

Arbitration

Introduction

Arbitration is a process by which parties submit their disputes for resolution by impartial third persons instead of by a judicial tribunal. A few statutes and some contracts require that disputes be resolved by arbitration.¹ Arbitration may be binding or non-binding. An arbitration award may be confirmed as a court judgment and has the same res judicata and collateral estoppel effect. Arbitration is similar to a general reference. Civil Code § 2860(c) compels arbitration of attorney fees disputes with insurers that concede that they have a duty to defend and that a disqualifying conflict of interest exists.

Arbitration

Arbitration may be described as a form of alternative dispute resolution that features a third party decision maker chosen by the parties, a mechanism for ensuring neutrality in the rendering of the decision, an opportunity for both parties to be heard, and a binding decision.² An arbitration award is not appealable.³ An arbitration agreement must be in writing,⁴ but signatures not required.⁵ Generally, an arbitrator cannot be called to testify in a subsequent civil proceeding as to matters occurring “at or in conjunction with” the arbitration proceedings.⁶

1. Statutory Authorization

Arbitration is authorized by statute. “A written agreement⁷ to submit to arbitration an existing controversy is valid, enforceable and irrevocable.”⁸ “If a court has ordered arbitration of [an] issue involved in an action pending, the court shall, upon motion stay the action until an arbitration is had.”⁹ “Any party to an arbitration in which an award has been made may petition the court to confirm the award.”¹⁰ The court retains jurisdiction “to determine any subsequent petition involving the same agreement to arbitrate and the same controversy.”¹¹

2. Fundamental Fairness

An arbitration must include some mechanism for ensuring impartiality.¹² Arbitrators must provide a fundamentally fair hearing including adequate notice, hearing on evidence, and

¹ Code Civ. Proc. § 1280 et. seq.; *Herman Feil, Inc. v. Design Center of Los Angeles* (1988) 204 Cal.App.3d 1406, 1414.

² *Cheng-Canindin v. Renaissance Hotel Assocs.* (1996) 50 Cal.App.4th 676, 684 (*Cheng-Canindin*).

³ *National Union Fire Ins. Co. v. Nationwide Ins. Co.* (1999) 69 Cal.App.4th 709, 723-724 (*National Union*).

⁴ Code Civ. Proc. § 1281; *Law Offices of Ian Herzog v. Law Offices of Joseph M. Fredrics* (1998) 61 Cal.App.4th 672, 677.

⁵ *Valero Refining, Inc. v. M/T Lauberhorn* (5th Cir. 1987) 813 F.2d 60, 64.

⁶ Evid. Code § 703.5.

⁷ See, *Arbitration Agreement* at DutytoDefend.com.

⁸ Code Civ. Proc. § 1281 (ellipsis omitted).

⁹ Code Civ. Proc. § 1281.4 (ellipses omitted).

¹⁰ Code Civ. Proc. § 1285 (ellipses omitted).

¹¹ Code Civ. Proc. § 1292.6.

¹² *Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 824-827; *Cheng-Canindin, supra*, 50 Cal.App.4th at 687.

impartial decision by the arbitrator.¹³ If the parties agree that evidence may be received, the arbitrator is required to respect and follow their agreement.¹⁴

3. Privacy

Arbitration hearings may be conducted privately and nonparties may be excluded from attending the hearing. Arbitration may be required to keep communications, documents and testimony confidential, but no such obligation is imposed on counsel or parties.¹⁵ Unless barred by a protective order, the parties may freely use evidence proffered in an arbitration and the arbitration award in other proceedings and for other purposes.¹⁶ It is not necessary to have a formal record of the arbitration, but frequently parties have the hearing reported to challenge an award¹⁷ or to assure a non-participating insurer of the bona fides of the process.

4. Expenses

Unless the arbitration agreement or rules adopted by the parties provide otherwise, the parties must share all expenses and fees of the arbitration, subject to reallocation by the arbitrator in the award.¹⁸ Unlike judicial proceedings, neither party can recover costs from the other.¹⁹

5. Res Judicata

An arbitration award is normally entitled to strict res judicata effect whether or not judicially confirmed.²⁰ Similarly, issues actually determined in arbitration proceedings that were necessary to such determination are entitled to collateral estoppel effect in later litigation between the same parties. But the arbitrator's findings do not bind the losing party in later litigation with a nonparty. A nonparty cannot invoke collateral estoppel even if the arbitration award was judicially confirmed.²¹ In one case, an insurer was not allowed to use findings from an arbitration in subsequent coverage litigation.²²

Judicial arbitration may be required where the amount in controversy is \$50,000 or less.²³

General Reference

Upon the motion of a party to a written contract that provides that any controversy shall be heard by a referee, a court may appoint a referee "(a) To hear and determine any or all of the issues in an action, whether of fact or of law, and to report a statement of decision. (b) To ascertain a fact necessary to enable the court to determine an action."²⁴ "In a consensual general reference, the decision of the referee upon the whole issue must stand as the decision of the court, and judgment may be entered thereon in the same manner as if the action had been tried by the

¹³ *Maaso v. Signer* (2012) 203 Cal.App.4th 362, 372-373.

¹⁴ *Bonshire v. Thompson* (1997) 52 Cal.App.4th 803, 811.

¹⁵ See AAA Code of Ethics for Arbitrators in Commercial Disputes, Canon VI.B; see also JAMS Comprehensive Arbitration Rules and Procedures, Rule 26.

¹⁶ *Universal City Studios, Inc. v. Superior Court* (2003) 110 Cal.App.4th 1273, 1274-1275.

¹⁷ See, Code Civ. Proc. § 1286.2.

¹⁸ Code Civ. Proc. § 1284.2; see also *Lifescan, Inc. v. Premier Diabetic Services, Inc.* (9th Cir. 2004) 363 F.3d 1010, 1013 (applying Calif. law).

¹⁹ *Austin v. Allstate Ins. Co.* (1993) 16 Cal.App.4th 1812, 1815.

²⁰ *Vandenberg v. Superior Court* (1999) 21 Cal.4th 815, 824, fn. 2.

²¹ *Id.* at 824.

²² *Id.* at 834-837.

²³ Code Civ. Proc. § 1141.10 et seq.

²⁴ Code Civ. Proc. § 638 (ellipses omitted).

court. In the case of all other references, the decision of the referee is only advisory.²⁵ A judgment following a general reference is appealable.²⁶

Civil Code § 2860 Fee Arbitration

1. The Statute

“Civil Code, section 2860 codifies (with clarifications and limitations) the holding in [*Cumis*²⁷], which concluded that an insurer is responsible to pay the reasonable cost for hiring independent counsel for the insured when the insured and insurer have divergent interests due to the insurer’s reservation of its right to deny coverage.”²⁸ “Any dispute concerning attorney’s fees not resolved by [agreement] shall be resolved by final and binding arbitration by a single neutral arbitrator selected by the parties to the dispute.”²⁹ Section 2860 arbitration is mandatory and binding.³⁰ It applies even though the insurer does not retain its own dependent counsel.³¹ The insurer does not waive its challenges to coverage by participating in a 2860 arbitration.³² The parties may not waive arbitration since courts are without jurisdiction to adjudicate 2860 fee disputes.³³ One case holds that disputes regarding costs (as opposed to fees) may not be arbitrated.³⁴ However, costs may be arbitrated by agreement of the parties.

2. Applicability of the Statute

Civil Code § 2860 confers upon qualifying insurers a number of protections to qualifying insurers. However, it has limited application that the insurer must earn. None of the statute’s protections are available unless the insurer qualifies, including its hourly rate limitation. The statute specifies a simple $A + B = C$ formula for its application.³⁵ Thus, “in the absence of a stipulation or unconditional agreement between the insurer and insured, unless and until there has been a judicial determination of an insurer’s duty to defend and the existence of a conflict of interest, the provisions of Civil Code section 2860 are inapplicable.”³⁶ These questions “may not be decided in an arbitration ordered pursuant to Civil Code section 2860 but must be resolved by the trial court in the first instance.”³⁷ Some insurers will agree to defend without conceding that

²⁵ Code Civ. Proc. § 644 (ellipses omitted).

²⁶ *National Union, supra*, 69 Cal.App.4th at 723-724.

²⁷ *San Diego Fed. Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358.

²⁸ *Seltzer v. Barnes* (2010) 182 Cal.App.4th 953, 966; see also, *Novak v. Low, Ball & Lynch* (1999) 77 Cal.App.4th 278, 282; *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1420.

²⁹ Civ. Code § 2860(c).

³⁰ *Fireman’s Fund Ins. Cos. v. Younesi* (1996) 48 Cal.App.4th 451, 459; *Compulink v. St. Paul Fire & Marine Ins. Co.* (2008) 169 Cal.App.4th 289, 300.

³¹ *Long v. Century Indem. Co.* (2008) 163 Cal.App.4th 1460, 1471-1474.

³² *Truck Ins. Exch. v. Superior Court (Cherng)* (1996) 51 Cal.App.4th 985, 997.

³³ *Long, supra*, 163 Cal.App.4th at 1474.

³⁴ *Gray Cary Ware & Freidenrich v. Vigilant Ins. Co.* (2004) 114 Cal.App.4th 1185, 1192.

³⁵ “If the provisions of a policy of insurance [A] impose a duty to defend upon an insurer and [B] a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, [then C] the insurer shall provide independent counsel to represent the insured.” (Civil Code § 2860(a).)

³⁶ *Handy v. First Interstate Bank* (1993) 13 Cal.App.4th 917, 926 (emphasis added).

³⁷ *Id.* at 924 (emphasis added).

they have a duty to defend and some will agree to pay for independent counsel without conceding that a disqualifying conflict of interest exists. An insurer that fails to fulfill its duty to defend may not invoke the protections of § 2860, including arbitration.³⁸ One case holds that parties who agree to arbitration of a fee dispute prior to any determination that a duty to defend and a disqualifying conflict of interest exist will nonetheless be bound by the arbitration award if these two prerequisites are later determined.³⁹

Practice Pointer

When an insurer agrees to defend and agrees to pay independent counsel under a reservation of rights, the policyholder and independent counsel should ask the insurer whether or not it agrees unconditionally. If the answer is “no”, § 2860 does not apply and any fee dispute may not be resolved by § 2860 mandatory arbitration but the rate limitation provision of § 2860(c) does not apply and the policyholder may be able to recover the full rates charged by independent counsel.

If an insurer is not faithfully providing a defense to its policyholder, the policyholder may be able to resolve the liability dispute despite the “actual trial” provision of many liability policies.

³⁸ *Housing Group v. PMA Capital Ins. Co.* (2011) 193 Cal.App.4th 1150, 1158; *Janopaul K Block Cos., LLC v. Superior Court* (2011) 200 Cal.App.4th 1239, 1241, 1249.

³⁹ *Truck Ins. Exchange v. Superior Court* (1996) 51 Cal.App.4th 985, 992-93 (The court supported this conclusion on the grounds of collateral estoppel, but not res judicata.)