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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

ARROWOOD INDEMNITY COMPANY, a
Delaware corporation formerly
known as ROYAL INDEMNITY
COMPANY, as successor to
GLOBE 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

**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 Arrowood Indemnity Company
("Arrowood") opposes the Motion (Doc. #50).

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1 I. BACKGROUND

2 This case arises from an underlying action brought pursuant
3 to the Comprehensive Environmental Response, Compensation and
4 Liability Act of 1980 ("CERCLA") by BAM against various owners
5 and operators of a dry cleaning facility on BAM's leased
6 property. The CERCLA defendants counterclaimed against BAM and
7 BAM tendered the defense of those claims to Arrowood, its
8 insurer. In January 2011, Arrowood agreed to defend BAM against
9 the counterclaims and appointed counsel under a reservation of
10 rights. BAM objected to the appointment of counsel, requesting
11 independent counsel of its choosing due to conflicts of interest.

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

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

1 reasonableness determinations.

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

8
9 II. OPINION

10 A. Legal Standard

11 California Civil Code § 2860 specifies that where an insurer
12 owes a duty to defend its insured and a conflict of interest
13 arises, the insurer is required to provide independent counsel to
14 represent the insured. Cal. Civ. Code § 2860(a). California
15 Civil Code § 2860(c) provides that "[a]ny dispute concerning [an
16 insured's independent counsel's] attorney's fees" shall be
17 submitted to arbitration. However, overarching coverage issues
18 concerning the existence of a duty to defend must be determined
19 at trial and not through arbitration. Compulink Mgmt. Ctr., Inc.
20 v. St. Paul Fire and Marine Ins. Co., 169 Cal. App. 4th 289, 300
21 (2008). Further, when a duty to defend exists, an insurer is
22 only responsible for representing its insured with respect to
23 defensive claims. James 3 Corp. v. Truck Ins. Exch., 91 Cal.
24 App. 4th 1093, 1104 (2001).

25 In addition to compelling arbitration, a court may stay
26 proceedings in order to "control the disposition of the causes on
27 its docket with economy of time and effort for itself, for
28 counsel, and for litigants." Landis v. N. Am. Co., 299 U.S. 248,

1 254 (1936). If a court determines that other issues between the
2 parties are not subject to arbitration and that their resolution
3 may make arbitration unnecessary, a court may stay arbitration
4 until those issues are resolved. Cal. Civ. Proc. Code §
5 1281.2(c).

6 B. Discussion

7 BAM argues in support of its motion that the language of
8 § 2860(c) clearly covers allocation and reasonableness in
9 specifying that “[a]ny dispute concerning attorney’s fees” is
10 subject to mandatory arbitration. Arrowood concedes that the
11 rates dispute is subject to arbitration, but maintains that
12 allocation and reasonableness fall outside § 2860(c)’s mandate
13 and thus should be decided by the Court or a jury. Arrowood also
14 contends that any arbitration should be stayed until the Court or
15 a jury has decided whether Arrowood owes a duty to defend and the
16 scope of that duty.

17 1. Defendant’s Motion to Compel Arbitration

18 a. Arbitrability of Rates

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

25 b. Arbitrability of the Reasonableness of Fees

26 Arrowood contends that the reasonableness issue, or a
27 determination of which independent counsel hours were reasonably
28 incurred in BAM’s defense, is not arbitrable. Arrowood argues

1 that § 2860(c)'s arbitration provision applies only to
2 determinations of hourly rates. It contends that the preceding
3 portion of § 2860(c), which discusses rates, confines the
4 arbitration requirement to apply to rates only. BAM maintains
5 that the plain language of § 2860 covers the present dispute over
6 attorney's fees.

7 Rulings on the appropriateness of arbitration have
8 ultimately rested on what courts have deemed the "gravamen of the
9 complaint." See Compulink, 169 Cal. App. 4th at 293 (citing
10 Fireman's Fund Insurance Co. v. Younesi, 48 Cal. App. 4th 451,
11 455 (1996)) (comparing the gravamen of the complaint in Younesi
12 that "counsel had engaged in a scheme of fraudulent billing
13 practices" to "the gravamen of Compulink's complaint . . . that
14 it was entitled to additional attorney's fees"). Intergulf
15 Development LLC v. Superior Court, 183 Cal. App. 4th 16, 20
16 (2010), for example, reversed an order to arbitrate where the
17 insurer did not respond to the insured's request for independent
18 counsel and thus "the gravamen of the complaint [was] bad faith
19 and breach of contract, not a dispute over the amount Interstate
20 should pay independent counsel" Id. By contrast, the
21 court in Long v. Century Indemnity Co., 163 Cal. App. 4th 1460,
22 1466 (2008), compelled arbitration where the parties had agreed
23 on independent counsel and "the gravamen of the breach-of-the-
24 implied-covenant claim [was that counsel] was not paid the hourly
25 rate he sought." Id.

26 An assertion of additional claims such as bad faith or
27 breach of contract will not preclude arbitration if fees
28 constitute the ultimate focus of the dispute. See Compulink, 169

1 Cal. App. 4th at 300 (“[T]he presence of other non-arbitrable
2 issues in an action does not preclude arbitration of [independent
3 counsel] fee issues, as long as any disputed matters regarding
4 the duty to defend . . . are resolved by the trial court.”).
5 However, where the parties’ dispute centers on issues outside the
6 scope of fees, or where fee amounts are not disputed, arbitration
7 is inappropriate. See Intergulf, 183 Cal. App. 4th at 20. For
8 instance, in BKM Total Office of California v. Pacific Insurance
9 Co., No. B173073, 2005 WL 36148, at *4 (Cal. App. Feb. 16, 2005),
10 the court affirmed denial of a motion to compel arbitration where
11 the insurer failed to tender a defense but the amount of fees and
12 billing rate were not contested. Id. Similarly, in Younesi, the
13 lower court’s denial of a motion to compel arbitration was
14 affirmed where the insurer alleged a scheme of fraudulent billing
15 practices on the part of independent counsel. See Younesi, 48
16 Cal. App. 4th at 458.

17 Arrowood relies on Younesi and BKM, but the facts of both
18 cases are distinguishable. Arbitration was denied in Younesi
19 because the dispute centered on alleged fraudulent billing
20 practices, not the amount of fees alone. Id. Arrowood’s
21 argument that the present case is similar because it centers on
22 the scope of coverage rather than fees is unconvincing. Unlike
23 fraudulent billing claims, which constitute allegations outside
24 the context of a fee disagreement, the supposed separate claim
25 here falls within the fee dispute itself. Arrowood also
26 overreads the Younesi court’s statement that § 2860 “limit[s] the
27 scope of arbitrable disputes to those in which only the amount of
28 legal fees or the hourly billing rates are at issue.” Id. at

1 459. Arrowood sees Younesi as restricting § 2860 arbitration to
2 rate determinations, but other courts have criticized this
3 interpretation. See Compulink, 169 Cal. App. 4th at 300. The
4 Compulink court refused to follow such a narrow reading of §
5 2860's scope on the grounds that it was not supported by the
6 plain language of the statute. Id. Examined in the context of
7 Younesi, the court's statement quoted above was likely made only
8 in reference to the fraud dispute at issue in that case. The
9 present dispute between BAM and Arrowood contains no allegation
10 of fraud, and absent authority to the contrary, the Court is not
11 inclined to read into Younesi any attempt to narrow the plain
12 language of § 2860(c) as it applies to the arbitrability of
13 disputes over the scope of fees.

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

26 Additional case law also supports submitting a dispute over
27 reasonableness of fees to arbitration. For instance, the court
28 in Larkin v. ITT Hartford, 1999 U.S. Dist. LEXIS 9960, at *21 fn.

1 1 (N.D. Cal. June 29, 1999), recognized that "any dispute between
2 the parties as to the amount of reasonable attorneys' fees and
3 costs incurred by plaintiffs in defense of [the insured] is
4 subject to arbitration." Id. In its decision, the court stated
5 that the plaintiffs maintained the ability to recover fees and
6 costs through arbitration "on the ground that such fees and costs
7 were reasonable and necessary to the defense." Id. Finally, in
8 Truck Insurance Exchange v. Superior Court, 51 Cal. App. 4th 985,
9 998 (1996), the court determined that disputes "over the rate *and*
10 *scope* of fees to be paid to independent counsel" are arbitrable.
11 Id. (emphasis added).

12 While the coverage action here involves a counterclaim for
13 breach of contract, the focus of the immediate dispute is clearly
14 the amount of fees to be paid to independent counsel. This case
15 is accordingly distinguishable from the precedent Arrowood cites,
16 in which fees constituted at most an aspect of the claims rather
17 than their focus. See BKM, 2005 WL 361418, at *4; Younesi, 169
18 Cal. App. 4th at 458. Here, Arrowood has paid a majority of
19 independent counsel's fees and simply contests payment of the
20 full amount billed. BAM's breach of contract counterclaim was
21 brought as a result of this fee dispute, and no overarching fraud
22 allegations are present. This is precisely the type of dispute
23 properly submitted to arbitration, with issues of a duty to
24 defend and any other legal determinations reserved for the Court.

25 Further, in light of the case law, the Court is unconvinced
26 by Arrowood's narrow reading of the statute. Because it would be
27 difficult to arbitrate rates absent determinations of
28 reasonableness, the Court sees the issues as closely related. To

1 hold that § 2860(c) nevertheless submits only the determination
2 of rates to arbitration would be illogical and would negate the
3 provision's purpose of relegating fee disputes to arbitration.

4 c. Arbitrability of Allocation

5 Arrowood also contends that the Court, not an arbitrator,
6 must allocate costs between offensive and defensive tasks, thus
7 determining which costs are Arrowood's responsibility. BAM
8 responds by emphasizing the broad language of § 2860's
9 arbitration mandate, arguing that the requirement to submit
10 "[a]ny dispute concerning attorney's fees" to arbitration covers
11 the allocation dispute.

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

22 As with reasonableness, allocation bears directly on the
23 amount of legal fees owed. An allocation inquiry would logically
24 proceed with a reasonableness inquiry, in that an arbitrator
25 would be unlikely to find an offensive task reasonably related to
26 BAM's defense. In light of the Court's finding that
27 reasonableness is arbitrable, it would again be impractical and
28 unnecessary to reserve the allocation determination for the

1 Court. To take allocation of defensive and offensive fees out of
2 the scope of arbitration would unnecessarily separate related and
3 dependent determinations and create judicial inefficiency.

4 In summary, the parties do not dispute that independent
5 counsel rates are arbitrable. Further, the Court finds that
6 reasonableness and allocation of defensive tasks should also be
7 submitted to arbitration.

8 d) Plaintiff's Request to Stay Arbitration

9 Arrowood asks the Court to stay arbitration on the basis
10 that proceeding with arbitration before resolution of the
11 coverage action would "not be meaningful" and would waste court
12 resources. Arrowood primarily relies on Janopaul + Block Cos. v.
13 Superior Court, 200 Cal. App. 4th 1239, 1251 (2011), in arguing
14 that the Court should stay any fee arbitration until it decides
15 the issues in the coverage action. BAM asserts that there is no
16 basis to stay arbitration in this case and that Truck Insurance
17 Exchange v. Superior Court, 51 Cal. App. 4th 985, 998 (1996),
18 applies and supports its contention.

19 California Courts of Appeals have been somewhat inconsistent
20 in their treatment of the timing of arbitration within larger
21 coverage actions over the duty to defend. See Pepsi-Cola Metro.
22 Bottling Co. v. Ins. Co. of N. Am., No. CV-10-2696 SVW (MANx),
23 2010 U.S. Dist. LEXIS 144401, at *45 fn. 18 (C.D. Cal. Dec. 28,
24 2010) ("[T]he Intergulf court may have broken with the Compulink
25 court in requiring that issues regarding the duty to defend and
26 bad faith be addressed *prior* to arbitration under § 2860(c)
27" (emphasis in original)). However, under Truck, fee
28 disputes may be arbitrable prior to any legal determination of

1 coverage issues in cases where an insurer (1) is providing a
2 defense under a reservation of rights and (2) has agreed to
3 independent counsel. See Truck, 51 Cal. App. 4th at 998. While
4 Truck did not address every precise issue presented in this case,
5 it does establish that arbitration may appropriately occur before
6 coverage issues over the duty to defend are resolved. Id. Where
7 an insurer has not agreed to the insured's representation by
8 independent counsel, the situation may be different. Id. at 997
9 (citing Truck Ins. Exch. v. Dynamic Concepts, Inc., 9 Cal. App.
10 4th 1147, 1150 (1992)) ("[W]here the [insurer] refuses to provide
11 a defense through independent counsel, the legal issue must be
12 decided by the court before section 2860 arbitration is
13 available."). For instance, in Janopaul, the court reversed a
14 grant of arbitration where the insurer had breached its duty to
15 defend and engaged in bad faith conduct. See Janopaul, 200 Cal.
16 App. 4th at 1251. However, Janopaul is distinguishable because
17 independent counsel had not been agreed upon in that case. Id.
18 By contrast, where independent counsel is appointed, "it would
19 undermine the concept of reservation of rights to preclude
20 resolution of the issue until after the declaratory relief action
21 has been decided." Truck, 51 Cal. App. 4th at 998. Under Truck,
22 once the reasonable amount of fees is determined in arbitration
23 and paid by Arrowood, the reservation of rights, or in this case
24 a pending declaratory relief action, would still permit Arrowood
25 to recover any overpayments pursuant to the Court's findings on
26 the duty to defend. Additionally, Arrowood has already paid a
27 substantial portion of BAM's independent counsel's fees, meaning
28 that even if arbitration were stayed, Arrowood would still have

1 to recover fees if it succeeds in the coverage action.

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

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5

II. ORDER

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

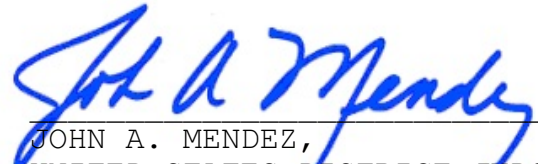
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IT IS SO ORDERED.

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Dated: June 3, 2013

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JOHN A. MENDEZ,
UNITED STATES DISTRICT JUDGE

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