UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	SACV 15-1970 JVS (JCGx)	Date	February 8, 2016
Title	**James Matthew Walsh v. James R. Zazzali**		

Present: The Honorable	James V. Selna	
Karla J. Tunis		Not Present
Deputy Clerk		Court Reporter
Attorneys Present for Plaintiffs:		Attorneys Present for Defendants:
Not Present		Not Present

Proceedings: (IN CHAMBERS) Order GRANTING Plaintiff's Motion for Preliminary Injunction and DENYING Defendant's Motion to Dismiss and Compel Arbitration

The Court, having been informed by the parties that they submit in the Court's tentative ruling previously issued, hereby GRANTS Plaintiff's Motion for Preliminary Injunction and DENIES Defendant's Motion to Dismiss and Compel Arbitration. The Court's rulings are made in accordance with the tentative ruling as follows:

Before the Court are two motions:[1]

First, Plaintiff James Matthew Walsh ("Walsh") has filed a motion for a preliminary injunction[2] prohibiting Defendant James R. Zazzali, Trustee for the DBSI

[1] Before the originally-scheduled hearing on both motions, the Court vacated both motions pending FINRA's decision to accept arbitration. Docket No. 34. After FINRA ultimately accepted arbitration, both parties re-noticed their respective motions. See Docket Nos. 35-36. The re-noticed motions incorporated the original motions by reference. For simplicity, all citations are to the original motions.

[2] In support of his motion for preliminary injunction, Walsh requests judicial notice of ten court documents filed in James R. Zazzali, as Trustee for the DBSI Private Actions Trust v. Alexander Partners, LLC, et al., Case No. 1:12-cv-00828; James R. Zazzali, as Trustee for the DBSI Private Actions Trust v. Alexander Partners, LLC, et al., Case No. 1:14-cv-00419; and James R. Zazzali, as Trustee for the DBSI Private Actions Trust v. James Matthew Walsh and John Does 1-20, Case No. 8:15-cv-00373. See Docket No. 9. Under Federal Rule of Evidence 201(b), the Court may take judicial notice of matters of public record not subject to reasonable dispute. Lee v. City of Los Angeles, 250 F.3d 668, 688-89 (9th Cir. 2001), overruled on other grounds, Galbraith v. Cnty. of Santa Clara, 307

Private Actions Trust ("Zazzali"), from proceeding in the arbitration before the Financial Industry Regulatory Authority entitled James R. Zazzali, Trustee for the DBSI Private Actions Trust v. James Matthew Walsh, FINRA Dispute Resolution Case No. 15-02725. Docket No. 8. Zazzali has filed an opposition. Docket No. 27. Walsh has filed a reply. Docket No. 31.

Second, Zazzali has filed a motion to dismiss and compel arbitration. Docket Nos. 18-19. Walsh has filed an opposition. Docket No. 28. Zazzali has filed a reply. Docket No. 32.

For the following reasons, the Court **grants** Walsh's motion for preliminary injunction and **denies** Zazzali's motion to dismiss and compel arbitration.

1. Background

In November 2008, Diversified Business Services & Investments, Inc. ("DBSI") filed for Chapter 11 bankruptcy in the U.S. Bankruptcy Court for the District of Delaware. Docket No. 7 ¶ 2. In October 2010, the bankruptcy court approved a Chapter 11 liquidation plan that created the DBSI Private Actions Trust ("PAT") to pursue claims on behalf of DBSI investors. Id. Zazzali was appointed litigation trustee for the PAT. Id. As part of the liquidation plan, certain DBSI investors ("Assigning Investors") executed an election form that assigned all "Non-Estate Causes of Action" to Zazzali.

In June 2012, Zazzali, as the assignee to the Assigning Investors' claims, sued Walsh and other securities brokers in Delaware federal court for violating federal securities law by improperly recommending certain investments to the Assigning Investors. See James R. Zazzali, as Trustee for the DBSI Private Actions Trust v. Alexander Partners, LLC, et al., Case No. 1:12-cv-00828 ("Delaware Action"), Docket No. 1; see also Docket No. 9-1. The complaint also alleged state law claims for breach of contract, common law fraud, negligence, and breach of fiduciary duty. Id. at 49-54. On September 25, 2013, the Delaware district court dismissed the federal securities claims

F.3d 1119, 1125 (9th Cir. 2002); see Fed. R. Evid. 201(b). This includes federal court records. Accordingly, the Court **grants** Walsh's request for judicial notice.

against Walsh as time-barred under 28 U.S.C. § 1658(b)(2) and certain of the state law claims for breach of contract and common law fraud.[3] Docket No. 9-1 at 94-118.

On February 7, 2014, Zazzali filed an amended complaint against Walsh and others alleging violation of federal securities law and state law claims for common law fraud, negligence, and breach of fiduciary duty. Docket No. 9-1 at 189-193. On April 28, 2014, Walsh, then proceeding pro se, filed a motion to dismiss the amended federal and state law claims as time-barred. Delaware Action, Docket Nos. 485-86. Zazzali filed an opposition, Delaware Action, Docket Nos. 495-96, and Walsh filed a reply, Delaware Action, Docket Nos. 503-04.

In September 2014, before ruling on Walsh's motion to dismiss, the Delaware district court transferred the action to the U.S. District Court for the District of Idaho. See James R. Zazzali, as Trustee for the DBSI Private Actions Trust v. Alexander Partners, LLC, et al., Case No. 1:14-cv-00419 ("Idaho Action"), Docket No. 554. The Idaho district court finally ruled on Walsh's motion to dismiss in February 2015. In its order, the Idaho district court recognized that Zazzali's federal securities claims were previously dismissed as time-barred in the Delaware district court's September 25, 2013 dismissal order, and then declined to exercise supplemental jurisdiction over the remaining state law claims. Docket No. 9-1 at 233, 239-40. The court then dismissed all state law claims against Walsh without prejudice. Id. at 240-241.

In March 2015, Zazzali sued Walsh in James R. Zazzali, as Trustee for the DBSI Private Actions Trust v. James Matthew Walsh and John Does 1-20, Case No. 8:15-cv-00373 ("California Action"), alleging state law claims for fraud, negligence, breach of fiduciary duty, and negligent misrepresentation. Id. at 243-296. In March 2015, Walsh, again proceeding pro se, filed a motion to dismiss the state law claims as time-barred. Id. at 298-328. Zazzali did not file timely opposition. In May 2015, before the hearing on Walsh's motion to dismiss, Zazzali voluntarily dismissed the California Action in its entirety without prejudice. Id. at 330-331.

[3] Walsh did not file a motion to dismiss Zazzali's initial complaint. The Court dismissed the claims against Walsh in a global dismissal order that consolidated multiple motions to dismiss brought by several other defendants.

In October 2015, Zazzali filed an arbitration claim before the Financial Industry Regulatory Authority ("FINRA"), an independent regulator of securities firms. See Docket No. 21 ¶ 16. The arbitration claim alleged state law claims for breach of fiduciary duty, misrepresentation, negligence, breach of contract, and recommendation of unsuitable investments. Docket No. 7 ¶¶ 3, 16; Docket No. 21 ¶ 16. In November 2015, Walsh sent FINRA a letter requesting that it decline arbitration for lack of standing. Docket No. 7 ¶ 17.

On December 1, 2015, Walsh filed the operative complaint seeking declaratory relief that Zazzali is not entitled to proceed with the FINRA arbitration and preliminary and permanent injunctive relief prohibiting Zazzali from proceeding with the FINRA arbitration. Docket No. 7 ¶¶ 33-43. In January 2016, FINRA denied Walsh's request to decline arbitration, and the claims are now pending in arbitration. Docket No. 35-1 at 4.

2. Legal Standards

2.1. Preliminary Injunction

To receive a preliminary injunction, the movant must establish: (1) a likelihood of success on the merits; (2) a likelihood of irreparable injury in the absence of preliminary relief; (3) the balance of equities favors the plaintiff; and (4) an injunction is in the public interest. Winter v. Nat'l Res. Def. Council, Inc., 555 U.S. 7, 20 (2008). The grant or denial of a preliminary injunction is within the discretion of the trial court. Deckert v. Independence Shares Corp., 311 U.S. 282, 290 (1940).

2.2. Motion to Compel Arbitration

Under the Federal Arbitration Act, a party to an arbitration agreement may bring a motion in federal district court to compel arbitration. 9 U.S.C. § 4. In determining whether to compel arbitration, the court must consider: "(1) whether a valid agreement to arbitrate exists and, if it does (2) whether the agreement encompasses the dispute at issue." Cox v. Ocean View Hotel Corp., 533 F.3d 1114, 1119 (9th Cir. 2008) (internal citation and quotation marks omitted). If a valid arbitration agreement exists, and the agreement encompasses the dispute at issue, the district court must enforce the arbitration agreement according to its terms. Lifescan, Inc. v. Premier Diabetic Servs., Inc., 363 F.3d 1010, 1012 (9th Cir. 2004). A district court may not review the merits of the dispute

when determining whether to compel arbitration. Cox, 533 F.3d at 1119. Ambiguities as to the scope of the arbitration provision must be interpreted in favor of arbitration. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 62 (1995).

3. Analysis

3.1. Motion for Preliminary Injunction

3.1.1. Likelihood of success on the merits

FINRA regulates its members through the FINRA Code. See UBS Fin. Servs., Inc. v. W. Va. Univ. Hosps., Inc., 660 F.3d 643, 648 (2d Cir. 2011) (quoting 72 Fed. Reg. 42169, 42170 (Aug. 1, 2007)). The FINRA Code states that parties must submit to arbitration before FINRA when: (1) the arbitration is requested by a customer; (2) the dispute is between a customer and a FINRA member (or an associate of a member); and (3) the dispute arises in connection with the member's business activities. FINRA Proc. R. 12200. The parties do not dispute that (1) the Assigning Investors were customers of Walsh, (2) the claims involve disputes between the Assigning Investors and Walsh, an associate of a member, and (3) the arbitration arises in connection with Walsh's business activities. See, e.g., Docket No. 20 at 9. Instead, Walsh argues that Zazzali must be enjoined from FINRA arbitration for three alternative reasons. First, Zazzali's claims are not eligible for arbitration because Zazzali, as the assignee to the Assigning Investors' claims, is not a "customer" eligible for FINRA arbitration. Docket No. 28 at 1. Second, Zazzali's claims are not eligible for arbitration because Zazzali lacks standing: the Assigning Investors only assigned claims related to the public issuance of debt or equity, and the investments at issue here were private offerings. Id. at 2. Third, even if Zazzali's claims were subject to arbitration, Zazzali has waived his right to compel arbitration by litigating the Delaware, Idaho, and California actions. Id. at 11-14. As explained below, the Court concludes that, although Zazzali's claims are eligible for arbitration, Zazzali nevertheless waived his right to compel arbitration.

3.1.1.1. Zazzali's claims are eligible for arbitration.

Zazzali's first two arguments that Zazzali's claims are ineligible for arbitration fail.

First, as to assignment, the Court concludes that Zazzali is a "customer" eligible for FINRA arbitration. In the Ninth Circuit, it is well established that an "assignee stands in the shoes of the assignor, and, if the assignment is valid, has standing to assert whatever rights the assignor possessed." Misic v. Building Service Employees Health & Welfare Trust, 789 F.2d 1374, 1378 n.4 (9th Cir. 1986); see also Northstar Fin. Advisors Inc. v. Schwab Investments, 779 F.3d 1036, 1047 (9th Cir.), as amended on denial of reh'g and reh'g en banc (Apr. 28, 2015), cert. denied, 136 S. Ct. 240 (2015) (holding that an assignee "unquestionably has the same standing to file a complaint that the assignor could have filed"). Here, the Assigning Investors validly assigned their rights as "customers" to Zazzali.[4] Under the "well established" law governing assignment,[5] Zazzali therefore has standing to assert claims held by the Assigning Investors.

Walsh's argument that Zazzali lacks standing because the Assigning Investors "irrevocably relinquished all rights as 'customers'" by assigning their claims to Zazzali is off-point. Docket No. 8 at 8. Although Walsh is correct that the assignment relinquished the Assigning Investors' rights as "customers," the assignment transferred these rights to Zazzali, who, as an assignee, now has standing to assert claims previously held by the Assigning Investors in their status as "customers." Put another way, the Assigning Investors' relinquishment of their rights was the natural effect of the assignment, and the fact that the Assigning Investors previously relinquished their rights through assignment is not relevant to whether Zazzali currently has standing to assert these rights. The assignment did not extinguish these rights, but merely transferred them.

Second, as to standing, the Court concludes that Zazzali has standing to assert claims related to private offerings. The form defines the assigned "Non-Estate Causes of Action" to include any claims against

> all Persons or Entities that provided professional services to any of the Plan Debtors, including, without limitation, all attorneys, accounts, auditors, financial advisors and other parties providing services

[4] Walsh does not dispute that the assignment was valid.

[5] Walsh cites no cases (and the Court has found none) holding that the general law governing assignment does not apply when determining whether a claimant is a "customer" for purposes of FINRA arbitration.

> to the Plan Debtors in connection with the public issuance of debt or equity, including, without limitation, all underwriters, due diligence providers, or securities brokers/dealers . . . .

Docket No. 27 at 18. This assignment was "without limitation." Id. (emphasis added). Because the assignment was "without limitation," the Court construes the language regarding the assignment of claims arising out of "services to the Plan Debtors in connection with the public issuance of debt or equity" as an example of the kinds of claims that were assigned, and not an express limitation. Accordingly, the Court rejects Walsh's argument that the assignment was limited to claims arising out of public offerings.

3.1.1.2. Zazzali's waived his right to compel arbitration.

In addition to his arguments that Zazzali's claims are ineligible for arbitration, Walsh argues that, even if Zazzali's claims are eligible for arbitration, Zazzali has nevertheless waived his right to compel arbitration. Docket No. 28 at 11-14. The "right to arbitration, like any other contract right, can be waived." United States v. Park Place Assocs., Ltd., 563 F.3d 907, 921 (9th Cir. 2009). A party waives his right to compel arbitration when: (1) the party knows his existing right to compel arbitration; (2) the party acts inconsistent with his right to compel arbitration; and (3) the party's inconsistent acts result in prejudice. Fisher v. A.G. Becker Paribas, Inc., 791 F.2d 691, 694 (9th Cir. 1986). All three requirements are met here.

Knowledge of right to compel arbitration. Zazzali had constructive knowledge of his existing right to compel arbitration when he was elected litigation trustee and the Assigning Investors executed the election form that assigned arbitration-eligible claims to Zazzali. See Steiner v. Horizon Moving Sys., Inc., 2008 WL 4822774, at *3 (C.D. Cal. Oct. 30, 2008) ("Plaintiff at least had constructive, if not actual, knowledge of the existing right to compel arbitration upon signing the agreement allegedly containing the arbitration provision."). This occurred no later than October 26, 2010. Docket No. 21 ¶¶ 9-10.

Acts inconsistent with right to compel arbitration. Zazzali's acts during the

Delaware, Idaho, and California actions are inconsistent with his right to compel arbitration. Adding up the three venues, Zazzali has filed three complaints spanning nearly three years from June 2012 (when he filed the Delaware Action) to May 2015 (when he voluntarily dismissed the California Action). Each complaint asserted the same or substantially-similar state law claims at issue here, and all claims are based on the same underlying conduct (i.e., Walsh's investment advice). Moreover, Zazzali has defended the merits of his state law claims by filing an opposition to Walsh's motion to dismiss in the Delaware Action. At no point during this period did Zazzali seek arbitration. None of this behavior is "[]consistent with" his right to compel arbitration. Fisher, 791 F.2d at 694.

Prejudice. Walsh has suffered prejudice from Zazzali's failure to seek arbitration. Although the Ninth Circuit has not developed a comprehensive test to determine prejudice, courts consider the following factors to determine prejudice: the substantive extent of litigation in court, delay in proceedings, litigation costs and expenses, and loss of witnesses. Riverside Publ'g Co. v. Mercer Publ'g LLC, 829 F. Supp. 2d 1017, 1021 (W.D. Wash. 2011). These factors favor prejudice.

Walsh has incurred costs and expenses in litigating the Delaware, Idaho, California, and present actions over the past four years. These costs and expenses include two motions to dismiss and their accompanying moving papers (e.g., reply papers and requests for judicial notice). Indeed, Zazzali's three-year delay in seeking arbitration only compounds the prejudice raised by the litigation costs and expenses: because Zazzali now seeks arbitration on the state law claims that were the subject of motions to dismiss in both the Delaware and California actions, these costs and expenses would have been unnecessary if Zazzali had instead timely sought arbitration. Kelly v. Pub. Util. Dist. No. 2 of Grant Cty., 552 F. App'x 663, 664 (9th Cir. 2014) (unpublished) ("A party that is aware that it has a right to compel arbitration of a dispute cannot wait to exercise that right until the parties have expended a significant amount of time and money to litigate that dispute in federal court."); Steiner, 2008 WL 4822774, at *3 ("Plaintiff's belated attempt to use arbitration as a method of forum shopping is prejudicial to Defendants."). Taken together, Walsh's litigation costs and expenses and Zazzali's three-year delay in seeking arbitration constitute prejudice. See Texas Nrgize No. 1 Inc. v. Kahala Franchise Corp., 2015 WL 3707979, at *3 (D. Ariz. June 15, 2015) ("These costs and the loss of ten months in resolving this dispute satisfy the prejudice

requirement of waiver.").

3.1.2. Irreparable injury

"Plaintiffs seeking preliminary relief [must] demonstrate that irreparable injury is likely in the absence of an injunction." Winter, 555 U.S. at 22. Courts generally find irreparable injury when the movant is "forced to expend time and resources arbitrating an issue that is not arbitrable, and for which any award would not be enforceable." Merrill Lynch Inv. Managers v. Optibase, Ltd., 337 F.3d 125, 129 (2d Cir. 2003); see also McLaughlin Gormley King Co. v. Terminix Int'l Co., L.P., 105 F.3d 1192, 1194 (8th Cir. 1997) ("If a court has concluded that a dispute is non-arbitrable, prior cases uniformly hold that the party urging arbitration may be enjoined from pursuing what would now be a futile arbitration, even if the threatened irreparable injury to the other party is only the cost of defending the arbitration and having the court set aside any unfavorable award."). This includes cases where, as here, the movant would spend time and resources defending itself in FINRA arbitration that has already been waived by the claimant. See Morgan Stanley & Co., LLC v. Couch, --- F. Supp. 3d ---, 2015 WL 5647946, at *16 (E.D. Cal. Sept. 24, 2015); Citigroup Global Markets, Inc. v. Municipal Elec. Auth. of Georgia, 2014 WL 3858509, at *2-3 (S.D.N.Y. June 18, 2014); Morgan Stanley & Co. v. Seghers, 2010 WL 3952851, at *6 (S.D.N.Y. Oct. 8, 2010). Under this case law, Walsh has shown that, absent an injunction, he will suffer irreparable injury.

3.1.3. Balance of Equities

"To qualify for injunctive relief, the [movant] must establish that 'the balance of equities tips in his favor.'" Stormans, Inc. v. Selecky, 586 F.3d 1109, 1138 (9th Cir. 2009) (quoting Winter, 555 U.S. at 20). To determine whether the balance of hardships favors the moving party, courts must "balance the interests of all parties and weigh the damage to each." L.A. Mem'l Coliseum Comm'n v. Nat'l Football League, 634 F.2d 1197, 1203 (9th Cir. 1980).

The balance of hardships favors Walsh. Without an injunction, Walsh would spend time and resources defending himself in an arbitration that Zazzali has no right to pursue. Charles Schwab & Co. v. Reaves, 2010 WL 447370, at *8 (D. Ariz. Feb. 4, 2010) (finding that "the balance of equities favors granting the

injunction to prevent arbitration" when, "[i]f the Court denied the preliminary injunction, [movant] would be forced to spend substantial time and resources defending Defendants' claims before FINRA"). Moreover, granting a preliminary injunction would not harm Zazzali because the Court would ultimately vacate any arbitration award because of waiver. Id. In any event, as already proven by Zazzali's past litigation conduct, Zazzali is capable of litigating his state claims in other forums.

3.1.4. Public Interest

Although there is a "liberal federal policy favoring arbitration," Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983), "[i]t is not in the public interest to force a party into arbitration on issues that are not arbitrable." Morgan Keegan & Co. v. Jindra, 2011 WL 5869586, at *4 (W.D. Wash. Nov. 22, 2011). The public interest therefore favors granting the preliminary injunction here.

3.1.5. Bond

Under Federal Rule of Civil Procedure 65(c), the court may require the party seeking the preliminary injunction to post bond "in an amount that the court considers proper to pay the costs and damages sustained by any party found to have been wrongfully enjoined or restrained." Fed. R. Civ. P. 65(c). In his opposition to Walsh's motion for preliminary injunction, Zazzali did not request bond or argue that bond is necessary. See Docket No. 27. Accordingly, the Court declines to require bond here. Connecticut Gen. Life Ins. Co. v. New Images of Beverly Hills, 321 F.3d 878, 883 (9th Cir. 2003) (holding that the district court does not abuse its discretion by not requiring bond when the enjoined party fails to present evidence that bond is necessary).

3.2. Motion to Dismiss and Compel Arbitration

In his motion to dismiss and compel arbitration, Zazzali argues that the Court should compel arbitration because the FINRA Code requires arbitration of his claims. See generally Docket No. 20 at 6-16. As explained in Section 3.1.1.2 supra, the Court finds that, even if the dispute was eligible for arbitration, Zazzali

has waived his right to compel arbitration. Accordingly, the Court denies Zazzali's motion to dismiss and compel arbitration.

4. Conclusion

For the reasons stated above, the Court **grants** Walsh's motion for preliminary injunction and **denies** Zazzali's motion to dismiss and compel arbitration. The Court **enjoins** Zazzali from proceeding in the arbitration before FINRA entitled James R. Zazzali, Trustee for the DBSI Private Actions Trust v. James Matthew Walsh, Dispute Resolution Case No. 15-02725.

IT IS SO ORDERED.

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