

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

----oo0oo----

DALE M. WALLIS, D.V.M., JAMES
L. WALLIS, and HYGIEIA
BIOLOGICAL LABORATORIES, INC.,
a California Corporation,

NO. CIV. 08-02558 WBS GGH

Plaintiffs,

v.

MEMORANDUM AND ORDER RE:
MOTION TO COMPEL ARBITRATION

CENTENNIAL INSURANCE COMPANY,
INC., a New York corporation,
ATLANTIC MUTUAL INSURANCE,
CO., INC., a New York
corporation,

Defendants,

_____ /

AND RELATED COUNTERCLAIMS AND
THIRD-PARTY COMPLAINT.

_____ /

----oo0oo----

Plaintiffs Dale M. Wallis ("Dr. Wallis"), James L.
Wallis ("Mr. Wallis"), and Hygieia Biological Laboratories Inc.
("Hygieia") brought this action against defendants Centennial
Insurance Company Inc. and Atlantic Mutual Insurance Co. Inc.
alleging breach of insurance contract, breach of the implied

1 covenant of good faith and fair dealing, and breach of fiduciary
2 duty relating to plaintiffs' veterinarian professional liability
3 insurance policy ("Policy"). Defendants now move to compel
4 binding arbitration pursuant to California Civil Code section
5 2860(c).

6 I. Factual and Procedural Background

7 Dr. Wallis is a research veterinarian. (Compl. ¶ 8.)
8 Beginning in 1993, Dr. Wallis was involved in a lawsuit over the
9 intellectual property rights to a bovine vaccine she had
10 developed while working for Poultry Health Laboratories ("PHL").
11 (Id. ¶¶ 11-14.) Several related lawsuits ensued, one of which
12 involved a complaint by Dr. Wallis against PHL and its
13 shareholders alleging that she had created the vaccine and that
14 PHL had defrauded her of her invention. (Id. ¶¶ 11-18.) In that
15 action, PHL filed a cross-complaint against Dr. Wallis, Mr.
16 Wallis, and Hygieia alleging unfair competition, interference
17 with contractual relations and prospective economic advantage,
18 misappropriation of trade secrets, and conversion. (Id. ¶ 19.)
19 Pursuant to the Policy, defendants in this case provided the
20 defense of the PHL cross-complaint under a reservation of rights.
21 (Id. ¶¶ 8, 21.)

22 Because defendants provided the defense under a
23 reservation of rights, plaintiffs retained independent counsel of
24 their own choosing and defendants proceeded to pay the legal fees
25 and costs incurred. (Id. ¶¶ 21-22.) However, defendants have
26 allegedly begun "to impose unreasonable and illegal limitations
27 upon the fees and costs that will be paid" and have "attempt[ed]
28 to control the litigation by refusing to abide by the terms of

1 the Policy.” (Id. ¶¶ 22-23.)

2 Plaintiffs filed their Complaint in this case on
3 October 27, 2008, asserting diversity jurisdiction, 28 U.S.C. §
4 1332(a), and alleging breach of insurance contract, breach of the
5 implied covenant of good faith and fair dealing, and breach of
6 fiduciary duty. Defendants subsequently filed a third-party
7 complaint against plaintiffs’ counsel, Joanna R. Mendoza.
8 (Docket No. 9). Defendants also moved for judgment on the
9 pleadings on plaintiffs’ claim for breach of fiduciary duty and
10 moved to strike plaintiffs’ request for injunctive relief, which
11 this court granted and denied, respectively, in an Order dated
12 February 3, 2009. (Docket Nos. 10, 17.)

13 Presently before the court is defendants’ motion to
14 compel binding arbitration pursuant to California Civil Code
15 section 2860(c).

16 II. Discussion

17 In California, when an insurer provides a defense under
18 a reservation of rights, California Civil Code section 2860
19 imposes on the insurer a duty to provide its insured with
20 independent counsel of the insured’s choice, commonly referred to
21 as Cumis counsel. See Cal. Civ. Code § 2860(a); San Diego Navy
22 Fed. Credit Union v. Cumis Ins. Soc’y, Inc., 162 Cal. App. 3d 358
23 (1984). In addition to requiring that the insurer cover the
24 reasonable fees of independent counsel, section 2860 also
25 requires that disputes regarding those fees be resolved by
26 arbitration. See Cal. Civ. Code § 2860(c).

27 Although one California court has broadly stated that
28 “[f]ederal actions involving Cumis fee issues . . . are not

1 subject to section[] 2860's arbitration procedure," Compulink
2 Mgmt. Ctr., Inc. v. St. Paul Fire & Marine Ins. Co., 169 Cal.
3 App. 4th 289, 298 (2008), this assertion does not precisely
4 describe the state of the law. This passage from Compulink was
5 intended to summarize the holding of Caiafa Professional Law
6 Corp. v. State Farm Fire and Casualty Co., 15 Cal. App. 4th 800
7 (1993), but Caiafa simply held that a California trial court did
8 not abuse its discretion by staying an arbitration of Cumis
9 counsel fees in favor of a federal fraud trial involving similar
10 issues between the parties, 15 Cal. App. 4th at 803. As the
11 Caiafa court explained,

12 The California Legislature did not say, and could not
13 say, Cumis fee issues must be decided through mandatory
14 arbitration and we forbid Federal judges or juries from
15 deciding these issues. . . . What the California
16 Legislature did say, and all it said, was that when a
17 Cumis fee issue is to be decided in the California courts
18 it is to be decided through the mandatory arbitration
19 procedure set forth in section 2860.

17 Id. at 804. Therefore, while a literal reading of Compulink may
18 suggest that section 2860(c) somehow eschews the doctrine of Erie
19 Railroad Co. v. Tompkins, 304 U.S. 64 (1938), a closer
20 examination reveals a far less dramatic proposition.

21 Accordingly, there is little doubt that this court,
22 sitting in diversity, must apply section 2860(c) to the case at
23 bar. See, e.g., Tucker v. First Md. Sav. & Loan, Inc., 942 F.2d
24 1401, 1406 (9th Cir. 1991) (providing that a federal district
25 court sitting in diversity "sit[s] in the same posture as the . .
26 . state court and there should be no different result in the
27 federal proceedings than would have been achieved in the state
28 court proceeding"); see also Karsant Family Ltd. P'ship v.

1 Allstate Ins. Co., No. 08-1490, 2009 WL 188036, at *6 (N.D. Cal.
2 Jan. 27, 2009) (granting defendant's motion to compel arbitration
3 pursuant to California Civil Code section 2860(c)).

4 Relying principally on Fireman's Fund Insurance Cos. v.
5 Younesi, 48 Cal. App. 4th 451 (1996), plaintiffs oppose
6 defendants' motion to compel arbitration because this case
7 "involves claims to be adjudicated beyond a mere dispute over
8 fees." (Opp'n 5:17-18.) Specifically, plaintiffs contend that
9 defendants are attempting to "control [the] litigation by conduct
10 designed to prevent [plaintiffs] from having the independent
11 counsel of their choice" because defendants "happen to disagree
12 with the defense strategy." (Id. at 2:18-19, 1:15-18; see Compl.
13 ¶¶ 26, 34-35.)

14 In Younesi, an insurer filed a state court action
15 against Cumis counsel alleging claims of fraud, malpractice, and
16 conversion. 48 Cal. App. 4th at 455. The appellate court denied
17 Cumis counsel's motion to compel arbitration because, while
18 acknowledging that attorney's fees were a "central issue" in the
19 suit, concluded that the action was "not merely a dispute about
20 billing rates" since it included allegations of malpractice and
21 fraud. Id. at 458. The Younesi court continued, "the language
22 of Civil Code section 2860 can only be interpreted to limit the
23 scope of arbitrable disputes to those which only the amount of
24 legal fees or the hourly billing rates are at issue." Id. at 459
25 (emphasis added).

26 Recently, the Second District Court of Appeal in
27 Compulink expressly "decline[d] to follow the decision in Younesi
28 to the extent it holds that section 2860's arbitration provision

1 only applies when the sole issue in dispute is the amount or rate
2 of Cumis counsel's fees." 169 Cal. App. 4th at 300. The
3 Compulink court observed that Younesi principally relied on the
4 Caiafa decision; as mentioned previously, Caiafa held that a
5 California trial court did not abuse its discretion by staying an
6 arbitration of Cumis counsel fees in favor of a federal action
7 involving similar issues, 15 Cal. App. 4th at 803. In so
8 holding, the Caiafa court stated that "[i]t [was] entirely proper
9 [for the trial court] to conclude [that] the full-scale Federal
10 fraud trial [was] a better forum for deciding the full range of
11 issues bearing on this subject matter than would a section 2860
12 hearing before a single arbitrator." Id. at 806.

13 After reviewing Caiafa and its conflicting
14 interpretations in Younesi and Compulink, this court agrees with
15 the analysis in Compulink.¹ Caiafa merely found it reasonable to
16 conclude that the "full range of issues" presented in a fraud
17 case should be adjudicated in federal court rather than a section
18 2860(c) hearing; contrary to Younesi's interpretation, Caiafa did
19 not make an "exception" to section 2860(c) for "Cumis fee
20 disputes that were [also] intertwined with other non-arbitrable
21 issues." Compulink, 169 Cal. App. 4th at 79.

23 ¹ The only other decision to consider the competing
24 analyses of Younesi and Compulink arrived at this same
25 conclusion. See 88 King Street, LLC v. The Travelers Cos., Inc.,
26 No. 08-224, 2009 WL 330236, at *3 n.2 (N.D. Tex. Feb. 10, 2009)
27 ("The Court recognizes Compulink as persuasive authority and
28 agrees with its observation that . . . Younesi incorrectly held
that section 2860's arbitration provision only applies when the
sole issue in dispute is the amount or rate of independent
counsel's fees."). The Compulink decision, moreover, was handed
down by the same division of the Second District Court of Appeal
that decided Caiafa.

1 Compulink's interpretation, moreover, comports with the
2 text of section 2860(c). That provision states that "[a]ny
3 dispute concerning attorney's fees not resolved by [alternative
4 dispute resolution procedures set forth in the policy] shall be
5 resolved by final and binding arbitration by a single neutral
6 arbitrator selected by the parties to the dispute." Cal. Civ.
7 Code 2860(c). As the Compulink court observed, the statute "does
8 not contain an exception for fee disputes in cases where other
9 claims or issues also are alleged," and "[i]t accordingly does
10 not exempt from arbitration Cumis fee disputes that are coupled
11 with additional . . . claims." 169 Cal. App. 4th at 296-97.

12 Plaintiffs also contend that "[a]rbitration is
13 improper" because "the complaint plainly alleges that the
14 defendants have refused to pay attorneys' fees and costs" and
15 therefore "must be treated like the Gray Cary case." (Opp'n 6-
16 7.) In Gray Cary Ware & Freidenrich v. Vigilant Insurance Co.,
17 the court held that section 2860(c) does not require arbitration
18 of disputes over "defense expenses" as opposed to disputes over
19 "attorney's fees" because defense expenses are not specified in
20 the statute. 114 Cal. App. 4th 1185, 1193-94 (2004). As that
21 court explained, "It appears the Legislature focused on the rates
22 to be paid Cumis counsel and a method for resolving disputes over
23 these rates, with the legislative history devoid of any
24 indication showing the Legislature considered disputes regarding
25 Cumis expenses." Id. at 1193. Nonetheless, as noted in
26 Compulink, "Gray Cary never suggested that attorney's fees issues
27 fall outside the scope of section 2860's arbitration provision
28 whenever other non-arbitrable issues also are alleged." 169 Cal.

1 App. 4th at 300. In other words, even if disputes over Cumis
2 counsel expenses are not subject to section 2860(c), their
3 presence in a lawsuit does not therefore immunize related fee
4 disputes from mandatory arbitration.

5 It is undisputed that third-party defendant Mendoza's
6 Cumis counsel fees are a central issue in this case. (See, e.g.,
7 Compl. ¶ 27 (requesting a declaration "as to which party's
8 interpretation of the Policy is correct and the extent to which
9 the defendants must pay the fees and costs incurred to date").)
10 Furthermore, as Compulink instructs, "[n]otwithstanding the
11 inclusion of other non-arbitrable issues in [the] complaint, any
12 contested issues concerning the amount of attorney's fees
13 allegedly owed by [an insurer] for [the insured's] independent
14 counsel are subject to mandatory arbitration under section 2860,
15 subdivision (c)." 169 Cal. App. 4th at 300. Accordingly, the
16 court will grant defendants' motion to compel arbitration with
17 respect to the amount of attorney's fees allegedly owed to Cumis
18 counsel.

19 The court will retain jurisdiction, however, over
20 issues not squarely involving the calculation of Cumis counsel
21 fees. See Compulink, 169 Cal. App. 4th at 302 (ordering on
22 remand that "[a]ll other issues [not concerning Cumis counsel's
23 fees] be adjudicated in the trial court"); see also 88 King
24 Street, LLC v. The Travelers Cos., Inc., No. 308-224, 2009 WL
25 330236, at *4 (N.D. Tex. Feb. 10, 2009) ("The dispute concerning
26 the fees owed to independent counsel must be submitted to
27 arbitration . . . , while all other claims in this action must be
28 adjudicated by this Court."). Although defendants insist that

1 this case is "nothing more" than a "billing dispute" (Mot. Compel
2 Arb. 4:22-23), plaintiffs are equally insistent that their
3 allegations are "much more far-reaching" (Opp'n 2:7; see Compl.
4 ¶¶ 26, 34-35). At this early stage in the litigation, the court
5 has little authority to look beyond the pleadings in order to
6 definitively limit the contours of plaintiffs' claims. The court
7 expresses no opinion, moreover, as to whether or not the
8 arbitration proceeding should be stayed pending resolution of the
9 issues in this case.

10 IT IS THEREFORE ORDERED that defendants' motion to
11 compel binding arbitration be, and the same hereby is, GRANTED
12 with respect to the amount of attorney's fees owed to Cumis
13 counsel; and DENIED in all other respects.

14 DATED: April 15, 2009

15 

16 WILLIAM B. SHUBB
17 UNITED STATES DISTRICT JUDGE
18
19
20
21
22
23
24
25
26
27
28