UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES—GENERAL

Case No. CV 22-02025-MWF (JPRx) **Date: December 5, 2022**
Title: Hui Cai et al v. CMB Export LLC

Present: The Honorable MICHAEL W. FITZGERALD, U.S. District Judge

Deputy Clerk:	Court Reporter:
Rita Sanchez	Not Reported
Attorneys Present for Plaintiff:	**Attorneys Present for Defendant:**
None Present	None Present

Proceedings (In Chambers): ORDER DENYING DEFENDANT'S MOTION TO COMPEL ARBITRATION [22]

Before the Court is Defendant CMB Export LLC's ("CMB") Motion to Compel Arbitration (the "Motion"), filed on June 1, 2022. (Docket No. 22). Plaintiff Hui Cai filed an Opposition on June 20, 2022. (Docket No. 24). CMB filed a Reply on June 27, 2022. (Docket No. 28).

The Court has read and considered the papers filed in connection with the Motion and held a hearing on **July 11, 2022**.

For the reasons discussed below, the Motion is **DENIED**. The scope of the Arbitration Clause in the Subscription Agreement does not encompass claims that arise from the Partnership Agreement.

I. BACKGROUND

This action arises from an allegedly mismanaged investment partnership organized and controlled by Defendant CMB. The partnership was created, at least in part, to enable foreign nationals (like Plaintiff) to obtain permanent legal residency under the federal government's "EB-5" visa program. (First Amended Complaint ("FAC") ¶ 3 (Docket No. 26)). Through the program, foreign nationals can obtain U.S. green cards by investing $500,000 in business ventures that create employment for at least ten American workers. (*Id.*).

Plaintiff seeks to represent a class of foreign nationals (collectively, "Plaintiffs") who are limited partners in CMB's Group 7 partnership ("Group 7" or the "Partnership"), asserting claims that all stem from CMB's alleged breach of its contractual obligations and fiduciary duties as general partner of Group 7. In accordance with the EB-5 visa program, Plaintiffs each joined Group 7 by individually purchasing one unit of the Partnership in exchange for a capital contribution of $500,000 and a $35,000 or $40,000 syndication fee. (FAC ¶¶ 4, 73).

Admittance to Group 7 required Plaintiffs to sign a suite of four documents: (1) a Private Placement Memorandum ("PPM"); (2) a Subscription Agreement; (3) a Limited Partnership Agreement ("Partnership Agreement"); and (4) an Escrow Agreement. (Moffit Decl. ¶ 3). According to the terms outlined in the Partnership Agreement, CMB served as the general partner and Plaintiffs were each limited partners. (FAC ¶¶ 4, 73).

Plaintiffs' claims in this action all arise from the Partnership Agreement, yet CMB's Motion seeks to compel arbitration through an arbitration clause found only in the Subscription Agreement. Therefore, the relationship between these two documents and the parties' dispute is significant.

The Partnership Agreement outlines the operational functions of Group 7 such as "Allocation of Profits and Losses"; "Distributions of Cash Flow"; "Right to Distributions"; and others. (*See* Partnership Agreement; Article V (Docket No. 26-1)). The Partnership Agreement also contains the "Rights, Powers, and Duties of the General Partner" and the "Rights, Powers, and Duties of Limited Partners." (*See id.*; Articles VI–VII).

Conversely, the Subscription Agreement is broad and governs the terms required to gain entry into Group 7. For example, the Subscription Agreement specifically discusses Plaintiffs' purchase and payment of their unit-share in the Partnership, discusses general representations and warranties, and provides miscellaneous provisions, such as the "Mandatory Arbitration" clause:

> **Mandatory Arbitration.** All disputes ***arising in connection with this Agreement*** between the parties which cannot be settled by agreement shall be finally settled by binding arbitration. The arbitration shall be held in the County of Los Angeles, State of California, and conducted in accordance with the rules and regulations of the American Arbitration Association. The award of the arbitrator shall be final and binding upon the parties. Either party may seek enforcement of any such arbitration award in any court of competent jurisdiction. Notwithstanding the foregoing, any disputes which involve the claims of third parties shall not be subject to the provisions of this paragraph.

(Subscription Agreement Part V.I. (Docket No. 22-3)) (the "Arbitration Clause") (emphasis added in the text). Importantly, the Subscription Agreement expressly defines the word "Agreement" to mean "[t]his Subscription Agreement." (*Id*. at 1).

The Subscription Agreement states that the "entire agreement" includes the Partnership Agreement:

> **Entirety of Agreement**. This Agreement, together with the Attachments hereto, the PPM and the Partnership Agreement, constitute the entire agreement among the parties hereto with respect to the subject matter hereof.

(Subscription Agreement Part V.J.).

The Subscription Agreement is also a condition precedent to joining Group 7, as it contains the following terms related to the Partnership's "Acceptance" of the Subscription Agreement:

> If the Partnership rejects the subscription herein, (i) the Investor shall promptly return to the General Partner all documents provided to the Investor, including the PPM, this Agreement, and the Partnership Agreement, and (ii) the General Partner shall return all signature pages

> that the Investor has executed and/or provided and the Capital Contribution and Syndication Fee pursuant to the terms and conditions of this Agreement.

(Subscription Agreement Part I.C. ("Partnership Acceptance of Subscription Agreement")).

II. LEGAL STANDARD

"[D]ue regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration." *Volt Info. Scis., Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989). However, the "policy favoring arbitration" does not authorize federal courts to invent special, arbitration-preferring procedural rules. *Morgan v. Sundance, Inc.*, No. 21-328, 2022 WL 1611788, at *4 (U.S. May 23, 2022) (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

Under the Federal Arbitration Act (the "FAA"), a party moving to compel arbitration must show: "(1) the existence of a valid, written agreement to arbitrate; and, if it exists, (2) that the agreement to arbitrate encompasses the dispute at issue." *Ashbey v. Archstone Prop. Mgmt., Inc.*, 785 F.3d 1320, 1323 (9th Cir. 2015). "[C]ourts must enforce the parties' agreement to arbitrate threshold issues regarding the arbitrability of the dispute," but only if there is "clear and unmistakable evidence" that the parties so agreed. *Momot v. Mastro*, 652 F.3d 982, 987 (9th Cir. 2011) (internal quotation marks and citation omitted). The party seeking arbitration need only prove the existence of an agreement to arbitrate by a preponderance of the evidence. *Norcia v. Samsung Telecoms. Am., LLC*, 845 F.3d 1279, 1283 (9th Cir. 2017).

III. DISCUSSION

To compel arbitration, CMB must demonstrate "(1) the existence of a valid, written agreement to arbitrate; and, if it exists, (2) that the agreement to arbitrate encompasses the dispute at issue." *Ashbey*, 785 F.3d at 1323.

A. The Existence of a Valid Agreement to Arbitrate

Section 2 of the FAA states that arbitration clauses in contracts "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. In other words, "a party may challenge the validity or applicability of the arbitration provision by raising the same defenses available to a party seeking to avoid the enforcement of any contract." *Cox v. Ocean View Hotel Corp.*, 533 F.3d 1114, 1121 (9th Cir. 2008) (internal quotation omitted).

Here, neither party disputes the existence of a valid agreement to arbitrate. The Arbitration Clause is conspicuously titled in bold font and was signed by all Plaintiffs when they joined the Partnership through the Subscription Agreement.

Therefore, the only issue before the Court is whether the dispute falls within the scope of the Arbitration Clause.

B. Whether the Dispute is Encompassed by the Arbitration Clause

This action presents a unique situation. The dispute arises from the terms and obligations of the Partnership Agreement, which contains no arbitration provision. But the Subscription Agreement contains an Arbitration Clause, and it defines the "entire agreement" to include both the Partnership Agreement and the Subscription Agreement. Therefore, the issue before the Court is whether the scope of the Arbitration Clause in the Subscription Agreement is broad enough to encompass claims that arise from the Partnership Agreement.

1. The Plain Language of the Arbitration Clause

The Arbitration Clause states that "[a]ll disputes ***arising in connection with this Agreement*** between the parties which cannot be settled by agreement shall be finally settled by binding arbitration." (emphasis added). The Subscription Agreement expressly defines "Agreement" to mean "[t]his Subscription Agreement." (Subscription Agreement at 1).

Plaintiffs argue that, based on the plain language, the Arbitration Clause does not encompass disputes arising from the Partnership Agreement because the Arbitration Clause expressly limits arbitrable disputes to those connected with the Subscription Agreement, not the Partnership Agreement. As Plaintiffs put it, CMB could have drafted unmistakable arbitration language like, "all disputes between the parties hereto shall be resolved by binding arbitration," but it did not. For whatever reason, CMB chose to limit the Arbitration Clause to "this Agreement," i.e., the Subscription Agreement.

At the hearing, CMB's counsel argued that the two contracts are integrated, so the Arbitration Clause should apply to the Subscription Agreement without further analysis. But the issue of integration – which is unsettled for its own reasons – is a red herring. Even if the contracts were integrated, the plain language of the Arbitration Clause here refers only to the Subscription Agreement.

Indeed, CMB does not seem to dispute that the phrase – "this Agreement" – is limiting language, in that it refers only to the Subscription Agreement. Nonetheless, CMB still argues that the Arbitration Clause should be read broadly to cover disputes arising from the Partnership Agreement because they arise "***in connection with***" the Subscription Agreement.

The Ninth Circuit has construed this phrase broadly, concluding, "that the language 'arising in connection with' reaches every dispute between the parties having a ***significant relationship*** to the contract and all disputes having their origin or genesis in the contract." *Simula, Inc. v. Autoliv, Inc*., 175 F.3d 716, 721 (9th Cir. 1999)

(emphasis added). Accordingly, arbitration is proper here if the Court finds that the dispute has a "significant relationship" to the Subscription Agreement.

This Court previously ruled – and the Ninth Circuit affirmed in an unpublished decision – that a "significant relationship" does not exist where the claims asserted (1) do not require an interpretation of the contract's terms; (2) do not arise from a failure to perform under the contract; and (3) do not relate to conduct that could not have occurred but for the contract. *See Malhotra v. Copa de Ora Realty, LLC*, 673 F. App'x 666, 668 (9th Cir. 2016). Indeed, where "[t]he allegations disclose that the contract's existence was a mere background fact against which the conduct at issue [] occurred; the relationship of the conduct to the contract is incidental rather than direct, and accordingly no 'significant relationship' exists." *Id*.

Here, all of Plaintiffs' claims are based on the central allegation that CMB breached its contractual obligations and fiduciary duties as the general partner of Group 7 – obligations and duties that are set forth in the Partnership Agreement, not the Subscription Agreement. Like the contract at issue in *Malhotra*, the existence of the Subscription Agreement is a "mere background fact" to Plaintiffs' claims because signing the Subscription Agreement was necessary to join the Group 7 Partnership, but it does not provide any of the terms or obligations that underpin the claims in this action. Moreover, this dispute does not require an interpretation of the Subscription Agreement's terms, nor does it arise from a failure to perform under the Subscription Agreement.

While it is true that CMB's alleged conduct could not have occurred but for the existence of the Subscription Agreement (because it was required to join Group 7), the Court concludes that this factor does not elevate the dispute into a "significant relationship" with the Subscription Agreement because its existence is a "mere background fact," as described above.

CMB argues that a "significant relationship" exists because, indeed, the contracts are intertwined with one another to create the "entire agreement." CMB claims that the Partnership Agreement was literally performed "in connection with" the

Subscription Agreement because the suite of contracts were all signed together. The Court agrees with CMB's arguments to the extent they demonstrate that the two contracts have a relationship with each other. But CMB's arguments miss the mark – "the language 'arising in connection with' reaches every ***dispute*** . . . having a significant relationship to the contract."

At the hearing, CMB's counsel cited to specific sections of the FAC to demonstrate that a significant relationship exists between Plaintiffs' claims and the Subscription Agreement. But each example counsel cited supports the Court's conclusion that the Subscription Agreement is a mere background fact to Plaintiff's claims. For example, counsel quoted from paragraph 78, which states:

> In essence, under the partnership structure that CMB created, it had no incentive to make investments or manage the partnership in a way that was likely to recoup the $500,000 capital outlay of each of the limited partners (since CMB had made no capital contribution). But CMB had every interest to maximize the interest payments to Group 7, because it would receive the overwhelming majority of such amounts.

(FAC ¶ 78).

While the Subscription Agreement does provide direction as to the limited partners' initial $500,000 capital outlay, it is an indirect background fact when compared to the alleged dispute. Indeed, paragraph 78 begins with the phrase "[i]n essence," because it summarizes the preceding paragraph that describes how "the partnership structure that CMB created" violates fiduciary duties that arise ***directly*** from the Partnership Agreement:

> The Annual Interest Income Pass-Through is defined in Section 6.08 of the [Partnership Agreement]. Under the Annual Interest Income Pass-Through, CMB was to receive the greater of (1) all but one percentage point of the annual interest received on loans made by the partnership, or (2) an amount of interest equal to 4% of the total capital contributions of all of the limited partners, i.e., $3.6 million. That is, under the first option,

> if Group 7 were able to fund a loan at an annual 10% interest rate, CMB was to receive 9% of that, with the limited partners to receive the remaining 1%. And under the second, CMB was to receive a minimum of $3.6 million in interest payments.

(FAC ¶ 77). To the extent the limited partners' initial contribution is relevant, it is incidental to the alleged conduct, not direct.

It is a fine distinction but an important one. It is not enough that the Subscription Agreement and the Partnership Agreement are related; rather, CMB must demonstrate that the ***dispute*** in this action – a breach of the general partner's duties and obligations – has a significant relationship to the Subscription Agreement. CMB has not done so.

Accordingly, the Motion is **DENIED**.

IT IS SO ORDERED.