not be settled at the time the insurer makes its decision. . . . [S]ubsequent case law can establish, in hindsight, that no duty to defend ever existed.” (*Scottsdale, supra*, 36 Cal.4th at p. 657.)

“These principles are equally true where, as here, the insurer does not deny a defense at the outset, but instead elects to provide one under a reservation of its right to reimburse. *By law applied in hindsight, courts can determine that no potential for coverage, and thus no duty to defend, ever existed.* If that conclusion is reached, the insurer, having reserved its right, may recover from its insured the costs it expended to provide a defense which, under the contract of insurance, it was never obliged to

furnish.” (*Scottsdale, supra*, 36 Cal.4th at p. 658, italics added.) “ ‘The insurer has not contracted to pay defense costs’ for claims that are not even potentially covered.” (*Buss, supra*, 16 Cal.4th at p. 48, quoting *Insurance Co. of North America v. Forty-Eight Insulations* (6th Cir. 1980) 633 F.2d 1212, 1224-1225, declined to follow on other grounds by *Montrose Chemical Corp. v. Admiral Ins. Co.* (1995) 10 Cal.4th 645, 674, 693.) Thus, an “insured could not reasonably expect to retain the benefit of an insurer’s payment of defense costs that can be allocated solely to claims that were not even potentially covered.” (*Mintarsih, supra*, 175 Cal.App.4th at p. 286.)

In contrast, “[w]hen the duty [to defend], having arisen, is extinguished by a showing that no claim can *in fact* be covered, ‘it is extinguished only prospectively and not retroactively.’ ” (*Scottsdale, supra*, 36 Cal.4th at p. 655, quoting *Buss, supra*, 16 Cal.4th at p. 46, italics added.) In such case, the insurer cannot recoup its defense costs because providing a defense for claims “ ‘which, if proved, would be within . . . coverage’ ” is what the insured bargained for. (*Buss, supra*, at p. 48, italics omitted.) “ ‘[A]n insurer may owe a duty to defend its insured in an action in which no damages ultimately are awarded.’ ” (*Haskel, Inc. v. Superior Court* (1995) 33 Cal.App.4th 963, 974.) “An insurer may obtain reimbursement only for defense costs that can be allocated solely to the claims that are not even potentially covered. (*Buss*, at p. 57, italics omitted.)

As we have discussed in the preceding section of this opinion, as a *legal* matter, no potential for coverage ever existed in this case. At the time the Mendocino trade secrets case was commenced, however, there was a question as to whether there might be coverage under the advertising injury provisions of the agents’ CGL policies given the Court of Appeal’s decision in *Hameid*. Accordingly, State Farm provided a defense pursuant to the advertising injury provisions of the policies, under a reservation of rights to deny coverage. When the Supreme Court granted review of the Court of Appeal’s decision, raising the prospect the high court might declare there was no prospect for coverage under the advertising injury provisions as a matter of law, State Farm issued a second reservation of rights letter, reserving its right to recoup defense costs expended after the date of that letter. Ultimately, the Supreme Court did reverse and held there is

no coverage under the advertising injury provisions of a CGL policy for claims based on the use of a competitor's customer information to solicit and lure away those customers. (*Hameid, supra*, 31 Cal.4th at p. 19.)

Thus, this is a case where the law "applied in hindsight" establishes there was no potential for coverage "and thus no duty to defend, ever existed." (*Scottsdale, supra*, 36 Cal. 4th at p. 658.) Accordingly, unless the agents' equitable defenses withstand examination, State Farm is entitled, as of the date of its supplemental reservation of rights letter, to recoup the costs of a defense it never owed.

The Waiver Defense⁶

The agents base their waiver defense on the fact State Farm, at the outset of the Mendocino case, reserved only its rights on indemnification and did not, at that time, also reserve *Buss* rights to recoup defense costs. State Farm maintains it could not, as a matter of law, have "waived" its right to recoup defense costs at the outset of the Mendocino case because at that time it had no legitimate basis to assert *Buss* rights. The law at that time, as established by the Court of Appeal's decision in *Hameid*,⁷ was that there *was* a potential for coverage under the advertising injury provisions of a CGL policy and therefore there *was* a duty to defend. Since there *was* a duty to defend under the then controlling law, no *Buss* rights existed at that time, since *Buss* rights exist only when there is *no* potential for coverage and therefore there is *no* duty to defend.⁸

⁶ Although the viability of equitable defenses is usually a question of fact, it can be determined as a matter of law if the evidence is susceptible of only one legal conclusion. (See *Oakland Raiders v. Oakland-Alameda County Coliseum, Inc.* (2006) 144 Cal.App.4th 1175, 1191 [waiver]; *CalFarm Ins. Co. v. Krusiewicz* (2005) 131 Cal.App.4th 273, 283 [estoppel]; *Peregrine Funding, Inc. v. Sheppard Mullin Richter & Hampton LLP* (2005) 133 Cal.App.4th 658, 681 [unclean hands].)

⁷ The Ninth Circuit had also held soliciting a competitor's customers could constitute "advertising injury" giving rise to a duty to defend. (*Sentex Systems, Inc. v. Hartford Accident & Indemnity Co.* (9th Cir. 1996) 93 F.3d 578, 580-581, abrogation recognized by *Rombe Corp. v. Allied Ins. Co., supra*, 128 Cal.App.4th at p. 491, fn. 3.)

⁸ The evidence showed State Farm considered, but rejected reserving *Buss* rights at the outset of the Mendocino case. (See, e.g., State Farm December 1999 memoranda indicating "No "Buss" type reservation.")

“Waiver requires the intentional relinquishment of a known right upon knowledge of the facts. The burden is on the party claiming a waiver of right to prove it by clear and convincing evidence that does not leave the matter to speculation. As a general rule, doubtful cases will be decided against the existence of a waiver. [Citations.] Waiver may be express, based on the words of the waiving party; or implied, based on conduct indicating an intent to relinquish the right. [Citations.]

“In the insurance context, California courts have applied the general rule that waiver requires the insurer to intentionally relinquish its right to deny coverage, and a denial of coverage on one ground does not, absent clear and convincing evidence to suggest otherwise, impliedly waive grounds not stated in the denial. (*Waller v. Truck Ins. Exchange, Inc.* [(1995) 11 Cal.4th 1,] 31; . . . *State Farm Fire & Casualty Co. v. Jioras* (1994) 24 Cal.App.4th 1619, 1627-1628, fn. 7; . . . [‘Waiver exists when the insurer intentionally relinquishes its right to rely on an exclusion. [Citation.] Waiver depends solely on the intent of the waiving party, and is not established merely by evidence the insurer failed to specify the exclusion in a letter reserving rights.’]; *Velasquez v. Truck Ins. Exchange* (1991) 1 Cal.App.4th 712, 722 . . . [‘Whether a waiver has occurred depends solely on the intention of the waiving party. . . . An intention to waive a limitations provision is not evinced by the failure to raise that point in a letter denying a claim.’].) Thus, an insured’s subjective understanding of its insurer’s conduct is insufficient to establish waiver, absent some evidence of actual intent. [Citation.] For this reason, the courts have repeatedly held that an insurer does not waive or relinquish any coverage defenses it fails to assert at the time of its acceptance of a tender of defense, even when it does not make any express and full reservation of rights for a substantial period of time after the defense has been accepted. ([*Garamendi v. Golden Eagle Insurance Co.* (2004) 116 Cal.App.4th 694, 721; see also] *Waller v. Truck Ins. Exchange, Inc., supra*, 11 Cal.4th at pp. 31-34 [insurer does not automatically waive coverage defenses by failing to raise or assert them from the outset; failure to raise specific defenses for seven years not inconsistent with an intent to enforce the terms of the policy]; *American Motorists Ins. Co. v. Allied-Sysco Food Services, Inc.* (1993)

19 Cal.App.4th 1342, 1350 . . . , overruled on other grounds in *Buss*[, *supra*,] 16 Cal.4th 35, 50, [fn. 12] . . . [insurer did not waive coverage defense despite nine-month delay in sending reservation-of-rights letter after acceptance of defense]; *National Union Fire Ins. Co. v. Siliconix, Inc.* (N.D. Cal. 1989) 726 F.Supp. 264, 270 [insurer did not waive coverage defense despite 15-month delay in reserving its rights after accepting tender of defense].’ ” (*Ringler Associates Inc. v. Maryland Casualty Co.* (2000) 80 Cal.App.4th 1165, 1188-1190 (*Ringler*).)⁹

As the court in *Ringler* explained, it was “insufficient for Ringler to rely on the fact respondents participated in its defense for approximately two years before formally reserving their rights to assert defenses to coverage In short, there is no evidence [the insurers] ever made any *intentional* relinquishment of their coverage defenses at any point, despite initially accepting Ringler’s tender of defense and funding that defense for two years. There is therefore no evidentiary basis for any claim of waiver in this case. [Citation.] Rather than a waiver of its rights to assert the [policy] exclusion, [the insurers’] defense of the underlying lawsuits actually constituted a windfall to Ringler.” (*Ringler, supra*, 80 Cal.App.4th at pp. 1188-1190.)

There is no evidence in this record that supports a finding State Farm “intentionally relinquished” any “known right” to recoup defense costs. Rather, the evidence shows only that State Farm did not believe it had any *Buss* rights at the outset of the Mendocino case—and it did not under the then controlling law. State Farm issued its supplemental reservation of rights letter, reserving its right to recoup defense costs, very shortly after the Supreme Court granted review in *Hameid*, raising the possibility the law might change. The supplemental letter specifically referenced the grant of review in

⁹ Similarly, the court in *Prichard v. Liberty Mutual Ins. Co.* (2000) 84 Cal.App.4th 890, held the insurer’s reservation of its rights to reimbursement made after trial and prior to appeal, based on evidence at trial that the covered acts took place outside the policy period, was not a breach of the duty to defend. (*Id.* at pp. 899, 904, 908-909.) The court explained a “ ‘retroactive termination’ is simply an ominous phrase for ‘reimbursement right,’ and *Buss* plainly allows for insurers to have reimbursement rights.” (*Id.* at p. 909.)

Hameid and stated that depending on the Supreme Court’s decision, there might not be a duty to indemnify or to defend. State Farm also limited its reservation of *Buss* rights to defense costs expended after the date of its supplemental reservation of rights letter. This scenario does not, and cannot, support a finding that State Farm “waived” its right to recoup of defense costs.

The Estoppel Defense

The agents base their estoppel defense on the same factual predicate underlying their waiver defense—the fact State Farm did not, at the outset of the Mendocino case, reserve its right to recoup defense costs. They contend “State Farm was entitled to reserve *Buss* rights from the beginning” of the Mendocino case, failed to do so, and therefore was estopped from ever reserving such rights. State Farm asserts it had no obligation to reserve recoupment rights that, at the time, did not exist under the controlling law.

The elements of estoppel in the insurance context are “(1) The party to be estopped has engaged in blameworthy or inequitable conduct; (2) that conduct caused or induced the other party to suffer some disadvantage; and (3) equitable considerations warrant the conclusion that the first party should not be permitted to exploit the disadvantage he has thus inflicted upon the second party.” (*City of Hollister v. Monterey Ins. Co.* (2008) 165 Cal.App.4th 455, 488.) “There can be no estoppel where one of the[] elements is missing.” (*Green v. Travelers Indemnity Co.* (1986) 185 Cal.App.3d 544, 556.) “In the insurance context especially, estoppel may arise from a variety of circumstances in which the insurer’s conduct threatens to unfairly impose a forfeiture of benefits upon the insured.” (*City of Hollister v. Monterey Insurance Co., supra*, at p. 488.)

The agents’ estoppel defense is based on the theory that because State Farm theoretically could have asserted *Buss* rights in its initial reservation of rights letter, regardless of whether it had any such rights under the then controlling law, it was *required* to do so. However, “ ‘[m]ere silence will not create estoppel unless the silent party was under some obligation to speak, and a party invoking such estoppel must show

that it was the duty of the other to speak, that he has been induced to act by reason of the silence, and that the silent party had reasonable cause to believe that he would so act.’ ” (*Chaplis v. County of Monterey* (1979) 97 Cal.App.3d 249, 262, quoting *E. D. McGillicuddy Constr. Co. v. Knoll Recreation Assn., Inc.* (1973) 31 Cal.App.3d 891, 901; *Transport Clearings-Bay Area v. Simmonds* (1964) 226 Cal.App.2d 405, 427.) “Estoppel is an equitable doctrine. It will not be applied against one who is blameless.” (*Ricciardi v. County of Los Angeles* (1953) 115 Cal.App.2d 569, 578.)

The agents assert the circumstances here are the same as in *Stonewall Surplus Lines Ins. Co. v. Johnson Controls, Inc.* (1993) 14 Cal.App.4th 637. It appears the agents meant to cite the case of *Stonewall Ins. Co. v. City of Palo Alto Verdes Estates* (1996) 46 Cal.App.4th 1810 (*Stonewall*). In *Stonewall*, the insurer assumed the defense of an action against its insured without a reservation of rights. Three weeks before trial, the insurer reserved its rights to deny coverage based on an “inverse condemnation” policy exclusion. (*Id.* at p. 1836.) Because there had been no reservation of rights by the insurer, the insured did not request separate counsel. (*Id.* at p. 1839.) The court held the insurer was precluded from asserting the policy exclusion because “[b]y the time the notice of reservation of rights was sent, trial was at hand and it would have been too late for an attorney representing solely the interests of the insured to have replaced the attorney who was representing the insurer’s interests as well.” (*Ibid.*)

Stonewall is markedly different than the case at hand. In the Mendocino action, State Farm provided a defense, but subject to a reservation of rights. That reservation provided: “Although we are agreeing to participate in the defense of the action, we are reserving our right to deny coverage at any time or to further defend the proceedings.” It further provided “participation in the providing of a defense is not to be construed as a waiver of any insurance coverage defense which might become involved in the lawsuit.” In addition, because State Farm was the plaintiff in the Mendocino action, it provided a defense by paying the attorneys who were chosen by and already representing the agents. Thus, there was no issue of counsel representing solely the interests of the insureds. Indeed, State Farm arranged for a third party to receive and review the attorneys’ bills,

and did “not expect that your attorneys provide any reports to us.” (See also *Dollinger DeAnza Associates v. Chicago Title Ins. Co.* (2011) 199 Cal.App.4th 1132, 1154 [only if “ “a liability insurer, with knowledge of a ground of forfeiture or noncoverage under the policy, assumes and conducts the defense of an action brought against its insured, *without* disclaiming liability and giving notice of its reservation of rights, it is thereafter precluded . . . from setting up such ground of forfeiture or noncoverage. In other words, the insurer’s unconditional defense of an action brought against the insured constitutes a waiver of the terms of the policy and an estoppel of the insured to asserts such grounds.” ”], italics added.)

As we have discussed, in the wake of the Supreme Court’s decision in *Hameid*, State Farm had a right to recoup defense costs, and it did not waive that right by asserting it when the court granted review of the court of appeal’s decision in that case and there was a possibility the existing law, which foreclosed any *Buss* rights, might change. That the timing of the Supreme Court’s grant of review resulted in State Farm’s supplemental reservation of rights letter being issued five days before trial was to begin in the Mendocino trade secrets case, does not make State Farm’s conduct “blameworthy or inequitable.” Accordingly, the first requisite element for estoppel is not, and cannot, be satisfied in this case. (See *Green v. Travelers Indemnity Co.*, *supra*, 185 Cal.App.3d at p. 556.)

American Modern Home Insurance Co. v. Fahmian (2011) 194 Cal. App.4th 162 (*American Modern*), is also of note. In that case, the insurer provided a defense under a homeowner’s policy, under a reservation of rights, in a personal injury action against the insured by one of the insured’s employees. The insurer subsequently notified the insured it intended to accept a policy-limits settlement offer unless the insured either took over his own defense or waived a bad faith claim based on the insurer’s failure to settle, and gave the insured five days to respond. (*Id.* at pp. 164-165.) The insured did not respond, and the insurer paid the policy limits to settle the case and then sued the insured for reimbursement of the settlement amount. Although the trial court concluded there was no coverage under the policy for the claim, it denied the insurer’s claim for reimbursement

on the ground the settlement notification had not given the insured sufficient time to review and decide among the options, including to carry on with his defense. (*Ibid.*)

The Court of Appeal reversed, holding the insurer had complied with the requirements established in *Blue Ridge Ins. Co. v. Jacobsen* (2001) 25 Cal.4th 489—it had (a) defended under a timely and express reservation of rights, (b) expressly notified the insured of its intent to accept the settlement, and (c) expressly advised the insured it could assume his own defense or waive any potential bad faith claim arising out of failure to settle. The appellate court held there was no additional requirement that the insured have “sufficient time” to consider the notice of intent to settle. Among other things, “a plaintiff’s settlement offer might come at any time and usually contains its own time limits.” (*American Modern, supra*, 194 Cal.App.4th at pp. 171-172.) The court also observed *Blue Ridge* has “two important purposes,” to avoid “unjust enrichment on the part of an insured that was not covered for the underlying loss in the first place” and to promote settlement. (*American Modern*, at p. 173.)

Considerations in the case at hand are similar. State Farm defended under a timely reservation of rights. When the Supreme Court granted review in *Hameid*, raising the prospect the law as to the duty to defend might change and there might be a *Buss* claim for reimbursement, State Farm issued a supplemental reservation of rights, expressly reserving *Buss* rights. The timing of the grant of review was not something over which State Farm had control. Nor is there any reason that these particular insureds should be unjustly enriched by retaining the benefits of policies that provided no coverage for “the underlying loss in the first place.”¹⁰

Defense of Forfeiture

The agents also base their forfeiture defense on the same factual predicate underlying their other defenses—the fact State Farm, at the outset for the Mendocino case, did not reserve its right to recoup defense costs. They assert “State Farm stipulated:

¹⁰ State Farm also claims the jury instructions on waiver and estoppel were erroneous. Given our conclusion that these defenses fail as a matter of law, we do not reach its claims of instructional error.

‘[it] was entitled to reserve the right to reimbursement in March 2000’ ” and since it did not do so, it forfeited any such right.¹¹

That State Farm, at the outset of the Mendocino case, theoretically could have included in its reservation of rights letter a reservation of *Buss* rights, does not mean that it was required to do so on pain of forfeiting any such right. As we have discussed, under the then controlling law, State Farm had no *Buss* rights at the outset of the Mendocino trade secrets case. On the contrary, the law in effect at the time established that there was a potential for coverage under the advertising injury provisions of the agents’ CGL policies and therefore there was a duty to defend. *Buss* rights exist, however, only when there is *no* duty to defend. The agents have not cited, nor are we aware of, any case suggesting that failure to assert a nonexistent right works a forfeiture of such right should it materialize in the future.

The cases the agents rely on are readily distinguishable—all concern whether an insurer forfeits the right to arbitration by engaging in a course of conduct designed to mislead the insured. In *Davis v. Blue Cross of Northern California* (1979) 25 Cal.3d 418 (*Davis*), the Supreme Court held Blue Cross could not compel arbitration because it had failed “timely or meaningfully to apprise its insureds of their rights to arbitration” (*Id.* at p. 421.) Similarly, in *Sarchett v. Blue Shield of California* (1987) 43 Cal.3d 1 (*Sarchett*), the court held “[o]nce it becomes clear to the insurer that its insured disputes its denial of coverage, however, the duty of good faith does not permit the insurer passively to assume that its insured is aware of his rights under the policy. The insurer must instead take affirmative steps to make sure that the insured is informed of his remedial rights.” (*Id.* at p. 15.) In those cases, the insurers unquestionably had a

¹¹ The agents provide no citation to the record showing State Farm “stipulated” to this. They cite only a jury instruction reading: “The Court has determined that, at the time State Farm sent its reservation of rights letters to John Wier and Richard Pyorre in March 2000, the law was unclear whether it had a duty to defend; that during the same time period, the underlying lawsuit contained both covered and uncovered claims; and that State Farm was entitled to reserve the right for reimbursement in March 2000.” Apparently, State Farm made no objection to this instruction.

contractual right to arbitrate. Thus, they had an existing right that could be forfeited. Moreover, even in the arbitral context, in *Chase v. Blue Cross of California* (1996) 42 Cal.App.4th 1142, the Court of Appeal explained “even if the insured in fact was unaware of the arbitration right, no forfeiture occurs if the insurer did not engage in behavior designed to mislead the insured. . . . [¶] . . . [¶] . . . As a matter of law, *Davis* and *Sarchett* do not require notification in every communication between the insurer and the insured. Instead, *Davis* and *Sarchett* call for forfeiture of the right to arbitration if the insurer . . . engag[es] in bad faith conduct designed to mislead the insured.” (*Id.* at pp. 1157-1158.) Here, State Farm did not fail to inform the agents of any of their rights under their policies. Nor, as we have discussed, did State Farm mislead them about its recoupment rights. Rather, State Farm reserved *Buss* rights as soon as it appeared there might be some prospect it actually had such rights.

Defense of Unclean Hands

The agents’ unclean hands defense is another variation of their waiver, estoppel and forfeiture defenses. “The defense of unclean hands arises from the maxim, ‘He who comes into Equity must come with clean hands.’ ” [Citation.] The doctrine demands that a plaintiff act fairly in the matter for which he seeks a remedy. He must come into court with clean hands, and keep them clean, or he will be denied relief, regardless of the merits of his claim. [Citations.] The defense is available in legal as well as equitable actions. [Citations.]” (*Kendall-Jackson Winery, Ltd. v. Superior Court* (1999) 76 Cal.App.4th 970, 978 (*Kendall-Jackson*).

“The unclean hands doctrine protects judicial integrity and promotes justice. It protects judicial integrity because allowing a plaintiff with unclean hands to recover in an action creates doubts as to the justice provided by the judicial system. Thus, precluding recovery to the unclean plaintiff protects the court’s, rather than the opposing party’s, interests. [Citations.] The doctrine promotes justice by making a plaintiff answer for his own misconduct in the action. It prevents ‘a wrongdoer from enjoying the fruits of his transgression.’ [Citations.] [¶] Not every wrongful act constitutes unclean hands. But, the misconduct need not be a crime or an actionable tort. Any conduct that violates

conscience, or good faith, or other equitable standards of conduct is sufficient cause to invoke the doctrine. [Citations.]

“The misconduct that brings the clean hands doctrine into play must relate directly to the cause at issue. Past improper conduct or prior misconduct that only indirectly affects the problem before the court does not suffice. The determination of the unclean hands defense cannot be distorted into a proceeding to try the general morals of the parties. [Citation.] Courts have expressed this relationship requirement in various ways. The misconduct ‘must relate directly to the transaction concerning which the complaint is made, i.e., it must pertain to the very subject matter involved and affect the equitable relations between the litigants.’ [Citation.] ‘[T]here must be a direct relationship between the misconduct and the claimed injuries . . . “so that it would be inequitable to grant [the requested] relief.’ ” ’ [Citation.] ‘The issue is not that the plaintiff’s hands are dirty, but rather “ “that the manner of dirtying renders inequitable the assertion of such rights against the defendant.” ’ ” ’ [Citation.] The misconduct must “ “ ‘prejudicially affect . . . the rights of the person against whom the relief is sought so that it would be inequitable to grant such relief.’ ” ’ [Citation.]” (*Kendall-Jackson, supra*, 76 Cal.App.4th at pp. 978-979.)

As we have discussed in the preceding portions of this opinion, there was nothing wrongful or improper about State Farm’s decision not to reserve *Buss* rights until the Supreme Court granted review in *Hameid*, raising the prospect there might actually be *Buss* rights in the instant case. Accordingly, State Farm’s issuance of a supplemental reservation of rights letter reserving *Buss* rights shortly after the court granted review in *Hameid* does not constitute unclean hands as a matter of law.¹²

DISPOSITION

The judgment in phase one of the trial, declaring that State Farm had no duty to defend the agents in the Mendocino action, is affirmed. The judgment in phase two of

¹² Given our conclusion on this point, we do not reach State Farm’s claim that the trial court erred in admitting certain evidence in connection with the agents’ affirmative defense.

the trial, denying State Farm’s claims for recoupment of defense costs incurred after issuance of its supplemental reservation of rights letter and awarding damages to Wier and declaratory relief to Pyorre, is reversed and the matter remanded for determination of the amount of recoupment to which State Farm is entitled.¹³ State Farm is awarded costs on appeal.

Banke, J.

We concur:

Marchiano, P. J.

Margulies, J.

¹³ While State Farm asserts the agents “stipulated” to the amounts expended in defense costs and fees following the June 19, 2002, supplemental reservation of rights letter (\$372,889.18 as to Pyorre and \$349,599.77 as to Weir), no such stipulation is in the record. We note the jury was instructed State Farm had to prove “the amount of attorney fees and costs that it paid in defense of Defendants, John Weir and Richard Pyorre . . . after reserving its right to seek reimbursement.”