2018 IL App (1st) 180412-U

THIRD DIVISION
December 28, 2018

No. 1-18-0412

IN THE
APPELLATE COURT OF ILLINOIS
FIRST JUDICIAL DISTRICT

HARRELD N. KIRKPATRICK III and KIRKPATRICK CAPITAL PARTNERS FUND I, L.P.,	)	Appeal from the Circuit Court of Cook County.
Plaintiffs-Appellants,	)	
v.	)	No. 17 CH 13381
BRUCE RAUNER,	)	Honorable David B. Atkins,
Defendant-Appellee.	)	Judge Presiding.

JUSTICE HOWSE delivered the judgment of the court.
Justices Ellis and Cobbs concurred in the judgment.

ORDER

¶ 1. *Held*: The judgment of the circuit court of Cook County is vacated and the cause remanded with instructions; the parties failed to clearly show whether or not their dispute over terms of a settlement agreement fell within the terms of the arbitration clause the parties previously agreed to; therefore, the arbitrability of this matter should in the first instance be determined by an arbitrator and the trial court is instructed to refer the matter to the arbitrator for an initial determination of the arbitrability of plaintiffs' claims.

¶ 2. The sole issue before us on appeal is whether the parties' clearly intended to arbitrate the claims plaintiffs raised in the complaint. After Harreld Kirkpatrick (Kirkpatrick) accepted a position as CEO of Shore Financial Services, Inc. (Shore), he entered into an agreement (Limited

Partnership Agreement) with defendant and two other individuals to form Kirkpatrick Capital Partners Fund I, L.P. (the Fund), with the Fund purchasing an equity interest in Shore. Kirkpatrick was named general partner of the Fund. A dispute arose between Kirkpatrick and the Fund and Shore, where Kirkpatrick and the Fund had separate claims against Shore. Kirkpatrick, the Fund, and Shore entered into a settlement agreement where Shore agreed to purchase the Fund's interest in Shore in exchange for Kirkpatrick's and the Fund's release of their claims against Shore. Kirkpatrick claimed a portion of the assets Shore paid to the Fund should be allocated to Kirkpatrick as consideration for releasing his individual claim against Shore. Defendant initiated arbitration proceedings against Kirkpatrick, claiming Kirkpatrick was going to breach the Limited Partnership Agreement's distribution provision. The parties are currently in arbitration over that claim. Plaintiffs filed the present action to receive a judicial determination of terms of the settlement agreement so that plaintiffs can go back to the arbitration tribunal with a judicial determination of the parties' rights under the settlement agreement. Defendant filed a motion to compel arbitration and dismiss plaintiffs' complaint, arguing that the issue of the arbitrability of the settlement agreement should be determined by the arbitration tribunal. The trial court dismissed plaintiff's complaint, finding the dispute concerned the Limited Partnership Agreement and fell under the arbitration provision of the Limited Partnership Agreement. For the reasons that follow we vacate the judgment of the trial court and remand with instructions.

¶ 3. BACKGROUND

¶ 4. In April 2011, Kirkpatrick accepted a position as CEO of Shore, a privately held mortgage lender, in Birmingham, Michigan. Kirkpatrick's employment agreement with Shore included a transaction bonus entitling Kirkpatrick to an escalating percentage of the proceeds of

the sale of the business.

¶ 5. Kirkpatrick, defendant, and the two remaining investors entered into the Limited Partnership Agreement to buy a 20% equity interest in Shore, forming the Fund. The Limited Partnership Agreement specified Kirkpatrick is the general partner of the fund, and the remaining three investors are limited partners. There was a $10 million capital commitment between the partners, with Kirkpatrick committing $1.5 million and defendant committing $5 million. The Fund was formed as a Delaware limited liability company. The Limited Partnership Agreement provides that "the General Partner shall have complete and exclusive discretion in the management and control of the affairs and business of the Fund and its Investments and shall have all powers necessary, convenient or appropriate to carry out the purposes, conduct the business and exercise the powers of the Fund." The general partner has the authority "to do all things and execute all documents the General Partner shall deem necessary or convenient to accomplish the purposes of the Fund or to protect and preserve its assets." The general partner also has the authority to enter contracts on behalf of the Fund:

> "Notwithstanding any other provision of this Agreement, any contract, instrument, or act of the General Partner on behalf of the Fund shall be conclusive evidence in favor of any third party dealing with the Fund that the General Partner has the authority, power, and right to execute and deliver such contract or instrument and to take such act on behalf of the Fund."

Although the Limited Partnership Agreement stated it "shall be governed by, and construed in accordance with, the substantive law of the State of Delaware," it also contained an arbitration clause providing for arbitration in Chicago.

> "Any controversy or claim arising out of or relating to this Agreement or any

> breach or claimed breach thereof shall be settled by arbitration in Chicago, Illinois in accordance with the rules then obtaining of the American Arbitration Association. Judgment upon the award rendered may be entered in any court having jurisdiction thereof. Any award entered by the arbitrator shall be final and binding."

¶ 6. In May 2013, Kirkpatrick was replaced as CEO of Shore. As a result, separate litigation arose between Kirkpatrick and Shore over Kirkpatrick's termination, and between the Fund and Shore over the Fund's investment. After negotiating with Shore, on May 26, 2016, Kirkpatrick sent a letter to defendant informing him of the possibility of a settlement between the Fund and Shore. The letter stated: "The Fund is proposing to settle its claims against [Shore] and deliver a 3.82x gross return to its outside limited partner investors. *** The remaining balance of settlement proceeds ($34.5 mm), net of legal and other expenses, would be allocated to [Kirkpatrick] and the team." Kirkpatrick wrote that:

> "At this time, Kip [(Kirkpatrick)] and USFS [(Shore)] have not reached a settlement relating to Kip's personal employment claims, and the resolution of such claims will not be a condition to the settlement of the Fund's claims. Kip is willing to continue to pursue his individual claims against USFS without the benefit of any continuing legal action by the Fund. Kip is also proposing to defer his rights to the settlement payments due upon closing and the first anniversary of closing to provide the outside investors with the 3.82x gross return on invested capital noted above. In consideration of the foregoing, including the litigation, credit and payment risks inherent in such deferral, Kip is proposing that he and the team share in the remaining proceeds of the settlement. Such proceeds, if paid

> in full, will exceed the amounts Kip would otherwise be entitled to receive based solely on his invested capital and carried interest."

The Fund agreed to settle their claims against Shore, and the parties entered into a redemption and settlement agreement.

¶ 7. The settlement agreement specified that the "Investor" (the Fund) owned 20,000 units of the "Company" (Shore), and that there was currently a dispute between the Fund and Shore. The settlement agreement also indicated that Kirkpatrick and Shore were also parties to an employment dispute. The parties indicated they agreed to settle all of those disputes under the terms of the settlement agreement. The settlement agreement read, in part, as follows:

> "WHEREAS, Investor and the Company wish to settle the Investment Dispute and Kirkpatrick and the Company wish to settle the Employment Dispute;
>
> WHEREAS, the Company would not enter into this Agreement but for Kirkpatrick's agreement to settle the Employment Dispute;
>
> WHEREAS, Kirkpatrick is an investor in Investor and will receive substantial benefit from the terms of this Agreement; and
>
> WHEREAS, in connection with the settlement of the Disputes, Investor desires to sell to the Company, and the Company desires to redeem and purchase from Investor, the Units, on the terms and subject to the conditions set forth herein (the 'Redemption')."

The settlement agreement provided the terms for the Fund's sale of its units of Shore as follows: "Investor agrees to, and hereby does, sell the Units to the Company, and the Company agrees to, and hereby does, redeem the Units from Investor. The aggregate purchase price (the 'Purchase Price') for the Units shall be Sixty-Seven Million Five Hundred Thousand Dollars

($67,500,000)."

¶ 8. The settlement agreement stated the $67.5 million shall be payable according to a schedule: "Thirteen Million Dollars ($13,000,000) (the 'Initial Payment') shall be paid by the Company to Investor on the Closing Date in cash by wire transfer." After the initial payment, "Fifty-four Million Five Hundred Thousand Dollars ($54,500,000) (the 'Deferred Payment') shall be paid by the Company to Investor in six (6) installments on each of the first, second, third, fourth, fifth and sixth anniversaries of the Closing Date." In exchange for the purchase of its equity interest in Shore, the Fund agreed to release Shore and its affiliates from the Fund's claims against Shore, stating: "Investor, on behalf of itself and its affiliates and subsidiaries and their respective officers, directors, partners, members, equity holders, employees, predecessors, successors; assigns, heirs, representatives, agents, insurers, and attorneys (collectively, the 'Investor Parties'), do hereby release, remise, and forever discharge the Company and its, affiliates *** from any and all causes of action." Kirkpatrick also agreed to release his individual claims against Shore, and the settlement agreement indicated Kirkpatrick received consideration for his promise to release his claims against Shore: "Kirkpatrick acknowledges and agrees that he has received good and valuable consideration in connection herewith, the adequacy and sufficiency of which are hereby acknowledged."

¶ 9. The settlement agreement contained a choice of law provision that stated the agreement "shall be governed by and construed in accordance with the laws of the State of Illinois." The agreement also contained a choice of venue provision:

> "Consent to jurisdiction, Etc: Each of the Company and Investor agrees that any suit, action, or proceeding seeking to enforce any provision of, or based on any matter arising out of or in connection with, this Agreement shall be brought only

> in the Circuit Court of Cook County, Illinois or, if under applicable law jurisdiction over the matter is available in the federal courts, the federal courts located in the City of Chicago, Illinois, and each of the Company and Investor hereby consents to the jurisdiction of such courts (and of the appropriate appellate courts therefrom) in any such suit, action, or proceeding and irrevocably waives, to the fullest extent permitted by law; any objection it may now or hereafter have to the laying of the venue of any such suit, action, or proceeding in any such court or that any such suit, action; or proceeding which is brought in any such court has been brought in an inconvenient forum."

¶ 10. On October 20, 2016, defendant wrote a letter to Kirkpatrick informing him of defendant's intention to seek arbitration over distribution of the assets in the Fund. On June 19, 2017, Kirkpatrick sent a letter to defendant and the other limited partners of the Fund informing them that the Fund had settled its litigation with Shore. Kirkpatrick stated:

> "The total consideration for the settlement ($67.5 million) is payable over a period of six years. Before entering the settlement, I discussed with each of you on multiple occasions the allocation of the proceeds (the 'Allocation'). Under the Allocation, I agreed to forego the consideration, other than tax distributions, payable at closing and on the first anniversary of closing, and the balance of consideration payable commencing with the second anniversary of the closing would be for my benefit as a limited partner in the Fund and as a former CEO of USFS. As discussed, this Allocation achieved a variety of objectives: (i) it enabled each of my partners to more quickly realize an approximate 4.0x return (as detailed on Schedule A hereto) and avoided risk of further issues with the

> Ishbias and (ii) it compensated me for the release of my significant claims against USFS for a transaction bonus and other compensation (as well as the incremental risk of receiving payments over an extended period of years)."

¶ 11. In July 2017, defendant filed for arbitration against Kirkpatrick, claiming breach of the Limited Partnership Agreement's distribution provisions. On October 5, 2017, plaintiffs filed the present complaint. Plaintiffs sought a declaratory judgment that the settlement agreement was silent as to the allocation of the payments between the Fund's claim and Kirkpatrick's individual claim. Plaintiffs filed a motion for leave to file a redacted complaint, and defendant filed a motion for leave to file a redacted motion to dismiss the complaint and compel arbitration.

¶ 12. The trial court held a hearing on January 1, 2018, on whether the matter should remain under seal and subject to redaction, and on defendant's motion to compel arbitration and dismiss plaintiffs' complaint. The court found defendant failed to provide a compelling interest or improper purpose to justify sealing or redacting the matter. The court then heard arguments on defendant's motion to compel arbitration and dismiss. Defendant argued that the dispute concerned distribution of Fund assets and did not require any interpretation of the settlement agreement. Plaintiffs claimed the only issue the complaint placed before the court was an interpretation of the settlement agreement and that plaintiffs were not asking the court to interpret or apply any provision of the Limited Partnership Agreement. Plaintiffs argued that the declaratory judgment would resolve the allocation of the settlement proceeds. Defendant contended that the settlement agreement did not address allocation of the settlement proceeds – the settlement agreement provided for payment directly to the Fund without any consideration of further distribution. That distribution among the limited partners, defendant argued, is governed by the Limited Partnership Agreement.

¶ 13. Plaintiffs argued that they are only seeking the court to provide

> "a declaratory judgment that the settlement agreement does not address the issue of how you allocate the settlement proceeds. That's all we're asking this court to do is to give us a very narrow declaratory judgment that the settlement agreement itself does not have any provision in it that actually mandates how you distribute and allocate the settlement proceeds. That will be decided in arbitration and not be decided by your honor."

During arguments, defendant informed the court that confidential arbitration was already underway between the parties and whether this dispute was arbitrable was before the arbitrator, who ruled that this dispute is arbitrable. Plaintiffs argued the arbitration panel has "not made any determination as to whether the settlement agreement actually determines exactly how the settlement proceeds should be allocated." The trial court found "the Settlement Agreement (SA) and the LPA facially conflict as to the dispute resolution forum. *** The Court is persuaded the issue presented is properly resolved through arbitration." The court further found that "the parties bargained for confidentiality and universal arbitration and would accordingly expect the benefits of the bargain between them (rather than a subsequent one that was not)." The court accordingly granted defendant's motion to dismiss and compel arbitration. This appeal followed.

¶ 14. ANALYSIS

¶ 15. Plaintiffs appeal the trial court's ruling granting defendant's motion to dismiss the complaint and compel arbitration. Plaintiffs first argue that the trial court erred in granting the motion because defendant's motion failed to raise a defense or other affirmative matter. A motion to dismiss and compel arbitration raises an affirmative matter "based on the exclusive remedy of arbitration." *Travis v. American Manufacturers Mutual Insurance Co.*, 335 Ill. App.

3d 1171, 1174 (2002). Defendant raised the affirmative matter that the Limited Partnership Agreement contained an arbitration provision and this current dispute fell under that arbitration provision. See *Hollingshead v. A.G. Edwards & Sons, Inc.*, 396 Ill. App. 3d 1095, 1101 (2009) ("The right to arbitration is treated as 'affirmative matter' that defeats the claim."). Plaintiffs argue that defendant's arguments were not proper for a 2-619(a)(9) motion because they contested the truth of matters asserted in plaintiff's complaint. Plaintiffs contend defendant's position that the venue provision of the settlement agreement is superseded by the arbitration provision of the Limited Partnership Agreement amounts to arguing well-pleaded claims in the complaint are "not true," and that the motion cannot be a basis for dismissal. See *Doe v. University of Chicago Medical Center*, 2015 IL App (1st) 133735, ¶ 41. "Subsection (a)(9) *** permits dismissal where 'the claim asserted *** is barred by other affirmative matter avoiding the legal effect of or defeating the claim.' [Citation.]" *Kedzie & 103rd Currency Exchange, Inc. v. Hodge*, 156 Ill. 2d 112, 115 (1993). Defendant raised the affirmative matter that the trial court was not the appropriate forum for plaintiffs' complaint because the parties agreed to arbitrate the dispute and that the ultimate allocation of the Fund's assets would be determined in arbitration. Defendant accordingly filed a motion to compel arbitration and a hearing was held on the motion. As noted above, invoking a right to arbitration raises an affirmative matter that defeats the claim. *Hollingshead*, 396 Ill. App. 3d at 1101.

¶ 16. Plaintiffs argue that the Limited Partnership Agreement's arbitration provision does not clearly apply to the dispute over interpretation of the settlement agreement. Plaintiffs argue the settlement agreement contains a choice of venue provision providing for resolution of disputes arising under the settlement agreement in the circuit court of Cook County. Defendant claims plaintiffs' complaint arises out of or relates to the Limited Partnership Agreement and that the

arbitration provision in the Limited Partnership Agreement therefore clearly applies.

¶ 17. "At a hearing on a motion to compel arbitration, the only issue before the court is whether an agreement exists to arbitrate the dispute in question." *Travis*, 335 Ill. App. 3d at 1175. We review an appeal from a trial court's order granting a motion to dismiss and compel arbitration *de novo*. *Id.* at 1174.

> "The Illinois Uniform Arbitration Act (Act) (710 ILCS 5/1 (West 2014)), must be deemed part of a contract containing an arbitration clause. The Act embodies a policy that favors arbitration as a cost-effective method of dispute resolution. Section 2 of the Act provides that, upon the application of a party, the trial court may compel or stay arbitration or stay a court action pending arbitration. A motion to compel raises a sole and narrow issue—whether there is an agreement between the parties to arbitrate the dispute at issue. In making that determination, a three-pronged approach is used: (1) if it is clear that the dispute falls within the scope of the arbitration clause or agreement, the court must compel arbitration; (2) if it is clear that the dispute does not fall within the arbitration clause or agreement, the court must deny the motion to compel; and (3) if it is unclear or ambiguous whether the dispute falls within the scope of the arbitration clause, the matter should be referred to the arbitrator to decide arbitrability." *Guarantee Trust Life Insurance Co. v. Platinum Supplemental Insurance, Inc.*, 2016 IL App (1st) 161612, ¶ 26.

¶ 18. The arbitration clause of the Limited Partnership Agreement provided that: "any controversy or claim arising out of or relating to this Agreement or any breach or claimed breach thereof shall be settled by arbitration." Defendant maintains this was a valid arbitration

agreement and that the parties' dispute fell within the scope of that agreement. Defendant argues the trial court was required to compel arbitration.

> "[T]he decision whether to compel arbitration is not discretionary. Where there is a valid arbitration agreement and the parties' dispute falls within the scope of that agreement, arbitration is mandatory and the trial court must compel it. *** On the other hand, where there is no valid arbitration agreement or where the parties' dispute does not fall within the scope of that agreement, the trial court may not compel it." *Travis*, 335 Ill. App. 3d at 1175.

¶ 19. Plaintiffs argue defendant uses an incorrect standard of "relating to" for determining whether to compel arbitration because a court should only dismiss an action and compel arbitration when it is clear the parties agreed the dispute ought to be submitted for arbitration.

> "[T]he Illinois Uniform Arbitration Act [(Act)], enacted in 1961 (Ill.Rev.Stat.1985, ch. 10, par. 101 *et seq.*), is substantially the Uniform Arbitration Act promulgated by the National Conference of Commissioners on Uniform State Laws in 1955. [Citation.] The Act embodies a legislative policy favoring enforcement of agreements to arbitrate future disputes. [Citations.] Accordingly, it empowers courts, upon application of a party, to compel or stay arbitration, or to stay court action pending arbitration. [Citation.] In such a proceeding the court is confronted with the issue of whether there is an agreement to arbitrate the subject matter of a particular dispute. [Citation.] Inseparable from this issue is the question of who decides arbitrability-the court or the arbitrator." *Donaldson, Lufkin & Jenrette Futures, Inc. v. Barr*, 124 Ill. 2d 435, 443–44 (1988).

¶ 20. The arbitration clause in the Limited Partnership Agreement is the broadest type of arbitration clause because it provides for arbitration of any dispute "arising out of or relating to" the agreement. *Donaldson, Lufkin & Jenrette Futures, Inc.*, 124 Ill. 2d at 445 ("The broadest arbitration clauses typically provide that 'any claim or controversy arising out of this agreement' is to be submitted to arbitration."). "A problem arises, however, when the parties broadly agree to arbitrate and it is still unclear whether the subject matter of the dispute falls within the scope of the arbitration agreement." *Id.* at 446. If neither party can show that the dispute clearly does or does not fall within the scope of the arbitration clause, then the initial determination of whether the dispute is arbitrable should be determined by an arbitrator. *Id*. at 447-48 ("[W]hen the language of an arbitration clause is broad and it is unclear whether the subject matter of the dispute falls within the scope of [the] arbitration agreement, the question of substantive arbitrability should initially be decided by the arbitrator."). "Whether the party seeking arbitration is right or wrong is a question of contract application and interpretation for the arbitrator, not the court, and the court should not deprive the party seeking arbitration of the arbitrator's skilled judgment by attempting to resolve the ambiguity." (Internal quotation marks and citations omitted.) *Id.* at 448. Our supreme court found that "it was the express intention of the drafters of the Uniform Arbitration Act that the arbitrator initially interpret the arbitration clause in unclear cases, subject to the ultimate determination of arbitrability by the court. [Citation.]" *Id.* at 450-51.

¶ 21. Defendant argues it is clear from the broad arbitration clause that the parties agreed to arbitrate this dispute. Plaintiffs argue that when Kirkpatrick entered the settlement agreement the Fund became bound to accept that "any suit, action, or proceeding seeking to enforce any provision of, or based on any matter arising out of or in connection with, this Agreement shall be

brought only in the Circuit Court of Cook County, Illinois." Plaintiffs claim that because the Limited Partnership Agreement gave Kirkpatrick the authority to enter into the settlement agreement on behalf of the Fund, and because defendant is a limited partner of the Fund, plaintiffs' claim for declaratory relief should therefore be heard by the court and not in arbitration. Defendant argues he is not bound by the settlement agreement because he was not a party to the agreement, and therefore the venue provision of the settlement agreement does not apply to the present dispute. Plaintiffs argue that defendant is a party to the settlement agreement because defendant received a benefit from the agreement.

¶ 22. We find defendant has not clearly shown that he is not bound by the settlement agreement. We also find plaintiffs failed to clearly show that defendant is bound by the settlement agreement. Therefore, it is unclear whether the venue provision of the settlement agreement is applicable or whether the arbitration provision of the Limited Partnership Agreement controls. As noted above, when the scope of the arbitration agreement is unclear, the issue is for the arbitrator to decide in the first instance, not the courts. *Donaldson, Lufkin & Jenrette Futures, Inc.*, 124 Ill. 2d at 447–48. In the Limited Partnership Agreement the parties broadly agreed to arbitrate. "[W]hen the parties broadly agree to arbitrate and it is still unclear whether the subject matter of the dispute falls within the scope of the arbitration agreement, the question of substantive arbitrability should initially be decided by the arbitrator." *Caudle v. Sears, Roebuck & Co.*, 245 Ill. App. 3d 959, 963 (1993).

¶ 23. Defendant argues that the arbitrability of the present case was already decided by an arbitrator, who found the issue was arbitrable. Plaintiffs argue the arbitrator did not have this matter before them, and therefore the arbitrator has not decided the arbitrability of this dispute. "[A] court may determine that an arbitrator should decide the issue of arbitrability in the first

instance. However, the arbitrator's decision is subject to an 'ultimate determination of arbitrability by the court.' " *Salsitz v. Kreiss*, 198 Ill. 2d 1, 12 (2001). The record on appeal does not contain the arbitrator's decision. It is not clear from the record what specific claim was submitted to the arbitrator for determination of arbitrability. Therefore, we cannot say that the arbitrability of this dispute has already been decided in favor of arbitration.

¶ 24. The trial court here found that the claims brought by plaintiffs fell within the scope of the arbitration clause of the Limited Partnership Agreement and granted defendant's motion to dismiss and compel arbitration. However, we find that the arbitrability of plaintiffs' claims is ambiguous because neither party has clearly shown the dispute either clearly does or does not fall within the scope of the arbitration clause. When it is ambiguous whether to compel arbitration, the court must refer the arbitrability of the dispute to the arbitrator. *Donaldson, Lufkin & Jenrette Futures, Inc.*, 124 Ill. 2d at 447–48. Because we find that the ultimate issue of arbitrability should be submitted to the arbitrator we must vacate the trial court's order granting defendant's motion to dismiss and compel arbitration. On remand, the trial court is instructed to refer the matter to the arbitrator for determination of the arbitrability of plaintiffs' claims.

¶ 25. CONCLUSION

¶ 26. For the forgoing reasons the judgment of the circuit court of Cook County is vacated and the cause remanded with instructions.

¶ 27. Vacated; remanded with instructions.