UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

In re FIRST ALLIANCE MORTGAGE COMPANY, a California corporation; FIRST ALLIANCE CORPORATION, a Delaware corporation; FIRST ALLIANCE MORTGAGE COMPANY, a Minnesota corporation; and FIRST ALLIANCE PORTFOLIO SERVICES, a Nevada Corporation,

Debtors.

THE PEOPLE OF THE STATE OF CALIFORNIA,

Plaintiff,

v.

FIRST ALLIANCE MORTGAGE COMPANY, a California corporation; FIRST ALLIANCE CORPORATION, a Delaware corporation; BRIAN CHISICK; SARAH CHISICK; PATTY SULLIVAN; JEFFREY SMITH,

Defendants.

AND RELATED CASES

CASE NO. SA CV 00-964 DOC (EEx) (Consolidated with Case No. 01-1126 DOC (MLGx))

(Bankruptcy Cases No. SA 00-12370 LR; SA 00-12371 LR; SA 00-12372 LR; and SA 00-12373 LR (Jointly Administered)

ORDER DENYING INDIVIDUAL DEFENDANTS' MOTIONS TO DISMISS AND COMPEL ARBITRATION

Before the Court is Defendants Brian Chisick, Sarah Chisick, Patty Sullivan, Jeffrey Smith's (the Individual Defendants) motions to dismiss the complaint as it relates to them and to compel arbitration. After reviewing the moving, opposing, and replying papers, after oral argument on January 7, 2002, and for the reasons set forth below, the Court DENIES the motions.

I.

BACKGROUND

Defendants First Alliance Mortgage Company of California, First Alliance Corporation of Delaware, First Alliance Mortgage Company of Minnesota, and First Alliance Portfolio Services of Nevada (collectively, First Alliance) have been in the business of subprime mortgage lending since 1971. First Alliance's customers generally were borrowers who would have had difficulty obtaining loans from conventional sources because of poor credit ratings or insufficient credit histories. The loans, many of which were refinancings by homeowners who had developed significant equity in their homes, typically were secured by the borrowers' first mortgages. As of 1999, First Alliance or affiliated entities were licensed to operate in eighteen states and the District of Columbia and serviced nearly $900 million in loans.

The Individual Defendants are all alleged to be officers, employees, or agents of First Alliance. In recent years, a number of lawsuits were filed against First Alliance, alleging that its lending practices violated various consumer protection laws. First Alliance's lending practices became the focus of national publicity when the *New York Times* and the television program "20/20" carried stories that exposed the company's allegedly deceptive practices and highlighted the number of lawsuits that had been filed against it. A few days later, on March 23, 2000, First Alliance filed a voluntary petition under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 101-1330, because of the costs associated with the growing number of lawsuits.

California filed the instant action on October 30, 2001 after this Court issued its Order Re Subject Matter Jurisdiction in a related case. The Individual Defendants now bring the present motions.

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II.

MOTION TO DISMISS

A. Legal Standard

Under Federal Rule of Civil Procedure 12(b)(6), a complaint can be dismissed when the plaintiff's allegations fail to state a claim upon which relief can be granted. The court must construe the complaint liberally, and dismissal should not be granted unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S. Ct. 99, 101-02, 2 L. Ed. 2d 80 (1957); *see Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1990) (stating that a complaint should be dismissed only when it lacks a "cognizable legal theory" or sufficient facts to support a cognizable legal theory). The court must accept as true all factual allegations in the complaint and must draw all reasonable inferences from those allegations, construing the complaint in the light most favorable to the plaintiff. *Westlands Water Dist. v. Firebaugh Canal*, 10 F.3d 667, 670 (9th Cir. 1993); *Balistreri*, 901 F.2d at 699; *NL Indus., Inc. v. Kaplan*, 792 F.2d 896, 898 (9th Cir. 1986). Dismissal without leave to amend is appropriate only when the court is satisfied that the deficiencies of the complaint could not possibly be cured by amendment. *Chang v. Chen*, 80 F.3d 1293, 1296 (9th Cir. 1996); *Noll v. Carlson*, 809 F.2d 1446, 1448 (9th Cir. 1987).

B. Unfair Business Practices Claim

The Individual Defendants argue that California's claims for Unfair Competition Law (UCL), Cal. Bus. & Prof Code §§ 17200, 17500, must fail because they are predicated on Federal Truth in Lending Act (TILA) claims. The Individual Defendants cite *Redhouse v. Quality Ford Sales, Inc.*, 511 F.2d 230, 236 (10th Cir. 1975) to show that a defendant not liable under the TILA cannot be liable under a state regulatory scheme. *Redhouse*, however, does not apply here. The state statute applicable there was the 1953 Utah Uniform Consumer Credit Code(UUCCC), as amended, Utah Code Ann. § 70B-1-101 *et seq.* (repealed 1985). *Redhouse*, F.2d at 233. That statute specifically required that a party be a "creditor" as defined by the TILA and the UUCCC. *See Redhouse*, 511 F.2d at 241 (Doyle, J., dissenting) ("Since it is

questionable as to whether Mr. Redd was a creditor under the Act and the regulations, it would seem proper to excuse Mr. Redd from liability personally.")

In effect, "the UCL borrows violations of other laws . . . and makes those unlawful practices actionable under the UCL." *Lazar v. Hertz Corp.*, 82 Cal. Rptr. 2d 368, 375 (Cal. Ct. App. 1999).[1] However, the fact that a claim is not successful under TILA does not mean that it necessarily fails under the UCL. While it is true that a business practice cannot be unfair if it has been determined by the legislature to be lawful, *id.* at 376, that does not mean that a practice is not unfair unless the legislature has specifically enumerated it as prohibited. Indeed, "[t]he only defense available is that the conduct is not unlawful within" the meaning of the underlying statute. *Hobby Indus. Assn. of Am., Inc. v. Younger*, 161 Cal. Rptr. 601, 609 (Cal. Ct. App. 1980). The Individual Defendants do not assert that the alleged conduct was lawful, but only that the TILA enforcement scheme will not hold them liable under federal law. That does not prevent holding him liable under the state's enforcement scheme for unfair business practices.

C. Preemption

The Individual Defendants next argues that the TILA preempts state laws. Preemption can occur in two circumstances. "When Congress intends federal law to 'occupy the field,' state law in that area is preempted." *Crosby v. National Foreign Trade Council*, 530 U.S. 363, 372, 120 S.Ct. 2288, 2293 (2000). State law is also preempted whenever state law conflicts with federal law making it impossible for a person to comply with both. *Id.*

Here, the TILA neither expressly nor impliedly occupies the whole field of regulation. *Black v. Financial Freedom Senior Funding Corp.*, 112 Cal. Rptr.2d 445, 460 (Cal. Ct. App. 2001); *see also Williams v. First Gov't Mortgage and Investors Corp.*, 176 F.3d 497, 500 (D.C. Cir.1999). TILA in fact specifically allows for state law to supplement its enforcement scheme, stating that it does "not annul, alter, or affect the laws of any State relating to the disclosure of information in connection with credit transactions, except to the extent that those laws are inconsistent with the provisions of this subchapter and then only to the extent of the

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[1] The UCL may borrow other statutes, but does not buy them wholesale.

inconsistency." 15 U.S.C. § 1610(a)(1).

The Individual Defendants argue that the additional penalties available under Section 17200 are inconsistent with the TILA. Additional penalties are not inconsistent with TILA, but merely provide greater protection to consumers. Section 17200 does not provide inconsistent disclosure requirements. *See Black*, 112 Cal. Rptr.2d at 460 ("an inconsistency or contradiction with federal law does not exist merely because the state requires disclosures in addition to those required by and under TILA.")

TILA and Section 17200 do not conflict either. *Id.* at 461. A Section 17200 claim merely advances the TILA purpose of meaningful disclosure of credit terms by providing increased penalties for non-disclosure. *Id.; see also Williams*, 176 F.3d at 500.

Accordingly, the Individual Defendants' motion to dismiss California's complaint with regard to them is DENIED.

III.

MOTION TO COMPEL

A. Legal Standard

In cases governed by the Federal Arbitration Act (FAA) of 1947, federal courts are empowered to compel arbitration and to stay actions arising out of disputes that are subject to an arbitration agreement. 9 U.S.C. § 3. A party aggrieved by another party's failure to submit a dispute to arbitration may petition a district court for an order compelling arbitration. 9 U.S.C. § 4. "The Court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration . . . ." *Id.* Further, the Court should then stay all arbitrable claims. 9 U.S.C. § 3 ("[U]pon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, [the court] *shall* on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement . . . .") (emphasis added). When a case includes both arbitrable and non-arbitrable claims, the district court has discretion either to stay all the claims or to stay only the arbitrable claims and proceed with the non-arbitrable claims. *Moses H. Cone Mem'l*

Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 21 n.23, 103 S. Ct. 927, 939 n.23, 74 L. Ed. 2d 765 (1983); *United States for the Use & Benefit of Newton v. Neumann Caribbean Int'l, Ltd.*, 750 F.2d 1422, 1426-27 (9th Cir. 1985).

There are some exceptions to arbitration. If the arbitration clause is not enforceable as a matter of contract law, or if no agreement to arbitrate was ever actually entered into, the dispute need not be sent to arbitration. In addition, the legislature may indicate that a statutory claim is not subject to arbitration.

B. Discussion

All of the First Alliance lending agreements include an arbitration agreement which requires borrowers to submit their disputes with First Alliance or its employees to binding arbitration. The arbitration agreement includes a specific waiver of the borrowers rights to trial by judge or jury, appeal, discovery, and the rules of evidence.

The question here, however, is whether the arbitration agreement can be used to force the state, a non-party to the agreement, into arbitrating its regulatory actions to enforce consumer protection laws. The FAA was passed by Congress to reverse the traditional disfavor with which federal courts looked upon arbitration agreements. *See Danielsen v. Entre Rios Rys. Co.*, 22 F.2d 326, 327 (D. Md. 1927). Prior to passage of the FAA, "agreements for arbitration would not be allowed to oust the jurisdiction of the federal courts. Therefore no effect was given to them, even though they might be recognized as valid." *Id.* The FAA now requires that district courts compel arbitration when another party has failed, neglected, or refused "to arbitrate under a written agreement for arbitration." 9 U.S.C. § 4. By enacting the FAA, Congress made arbitration agreements enforceable against the parties to the agreement.

The Individual Defendants cite several cases in which a governmental agency has been required to arbitrate its claims. In all of those cases, however, the governmental entity was either a party to the arbitration agreement or was representing the interest of a party to the agreement. *United States v. Bankers Ins. Co.*, 245 F.3d 315 (4th Cir. 2001) (requiring the United States, suing on behalf of the Federal Emergency Management Agency, to arbitrate its claims stemming from a Financial Assistance/Subsidy Agreement between FEMA and the defendant);

Quackenbush v. Allstate Ins. Co., 121 F.3d 1372 (9th Cir. 1997) (requiring that claims of the California Insurance Commissioner, as trustee for insolvent reinsureds, to recover reinsurance proceeds be arbitrated).

No cases, however, can be found where a defendant seeks to compel a government regulatory agency to arbitrate its claims. The Individual Defendants argue that these claims are subject to arbitration because they arise from alleged practices which individual consumers, were they to bring the claims, would be forced to arbitrate. Additionally, the Individual Defendants point out that the mere fact that the plaintiff seeks to enforce a statutory regulation which a governmental agency can also enforce does not take the case out of the ambit of the FAA. The Individual Defendants cite *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 28, 111 S. Ct. 1647, 1653 (1991). *Gilmer* holds that regulatory claims, even when they further important public policy goals, are subject to arbitration. There is no question that the state's claims may be arbitrated. However, as *Gilmer* notes, arbitration may only be compelled if both parties have agreed to arbitrate the claim. *Id.* at 35, 111 S. Ct. at 1657 ("since the employees there had not agreed to arbitrate their statutory claims . . . the arbitration in those cases understandably was held not to preclude subsequent statutory actions."). Gilmer involved an individual who was a party to a contract, not a state agency that never agreed to resolve its enforcement action by arbitration.

The Individual Defendants contend that the state should be compelled to arbitrate representative consumer protection claims as the Court ordered in *Gray v. Conseco*, No. SA CV 00-322 DOC (EEx), 2000 WL 1480273, *7 (C.D. Cal. Sept. 29, 2000). These matters, however, are not "representative" actions brought on behalf of defrauded borrowers, but are instead instituted under the regulatory and police power to enforce state and federal consumer protection laws. *See FTC v. First Alliance Mortgage. Co. (In Re First Alliance Mortgage. Co.)*, 264 B.R. 634, 650 (C.D. Cal. 2001). Because the state is not a party to the arbitration agreement, and is seeking to enforce its regulatory scheme rather than representing defrauded borrowers, it is not bound by the arbitration agreement.

Accordingly, the Individual Defendants' motion to compel arbitration is DENIED.

IV.

CONCLUSION

For the foregoing reasons, the Individual Defendants' motions to dismiss and to compel arbitration are DENIED.

IT IS SO ORDERED.

DATED: JANUARY 8, 2002

DAVID O. CARTER
United States District Judge