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ARROWOOD INDEMNITY COMPANY, a Delaware corporation formerly known as ROYAL INDEMNITY COMPANY, Plaintiff, v. BEL AIR MART, a California corporation; R. GERN NAGLER, as Trustee of the John W. Burns Testamentary Trust; ROBERT GERN NAGLER, an individual, Defendants.

No. 2:11-CV-00976-JAM-DAD

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

2013 U.S. Dist. LEXIS 78535

June 3, 2013, Decided

June 4, 2013, Filed

PRIOR HISTORY: Arrowwood Indem. Co. v. Bel Air Mart, 2011 U.S. Dist. LEXIS 100756 (E.D. Cal., Sept. 7, 2011)

COUNSEL: [*1] For Arrowwood Indemnity Company, a Delaware corporation, as successor to Globe Indemnity Company formerly known as Royal Indemnity Company, Plaintiff: Alexander Eugene Potente, LEAD ATTORNEY, Sedgwick, LLP, San Francisco, CA.

For Bel Air Mart, Defendant, Counter Claimant: Dominic Stephen Nesbitt, LEAD ATTORNEY, Gary Wayne Osborne, Osborne & Nesbitt Llp, San Diego, CA.

For R. Gern Nagler, As Trustee of the John W. Burns Testamentary Trust, Robert Gern Nagler, an individual, Defendants: Carl Paul Blaine, LEAD ATTORNEY, Wagner Kirkman Blaine Klomparens & Youmans LLP, Mather, CA.

For Arrowwood Indemnity Company, a Delaware corporation, as successor to Globe Indemnity Company, Counter Defendant: Alexander Eugene Potente, LEAD ATTORNEY, Eryk Rolf Gettell, Sedgwick, LLP, San Francisco, CA.

JUDGES: JOHN A. MENDEZ, UNITED STATES DISTRICT JUDGE.

OPINION BY: JOHN A. MENDEZ

OPINION

ORDER GRANTING BEL AIR MART'S MOTION TO COMPEL FEE ARBITRATION PURSUANT TO CALIFORNIA CIVIL CODE § 2860(c)

This matter is before the Court on Defendant Bel Air Mart's ("BAM") Motion to Compel Arbitration under California Civil Code § 2860(c) (Doc. #47). Plaintiff Arrowwood Indemnity Company ("Arrowwood") opposes the Motion (Doc. #50).

I. BACKGROUND

This case [*2] arises from an underlying action brought pursuant to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA") by BAM against various owners and operators of a dry cleaning facility on BAM's leased

property. The CERCLA defendants counterclaimed against BAM and BAM tendered the defense of those claims to Arrowood, its insurer. In January 2011, Arrowood agreed to defend BAM against the counterclaims and appointed counsel under a reservation of rights. BAM objected to the appointment of counsel, requesting independent counsel of its choosing due to conflicts of interest.

In April 2011, Arrowood filed the present action seeking a declaration of whether it owed a duty to defend, whether BAM was entitled to independent counsel, and whether BAM had breached the policy's cooperation clause. BAM counterclaimed against Arrowood for breach of contract, alleging that Arrowood failed to pay independent counsel's fees. In September 2011, the Court granted BAM's Motion for Partial Summary Judgment, holding that BAM was entitled to independent counsel under § 2860 of the California Civil Code due to conflicts of interest between BAM and Arrowood. The Court did not [*3] resolve the ultimate issue of whether Arrowood owed BAM a duty to defend.

BAM now requests that Arrowood pay its independent counsel's fees in the amount of \$365,089.65. BAM determined the requested amount through an allocation analysis by its independent counsel designating "covered" tasks as those deemed reasonable and necessary to the defense. Arrowood disputes the fees and has paid only \$208,835.79. It challenges BAM's allocation and reasonableness determinations.

While Arrowood agrees that § 2860 requires arbitration of independent counsel's rates, it refuses to arbitrate the allocation and reasonableness issues, contending that those issues are solely within the purview of the Court. Arrowood also requests that any arbitration be stayed until the Court or a jury determines whether Arrowood owes a duty to defend.

II. OPINION

A. Legal Standard

California Civil Code § 2860 specifies that where an insurer owes a duty to defend its insured and a conflict of interest arises, the insurer is required to provide independent counsel to represent the insured. Cal. Civ. Code § 2860(a). California Civil Code § 2860(c) provides that "[a]ny dispute concerning [an insured's independent counsel's] [*4] attorney's fees" shall be submitted to

arbitration. However, overarching coverage issues concerning the existence of a duty to defend must be determined at trial and not through arbitration. *Compulink Mgmt. Ctr., Inc. v. St. Paul Fire and Marine Ins. Co.*, 169 Cal. App. 4th 289, 300, 87 Cal. Rptr. 3d 72 (2008). Further, when a duty to defend exists, an insurer is only responsible for representing its insured with respect to defensive claims. *James 3 Corp. v. Truck Ins. Exch.*, 91 Cal. App. 4th 1093, 1104, 111 Cal. Rptr. 2d 181 (2001).

In addition to compelling arbitration, a court may stay proceedings in order to "control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants." *Landis v. N. Am. Co.*, 299 U.S. 248, 254, 57 S. Ct. 163, 81 L. Ed. 153 (1936). If a court determines that other issues between the parties are not subject to arbitration and that their resolution may make arbitration unnecessary, a court may stay arbitration until those issues are resolved. Cal. Civ. Proc. Code § 1281.2(c).

B. Discussion

BAM argues in support of its motion that the language of § 2860(c) clearly covers allocation and reasonableness in specifying that "[a]ny dispute concerning attorney's fees" is subject to mandatory [*5] arbitration. Arrowood concedes that the rates dispute is subject to arbitration, but maintains that allocation and reasonableness fall outside § 2860(c)'s mandate and thus should be decided by the Court or a jury. Arrowood also contends that any arbitration should be stayed until the Court or a jury has decided whether Arrowood owes a duty to defend and the scope of that duty.

1. Defendant's Motion to Compel Arbitration

a. Arbitrability of Rates

The parties agree that a determination of the appropriate hourly rate to be paid by Arrowood to independent defense counsel for BAM is subject to arbitration, so this issue is not in dispute. While the parties disagree regarding the appropriateness of a stay on arbitration, they do not dispute that the rates issue is ripe for determination.

b. Arbitrability of the Reasonableness of Fees

Arrowood contends that the reasonableness issue, or

a determination of which independent counsel hours were reasonably incurred in BAM's defense, is not arbitrable. Arrowood argues that § 2860(c)'s arbitration provision applies only to determinations of hourly rates. It contends that the preceding portion of § 2860(c), which discusses rates, confines the arbitration [*6] requirement to apply to rates only. BAM maintains that the plain language of § 2860 covers the present dispute over attorney's fees.

Rulings on the appropriateness of arbitration have ultimately rested on what courts have deemed the "gravamen of the complaint." See *Compulink*, 169 Cal. App. 4th at 293 (citing *Fireman's Fund Insurance Co. v. Younesi*, 48 Cal. App. 4th 451, 455, 55 Cal. Rptr. 2d 671 (1996)) (comparing the gravamen of the complaint in *Younesi* that "counsel had engaged in a scheme of fraudulent billing practices" to "the gravamen of *Compulink's* complaint . . . that it was entitled to additional attorney's fees"). *Intergulf Development LLC v. Superior Court*, 183 Cal. App. 4th 16, 20, 107 Cal. Rptr. 3d 162 (2010), for example, reversed an order to arbitrate where the insurer did not respond to the insured's request for independent counsel and thus "the gravamen of the complaint [was] bad faith and breach of contract, not a dispute over the amount Interstate should pay independent counsel . . ." *Id.* By contrast, the court in *Long v. Century Indemnity Co.*, 163 Cal. App. 4th 1460, 1466, 78 Cal. Rptr. 3d 483 (2008), compelled arbitration where the parties had agreed on independent counsel and "the gravamen of the breach-of-the-implied-covenant [*7] claim [was that counsel] was not paid the hourly rate he sought." *Id.*

An assertion of additional claims such as bad faith or breach of contract will not preclude arbitration if fees constitute the ultimate focus of the dispute. See *Compulink*, 169 Cal. App. 4th at 300 ("[T]he presence of other non-arbitrable issues in an action does not preclude arbitration of [independent counsel] fee issues, as long as any disputed matters regarding the duty to defend . . . are resolved by the trial court."). However, where the parties' dispute centers on issues outside the scope of fees, or where fee amounts are not disputed, arbitration is inappropriate. See *Intergulf*, 183 Cal. App. 4th at 20. For instance, in *BKM Total Office of California v. Pacific Insurance Co.*, No. B173073, 2005 Cal. App. Unpub. LEXIS 1346, 2005 WL 36148, at *4 (Cal. App. Feb. 16, 2005), the court affirmed denial of a motion to compel arbitration where the insurer failed to tender a defense but the amount of fees and billing rate were not contested. *Id.*

Similarly, in *Younesi*, the lower court's denial of a motion to compel arbitration was affirmed where the insurer alleged a scheme of fraudulent billing practices on the part of independent counsel. See *Younesi*, 48 Cal. App. 4th at 458.

Arrowood [*8] relies on *Younesi* and *BKM*, but the facts of both cases are distinguishable. Arbitration was denied in *Younesi* because the dispute centered on alleged fraudulent billing practices, not the amount of fees alone. *Id.* Arrowood's argument that the present case is similar because it centers on the scope of coverage rather than fees is unconvincing. Unlike fraudulent billing claims, which constitute allegations outside the context of a fee disagreement, the supposed separate claim here falls within the fee dispute itself. Arrowood also overreads the *Younesi* court's statement that § 2860 "limit[s] the scope of arbitrable disputes to those in which only the amount of legal fees or the hourly billing rates are at issue." *Id.* at 459. Arrowood sees *Younesi* as restricting § 2860 arbitration to rate determinations, but other courts have criticized this interpretation. See *Compulink*, 169 Cal. App. 4th at 300. The *Compulink* court refused to follow such a narrow reading of § 2860's scope on the grounds that it was not supported by the plain language of the statute. *Id.* Examined in the context of *Younesi*, the court's statement quoted above was likely made only in reference to the fraud dispute at issue [*9] in that case. The present dispute between BAM and Arrowood contains no allegation of fraud, and absent authority to the contrary, the Court is not inclined to read into *Younesi* any attempt to narrow the plain language of § 2860(c) as it applies to the arbitrability of disputes over the scope of fees.

The facts of *BKM* are also distinguishable from the present case. *BKM* involved a complete refusal to defend and "nowhere in the complaint [did] respondents allege that the *amount* of legal fees or counsel's *billing rate* was in dispute. Rather, all of the allegations concerning legal fees pertain[ed] to appellants' failure to pay them at all." *BKM*, 2005 Cal. App. Unpub. LEXIS 1346, 2005 WL 361418, at *4 (emphasis in original). By contrast, independent counsel has been appointed here pending resolution of the underlying scope of coverage and duty to defend issues in a situation similar to a reservation of rights. The amount of legal fees constitute the focus of the parties' immediate dispute. As a result, *BKM* does not apply.

Additional case law also supports submitting a dispute over reasonableness of fees to arbitration. For instance, the court in *Larkin v. ITT Hartford*, 1999 U.S. Dist. LEXIS 9960, at *21 fn. 1 (N.D. Cal. June 29, 1999), [*10] recognized that "any dispute between the parties as to the amount of reasonable attorneys' fees and costs incurred by plaintiffs in defense of [the insured] is subject to arbitration." *Id.* In its decision, the court stated that the plaintiffs maintained the ability to recover fees and costs through arbitration "on the ground that such fees and costs were reasonable and necessary to the defense." *Id.* Finally, in *Truck Insurance Exchange v. Superior Court*, 51 Cal. App. 4th 985, 998, 59 Cal. Rptr. 2d 529 (1996), the court determined that disputes "over the rate *and scope* of fees to be paid to independent counsel" are arbitrable. *Id.* (emphasis added).

While the coverage action here involves a counterclaim for breach of contract, the focus of the immediate dispute is clearly the amount of fees to be paid to independent counsel. This case is accordingly distinguishable from the precedent *Arrowood* cites, in which fees constituted at most an aspect of the claims rather than their focus. See *BKM*, 2005 Cal. App. Unpub. LEXIS 1346, 2005 WL 361418, at *4; *Younesi*, 48 Cal. App. 4th at 458. Here, *Arrowood* has paid a majority of independent counsel's fees and simply contests payment of the full amount billed. BAM's breach of contract counterclaim was [*11] brought as a result of this fee dispute, and no overarching fraud allegations are present. This is precisely the type of dispute properly submitted to arbitration, with issues of a duty to defend and any other legal determinations reserved for the Court.

Further, in light of the case law, the Court is unconvinced by *Arrowood's* narrow reading of the statute. Because it would be difficult to arbitrate rates absent determinations of reasonableness, the Court sees the issues as closely related. To hold that § 2860(c) nevertheless submits only the determination of rates to arbitration would be illogical and would negate the provision's purpose of relegating fee disputes to arbitration.

c. Arbitrability of Allocation

Arrowood also contends that the Court, not an arbitrator, must allocate costs between offensive and defensive tasks, thus determining which costs are *Arrowood's* responsibility. BAM responds by emphasizing the broad language of § 2860's arbitration

mandate, arguing that the requirement to submit "[a]ny dispute concerning attorney's fees" to arbitration covers the allocation dispute.

No California court has come close to articulating an allocation carveout to the § 2860(c) arbitration [*12] requirement. While it also appears that no court has explicitly resolved a dispute over allocation issues and included them in arbitration, this is not determinative. Because allocation of fees is related to determinations of rates and reasonableness, the absence of case law excluding allocation should tip in favor of submitting the issue to arbitration. In other words, there is no reason to disregard the plain language of § 2860(c) in the absence of contrary authority.

As with reasonableness, allocation bears directly on the amount of legal fees owed. An allocation inquiry would logically proceed with a reasonableness inquiry, in that an arbitrator would be unlikely to find an offensive task reasonably related to BAM's defense. In light of the Court's finding that reasonableness is arbitrable, it would again be impractical and unnecessary to reserve the allocation determination for the Court. To take allocation of defensive and offensive fees out of the scope of arbitration would unnecessarily separate related and dependent determinations and create judicial inefficiency.

In summary, the parties do not dispute that independent counsel rates are arbitrable. Further, the Court finds that [*13] reasonableness and allocation of defensive tasks should also be submitted to arbitration.

d) Plaintiff's Request to Stay Arbitration

Arrowood asks the Court to stay arbitration on the basis that proceeding with arbitration before resolution of the coverage action would "not be meaningful" and would waste court resources. *Arrowood* primarily relies on *Janopaul + Block Cos. v. Superior Court*, 200 Cal. App. 4th 1239, 1251, 133 Cal. Rptr. 3d 380 (2011), in arguing that the Court should stay any fee arbitration until it decides the issues in the coverage action. BAM asserts that there is no basis to stay arbitration in this case and that *Truck Insurance Exchange v. Superior Court*, 51 Cal. App. 4th 985, 998, 59 Cal. Rptr. 2d 529 (1996), applies and supports its contention.

California Courts of Appeals have been somewhat inconsistent in their treatment of the timing of arbitration within larger coverage actions over the duty to defend.

See *Pepsi-Cola Metro. Bottling Co. v. Ins. Co. of N. Am.*, No. CV-10-2696 SVW (MANx), 2010 U.S. Dist. LEXIS 144401, at *45 fn. 18 (C.D. Cal. Dec. 28, 2010) ("[T]he Intergulf court may have broken with the Compulink court in requiring that issues regarding the duty to defend and bad faith be addressed *prior* [*14] to arbitration under § 2860(c) . . ." (emphasis in original)). However, under *Truck*, fee disputes may be arbitrable prior to any legal determination of coverage issues in cases where an insurer (1) is providing a defense under a reservation of rights and (2) has agreed to independent counsel. See *Truck*, 51 Cal. App. 4th at 998. While *Truck* did not address every precise issue presented in this case, it does establish that arbitration may appropriately occur before coverage issues over the duty to defend are resolved. *Id.* Where an insurer has not agreed to the insured's representation by independent counsel, the situation may be different. *Id.* at 997 (citing *Truck Ins. Exch. v. Dynamic Concepts, Inc.*, 9 Cal. App. 4th 1147, 1150, 11 Cal. Rptr. 2d 873 (1992)) ("[W]here the [insurer] refuses to provide a defense through independent counsel, the legal issue must be decided by the court before section 2860 arbitration is available."). For instance, in *Janopaul*, the court reversed a grant of arbitration where the insurer had breached its duty to defend and engaged in bad faith conduct. See *Janopaul*, 200 Cal. App. 4th at 1251. However, *Janopaul* is distinguishable because independent counsel had not been agreed [*15] upon in that case. *Id.* By contrast, where independent counsel is appointed, "it would undermine the concept of reservation of rights to preclude resolution of the issue until after the declaratory relief action has been decided."

Truck, 51 Cal. App. 4th at 998. Under *Truck*, once the reasonable amount of fees is determined in arbitration and paid by Arrowood, the reservation of rights, or in this case a pending declaratory relief action, would still permit Arrowood to recover any overpayments pursuant to the Court's findings on the duty to defend. Additionally, Arrowood has already paid a substantial portion of BAM's independent counsel's fees, meaning that even if arbitration were stayed, Arrowood would still have to recover fees if it succeeds in the coverage action.

The Court finds *Truck* controlling in the present case and accordingly denies Arrowood's request for a stay.

II. ORDER

For the foregoing reasons, the Court hereby grants Bel Air Mart's Motion to Compel Arbitration and orders that Arrowood submit all issues concerning the amount of fees it owes for the work of BAM's independent counsel to binding arbitration pursuant to California Civil Code § 2860(c). Arrowood's request for [*16] a stay is denied.

IT IS SO ORDERED.

Dated: June 3, 2013

/s/ John A. Mendez

JOHN A. MENDEZ,

UNITED STATES DISTRICT JUDGE