

2012 IL App (2d) 120510-U
No. 2-12-0510
Order filed July 26, 2012

NOTICE: This order was filed under Supreme Court Rule 23(b) and may not be cited as precedent by any party except in the limited circumstances allowed under Rule 23(e)(1).

IN THE
APPELLATE COURT OF ILLINOIS
SECOND DISTRICT

S. LOUIS RATHJE, as Trustee of the S. Louis Rathje Trust U/T/A dated February 24, 1984,)	Appeal from the Circuit Court of Kane County.
Plaintiff-Appellee,)	
v.)	No. 11-CH-3589
HORLBECK CAPITAL MANAGEMENT, LLC, TODD HORLBECK, STACY KELLOGG, and HCM L.P.,)	
Defendants-Appellants)	
(Thomas E. Henderson and Cantella & Co., Respondents in Discovery.))	Honorable James R. Murphy, Judge, Presiding.

JUSTICE ZENOFF delivered the judgment of the court.
Justices McLaren and Burke concurred in the judgment.

Held: The trial court's denial of defendants' motion to compel arbitration was affirmed. The instant controversy did not arise out of a dispute that was within the scope of the arbitration agreements.

ORDER

¶ 1 Defendants, Horlbeck Capital Management, LLC (HCM, LLC), Todd Horlbeck, Stacy Kellogg, and HCM, L.P. (the partnership), bring this interlocutory appeal from an order of the circuit court of Kane County denying their motion to compel arbitration. We affirm.

¶ 2 The record shows the following facts. Todd Horlbeck was an owner/manager of HCM, LLC, an investment firm located in St. Charles, Illinois. Todd was also an independent registered representative with Cantella & Co., Inc. (Cantella), a securities broker/dealer. The partnership was an Illinois limited partnership in which HCM, LLC, was the general partner. The partnership operated a hedge fund. Todd was the hedge fund manager. Stacy Kellogg was his assistant.

¶ 3 In 2002, the partnership was soliciting investors, and in October 2002, plaintiff entered into a subscription agreement with the partnership in which he agreed to make a capital contribution of \$500,000 in exchange for a partnership interest. The subscription agreement required plaintiff to open an investor account at Cantella and to deposit into the account an amount equal to his capital contribution to the partnership. If a sufficient number of investors accumulated \$5 million for the partnership before January 2, 2003, the investors would then direct that the monies in the investment accounts be transferred to the partnership.¹ Pursuant to an agreement between Todd and Cantella, the partnership was obligated to use Cantella's services as the broker/dealer with respect to all of the partnership's investments. The agreement between Todd and Cantella further provided that Cantella would establish brokerage accounts with Bear, Stearns & Company (Bear, Stearns) and secure

¹The purpose of the Cantella investor account is not spelled out, but it appears that its purpose was to accumulate the capital needed to launch the hedge fund. According to Todd's affidavit in support of the motion to compel arbitration, plaintiff deposited his three capital contributions into the Cantella account. The monies in the Cantella account were then transferred to the partnership.

custody, clearing, and execution services for all transactions relating to the Bear, Stearns brokerage accounts.

¶ 4 The partnership accepted plaintiff as a limited partner, and on January 1, 2003, the partnership and plaintiff entered into a partnership agreement. Thereafter, plaintiff invested an additional \$500,000 and then another \$300,000 for a total investment of \$1.3 million. The agreements plaintiff and the partnership entered into did not provide for arbitration in the event a dispute arose between the parties. However, two documents plaintiff signed updating his investment account with Cantella provided for arbitration of any disputes between plaintiff and Cantella. Similarly, the document creating the relationship between plaintiff and Bear, Stearns contained an arbitration clause.

¶ 5 From time to time, plaintiff received a statement from the partnership valuing his share of the partnership's assets. Todd was responsible for calculating the account value of the hedge fund. Based upon the statement valuing plaintiff's share of the partnership's assets as of December 31, 2008, plaintiff expected to receive approximately \$1.4 million upon liquidation of the partnership. The partnership was dissolved on April 29, 2009, and plaintiff then learned that the actual value of his share of the partnership assets was \$421,217.64. In statements to plaintiff and to financial regulatory authorities, Todd admitted that the partnership had committed "performance and reporting inaccuracies." As a result of these "inaccuracies," the investors were misinformed as to the value of their investment.

¶ 6 On October 7, 2011, plaintiff filed suit against defendants and included Cantella and Thomas E. Henderson (the partnership's accountant) as respondents in discovery. Count I requested an accounting from Todd, HCM, LLC, and the partnership. Count II alleged breach of contract against

HCM, LLC. Count III alleged breach of fiduciary duty against HCM, LLC and Todd. Count IV alleged fraudulent misrepresentation against all defendants. Count V alleged negligent misrepresentation against all defendants. Count VI alleged violations of the Consumer Fraud Act against all defendants, and count VII sought discovery from Cantella and Henderson. The gravamen of plaintiff's allegations against defendants was that he sustained significant damages as a result of the partnership's misrepresentations of the value of his share of the partnership's assets.

¶ 7 Defendants moved to dismiss the complaint and to compel arbitration or, in the alternative, to stay the proceedings and compel arbitration, citing the arbitration clauses in the forms plaintiff signed with Cantella and Bear, Stearns. Cantella filed a similar motion as to count VII, but Cantella's motion is not part of this appeal. The trial court ruled that the arbitration provisions did not apply, because the dispute was not with Cantella, Cantella's role having been only as a "conduit" of the money. On April 10, 2012, the trial court entered a written order denying defendants' motion to compel arbitration, and defendants filed a timely interlocutory appeal.

¶ 8 Preliminarily, we must address defendants' motion to strike plaintiff's statement of facts as argumentative, inaccurate, and unsupported by the evidence. Illinois Supreme Court Rule 341(h)(6) (eff. July 1, 2008) requires that a statement of facts contain the facts necessary to an understanding of the case, stated accurately and fairly without argument or comment. Where a review of the record discloses that a statement of facts is not sufficiently egregious to warrant granting a motion to strike, the motion will be denied. *Bloomquist v. Ely*, 247 Ill. App. 3d 656, 661 (1993). Here, plaintiff included his own statement of facts in his appellee's brief. We do not agree that it is argumentative. Moreover, defendants appear to use the alleged "inaccuracies" to reargue points made in their briefs.

The record is short, and the issues are straightforward, so that this court is not in danger of being misled. Accordingly, we deny the motion to strike plaintiff's statement of facts in whole or in part.

¶ 9 We turn now to the merits of the appeal. Defendants contend that, as an investor in the partnership, plaintiff signed two arbitration agreements with Cantella and a third arbitration agreement with Cantella's clearing agent, Bear, Stearns. Defendants maintain that the trial court was correct in ruling that valid arbitration agreements existed but that the trial court erred in ruling that defendants could not compel arbitration pursuant to those agreements. Defendants requested arbitration under both the Federal Arbitration Act (FAA) (9 U.S.C. § 1 *et seq.* (2012)) and the Illinois Uniform Arbitration Act (Act) (750 ILCS 5/1 *et seq.* (West 2012)). We have jurisdiction over this interlocutory appeal pursuant to Illinois Supreme Court Rule 307(a)(1) (eff. July 6, 2000), which allows interlocutory review of an order granting, modifying, refusing, dissolving, or refusing to dissolve or modify injunctions. *Fahlstrom v. Jones*, 2011 IL App (1st) 103318, ¶ 3 (motion to compel arbitration is analogous to a motion for injunctive relief). Here, there was no evidentiary hearing on defendants' motion to compel arbitration, and the trial court made no factual findings. Accordingly, our review is *de novo*. *Fahlstrom*, 2011 IL App (1st) 103318, ¶ 13.

¶ 10 It is a well-established principle that arbitration is a favored alternative to litigation by state, federal, and common law, because it is a speedy and relatively inexpensive procedure for resolving controversies. *Bass v. SMG, Inc.*, 328 Ill. App. 3d 492, 497 (2002). Nevertheless, while arbitration is a favored method of dispute resolution, our supreme court has cautioned that an agreement to arbitrate is a matter of contract. *Salsitz v. Kriess*, 198 Ill. 2d 1, 13 (2001). "The parties to an agreement are bound to arbitrate only those issues they have agreed to arbitrate, as shown by the clear language of the agreement and their intentions expressed in that language." *Salsitz*, 198 Ill. 2d

at 13. Consequently, when considering a motion to compel arbitration, the court is confronted with the question of whether the parties agreed to arbitrate the particular subject matter of the dispute at issue. *Bass*, 328 Ill. App. 3d at 498.

¶ 11 The instant dispute arose out of plaintiff's investment of \$1.3 million in a hedge fund managed by Todd and operated by the partnership, in which plaintiff was a limited partner and HCM, LLC was the general partner. The lawsuit resulted from losses plaintiff allegedly sustained related to his investment in the hedge fund, and those losses were allegedly caused by the partnership's failure to provide correct valuations of plaintiff's share of the partnership assets. In connection with his investment in the hedge fund, plaintiff signed a subscription agreement, a confidential private placement memorandum (PPM), and a limited partnership agreement (collectively the hedge fund agreements). The parties to each of these agreements were plaintiff and the partnership. The PPM outlined the purpose and goal of the partnership and the management structure. HCM, LLC was the general partner owned by Todd and his family. Todd was the sole manager of HCM, LLC, and made "all decisions on behalf of" HCM, LLC. The PPM detailed the terms of the "offering." The partnership proposed to raise an equity of a minimum of \$5 million by offering partnership interests to accredited investors. Each investor was required to contribute a minimum of \$250,000 to the partnership. Prior to January 2, 2003, investors were required to open an investor account at Cantella and to deposit into the investor account an amount equal to the investor's capital contribution in the partnership. The investor was further required to retain the deposit amount in the investor account at Cantella until January 2, 2003. If the \$5 million in equity was raised on or before January 1, 2003, and if the partnership received instructions from the investors directing the transfer of the \$5 million to the partnership, then HCM, LLC would apply the

\$5 million as a capital contribution to the partnership in accordance with the subscription agreement.

An investor who signed a subscription agreement after January 2, 2003, was to make a capital contribution directly to the partnership without opening a Cantella account.

¶ 12 The PPM disclosed that Todd was an independent registered representative with Cantella. The PPM further disclosed that, pursuant to an agreement between Todd and Cantella, the partnership was obligated to use the services of Cantella as the broker/dealer with respect to “any and all” partnership investments. Todd’s agreement with Cantella included that Cantella would provide certain services to the partnership and HCM, LLC, such as brokerage accounts at Bear, Stearns. Cantella was to receive a fee for these services. The PPM contained the following disclaimer:

“Partnership interests are being offered by [HCM, LLC] and not through a sponsoring broker dealer or placement agent. [HCM, LLC], [Todd], and Cantella will not receive commission [*sic*] or other remuneration based on the sale of securities in the Offering. While Cantella is providing support services to the Partnership pursuant to the Support Services Agreement and is familiar with the Offering, Cantella is not participating in the selling effort of the Offering and has not assumed the responsibilities and assurances than [*sic*] an underwriter or sponsor would normally provide to prospective investors. Accordingly, Investors will not have the advantage of an independent underwriter’s due diligence investigation on the merits of the Offering or negotiation of the price of the Partnership interests. Cantella has advised the Partnership that it will continue to supervise [Todd] individually in his capacity as an independent registered representative of Cantella as required by federal and state broker dealer laws and regulations.”

The PPM further spelled out Cantella's and Todd's relationship vis-a-vis the partnership:

“The allocations of Net Gains and Profits allocated to [HCM, LLC] by the Partnership and the compensation paid to Cantella for the support services and broker/dealer responsibilities have not been negotiated entirely on an ‘arm’s length’ basis. Furthermore, since Cantella is acting as broker/dealer for the Partnership’s securities accounts and [Todd] will be acting as an independent registered representative of Cantella, conflicts of interest may arise between the interests and responsibilities of Cantella and [Todd] and their respective duties and responsibilities to the Partnership.”

¶ 13 The subscription agreement further illuminated the relationship among Todd, Cantella, and the partnership in explaining:

“(i) that the Partnership, its operations, including any investment decisions of the Partnership, and any investments offered in the Partnership, are in no way controlled by, or under the direction of Cantella, (ii) the Partnership was established by, and its operations are wholly controlled by [Todd] or his affiliate in his individual capacity and not in his capacity as an employee or agent of Cantella, (iii) the activities of [Todd] with respect to the Partnership are separate and apart from his employment with Cantella, and Cantella has no right or obligation whatsoever to supervise him with respect to the Partnership related activities, and (iv) [investor] in no way, including through a legal action, will attempt to hold or hold Cantella responsible for any action of [Todd] or [HCM, LLC].”

¶ 14 Plaintiff signed the hedge fund agreements prior to January 2, 2003. In accordance with the PPM's requirement that he deposit an amount equal to his capital contribution into a Cantella investor's account, plaintiff opened such an account on April 3, 2002. The “new account form” was

signed by plaintiff and purportedly was signed by Todd as Cantella's representative (the signature resembles Todd's signature on the hedge fund agreements). On June 30, 2002, plaintiff signed a "customer agreement" with Bear, Stearns, Cantella's clearing agent. According to the "customer agreement," the parties thereto were plaintiff and all present or future subsidiaries of the Bear, Stearns Companies, Inc. The "customer agreement" contained an arbitration clause that provided in part that the "parties are waiving their right to seek remedies in court, including the right to jury trial." On May 18, 2005, plaintiff signed a suitability update form with Cantella that contained an arbitration agreement. The arbitration agreement provided that it covered the "customer" and the entities and authorized agents thereof listed in the account information section of the form. The two names listed in the account information section were Cantella and plaintiff. There are two signatures below plaintiff's that appear to be the same but are illegible (and do not resemble Todd's signature on the hedge fund agreements). The scope of the arbitration agreement was as follows:

"I agree that all controversies that may arise between us concerning any order or transaction, or the continuation, performance or breach of this or any other agreement between us, whether entered into before, on, or after the date this account is opened, shall be determined by arbitration before a panel of independent arbitrators set up by the National Association of Securities Dealers, Inc."

On May 4, 2007, plaintiff signed another update form with Cantella that contained an arbitration clause, which provided in part that:

"All controversies that may arise between us (including, but not limited to controversies concerning any account, order or transaction, or the continuation, performance, interpretation

or breach of this or any other agreement between us, whether entered into or arising before, on or after the date this account is opened) shall be determined by arbitration.”

There are two illegible signatures below plaintiff’s that do not resemble each other or the signatures on the May 18, 2005, update form. Todd signed the hedge fund agreements on behalf of the partnership, and the illegible signatures on the May 18, 2005, update form do not resemble Todd’s signature on the hedge fund agreements.

¶ 15 Defendants argue that they can compel arbitration under different theories. Todd asserts that he can compel arbitration because he signed the Cantella account agreements and is a party to those agreements. It is well settled that nonparties to an arbitration agreement can neither compel arbitration nor be compelled to arbitrate. *Trover v. 419 OCR, Inc.*, 397 Ill. App. 3d 403, 407 (2010). Nevertheless, Kellogg and HCM, LLC contend that they can compel arbitration even though they are not parties to the arbitration agreements, because plaintiff is equitably estopped from denying the existence of the arbitration agreements where his claims are based on, or intertwined with, a signatory to the arbitration agreements. Additionally, Kellogg and HCM, LLC argue that they were Cantella’s agents, and, as the arbitration agreements bind Cantella, the principal, they bind Cantella’s agents. In response, plaintiff states that the Bear, Stearns “customer agreement” was signed two months before the partnership was formed and did not involve Cantella or Todd. Plaintiff urges that Todd is raising for the first time on appeal that he was a party to the Cantella account update agreements because he signed them. Plaintiff further asserts that, even if Todd did sign the Cantella forms, he did so in his individual capacity and not as Cantella’s representative. With respect to Kellogg and HCM, LLC, plaintiff argues that his claim that the partnership falsified the valuations of his share of the partnership’s assets has nothing to do with Bear, Stearns or Cantella’s handling of

investments, and, therefore, whether Kellogg and HCM, LLC were Cantella's agents or not is immaterial.

¶ 16 Defendants did not present any evidence to the trial court either that Todd signed the Cantella forms or that Kellogg and HCM, LLC were Cantella's agents. Defendants argue in their reply brief that their bare assertion in their motion to compel arbitration that Kellogg was Cantella's agent is evidence of that fact. It is not. Evidence is the collective mass of things, especially testimony and exhibits, presented before a tribunal in a given dispute. Black's Law Dictionary 595 (8th ed. 2004). Defendants furnished no testimony or documentary evidence of Kellogg's relationship to Cantella. Also, there is nothing in the record linking Todd, Kellogg, and HCM, LLC to the Bear, Stearns agreement, and defendants do not make any argument that they were agents of Bear, Stearns. Consequently, defendants have no standing to compel arbitration under the Bear, Stearns agreement.

¶ 17 With respect to the Cantella agreements, even assuming that Todd signed the forms and that Kellogg and HCM, LLC were Cantella's agents, and that their agency relationship would allow them to compel arbitration, the dispute raised in plaintiff's lawsuit is not within the scope of the arbitration clauses. Whether parties agreed to arbitrate a certain matter is a question of state-law principles governing the formation of contracts. *Ervin v. Nokia, Inc.*, 349 Ill. App. 3d 508, 511 (2004). Parties are bound to arbitrate only those issues that, by clear language, they have agreed to arbitrate. *Keeley & Sons, Inc. v. Zurich American Insurance Co.*, 409 Ill. App. 3d 515, 520 (2011). In other words, arbitrability depends on the contracting parties' intent. *United Cable Television Corp. v. Northwest Illinois Cable Corp.*, 128 Ill. 2d 301, 306 (1989). The agreement will not be extended by construction or implication. *Salsitz*, 198 Ill. 2d at 13. Defendants contend that "each and every one" of the claims raised by plaintiff in his complaint is covered by the "unambiguous" language in the

Cantella forms. Defendants specifically rely upon the arbitration clause in the May 4, 2007, Cantella update form that requires arbitration of the following:

“[A]ll controversies that may arise between us (including, but not limited to controversies concerning any account, order or transaction, or the continuation, performance, interpretation or breach of this or any other agreement between us, whether entered into or arising before, on or after the date this account is opened) ***.”

Defendants assert that plaintiff’s claims were for losses incurred due to transactions made in the Cantella account, and that plaintiff deposited monies into the Cantella account because it was the only way in which he could invest in the partnership.

¶ 18 Arbitration clauses that provide that all claims “arising out of” or “relating to” an agreement shall be decided by arbitration are categorized as generic arbitration clauses. *Keeley*, 409 Ill. App. 3d at 520. The arbitration clause in the May 2007 Cantella update form is generic. To determine the scope of a generic arbitration clause, a court examines the wording of the clause along with the terms of the contract in which the clause is found. *Keeley*, 409 Ill. App. 3d at 521. When two agreements relate to the same subject matter so that they must be read in conjunction with each other to get the full scope of the contract, and one of the agreements contains a valid generic arbitration clause, then any dispute arising out of the overall subject matter of the agreements is subject to arbitration. *Keeley*, 409 Ill. App. 3d at 521. Here, defendants reference not only the Cantella update forms but also the hedge fund agreements.

¶ 19 The arbitration clauses in the Cantella update forms pertain to a breach of “this or any other agreement between us.” “This” obviously refers to the Cantella investment account agreement. The documents contained the brokerage account number, plaintiff’s personal, marital, and financial

information, investment objectives, and risk-tolerance. The arbitration clauses pertain to “all controversies that may arise between us.” “Us” is plaintiff and Cantella. The supposedly broader language in the May 2007 form upon which defendants rely that includes “any other agreement between us” still refers to plaintiff and Cantella. If Todd signed either of the forms, he signed as Cantella’s agent, because the forms contained a signature line for the “customer signature” (plaintiff), the “representative signature,” and the “principal signature.” In contrast, Cantella was not a party to the hedge fund agreements. When we examine the hedge fund agreements, we see that the drafter of those agreements took pains to distinguish Todd’s role in the partnership from his role at Cantella. The subscription agreement spelled out that Todd’s activities with respect to the partnership were “separate and apart” from his employment with Cantella, and that Cantella had no right or obligation “whatsoever” to supervise Todd’s partnership activities. The subscription agreement further provided that plaintiff could not hold Cantella legally responsible for any of Todd’s or the partnership’s actions.

¶ 20 Defendants find the nexus between the hedge fund agreements and Cantella in their conclusion that establishing the Cantella investment account was the only way plaintiff could invest in the partnership. However, this conclusion is not sustained by the record. The PPM required persons who invested in the partnership prior to January 2, 2003, to open a Cantella investment account, but those who invested after that date were to make their contributions directly to the partnership. Plaintiff could have waited and avoided dealing with Cantella altogether. That the partnership’s investments were to be made through Cantella was a result of a side agreement between Todd and Cantella to which plaintiff was not a party. The mere mention of a Cantella investment account in the hedge fund agreements is not sufficient to subject plaintiff to the

arbitration provisions of the Cantella update forms. In order to invoke the arbitration clauses, defendants have to demonstrate that the instant controversy arose out of the investment-account agreements with Cantella and not out of the hedge fund agreements.

¶ 21 In its simplest terms, this controversy stems from allegedly false or misleading statements Todd and the partnership made to plaintiff regarding the value of his share of the partnership assets. Plaintiff pleaded that the partnership breached its obligations under the hedge fund agreements by maintaining inaccurate books, records, and accounts and by systematically misrepresenting the value of plaintiff's share of the partnership assets. The subscription agreement specifically held Cantella harmless for this activity. Plaintiff nowhere in his complaint alleges that his damages were caused by Cantella's culpable negligence in putting him into unsuitable positions, or that Cantella misappropriated funds in the account. Indeed, plaintiff's deposits into the Cantella investor account were transferred out of the account. Accordingly, the instant controversy is not within the scope of the arbitration agreements, and the trial court did not err in denying defendants' motion to compel arbitration.

¶ 22 Plaintiff seeks sanctions under Illinois Supreme Court Rule 375(b) (eff. Feb. 1, 1994), which provides that damages, costs of the appeal, and any other necessary expenses, including reasonable attorney fees, may be assessed against a party who files a frivolous appeal. Plaintiff contends that it is "clear" that the arbitration provisions in the Bear, Stearns agreement as well as the Cantella update forms were not intended to cover the types of claims plaintiff raised in this case, making this appeal sanctionable. The imposition of sanctions is a matter left strictly to the appellate court's discretion. *Kheirkhavash v. Baniassadi*, 407 Ill. App. 3d 171, 182 (2011). An award of attorney fees for defending an appeal may be granted as a sanction if a party wilfully refuses to comply with

appellate rules, or where an appeal is taken in bad faith or for an improper purpose. *Edwards v. City of Henry*, 385 Ill. App. 3d 1026, 1039 (2008). An appeal is deemed frivolous if a reasonable, prudent attorney acting in good faith would not have brought it. *Edwards*, 385 Ill. App. 3d at 1039. Here, while the appeal was unsuccessful, we cannot say it was frivolous or was brought for an improper purpose. Because of Todd's and the partnership's intricate relationship with Cantella, defendants made a good faith, if erroneous, argument that plaintiff's claims were intertwined with Cantella. Accordingly, plaintiff's request for sanctions is denied.

¶ 23 For the foregoing reasons, the judgment of the circuit court of Kane County is affirmed.

¶ 24 Affirmed.