

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

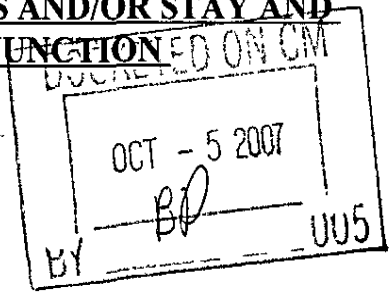
CIVIL MINUTES - GENERAL

Case No. CV 07-5194 GAF (JTLx) Date October 4, 2007  
Title Woodward, et al. v. Quixtar, Inc.

Present: The Honorable **GARY ALLEN FEESS**  
Marilynn Morris None N/A  
Deputy Clerk Court Reporter / Recorder Tape No.  
Attorneys Present for Plaintiffs: Attorneys Present for Defendants:  
None None

Proceedings: (In Chambers)

**ORDER RE: MOTIONS TO DISMISS AND/OR STAY AND FOR PRELIMINARY INJUNCTION**



**I. INTRODUCTION & BACKGROUND**

**A. THE PENDING LAWSUITS**

Quixtar, the successor-in-interest to Amway Corporation, sells a wide variety of consumer products to customers through distributors, known as Independent Business Operators ("IBOs"), who market these products through an internet-based business. A group of these distributors brings the present putative class action ("the Woodward federal action") in which they contend that Quixtar operates an illegal pyramid scheme and that it locks its IBOs into this illegal operation through the enforcement of unlawful covenants not to compete and not to solicit other Quixtar IBOs to compete with Quixtar. In this suit, which they filed on August 9, 2007, they seek a declaration that the non-competition and non-solicitation agreements are illegal and unenforceable as a matter of law.

A day after the Woodward federal action was filed, Quixtar filed a demand for arbitration and brought suit in Michigan state court ("the Quixtar state action") against two IBOs who are parties in this lawsuit - Orrin Woodward and Chris Brady - seeking a TRO barring them from breaching the non-compete and non-solicitation clauses pending resolution of the arbitration. The Michigan court issued a TRO and set the matter for hearing on whether a preliminary injunction should be entered; within a week, Quixtar amended its suit to include all of the IBOs

*76*

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

**CIVIL MINUTES - GENERAL**

Case No. CV 07-5194 GAF (JTLx)

Date October 4, 2007

Title Woodward, et al. v. Quixtar, Inc.

who appear as plaintiffs in this case.<sup>1</sup>

**B. THE MICHIGAN RULING**

In response to Quixtar's request for a preliminary injunction, the Defendant IBOs filed an opposition and made their own motion to dismiss or to stay the Michigan action in deference to the Woodward federal action. The Michigan court refused to dismiss or stay the lawsuit and entered a preliminary injunction against the IBOs precluding them from breaching the covenants not to compete and not to solicit during the pendency of the arbitration. In its written decision, the court noted:

(1) Regarding the likelihood of success, the Michigan court observed that it had no means of assessing whether the IBOs would be able to prove the existence of a pyramid scheme in the Woodward federal action, but that the parties undeniably entered into a contract that contained a binding arbitration clause. The court concluded that its refusal to grant the injunction would render the arbitration clause ineffective and frustrate the intent of the parties. In passing, the court also noted that the contract provisions appeared reasonable on their face and that Quixtar appeared likely to succeed in enforcing those provisions.

(See Page Decl. in Compendium of Exhibits in Support of Plaintiffs' Opposition to Defendant's Motions to Dismiss or Stay ("Page Decl."), Ex. 1 [8/24/07 Michigan court order] at 2-3.)

(2) The balance of harms would fall on Quixtar if the injunction were not granted because of the potential loss of proprietary information and that the injunction would do nothing more than require the IBOs to abide by the contractual terms to which they voluntarily agreed. Monetary damages would not be an adequate remedy for the loss of confidential information, and entering the injunction would not harm the public interest.

(See *id.* at 3-4.)

(3) Regarding the motion to stay, the court wrote:

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<sup>1</sup> To further complicate matters, a third lawsuit involving some of these parties was filed by Independent Business Owners Association International ("IBOAI"), an independent trade association comprised of IBOs, seeking a TRO to enjoin Plaintiffs Woodward, Brady, and others from allegedly misappropriating Quixtar and IBOAI trade secrets ("the IBOAI action"). The same Michigan court granted the TRO on August 14, 2007. (See 8/16/07 Def.'s Opp. to Pls.' *Ex Parte* Application, Ex B [8/14/07 Order granting TRO] ) The current status of this action is not known to the Court, but does not appear material to the resolution of the pending motions

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

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The issues in the case before this Court, as well as those being submitted to arbitration, are issues of contract. These issues are independent from the allegations and claims made in the federal class action suit . . . which involves plaintiff's business practice as a whole. Due to the separation of issues in the two cases, the Court believes that there is no basis upon which to stay the instant matter pending resolution in California.  
(Id. at 5.)

**C. THE PRESENT MOTIONS**

Having persuaded the Michigan court to proceed and enter an injunction against the IBOs, Quixtar then moved this Court to dismiss or stay the action based on the theory of declaratory relief abstention set forth in Brillhart v. Excess Insurance Co. of America, 316 U.S. 491 (1942) ("abstention motion"). Even though Quixtar persuaded the Michigan court *not to stay* the Michigan action because of differences in the issues presented in that case, it now argues that this Court should dismiss or stay this case because it is nearly identical to the Michigan action.

Second, and in the alternative, Quixtar moves the Court to dismiss or stay the action and compel compliance with the three-tier ADR process set forth in Rule 11 of the Rules of Conduct and signed by each Plaintiff ("ADR motion").

Third, Plaintiffs move for their own preliminary injunction to enjoin Quixtar from enforcing the non-compete, data management, and arbitration provisions of the distributorship agreements ("motion for a preliminary injunction"). Plaintiffs assert: (1) they are likely to succeed on the merits because they can demonstrate that Quixtar is an illegal pyramid scheme, thereby making the distributorship agreement (and the provisions contained therein) unenforceable, and (2) they are able to demonstrate irreparable harm because Quixtar has trapped its IBOs into supporting and perpetuating an illegal pyramid scheme, subjecting IBOs to either: (a) criminal or civil liability if they remain with Quixtar, or (b) costly legal fees and income loss if they decide to breach their illegal distributorship agreements. Plaintiffs also seek provisional class certification (on the ground that if the injunction is granted, it should apply to the entire class of Quixtar IBOs, and not the named Plaintiffs alone), as well as an expedited evidentiary hearing.

The Court concludes that the Woodward federal action and the Quixtar state action are substantially identical and threaten inconsistent results. The Michigan court has already enjoined Plaintiffs from violating the covenants not to compete and not to solicit and ordered the case to arbitration, and Plaintiffs have asked this Court to issue an inconsistent ruling and enjoin

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

**CIVIL MINUTES - GENERAL**

Case No.	CV 07-5194 GAF (JTLx)	Date	October 4, 2007
Title	Woodward, et al. v. Quixtar, Inc.		

enforcement of the very contract terms that the Michigan court says they must obey. Since this Court: (1) agrees with the Michigan court that the arbitration clause is valid, binding, and will resolve the pending disputes between the parties, and (2) finds that abstention and dismissal will, among other things, avoid duplicative litigation, the Court **GRANTS** Quixtar's abstention motion. The following sets forth a more detailed recitation of the Court's reasoning.

## II. DISCUSSION

### A. QUIXTAR'S ABSTENTION MOTION

#### 1. Legal Standard

The Declaratory Judgment Act provides that “[i]n a case of actual controversy within its jurisdiction. . . . any court of the United States. . . . may declare the rights and other legal relations of any interested party seeking such declaration.” 28 U.S.C. § 2201(a). “First, the court must inquire whether there is a case of actual controversy within its jurisdiction. Jurisdiction to award declaratory relief exists only in a case of actual controversy.” Am. States Ins. Co. v. Kearns, 15 F.3d 142, 143 (9th Cir. 1994) (citation omitted). Here, it is undisputed that an actual controversy exists before the Court pursuant to the Class Action Fairness Act (“CAFA”), thereby satisfying this requirement.

“Second, if there is a case or controversy within its jurisdiction, the court must decide *whether* to exercise that jurisdiction.” Id. at 143-44 (emphasis added). Several considerations, set forth in Brillhart v. Excess Insurance Co. of America, 316 U.S. 491, 495 (1942), “remain the philosophic touchstone” for the district court when determining whether to exercise jurisdiction in a declaratory relief action. Gov’t Employees Ins. Co. v. Dizon, 133 F.3d 1220, 1225 (9th Cir. 1998). “The Brillhart factors are non-exclusive and state that, ‘[1][t]he district court should avoid needless determination of state law issues; [2]) it should discourage litigants from filing declaratory actions as a means of forum shopping; and [3]) it should avoid duplicative litigation.’” Principal Life Ins. Co. v. Robinson, 394 F.3d 665, 672 (9th Cir. 2004) (quoting Gov’t Employees, 133 F.3d at 1225). “Essentially, the district court ‘must balance concerns of judicial administration, comity, and fairness to the litigants.’” Id. (quoting Kearns, 15 F.3d at 144).<sup>2</sup>

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<sup>2</sup> The Ninth Circuit has “suggested other considerations” for a district court to consider when deciding whether to exercise jurisdiction in a declaratory relief action, such as “whether the declaratory action will settle all aspects of the controversy; whether the declaratory action will serve a useful purpose in clarifying the legal relations at issue; whether the declaratory action is being sought merely for the purposes of procedural fencing or

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**2. Analysis**

As noted above, the Michigan court has already enjoined Plaintiffs from breaching the non-competition and non-solicitation clauses of their distributorship agreements with Quixtar. (See Page Decl., Ex. 1 [8/24/07 Michigan court order at 5]). Here, Plaintiffs ask this Court to issue an inconsistent ruling and enjoin enforcement of the very contract terms the Michigan court already found they must obey. (See, e.g., Compl. ¶ 141.) While the Quixtar state action involves a smaller subset of parties than the instant action, the Court finds that the underlying issue in both proceedings is the same – that is, whether the non-competition and non-solicitation clauses contained in the parties’ uniform distributorship agreements are valid and enforceable – and that resolution of this threshold issue will directly affect the respective rights and obligations of all parties in these actions.<sup>3</sup> Given that the Court finds the instant action and the Quixtar state action are substantially identical, it makes little sense for the Court to hear the instant action. Doing so would only threaten inconsistent results, lead to duplicative litigation, and involve needless determination of state law issues, all factors weighing heavily in favor of the Court abstaining from this declaratory relief action. See Robinson, 394 F.3d at 672.<sup>4</sup>

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to obtain a ‘res judicata’ advantage; or whether the use of a declaratory action will result in entanglement between the federal and state court systems. In addition, the district court might also consider the convenience of the parties, and the availability and relative convenience of other remedies.” Gov’t Employees, 133 F.3d at 1225 n.5 (quoting Kearns, 15 F.3d at 145).

<sup>3</sup> The Court is mindful of Judge Sullivan’s comments indicating that the two actions involve different issues (see Page Decl., Ex. 1 [8/24/07 Michigan court order] at 5), but finds that the underlying and threshold issue, noted above, is the same in both actions. In reality, the Woodward federal action is little more than the flip side of the Michigan action. In that case, Quixtar seeks to enforce its contract rights; in this case, the IBOs contend that the contract provisions it seeks to enforce are illegal. Indeed, the Complaint states:

Plaintiffs do not seek damages against Quixtar, or to shut Quixtar down. Rather, Plaintiffs merely seek a judicial declaration that the non-competition and non-solicitation provisions of the uniform Quixtar distributor agreement are unenforceable as a matter of law, so those Plaintiffs who so choose will be able to extricate themselves from continued forced participation in Quixtar’s illegal pyramid scheme . . . .

(Compl. ¶ 2.) This paragraph indicates that, while Plaintiffs assert that Quixtar operates as an illegal pyramid scheme, they are not so much interested in litigating the legitimacy of Quixtar’s operation as they are in finding a way out. The Court thus sees the lawsuits as the two sides of a single dispute over the enforceability of the contract’s non-compete clauses.

<sup>4</sup> While the Court does not expressly find that Plaintiffs are engaging in forum shopping, the Court notes that the majority of named parties appear to be Michigan citizens. See Robinson, 394 F.3d at 672 (district court should discourage litigants from filing declaratory actions as a means of forum shopping).

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

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Moreover, the Court is not persuaded by Plaintiffs' various arguments against abstention. Plaintiffs contend that this lawsuit should take precedence under the "first-to-file rule" because the instant action was filed one day before the Quixtar state action. (See Combined Opp. at 20-21.) However, courts have consistently abstained from hearing declaratory relief actions notwithstanding the first-to-file rule. See Transamerica Occidental Life Ins. Co. v. DiGregorio, 811 F.2d 1249, 1251 (9th Cir. 1987); see also DeFeo v. Procter & Gamble Co., 831 F. Supp. 776, 779-80 (N.D. Cal. 1993). While Plaintiffs also contend that there is a strong presumption in favor of exercising jurisdiction because this is a putative class action (see Combined Opp. at 15), courts have nevertheless applied declaratory relief abstention analysis in the class action setting. See Smith v. Lenches, 263 F.3d 972, 977 (9th Cir. 2001).<sup>5</sup>

In sum, while the Court recognizes that Quixtar appears to be taking inconsistent positions by claiming, before the Michigan court, that the Quixtar state action and the instant action are dissimilar, and then claiming, before this Court, that the actions are similar, this inconsistency bears little weight in the Court's analysis given that: (1) the Court finds the two actions are substantially identical such that the Court should abstain from hearing the instant declaratory relief action, and (2) ultimately, the Court agrees with the Michigan court and believes that the parties' arbitration agreement is valid, binding, and will resolve the pending disputes between the parties. Accordingly, the Court **GRANTS** Quixtar's abstention motion.

### B. OTHER MOTIONS

While the Court agrees with the Michigan court and believes the parties' arbitration agreement is valid and binding, because the Court abstains from hearing the instant matter, the Court **DENIES** Quixtar's alternate motion to dismiss and compel the ADR process as **MOOT**. Moreover, there is no occasion for the Court to determine who (JAMS, AAA or anyone else) should arbitrate the parties' dispute. The Court similarly **DENIES** Plaintiffs' motion for a preliminary injunction as **MOOT**.

### III. CONCLUSION

For the reasons set forth above, the Court **GRANTS** Quixtar's motion to dismiss on declaratory relief abstention grounds and the matter is hereby **DISMISSED WITH PREJUDICE**. Moreover, the Court **DENIES** both Quixtar's alternate motion to dismiss and compel the ADR process and Plaintiffs' motion for a preliminary injunction as **MOOT**.

**IT IS SO ORDERED.**



<sup>5</sup> While the instant action is a CAFA action and Lenches pre-dates CAFA, it does not appear that CAFA in any way limits the applicability of declaratory relief abstention analysis in the class action setting.