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ARBITRATOR

IN THE MATTER OF THE ARBITRATION

OF THE CLAIM OF

VERTEQ, INC., a California corporation, Petitioner, vs. NORTHBROOK PROPERTY & CASUALTY INSURANCE COMPANY, an Illinois corporation, Respondent.	CORRECTED AWARD OF ARBITRATOR (BINDING) C.C.P. 1141.10 ET SEQ. C.R.C. 1600 ET SEQ.

This matter came on for hearing on September 21, 22 and 24, 1993. Upon consideration of the testimony, the documentary evidence and the argument of counsel, the Arbitrator made his findings and award on November 1, 1993. Thereupon, letters were received from Mr. Marquez on behalf of Northbrook, dated November 1, 1993, and from Mr. Richardson on behalf of Verteq, dated November 3, 1993. By letter dated November 4, 1993 the Arbitrator informed Mr. Marquez and Mr. Richardson that those letters were

considered to be applications for correction of the award pursuant to C.C.P. § 1284 and that Mr. Richardson's letters were considered also to be objection to Northbrook's application for correction. Counsel were advised that the Arbitrator would withhold acting upon the applications until November 15, 1993 pending receipt of objection by Northbrook to Verteq's application for correction. On November 15, 1993 a letter dated November 12, 1993 was received from Mr. Marquez on behalf of Northbrook. Upon consideration of the parties' applications for correction, it is the finding of the Arbitrator that he has not exceeded his powers under his statutory authority or as provided in the Stipulation To Arbitrate Attorney's Fee Dispute dated April 28 and 29, 1993. It is also the finding of the Arbitrator that there was an evident miscalculation of figures in the Award dated November 1, 1993. Correction of those miscalculations are shown in this Corrected Award of Arbitrator. The Arbitrator now makes his corrected findings and award as follows:

Prior to the enactment of C.C. 2860, in circumstances such as existed in this case, the rule was that the insurer was obligated to pay the reasonable value of the legal services and costs performed by independent counsel. It was also the rule that the insurer's duty was to pay for the services of counsel competent to handle cases of the kind at issue in the litigation. Upon enactment of C.C. 2860 (c) a limitation was added to the existing rule limiting the

insurers obligation to the rates which are actually paid by the insurer to attorneys retained by the insurer in the defense of similar actions in the community where the claim arose or is being defended. Upon a showing by the insurer that in the ordinary course of business, it actually paid a specific rate (or less) to attorneys retained by the insurer to defend similar action, the insurer is not obligated to pay to the insureds' independent counsel more than that maximum actual rate (or indemnify the insured at more than that actual rate for fees paid by the insured to its independent counsel).

Northbrook insisted throughout the Semitool litigation that the actual rate it paid to its retained counsel in defending actions similar to Semitool was $125.00. Throughout the Semitool litigation Northbrook took the position that it did not have to disclose what cases involving similar issues its retained attorneys had defended, or who those attorneys were.

Regardless of whether or not Northbrook was obliged to disclose the cases and/or attorneys in which, or to whom, the rate paid for similar actions was $125.00, in this arbitration it is required to support its asserted $125.00 rate with evidence that it has in fact actually paid that rate to retained counsel in cases similar to this. It has failed to do so. Mr. Bennett who actually handled the Semitool matter for Northbrook testified that Northbrook had

not paid any retained counsel $125.00 to handle the defense of a patent infringement case. Although Mr. Bennett, at the time he testified was called by Verteq as its witness and was no longer employed by Northbrook, having been terminated by Northbrook in an economy move, there is no other evidence presented to overcome his testimony. Northbrook called Mrs. Price who testified that she was to some extent involved in dealing with independent counsel in C.C. 2860 (c) situations. She related the names of seven law firms or attorneys. Although some of the cases in which those attorneys had been engaged were intellectual property cases, none of them were patent infringement cases and none of them were shown to involve the necessity for the level of competence required of counsel in the Semitool case. Mr. Robinson testified that as independent counsel Northbrook paid him fees at the rate of $125.00 per hour which he accepted without agreement to do so and that no claim has been made against Northbrook for a higher rate in that matter. However, Mr. Robinson was not retained counsel within the contemplation of C.C. 2860 (c).

It is the finding of the Arbitrator that the evidence fails to establish that Northbrook paid on actual rate of $125.00 to any retained counsel to defend a case similar to the Semitool case. Therefore, the fee issue presented here is governed by the rule of reasonable value in the community of services of counsel competent to handle the particular

type of lawsuit at issue.

The evidence presented at the arbitration hearing establishes that Knobbe, Marten, Olson and Bear's (KMOB) services in the Semitool case were reasonable and appropriate, and that they were fully competent to handle the Semitool case which was exceptionally complex. Further the evidence presented shows that the rates billed by KMOB were comparable to those paid to patent defense counsel in San Francisco, California.

The evidence presented more than amply supports a finding that the fees billed by KMOB were reasonable for the skill, experience and legal and technical expertise required by the Semitool case. The billings were audited by Northbrook's agents who found that the work done and the time expended were appropriate to the issues presented.

Although Northbrook's auditing and its communications, correspondence and conduct during the litigation did not question the billing as to allocation between Verteq's prosecution of its claim against Semitool and Verteq's defense against the counter claim, Northbrook had clearly reserved that question in its reservation of rights letter. The subsequent events did not constitute a waiver of their right to claim such an allocation. That issue was properly before the Arbitrator.

Upon consideration of the evidence concerning the issues addressed in the Semitool complaint and counter claim

the Arbitrator is persuaded that the defense against the counter claim was inextricably intertwined with Verteq's complaint against Semitool. In fact it was established by the testimony and evidence presented that in order for Verteq to prevail on its complaint it had to prevail against Semitool on the counter claim. The testimony and evidence also proved that when Verteq prevailed on the counter claim it thereby prevailed on its complaint. It is the finding of the Arbitrator that the entire fees and costs from the time of the filing of Semitool's counter claim are chargeable to Northbrook.

At the commencement of the arbitration Northbrook asserted that the "other insurance" provisions of its policy were applicable and that based upon the existence of the Cigna policy it was not obligated to Verteq for more than half of the defense expense. This issue was resolved by the Arbitrator on the motion For Order Quashing or Modifying Subpenas Duces Tecum. In granting that motion on September 21, 1993, the Arbitrator found that the "other insurance" provisions in Northbrook's policy are not applicable to its duty to defend.

Northbrook claims that it is entitled to a credit in the sum of $148,992.82 which was the sum Cigna paid Verteq in settlement of Verteq's bad faith claim against Cigna. Verteq asserts that the entire settlement sum was one for the tort damages for Cigna's alleged bad faith and not as

payment of defense expense. Mr. Toolen negotiated the settlement with Cigna. He testified that although the settlement amount was equal to attorney fees billed as of the date of settlement, that sum was accepted by Verteq as settlement for its extra contractual claim of bad faith and not as expense of defense of the Semitool case. Mr. Gnesda testified that the settlement amount was equal to one half of the attorneys fees and costs to the date of the settlement. On cross examination when Mr. Gnesda was asked to look at the words of the settlement agreement beginning, on page 2, with the words "...breach of the implied covenant, [etc]..." he acknowledged that the sum paid in settlement was agreed to be paid for Cigna's release from Verteq's bad faith claim. However, the settlement agreement expressly states that it applies to both contractual and extra-contractual claims; and, on cross examination of Mr. Toolen he acknowledged that is what is stated in the settlement agreement. From the evidence presented, it is the finding of the Arbitrator that Northbrook is entitled to a credit. Since there is no clear evidence that the total sum of $148,992.82 was paid for legal expense and costs the Arbitrator will accept Northbrook's proposal to credit the sum of $74,496.41 against Verteq's claim.

The evidence presented by Verteq supports a finding that the unpaid reasonable attorney fees and costs, after

deduction of the credit for payment by Cigna in the settlement of 5/20/92, is the sum of $317,870.22.

Verteq claims that Northbrook acted in bad faith in providing a defense for Verteq, and that therefore Verteq is entitled to recover its attorney fees and cost incurred in this arbitration. Verteq's claim in this regard is supported by case authority and the evidence produced at the arbitration hearing.

Northbrook's refusal to pay independent counsel fees at a rate higher than $150.00 was based on a knowingly false claim that it had actually paid fees of no more than $125.00 to retained counsel for defense of similar actions. Its failure to pay fees on the agreed periodic basis contributed to Verteq's developing financial problems. Northbrook's conduct in that regard was with conscious disregard of its insured's interests in violation of its duty to Verteq. Verteq is entitled to an award of reasonable attorney fees and costs incurred in this arbitration.

Verteq is awarded the sum of $317,870.22 as against Northbrook plus prejudgment interest. Additionally Verteq is awarded reasonable attorney fees and costs incurred in this arbitration.

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Counsel for Verteq shall prepare and submit within fifteen days of the date of this order declarations by competent and qualified persons as to accrued interest; and attorney fees and costs, supported by billing statements and invoices, incurred in the arbitration. Northbrook shall have ten days thereafter to submit a written response.

DATED: 11/27/93

PHILIP H. SCHWAB, Arbitrator