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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

HAIDEE ESTRELLA,
Plaintiff,

v.

FREEDOM FINANCIAL,
Defendant.

No. C 09-03156 SI

**ORDER GRANTING DEFENDANTS'
MOTION TO COMPEL ARBITRATION
OF PLAINTIFFS' UCL, CLRA, AND
NEGLIGENCE CLAIMS AND STAYING
ACTION ON PLAINTIFFS' CROA
CLAIM**

On June 24, 2011, the Court heard oral argument on defendants' motion to compel arbitration and stay action on plaintiffs' claims. Having considered the arguments of counsel and the papers submitted, and for good cause shown, the Court hereby GRANTS defendants' motion to compel arbitration of plaintiffs' Unfair Competition Law, Consumer Legal Remedies Act, and negligence claims. The Court STAYS action on the plaintiffs' Credit Repair Organization Act claim pending the outcome of *CompuCredit Corp. v. Greenwood*, — S. Ct. —, 2011 WL 220683.

BACKGROUND

Defendants Freedom Debt Relief, Inc. ("FDR"), Freedom Financial Network, LLC, Freedom Debt Relief, LLC, and FDR's Chief Executive Officers Andrew Houser and Bradford Stroh (collectively the "Network defendants") offer a debt reduction service. Upon enrolling in the program, which FDR's advertisements describe as "an innovative solution for consumers struggling with large debt burdens and who need debt relief," the consumer signs a contract and authorizes an automatic monthly transfer of funds from the consumer's existing bank account to a new Special Purpose Account

1 (SPA). After sufficient funds have accumulated in the client’s SPA, FDR contacts the client’s creditors
2 and attempts to negotiate a settlement of the client’s debt for less than is owed. Second Amended
3 Complaint (“SAC”) ¶ 10. The contractual agreement provides that clients will pay FDR a retainer fee
4 and service fee equal to approximately 15% of their existing debt (10% for the service fee and 5% for
5 the retainer fee). SAC ¶ 13. These fees are paid directly from the client’s SPA; the retainer fees are
6 deducted over the first four months and the service fees are deducted over the following fifteen months.
7 SAC ¶ 13.

8 On the basis of these and other allegations, plaintiffs plead four causes of action against
9 defendants: (1) unfair competition in violation of California’s Unfair Competition Law (UCL), Cal. Bus.
10 & Prof. Code § 17200; (2) violation of the federal Credit Repair Organization Act (CROA), 15 U.S.C.
11 § 1679b; (3) violation of California’s Consumers Legal Remedies Act (CLRA), Cal. Civ. Code §§ 1750
12 et seq.; and (4) negligence in violating California’s “prorater” statute, Cal. Fin. Code § 12315.1. SAC
13 ¶¶ 55-75. The claims are described in more detail in the Court’s order certifying a class action, which
14 was issued June 25, 2010. Order Granting Pl. Mot. For Class Cert., Doc. 134.

15 The fourth claim and part of the first claim are premised on the allegation that defendants are
16 proraters, as defined by California’s prorater statute. Cal. Fin. Code §§ 12000 to 12404. The parties
17 submitted cross-motions for summary adjudication on whether FDR qualifies as a prorater under Cal.
18 Fin. Code § 12002.1. The question of whether FDR is a prorater was critical: if FDR were found not
19 to be a prorater, the plaintiffs’ negligence claim and third UCL claim would be eviscerated, but if FDR
20 were found to be a prorater, the plaintiffs would be able to establish the grounds for their third UCL
21 claim, as well as establish a framework for making their other UCL claims and their negligence claim.
22 The Court denied both the plaintiffs’ motion for summary judgment and the defendants’ motion for
23 either summary judgment or summary adjudication on the issues on March 14, 2011.

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1 The contract the plaintiffs signed with FDR also includes an arbitration clause. Section 9 of the
2 contract, the “Arbitration of Dispute” provision, in all capital letters, starts at the bottom of the second
3 page of the contract and states:

4
5 IN THE EVENT OF ANY CONTROVERSY, CLAIM OR DISPUTE BETWEEN THE
6 PARTIES ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE
7 BREACH, TERMINATION, ENFORCEMENT, INTERPRETATION OR VALIDITY
8 THEREOF, INCLUDING THE TERMINATION OF THE SCOPE OR
9 APPLICABILITY OF THIS AGREEMENT TO ARBITRATE, SHALL BE
10 DETERMINED BY ARBITRATION IN SAN FRANCISCO, CALIFORNIA OR IN
11 THE COUNTY IN WHICH THE CONSUMER RESIDES, IN ACCORDANCE WITH
12 THE LAWS OF THE STATE OF CALIFORNIA FOR AGREEMENTS TO BE MADE
13 IN AND TO BE PERFORMED IN CALIFORNIA. THE PARTIES AGREE, THE
14 ARBITRATION SHALL BE ADMINISTERED BY THE AMERICAN
15 ARBITRATION [Sic] (“AAA”) PURSUANT TO ITS RULES AND PROCEDURES
16 AND AN ARBITRATOR SHALL BE SELECTED BY THE AAA. THE
17 ARBITRATOR SHALL BE NEUTRAL AND INDEPENDENT AND SHALL
18 COMPLY WITH THE AAA CODE OF ETHICS. THE AWARD RENDERED BY
19 THE ARBITRATOR SHALL BE FINAL AND SHALL NOT BE SUBJECT TO
20 VACATION OR MODIFICATION. JUDGMENT ON THE AWARD MADE BY THE
21 ARBITRATOR MAY BE ENTERED IN ANY COURT HAVING JURISDICTION
22 OVER THE PARTIES. IF EITHER PARTY FAILS TO COMPLY WITH THE
23 ARBITRATOR’S AWARD, THE INJURED PARTY MAY PETITION THE CIRCUIT
24 COURT FOR ENFORCEMENT. THE PARTIES AGREE THAT EITHER PARTY
25 MAY BRING CLAIMS AGAINST THE OTHER ONLY IN HIS/HER OR ITS
26 INDIVIDUAL CAPACITY AND NOT AS A PLAINTIFF OR CLASS MEMBER IN
27 ANY PURPORTED CLASS OR REPRESENTATIVE PROCEEDING. FURTHER,
28 THE PARTIES AGREE THAT THE ARBITRATOR MAY NOT CONSOLIDATE
PROCEEDINGS OF MORE THAN ONE PERSON’S CLAIMS, AND MAY NOT
OTHERWISE PRESIDE OVER ANY FORM OF REPRESENTATIVE OR CLASS
PROCEEDINGS. THE PARTIES SHALL SHARE THE COST OF ARBITRATION,
INCLUDING ATTORNEY’S FEES, EQUALLY. IF THE CONSUMERS SHARE OF
THE COST IS GREATER THAN \$1,000 (ONE-THOUSAND DOLLARS), THE
COMPANY WILL PAY THE CONSUMERS SHARE OF COSTS IN EXCESS OF
THAT AMOUNT. IN THE EVENT A PARTY FAILS TO PROCEED WITH
ARBITRATION, UNSUCCESSFULLY CHALLENGES THE ARBITRATOR’S
AWARD, OR FAILS TO COMPLY WITH THE ARBITRATOR’S AWARD, THE
OTHER PARTY IS ENTITLED TO COSTS OF SUIT, INCLUDING A
REASONABLE ATTORNEY’S FEE FOR HAVING TO COMPEL ARBITRATION
OR DEFEND OR ENFORCE THE AWARD.

24 Bretan Decl., Exh. C.

25 On May 16, 2011, defendants filed a Motion to Compel Arbitration and Stay Action Pursuant
26 to the Federal Arbitration Act. The Motion to Compel Arbitration was filed in response to the U.S.
27 Supreme Court’s decision in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, issued April 27, 2011,
28 which held that the Federal Arbitration Act (FAA) preempts California’s *Discover Bank* rule and

1 prohibits states from conditioning the enforceability of certain arbitration agreements on the availability
2 of classwide arbitration procedures. *Concepcion*, 131 S. Ct. at 1744, 1753.

3
4 **LEGAL STANDARD**

5 Section 4 of the Federal Arbitration Act ("FAA") permits "[a] party aggrieved by the alleged
6 failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration [to] petition
7 any United States district court . . . for an order directing that . . . arbitration proceed in the manner
8 provided for in [the arbitration] agreement." 9 U.S.C. § 4. Upon a showing that a party has failed to
9 comply with a valid arbitration agreement, the district court must issue an order compelling arbitration.
10 *Id.*

11 The Supreme Court has stated that the FAA espouses a general policy favoring arbitration
12 agreements. *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *see also*
13 *Hall Street Assoc., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 581 (2008). Federal courts are required to
14 rigorously enforce an agreement to arbitrate. *See Hall Street Assoc.*, 552 U.S. at 582. In determining
15 whether to issue an order compelling arbitration, the court may not review the merits of the dispute but
16 must limit its inquiry to (1) whether the contract containing the arbitration agreement evidences a
17 transaction involving interstate commerce, (2) whether there exists a valid agreement to arbitrate, and
18 (3) whether the dispute(s) fall within the scope of the agreement to arbitrate. *See Republic of Nicaragua*
19 *v. Standard Fruit Co.*, 937 F.2d 469, 477-478 (9th Cir. 1991), *cert denied*, 503 U.S. 919 (1992). If the
20 answer to each of these queries is affirmative, then the court must order the parties to arbitration in
21 accordance with the terms of their agreement. 9 U.S.C. § 4.

22 The FAA provides that arbitration agreements generally "shall be valid, irrevocable, and
23 enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9
24 U.S.C. § 2. "Thus, generally applicable contract defenses, such as fraud, duress, or unconscionability,
25 may be applied to invalidate arbitration agreements without contravening" federal law. *Doctor's Assoc.,*
26 *Inc. v. Casarotto*, 517 U.S. 681, 687 (1996). In interpreting the validity and scope of an arbitration
27 agreement, the courts apply state law principles of contract formation and interpretation. *See id.*; *see*
28 *also Wolsey, Ltd. v. Foodmaker, Inc.*, 144 F.3d 1205, 1210 (9th Cir. 1998). Accordingly, the Court

1 reviews plaintiff's arbitration agreement in light of the "liberal federal policy favoring arbitration
2 agreements," *Moses H. Cone*, 460 U.S. at 24, and considers the enforceability according to the laws of
3 the state of contract formation. See *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995);
4 *Ingle v. Circuit City Stores*, 328 F.3d 1165, 1170 (9th Cir. 2003).

6 DISCUSSION

7 In *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (Cal. 2005), the California Supreme Court
8 held that when class-action waivers are

9 found in a consumer contract of adhesion in a setting in which disputes between the
10 contracting parties predictably involve small amounts of damages, and when it is alleged
11 that the party with the superior bargaining power has carried out a scheme to deliberately
12 cheat large numbers of consumers out of individually small sums of money, then . . . the
waiver becomes in practice the exemption of the party "from responsibility for [its] own
fraud, or willful injury to the person or property of another." Under these circumstances,
such waivers are unconscionable under California law and should not be enforced.

13 *Id.* at 162 (quoting Cal. Civil Code § 1668).

14 In *Concepcion*, the Supreme Court said that the "overarching purpose" of the FAA is to "ensure
15 the enforcement of arbitration agreements according to their terms so as to facilitate streamlined
16 proceedings." *Concepcion*, S. Ct. 131 at 1748. Because requiring the availability of classwide
17 arbitration "interferes with fundamental attributes of arbitration," the Court said the requirement is
18 inconsistent with the FAA. *Id.* In support of its argument that a change from bilateral arbitration to
19 class-action arbitration is "fundamental," the Court cited the loss of arbitration's informality, making
20 the "process slower, more costly, and more likely to generate procedural morass," and an increased risk
21 to defendants. *Id.* at 1750-52. While the *Concepcion* dissent argued that class proceedings are
22 necessary to prosecute small-dollar claims that might otherwise slip through the cracks of the legal
23 system, the Court said that "States cannot require a procedure that is inconsistent with the FAA, even
24 if it is desirable for unrelated reasons." *Id.* at 1753. The Court acknowledged that States are still able
25 to take action to address concerns about adhesion contracts, providing as an example a requirement that
26 class-action waivers be highlighted in arbitration agreements, but said "such steps cannot, however,
27 conflict with the FAA or frustrate its purpose to ensure that private arbitration agreements are enforced
28 according to their terms." *Id.* at 1750 n. 6.

1 Twenty-seven months after this case was brought, but only nineteen days after the Supreme
2 Court’s ruling in *Concepcion*, defendants moved to compel arbitration. They argue that they are now,
3 for the first time, entitled to have the plaintiffs’ claims decided in arbitration on an individual basis.

4 Plaintiffs oppose the motion to compel arbitration on several grounds. They argue that
5 defendants waived their right to arbitrate by litigating the case for over two years. They also argue that
6 the arbitration clause does not govern claims against several of the defendants and that the clause does
7 not govern the unlicensed prorate claim against any defendant. Plaintiffs also argue that a CROA claim
8 is not arbitrable.

9
10 **I. Waiver**

11 In *Fisher v. A.G. Becker Paribas, Inc.*, the Ninth Circuit held that a party seeking to prove
12 waiver of a right to arbitration must show: “(1) knowledge of an existing right to compel arbitration; (2)
13 acts inconsistent with that existing right; and (3) prejudice to the party opposing arbitration resulting
14 from such inconsistent acts.” *Fisher*, 791 F.2d 691, 694 (9th Cir. 1986). Because waiver of a contractual
15 right to arbitration is not favored, “any party arguing waiver of arbitration bears a heavy burden of
16 proof.” *Id.*

17 In *Fisher*, the Ninth Circuit examined whether a defendant’s decision not to file a motion to
18 compel arbitration prior to the Supreme Court’s rejection of the intertwining doctrine – which held that
19 when it was impractical or impossible to separate nonarbitrable from arbitrable contract claims, a court
20 should deny arbitration in order to preserve its exclusive jurisdiction over federal securities claims –
21 constituted waiver. *See id.* at 695. Prior to the Supreme Court’s decision, the Ninth Circuit had
22 approved of the intertwining doctrine and had said in *De Lancie v. Birr, Wilson & Co.*, 648 F.2d 1255
23 (9th Cir. 1981), that arbitration should be denied where common law claims are intertwined with
24 securities law violations. *Id.* at 693. The defendant relied on the doctrine and the Ninth Circuit’s
25 decision in *De Lancie* in deciding not to file a motion to compel arbitration because it would have been
26 “futile” prior to the Supreme Court’s ruling. *Id.* The Ninth Circuit concluded that there was no waiver
27 because the defendant was entitled to rely on the intertwining doctrine and that court’s prior decisions
28 in deciding that it would be futile to file a motion to compel arbitration. *Id.* Because the arbitration

1 agreement was unenforceable before the Supreme Court’s decision, the court held that the defendant
2 did not act inconsistently with a known existing right to compel arbitration and had not waived the right
3 to arbitration. *Id.* at 697.

4 Plaintiffs argue that defendants waived the right to arbitrate by not seeking to arbitrate earlier
5 and instead electing to litigate through class certification. However, this case is similar to *Fisher*
6 because, prior to the Supreme Court’s decision in *Concepcion*, it would have been futile for the
7 defendants to file a motion to compel arbitration: prior to *Concepcion*, California and Ninth Circuit law
8 held that similar arbitration agreements with class action waivers were unconscionable and
9 unenforceable. *See Discover Bank*, 36 Cal. 4th 148; *Shroyer v. New Cingular Wireless Servs., Inc.*, 498
10 F.3d 976 (9th Cir. 2007).

11 Plaintiffs try to distinguish their case from *Fisher* by saying that in *Fisher* the right to arbitration
12 did not exist at all under controlling authority, whereas here the right to arbitration always existed
13 because the “*Discover Bank* rule held that contractual provisions preventing class-wide arbitration were
14 unenforceable; not that arbitration clauses were unenforceable.” Plaintiffs’ Opp. to Mot. to Compel
15 Arbitration p. 6. However, the Supreme Court has held that “‘changes brought about by the shift from
16 bilateral arbitration to class-action arbitration’ are ‘fundamental.’” *Concepcion*, 131 S. Ct. at 1750
17 (quoting *Stolt-Nielsen S.A. v. Animal Feeds Int’l Corp.*, 130 S. Ct. 1758, 1776 (2010)). This
18 “fundamental” shift in how the arbitration would occur means that defendants did not act inconsistently
19 with a known existing right to compel arbitration. Plaintiffs have failed to demonstrate that defendants
20 waived their right to arbitration under the *Fisher* test.

21
22 **II. Scope: Defendants and Claims**

23 Plaintiffs argue that the arbitration clause is inapplicable because it is limited in scope and does
24 not apply to claims that arise before consumers see the debt settlement agreement (i.e. claims about
25 deceptive and misleading business practices) or to the issue of whether defendants were properly
26 licensed as prorsaters. However, this argument is contrary to arguments previously made by plaintiffs
27 and to the law of the case. When plaintiffs moved for class certification, they argued that the choice-of-
28 law provision in the contract applied to all of their state law claims. The Court determined that all of

1 “plaintiffs’ claims fall within the scope of the contract.” Order Granting Plaintiffs’ Mot. for Class Cert.
2 p. 7. The arbitration clause covers “any controversy, claim or dispute . . . arising out of or relating to”
3 the contract. Bretan Decl., Exh. C. The choice-of-law provision states that the “Agreement is governed
4 by the laws of the state of California.” *Id.* The arbitration clause applies to all of plaintiffs’ claims.

5 The plaintiffs also argue that the arbitration clause is inapplicable because it only applies to
6 FDR, LLC, **not** to Stroh, Houser, or FFN, LLC, or FDR, Inc. However, plaintiffs’ argument contradicts
7 their earlier claims about defendants. When defendants tried to assert that FDR is the only defendant
8 that offered debt settlement services during the class period, the plaintiffs offered evidence that the
9 defendant companies are “all joint venturers and/or alter egos of each other.” Pl. Opp. at 2; *see* Order
10 Denying Cross-Mot. for Summary Judgment at 1, 13. On that basis, the Court refused to grant
11 defendants’ motion for summary adjudication with respect to all Network defendants other than FDR.
12 Order Denying Cross-Mot. for Summary Judgment at 13-14. The arbitration clause applies to all of the
13 defendants.

14
15 **III. CROA Claims**

16 Plaintiffs claim the arbitration clause is inapplicable because it does not apply to federal CROA
17 claims. Plaintiffs’ Opposition to Mot. To Compel Arbitration p. 1-2, 11. Defendants submit that the
18 CROA claim should be arbitrated. Mot. To Compel Arbitration p. 11. However, defendants admit that
19 the plaintiffs’ CROA claim is “arguably not subject to arbitration,” and urge the Court to, “at the very
20 least,” stay the CROA claim. Reply Mem. Iso Mot. To Compel Arbitration and Stay Action p. 14-15.

21 On May 2, 2011, the Supreme Court granted *certiorari* in the matter of *CompuCredit Corp. v.*
22 *Greenwood*, — S. Ct. —, 2011 WL 220683, to decide whether CROA claims are arbitrable and to
23 resolve a split in the Circuits on this issue. *See* Mot. To Compel Arbitration p. 11; *Gay v. CreditInform*,
24 511 F.3d 369 (3d Cir. 2007) (CROA claims are arbitrable); *Picard v. Credit Solutions, Inc.*, 564 F.3d
25 1249 (11th Cir. 2009) (CROA claims arbitrable); *but see Greenwood v. CompuCredit Corp.*, 615 F.3d
26 1204 (9th Cir. 2010) (CROA claims non-arbitrable).

27 The Court hereby orders action on the plaintiffs’ CROA claim STAYED pending the outcome
28 in *CompuCredit Corp. v. Greenwood*. Parties are ordered to file a joint status update with the Court

1 within fifteen days of the resolution in *Compucredit*.

2
3 **IV. Notice to Class**


4 On June 25, 2010, the Court certified a class action. Notice of this litigation has been issued to
5 class members and the opt-out period has passed. Order Regarding the Form of Class Notice and Notice
6 Plan p. 2, Doc. 149. Members of the class must now be notified of this Order. Parties are hereby
7 ordered to submit a joint proposal to the Court within fifteen days from the date of this Order
8 detailing how appropriate notice will be issued to the class.

9
10 **CONCLUSION**

11 For the foregoing reasons and for good cause shown, the Court hereby GRANTS the defendants'
12 motion to compel arbitration of the plaintiffs' UCL, CLRA, and negligence claims. The court STAYS
13 action on the plaintiffs' CROA claim pending the outcome in *CompuCredit Corp. v. Greenwood*. (Doc.
14 197.) Parties are ordered to submit a joint status update to the Court within fifteen days from the date
15 of the resolution in *CompuCredit*. Parties are also ordered to submit to the Court, within fifteen days
16 from the date of this Order, a joint proposal detailing how notice of this Order will be issued to
17 members of the class.

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19 **IT IS SO ORDERED.**

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21 Dated: July 5, 2011

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23 _____
24 SUSAN ILLSTON
25 United States District Judge
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