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UNITED STATES DISTRICT COURT

DISTRICT OF ARIZONA

Pamela Balezos and Peter Balezos, on behalf of themselves and all others similarly situated, Plaintiffs, vs. Calvary Portfolio Service, LLC; Ewing & Ewing, P.C. and Nelson Ewing II, Defendants.	No. CV-06-1952 PHX SMM **REPLY IN SUPPORT OF MOTION TO COMPEL ARBITRATION**

Cavalry Portfolio Services, LLC ("Cavalry"), Ewing & Ewing, P.C. and Nelson Ewing II (collectively, the "Ewing defendants"), through counsel, respectfully state as follows for their Reply in Support of their Motion to Compel Arbitration:

I. INTRODUCTION

Plaintiffs, Pamela and Peter Balezos, do not deny that the arbitration clause in the Discover Cardmember Agreement is enforceable and binding on them, and encompasses the FDCPA claims they assert. They oppose arbitration solely on the ground of waiver.

To prove waiver, they must show, *inter alia,* that defendants acted inconsistently with their right to arbitration. Plaintiffs suggest there were two instances of inconsistent conduct: (1) Cavalry filed a small claims suit against them to recover a balance of about $4,355 on their Discover card; and (2) defendants allegedly defended this suit for 10

months before moving to compel arbitration. Both claims are baseless. The small claims suit does not avail plaintiffs because the arbitration clause expressly preserves defendants' right to elect arbitration of newly asserted claims (such as the FDCPA claim) after they have litigated earlier claims (such as Cavalry's small claims suit). Further, defendants' defense of this suit was consistent with an intent to arbitrate: defendants' initial pleading asserted arbitration as an affirmative defense, defendants' first substantive motion sought to compel arbitration, and barely six months passed between Cavalry's answer and the motion to compel. Moreover, plaintiffs only accomplished service of process on co-defendants Ewing in mid-April, 2007. Because no conduct inconsistent with arbitration has occurred, the waiver defense fails.

Plaintiffs also cannot show waiver because they cannot show that defendants' purported delay has prejudiced them. Defendants did not file a single substantive motion before moving to compel. The motion to compel came only six months after Cavalry answered the suit and six weeks after the Ewing defendants answered the suit. No undue delay occurred. Further, plaintiffs voluntarily incurred the litigations expenses they point to as prejudicial, and they incurred the expenses despite Cavalry's repeated attempts to settle the FDCPA claim. They cannot show prejudice. Because the waiver defense fails, the arbitration clause must be enforced as written.

II. WAIVER HAS NO APPLICATION TO THE FACTS OF THIS CASE.

Waiver of the right to arbitrate is disfavored because it is a contractual right that must be liberally enforced under federal law. *Van Ness Townhouses v. Mar Industries Corp.*, 862 F.2d 754, 758 (9th Cir. 1988). Courts resolve all doubts as to whether waiver occurred in favor of arbitration, *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.,* 460 U.S. 1, 24-25 (1983), and should "not lightly find waiver." *Chappel v. Laboratory Corp. of America*, 232 F.3d 719, 724 (9th Cir. 2000). "The party arguing waiver of arbitration bears a heavy burden of proof." *Sovak v. Chugai Pharmaceutical*

Co., 280 F.3d 1266, 1270 (9th Cir. 2002); *Britton v. Co-op Banking Group*, 916 F.2d 1405, 1412 (9th Cir. 1990).

To establish waiver of the right to arbitrate, plaintiffs must show that: (1) defendants had knowledge of an existing right to compel arbitration; (2) defendants acted inconsistently with their right to arbitrate; and (3) defendants' inconsistent acts caused prejudice to the plaintiffs. *United Computer System, Inc. v. AT&T Corp*., 298 F.3d 756, 765 (9th Cir. 2002). As a matter of law, plaintiffs are incapable of establishing conduct inconsistent with the arbitration clause or prejudice resulting from such conduct.

A. Defendants did not engage in conduct inconsistent with their right to arbitrate.

None of the conduct that plaintiffs claim is inconsistent with defendants' right to enforce the arbitration clause supports waiver under the FAA and the interpreting case law. Plaintiffs contend that defendants' inconsistent conduct consisted of filing stipulations for an extension of time, answering the complaint, and serving and answering discovery. This argument is absurd. In the first place, defendants' first substantive filing in this action was the answer to the first amended complaint. That answer asserted defendants' arbitration rights as an affirmative defense; the Cardmember Agreement setting out those arbitration rights was attached as an exhibit. (Dock. # 17). That defendants asserted their arbitration rights in their initial pleading refutes plaintiffs' allegation of waiver.

In the second place, plaintiffs' argument ignores that the Federal Rules forced defendants to answer the complaint and discovery on pain of entry of a default judgment or other sanction. Federal law does not provide, and plaintiffs cite no case holding, that a defendant forever waives its right to compel arbitration unless it hires counsel and files a motion to compel arbitration within 20 days of service of the summons or before the deadline to answer requests to admit or interrogatories. In essence, plaintiffs suggest that

a defendant must move to compel arbitration before it takes any action dictated by the Federal Rules or a district court, even if it has already asserted its arbitration rights in its answer. This contention flies in the face of the federal policy that liberally favors arbitration and strongly disfavors findings of waiver. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.,* 460 U.S. 1, 24-25 (1983); *Chappel v. Laboratory Corp. of America*, 232 F.3d 719, 724 (9th Cir. 2000).

Plaintiffs' argument regarding the answer to the complaint and discovery also undermines the federal policy in favor of prompt settlement, because any time used to explore settlement at the outset of litigation could later be construed as conduct inconsistent with enforcing the defendant's right to arbitrate. A prompt settlement is exactly what Cavalry sought to achieve in this matter. For the first six months following service on Cavalry, it entreated plaintiffs to abandon or settle the FDCPA claims on an individual basis to avoid unnecessary litigation expenses. (*See* settlement communications attached as Ex. A). Cavalry pursued settlement despite the fact that the FDCPA claims have absolutely no merit.[1] Thus, Cavalry was not actively litigating this matter during most of its pendency, but actively trying to persuade plaintiffs to stop litigating this matter. Federal waiver principles do not strip defendants of their right to arbitrate simply because they attempted to reach a cost effective settlement rather than incurring thousands of dollars to litigate a frivolous FDCPA action.

Plaintiffs argue that defendants engaged in conduct inconsistent with arbitration by filing a motion for summary judgment. This argument flunks the straight-face test. Defendants filed the motion to compel arbitration simultaneously with the motion for

I. _____

[1] The frivolous premise of the FDCPA claim is that the law of Delaware – which is the state of incorporation of more publicly traded financial institutions than any other state - forbids the charging of compound interest. Defendants show that this claim is invalid in their motion for summary judgment.

summary judgment. (*See* Docket). Defendants' position is that, if the Court denies the motion to compel arbitration, the Court must grant summary judgment to defendants. That defendants presented the Court with grounds for dismissing the suit on the merits if the Court does not order arbitration is hardly inconsistent with the motion to compel. *Cf.* Fed.R.Civ.P. Rule 8 (party may seek relief in the alternative).

Plaintiffs argue that defendants acted inconsistently with their right to arbitrate by agreeing to present for deposition a corporate representative of Cavalry under Rule 30(b)(6). This argument distorts the facts. Cavalry had sought to continue the deposition until the Court ruled on the motion to compel. (*See* correspondence and e-mails attached as Exhibit B). Plaintiffs objected to the continuance, and at a telephone hearing, the Court ordered Cavalry to produce the witness. (Dock. # 49). That Cavalry obeys the Court's orders is not inconsistent with Cavalry's request that the Court enforce the arbitration the clause.

Plaintiffs claim defendants waived the right to arbitrate by allegedly waiting ten months before filing the motion to compel. This argument again mischaracterizes the facts. Defendants, through Cavalry's answer, asserted their arbitration rights in their initial substantive filing. (Dock. # 17). Plaintiffs did not even serve the Ewing defendants until April 11, 2007. Defendants filed the motion to compel just six months and eight days after Cavalry's answer and only six weeks after Ewings' answer, and filed the motion to compel simultaneously with the only other substantive motion they have filed. (See Dock. # 44, 17). There was no 10 month delay.

Even if a 10 month delay had occurred, it would not give rise to waiver. In the Eighth Circuit case plaintiffs rely upon, *Lewallen v. Green Tree Fin.,* 2007 WL 1583876 (8th Cir. June 4, 2007), the court found that the defendant in an adversary bankruptcy proceeding waived its arbitration rights only because it moved to compel <u>after</u> it had actively litigated the debtor's RESPA claim for 16 months, after it served the debtor with

extensive discovery, after it insisted that the debtor institute the adversary proceeding, and after it filed a motion to dismiss the RESPA claim and other substantive motions. *Id.* at *3-*5. Not surprisingly, the court found that, by seeking a ruling on the merits before moving to compel, the defendant had "substantially invoke[d] the litigation machinery" and had effectively attempted to proceed in multiple forums, thereby waiving its arbitration rights. *Id.* at *5.

Here, in contrast, defendants did **not** file substantive motions and seek a ruling on the merits prior to moving for arbitration, they did **not** wait 16 months to assert their arbitration rights (rather, Cavalry asserted those rights in its first substantive filing), and they did **not** serve plaintiffs with extensive discovery before moving to compel. *Lewallen* has no application here. Rather, this case is on four legs with *Patten Grading & Paving, Inc. v. Skanska USA Building, Inc.*, 380 F.3d 200, 206 (4th Cir. 2004), where the court held that a defendant who had simply filed responsive pleadings did not act inconsistently with an intent to pursue arbitration. Similarly, in *Steel Warehouse Co. v. Abalone Shipping Ltd. of Nicosai*, 141 F.3d 234, 238 (5th Cir. 1998), the court rejected a waiver claim that was based on the fact that the defendant had also filed a motion for summary judgment and participated in the discovery process.

To the extent that plaintiffs contend that Cavalry's small claims suit in Arizona state court was inconsistent with defendants' arbitration rights, their argument fails as a matter of law. First, the arbitration clause, by its terms, preserves the right of defendants to elect arbitration of a new claim after they voluntarily litigated an earlier claim:

> Even if all parties have opted to litigate a claim in court, you or we may elect to arbitration with respect to any claim made by a new party or any new claims later asserted in that lawsuit, and nothing undertaken therein shall constitute a waiver of any rights under this arbitration provision. (See Ex. B to Dock. #44).

Second, the prior action cannot operate as a waiver of defendants' right to compel arbitration here because the prior action involved Cavalry's right to recover plaintiffs'

credit card debt, not plaintiffs' claims under the FDCPA. In *Doctor's Assoc., Inc. v. Distajo,* 107 F.3d 126, 133 (2d Cir. 1997), the court stated that filing a prior action would result in waiver only if the party litigated the same claims in the prior action that it sought to arbitrate in a later case. Here, defendants are seeking to compel arbitration of plaintiffs' FDCPA claims. They did not litigate the FDCPA claims in the small claims suit against plaintiffs. Thus, the small claims suit was not conduct inconsistent with the right to arbitrate.

In sum, Cavalry asserted its right to arbitration in the first substantive pleading it filed in this action. Defendants moved to compel plaintiffs to arbitrate just six months later. That motion was filed simultaneously with the only other substantive motion defendants have filed. The other actions defendants took in this suit were dictated by the Federal Rules and this Court's orders. Defendants accordingly have not engaged in conduct inconsistent with their right to compel arbitration, the elements of waiver are not met, and the Court should order plaintiffs to arbitrate their claims in accordance with the arbitration clause.

B. Defendants' conduct has not caused plaintiffs to suffer prejudice that will support a waiver defense.

"Under the federal policy favoring arbitration, a party does not waive arbitration merely by engaging in action inconsistent with an arbitration provision. … The party opposing the motion to compel arbitration must have suffered prejudice." *ATSA of California, Inc. v. Continental Insur. Co.,* 702 F.2d 172, 175 (9th Cir. 1983); *Lake Communications, Inc. v. ICC Corp.,* 738 F.2d 1473, 1477 (9th Cir. 1984) ("More is required than action inconsistent with an arbitration provision; prejudice to the party opposing arbitration must also be shown."); *see also Hoxworth v. Blinder, Robinson & Co., Inc.,* 980 F.2d 912, 925 (3d Cir. 1992)) ("prejudice is the touchstone for determining whether the right to arbitrate has been waived.").

The type of prejudice that will support a waiver defense is limited. In *Lake Communications.,* 738 F.2d at 1477, the Ninth Circuit found that the plaintiff had not been prejudiced where the defendant had served limited discovery and deposed the plaintiff's president before moving to compel arbitration. Similarly, in *Doctor's Assoc.,* 107 F.3d at 134, the court stated the general rule that incurring litigation expenses prior to resolution of a motion to compel arbitration does not constitute prejudice.

Plaintiffs here cannot establish any injury that qualifies as prejudice for purposes of the waiver doctrine under federal law. They have not even given depositions as the plaintiff in *Lake Communications* did, nor have they responded to defendants' summary judgment motion. Their counsel claim to have incurred expenses in pursuing their meritless FDCPA claims, but these expenses do not constitute prejudice under the federal law of arbitration. *Doctor's Assoc.,* 107 F.3d at 134. Further, any expenses they incurred were in spite of defendants' attempt to settle this suit.

As a further effort to minimize expenses incurred during pendency of the motion to compel, defendants offered to postpone all litigation activities until the Court rules. Plaintiffs rejected this proposal. Plaintiffs cannot inflict costs on themselves despite defendants' entreaties to settle and then claim those costs as prejudice inflicted on them by defendants. Because they have not been prejudiced, their waiver defense fails, and the Court should order arbitration of their claims.

Plaintiffs again cite *Lewallen,* 2007 WL 1583876, to support their waiver defense, but *Lewallen* actually illustrates why plaintiffs cannot prove prejudice. There, the court noted that the prejudice that will support a waiver defense occurs only when a party uses discovery procedures not available in arbitration, when it litigates substantial claims on the merits, or when compelling arbitration would entail a duplication of efforts. *Id.* at *6. The defendant had prejudiced the adversary proceeding plaintiff in *Lewallen* because it asserted its arbitration rights only after it litigated the merits of the RESPA claim, after it

demanded that the plaintiff commence the adversary proceeding, and after it forced the plaintiff to prepare for trial. *Id.*

Here, none of those factors is present. Rather than demanding that plaintiffs litigate and forcing them to prepare for trial, Cavalry implored the plaintiffs to settle or abandon their meritless FDCPA claims from the outset. (*See* Ex. A). Cavalry reluctantly filed the motion to compel and the alternative motion for summary judgment when it became apparent Cavalry could not buy peace for a reasonable sum. By deciding to move to compel after settlement efforts proved fruitless (because plaintiffs clung to an unrealistic assessment of their claims), Cavalry did not prejudice plaintiffs; they prejudiced themselves.

In any case, the decisions in *Lake Communications*., 738 F.2d at 1477, and *Doctor's Assoc.,* 107 F.3d at 134, show that plaintiffs have not suffered prejudice that supports a waiver defense. They must therefore be ordered to arbitrate their claims in accordance with the arbitration agreement to which they assented when they used their Discover card.

III. CONCLUSION

As set forth above and in defendants' opening memorandum, the arbitration clause in the Discover Cardmember Agreement is enforceable as a matter of federal law, binding on plaintiffs, and it encompasses the claims they raised under the FDCPA. The arguments plaintiffs make in support of waiver fail because defendants' conduct was not inconsistent with the right to arbitrate and in any case defendants' conduct has not caused them prejudice.

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For all the above reasons, Cavalry Portfolio Services, LLC, Ewing & Ewing, P.C. and Nelson Ewing II respectfully request that this Honorable Court order plaintiffs to arbitrate their claims in accordance with the written arbitration clause, dismiss this suit, and grant such further relief as the Court deems appropriate.

DATED this 5th day of July, 2007.

HINSHAW & CULBERTSON LLP

/s/ Victoria L. Orze
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Attorneys for Defendants

CERTIFICATE OF SERVICE

I certify that on the 5th day of July, 2007, I electronically transmitted the attached document to the Clerk's Office using the CM/ECF System for filing and transmittal of a Notice of Electronic Filing to the following CM/ECF registrants:

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