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6 **IN THE UNITED STATES DISTRICT COURT**
7 **FOR THE DISTRICT OF ARIZONA**

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9 Texas Nrgize #1 Incorporated,
10 Plaintiff,

No. CV15-0337-PHX-DGC

ORDER

11 v.

12 Kahala Franchise Corporation, et al.,
13 Defendants.

14
15 Plaintiff has filed a motion to compel arbitration and stay judicial proceedings.
16 Doc. 39. The motion is fully briefed and no party has requested oral argument. Docs. 43,
17 46. The Court will deny the motion.

18 **I. Background.**

19 Plaintiff Texas Nrgize #1, Inc. is a Texas corporation with its principal place of
20 business in Tarrant County, Texas. Doc. 1-5, ¶ 1. Plaintiff entered into a Franchise
21 Agreement with Defendant Kahala Franchise Corporation to operate a Nrgize juice and
22 snack bar inside an L.A. Fitness gym. Doc. 39 at 1-2; Doc. 1-5, ¶ 3. The Franchise
23 Agreement includes a Single Unit Facility License Agreement (the “Sublicense”)
24 between Plaintiff and Kahala Holdings, L.L.C., which allows Plaintiff to enter the L.A.
25 Fitness location to operate its franchise. Doc. 39 at 2. The Sublicense contains an
26 arbitration clause requiring that “any controversy, dispute or claim between the parties
27 arising out of, in connection with or in relation to this Agreement . . . shall, on the written
28 request of either party served on the other, be submitted to arbitration for resolution.”

1 Doc. 39 at 2.

2 Plaintiff filed a complaint against Defendants in state court in Tarrant County,
3 Texas on June 14, 2014, alleging breach of contract and violations of the Texas Business
4 Opportunities Act. Doc. 1-5. Kahala Franchise Corp. subsequently assigned its interest
5 in the franchise in question to Kahala Franchising, L.L.C., an Arizona limited liability
6 company. Doc. 1 at 2. Defendants removed the case to the United States District Court
7 for the Northern District of Texas and then obtained transfer to this Court pursuant to the
8 forum selection clause in the Franchise Agreement. Doc. 7 at 1.

9 On April 16, 2015, more than ten months after it initiated this lawsuit, Plaintiff
10 moved to compel arbitration. Doc. 39. Plaintiff argues that Defendants are bound by the
11 arbitration clause contained within the Sublicense and that the claims in this case stem
12 from both the Franchise Agreement and the Sublicense. *Id.* at 7; Doc. 46 at 2-3.
13 Defendants argue that “neither Plaintiff’s nor Kahala’s claims fall within the Sublicense’s
14 arbitration clause” and that “Plaintiff’s initiation of the Complaint and extended
15 participation in litigation have waived an alleged right to demand arbitration.” Doc. 43.

16 **II. Legal Standard.**

17 The Federal Arbitration Act creates a national policy favoring arbitration. *Preston*
18 *v. Ferrer*, 552 U.S. 346, 349 (2008). A written arbitration agreement “shall be valid,
19 irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the
20 revocation of any contract.” 9 U.S.C. § 2. But the “right to arbitration, like any other
21 contract right, can be waived.” *United States v. Park Place Assocs., Ltd.*, 563 F.3d 907,
22 921 (9th Cir. 2009). “[T]he filing of a complaint, an answer, a counterclaim or a third
23 party complaint does not waive the right to pursue arbitration.” *Creative Telecomms.,*
24 *Inc. v. Breeden*, 120 F. Supp. 2d 1225, 1232 (D. Haw. 1999). “‘Waiver of a contractual
25 right to arbitration is not favored,’ and, therefore, ‘any party arguing waiver of arbitration
26 bears a heavy burden of proof.’” *Richards v. Ernst & Young, LLP*, 744 F.3d 1072, 1074
27 (9th Cir. 2013) (quoting *Fisher v. A.G. Becker Paribas Inc.*, 791 F.2d 691, 694 (9th Cir.
28 1986)). “Specifically, ‘[a] party seeking to prove waiver of a right to arbitration must

1 demonstrate: (1) knowledge of an existing right to compel arbitration; (2) acts
2 inconsistent with that existing right; and (3) prejudice to the party opposing arbitration
3 resulting from such inconsistent acts.” *Id.* (quoting *Fisher*, 791 F.2d at 694).

4 **III. Choice of Law.**

5 Unless the arbitration agreement specifies that state law controls the rules for
6 arbitration, the issue of waiver is decided under federal law. *Sovak v. Chugai Pharm.*
7 *Co.*, 280 F.3d 1266, 1269-70 (9th Cir. 2002). “[T]he strong default presumption is that
8 the FAA, not state law, supplies the rules for arbitration.” *Id.* at 1269. General choice-
9 of-law clauses do not override this presumption. *Id.* at 1269-1270.

10 Plaintiff argues that Texas law should control because § 14(b) of the Sublicense
11 provides that the law of the state where the Identified Facility is located will govern the
12 Sublicense and any dispute arising under the Sublicense. Doc. 39 at 7; Doc. 10 at 12. As
13 the Ninth Circuit held in *Sovak*, however, such a general choice of law provision does not
14 override the strong presumption that federal law controls. 280 F.3d at 1269-70. The
15 Court will apply federal law.

16 **IV. Waiver.**

17 The three prongs of the waiver test established by the Ninth Circuit are satisfied in
18 this case.

19 First, Plaintiff had knowledge of its right to compel arbitration. The arbitration
20 clause is explicitly set out in § 14(a) of the Sublicense, and the Sublicense was signed by
21 Plaintiff’s representatives. Doc. 10 at 13-14; *see Hoffman Const. Co. of Or. v. Active*
22 *Erectors and Installers, Inc.*, 969 F.2d 796, 798 (9th Cir. 1992) (finding that the contract
23 itself informs a party of the arbitrability of its claim when the arbitration clause is
24 contained within the contract). Moreover, Plaintiff has admitted that it made a conscious
25 decision to pursue litigation in state court “instead of initiating arbitration in accordance
26 with the Sublicense” in order to minimize expenses. Doc. 46 at 5.

27 Second, Plaintiff acted inconsistently with its right to compel arbitration. Filing a
28 lawsuit and seeking legal relief is inconsistent with such a right. *See United Computer*

1 *Sys., Inc. v. AT&T Corp.*, 298 F.3d 756, 765 (9th Cir. 2002) (holding that filing a lawsuit
2 instead of paying an administrative arbitration fee is inconsistent with an arbitration
3 clause and that filing a state court complaint seeking monetary damages satisfies the first
4 two prongs of the waiver test); *see also Riverside Publ'g. Co. v. Mercer Publ'g. L.L.C.*,
5 829 F. Supp. 2d 1017, 1020 (W.D. Wash. 2011) (holding that filing suit and requesting
6 monetary relief without mentioning the arbitrability of claims is inconsistent with a right
7 to compel arbitration).

8 Plaintiff initiated this litigation by filing a complaint in Texas state court and
9 seeking legal relief through monetary damages. Doc. 1-5. Plaintiff engaged in motion
10 practice by filing its response to Defendants' motion to transfer, again without
11 mentioning the arbitration clause. Doc. 14; Doc. 20. Plaintiff participated in the case
12 management conference on April 17, 2015, and served initial disclosures. Doc. 44;
13 Doc. 45. All of this is inconsistent with Plaintiff's right to arbitrate.

14 Third, Defendants have suffered prejudice from Plaintiff's delay in seeking
15 arbitration. The Ninth Circuit has not established a comprehensive test for evaluating this
16 factor. *Riverside Publ'g. Co.*, 829 F. Supp. 2d at 1021-1022. "[It] has considered the
17 duration and substantive extent of litigation in court as an indicator of prejudice." *Id.* at
18 1021. "It has also considered delay in proceedings, costs and expenses resulting from
19 litigation, and loss of witnesses as a result of delay." *Id.*

20 As a result of Plaintiff's filing of this lawsuit and waiting ten months before
21 seeking arbitration, Defendants have incurred the expense of filing answers and
22 counterclaims, removing this case to federal court, seeking and obtaining a transfer to
23 Arizona, retaining Arizona counsel, participating in a Rule 26(f) conference and
24 preparing a Rule 26(f) report, participating in a case management conference, and
25 providing initial disclosures. Plaintiff's delay has imposed substantial costs on
26 Defendants – costs which will aid in the completion of this litigation, which would have
27 been largely unnecessary if Plaintiff had timely invoked its right to arbitrate, and which
28 will have been wasted if arbitration is now granted. These costs and the loss of ten

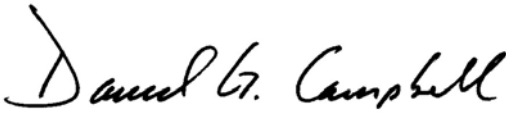
1 months in resolving this dispute satisfy the prejudice requirement of waiver. *See Plows v.*
2 *Rockwell Collins, Inc.*, 812 F. Supp. 2d 1063, 1068 (C.D. Cal. 2011) (finding that a delay
3 in moving for arbitration resulting in 13 months of legal fees and establishing a different
4 litigation strategy constituted prejudice sufficient for waiver); *Kelly v. Pub. Util. Dist. No.*
5 *2 of Grant Cnty.*, 552 Fed. Appx. 663, 664 (9th Cir. 2014) (determining that prejudice
6 would result if parties were forced to initiate arbitration after 11 months of litigation); *see*
7 *also Hoffman*, 969 F.2d 796, 799 (finding prejudice in the “staleness of the claim” after a
8 delay in moving to compel arbitration). And, of course, Plaintiff’s delay is utterly
9 inconsistent with the fundamental goals of speed and efficiency established by the FAA.
10 *Lyzwa v. Chu*, No. C-97-20053, 1998 WL 326768, at *4 (N.D. Cal. Feb. 2, 1998).

11 The Court finds that all three factors of the Ninth Circuit test are satisfied and that
12 Plaintiff has waived its right to compel arbitration.

13 **IT IS ORDERED** that Plaintiff’s Motion to Compel Arbitration and Stay Judicial
14 Proceedings (Doc. 39) is **denied**.

15 Dated this 15th day of June, 2015.

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David G. Campbell
United States District Judge