2015 IL App (1st) 143359-U

FIRST DIVISION
November 2, 2015

No. 1-14-3359

IN THE
APPELLATE COURT OF ILLINOIS
FIRST JUDICIAL DISTRICT

ALAN J. KAUFMAN, SUE E. KAUFMAN, LFENET, LLC; BBROOK, LLC, and DRALLI, LLC,	)	Appeal from the Circuit Court of Cook County
Plaintiffs-Appellants,	)	
v.	)	No. 12 L 13292
BDO SEIDMAN, L.L.P., and MICHAEL COLLINS, PAUL SHANBROM, and LAWRENCE COHEN,	)	Honorable John C. Griffin,
Defendants-Appellees.	)	Judge Presiding.

JUSTICE HARRIS delivered the judgment of the court
Presiding Justice Liu and Justice Connors concurred in the judgment.

ORDER

Held: The circuit court's determination granting defendants' motion to stay the proceedings pending arbitration is affirmed where plaintiffs' contention that the arbitration provision was included to further a fraudulent scheme is insufficient to allow for judicial review under federal law, plaintiffs' claims fall within the scope of the arbitration provision, and the arbitration provision was not unconscionable.

¶ 1 Plaintiffs, Alan J. Kaufman, Sue E. Kaufman, LFNET, LLC, BBROOK, LLC, and DRALLI, LLC, appeal the orders of the circuit court granting defendants BDO Seidman, L.L.P. (BDO), Michael Collins, Paul Shanbrom, and Lawrence Cohen's motion to stay the action pending arbitration. On appeal, plaintiffs contend that the arbitration provision is unenforceable as part of BDO's plan to effect a fraudulent scheme, the arbitration provision itself was procured by fraud, and the provision is unconscionable. Plaintiffs also contend that the trial court erred in granting the stay pending arbitration because their claims arise from defendant BDO's investment and legal advice, and such claims are expressly excluded from arbitration by the contracts signed by the parties. For the following reasons, we affirm.

¶ 2 JURISDICTION

¶ 3 The trial court granted defendant's motion to stay the proceedings pending arbitration on October 6, 2014. Plaintiffs filed their notice of appeal on November 4, 2014. Accordingly, this court has jurisdiction pursuant to Illinois Supreme Court Rule 307, allowing appeals of interlocutory orders as of right. Ill. S. Ct. R. 307 (eff. Feb. 26, 2010).

¶ 4 BACKGROUND

¶ 5 The following are the facts pertinent to the resolution of this appeal. In August 2002, and May 2003, the parties entered into two consulting agreements regarding the services BDO would provide, including the implementation of BDO's distressed debt strategy.[1]

¶ 6 Portions of the consulting agreements relevant to this appeal are as follows:

[1] The record on appeal contains two signed consulting agreements (2002 and 2003), and a signed Tax Audit Representation Agreement (TARA) effective August 21, 2002. A second TARA was prepared effective May 22, 2003 but neither party signed that agreement.

"2. Services

(a) During the Term, BDO agrees to provide the following accounting and consulting services to the Client (the "Services"): accounting and consulting services in conjunction with planning, structuring and assistance in negotiating certain transactions, certain federal income tax, international tax, financial, estate planning and other financial aspect of various anticipated investment activities. **BDO is not in the business of providing investment or legal advice or related services; thus, none of the services to be rendered by BDO to Client can or will include investment or legal advice and should not be considered as investment or legal advice. Client acknowledges and represents that it will, and is, not relying upon BDO for investment or legal advice or related services.**

(b) BDO will provide the Client with an opinion concerning the federal income tax consequences of the Transactions. The opinion will be in addition to and not in lieu of the opinion the Client may receive from legal counsel.

* * *

5. No Warranty **BDO makes no warranties, express or implied, under this Agreement with respect to the Services or otherwise.** *** As stated above, the Services to be provided in connection with this Agreement include the issuance of an opinion regarding the federal income tax consequences of the Transactions. In this regard, BDO accepts responsibility for the opinion BDO will provide to Client. BDO does not assume any responsibility whatsoever, and shall not be held liable for, any legal and/or tax opinions regarding any strategies that may be implemented by Client during

the term of this Agreement. Client acknowledges and agrees that BDO has advised the Client to retain a law firm for legal as well as tax opinions on any strategies or Transactions in which Client engages during the term of this Agreement. The Client's exclusive remedy, and BDO's sole liability to the Client, for any cause whatsoever related in any way to this Agreement or to the Services provided by BDO to Client, shall be limited to the dollar amount of the Consulting Fees actually paid to BDO by the Client under this Agreement. ***

* * *

7. Dispute Resolution

* * *

(d) If any dispute, controversy or claim arises in connection with the performance or breach of this agreement and cannot be resolved by facilitated negotiations (or the parties agree to waive that process) then such dispute, controversy or claim shall be settled by arbitration in accordance with the laws of the State of Michigan, and the then current Arbitration Rules for Professional Accounting and Related Disputes of the American Arbitration Association ("AAA"), except that no pre-hearing discovery shall be permitted unless specifically authorized by the arbitration panel, and shall take place in Southfield, Michigan, unless the parties agree to a different locale.

(e) Such arbitration shall be conducted before a panel of three (3) persons, one (1) chosen by each party and the third selected by the two (2) party-selected arbitrators. ***

* * *

10. Governing Law This Agreement shall be governed and construed in accordance with the laws of the State of Michigan, except for its conflict of law principles."

11. Entire Agreement This Agreement *** sets forth the entire agreement between the parties with respect to the subject matter herein, superseding all prior agreements, negotiations or understandings, whether oral or written, with respect to such subject matter."

(Emphasis added).

The TARA agreement signed by the parties contains the same arbitration clause as is found in the consulting agreements above. BDO also issued opinion letters per the agreements indicating that plaintiffs could "properly and legally claim [the] losses" generated by tax shelters established by BDO. Plaintiffs were represented by independent counsel, and counsel engaged in detailed negotiations concerning the 2002 consulting agreement. As a result of the negotiations, BDO agreed to change the choice of law and arbitration venue provisions to the state of Michigan.

¶ 7 In accordance with the consulting agreement, plaintiff Kaufman claimed deductions on his tax returns in tax years 2002 through 2004. The Internal Revenue Service (IRS) subsequently audited his tax returns from those years and disallowed the strategy as an illegal and abusive tax shelter. The IRS indicated that it would assess "substantial back-taxes, interest, and penalties."

¶ 8 Plaintiffs filed an eight-count complaint against defendants in the circuit court of Cook County on November 27, 2012. For purposes of this appeal, the complaint alleged that BDO conspired to design, market, sell, and implement investment strategies it knew the IRS would disallow. It further alleged that BDO made these representations to convince the Kaufmans to

enter into the consulting agreement and participate in BDO's distressed debt strategy. Relying on BDO's misrepresentations, the Kaufmans executed the agreements and implemented the investment strategies. Plaintiffs requested actual and punitive damages, as well as attorney fees and court costs, pre and post judgment interest, and disgorgement of all monies and fees.

¶ 9 In March 2013, BDO filed a motion to compel arbitration in Michigan and a petition to stay the Illinois claims pending resolution of the Michigan matter. The circuit court in Michigan dismissed BDO's petition and ordered BDO to answer plaintiffs' complaint. On October 10, 2013, BDO filed a motion to dismiss pursuant to the doctrine of *forum non conveniens*. The trial court denied BDO's motion on April 30, 2014. On July 2, 2014, BDO moved to stay the action in favor of arbitration pursuant to section 3 of the Federal Arbitration Act (Arbitration Act) (9 U.S.C. § 1, *et seq.*). In response, plaintiffs sought discovery on the issue of whether plaintiffs were fraudulently induced to enter into the arbitration provisions of the agreements. BDO objected and moved for a protective order. On October 6, 2014, the trial court granted BDO's motion to stay the proceedings pending arbitration, but did not rule on the motion for the protective order. Plaintiffs filed this timely appeal.

¶ 10 ANALYSIS

¶ 11 On appeal, plaintiffs argue that the trial court erred in granting the motion to stay pending arbitration. The trial court's order is appealable as an interlocutory order pursuant to Rule 307(a)(1). The issue in such an appeal is "whether a sufficient showing was made to sustain the order of the trial court." *Menard County Housing Authority v. Johnco Construction, Inc.*, 341 Ill. App. 3d 460, 463 (2003). Therefore, in an interlocutory appeal, this court generally reviews the trial court's determination under the abuse of discretion standard. *Fuqua v. SVOX AG*, 2014 IL App. (1st) 131429, ¶ 15. However, if the question presented is purely one of law, a

reviewing court will apply the *de novo* standard. *In re Lawrence M.*, 172 Ill. 2d 523, 526 (1996); *Bovay v. Sears, Roebuck and Company*, 2013 IL App (1st) 120789, ¶ 24. An agreement to arbitrate is a matter of contract, and the interpretation of a contract is a question of law subject to *de novo* review. *Carr v. Gateway, Inc.*, 241 Ill. 2d 15, 20 (2011).

¶ 12 Plaintiffs first contend that the arbitration provision is unenforceable as part of BDO's conspiracy to commit fraud. Initially, we must determine whether Michigan law applies here, given that the arbitration clause states that a dispute "shall be settled by arbitration in accordance with the laws of the State Michigan," and the "Governing Law" paragraph states that Michigan law applies to the consulting agreement as a whole. Unambiguous language in the contract should be given its plain and ordinary meaning. *Buenz v. Frontline Transportation Company*, 227 Ill. 2d 302, 308 (2008). According to the plain language of the arbitration clause, Michigan law governs how arbitration will be conducted once a dispute proceeds to arbitration, but not whether it should be conducted in the first instance. Furthermore, although the governing law provision of the consulting agreement also states that Michigan law applies as a whole, Michigan courts have held that if the contract involves interstate commerce, federal law applies on the arbitrability issue. *DeCaminada v. Coopers & Lybrand*, 232 Mich. App. 492, 496 (1998).

¶ 13 We recently addressed this very issue in *Coe v. BDO Seidman, LLP*, 2015 IL App (1st) 142215. In *Coe* we determined that pursuant to federal law, "if the claim is fraud in the inducement of the arbitration clause itself – an issue which goes to the 'making' of the agreement to arbitrate – the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *Coe*, 2015 IL App (1st) 142215, ¶ 18, quoting *Prima Paint Corp. v. Flood & Conklin Manufacturing Company*, 388 U.S. 395, 403-04 (1967). *Prima Paint* addressed whether a court

or an arbitrator "is to resolve a claim of 'fraud in the inducement,' under a contract governed by the United States Arbitration Act of 1925, where there is no evidence that the contracting parties intended to withhold that issue from arbitration." *Id*. at 396-97. The Supreme Court held that in ruling on a section 3 motion for a stay pending arbitration, "a federal court may consider only issues relating to the making and performance of the agreement to arbitrate." *Id*. at 404. In other words, "regardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator." *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 449 (2006).

¶ 14 Here, as in *Coe*, plaintiffs' complaint alleged fraud in the making of the agreement as a whole. They alleged that BDO conspired to design, develop, market, sell, and implement investment strategies it knew the IRS would disallow, and that BDO made misrepresentations to convince the Kaufmans to enter into the consulting agreement and participate in BDO's distressed debt strategy. As in *Coe*, plaintiffs here also question the enforceability of an agreement to arbitrate contained within a contract induced by fraud. These issues, however, are for the arbitrator to determine. *Prima Paint*, 388 U.S. at 403-04.

¶ 15 Plaintiffs argue that their complaint also alleged fraud in the agreement to arbitrate because they alleged that "the arbitration provision contained in the agreements are *** null and void [because *inter alia*] the arbitration provision was procured by fraud, was fraudulently induced, and/or the fraud permeated the entire agreement, including the arbitration provision." Although plaintiffs need not prove their fraud allegations at this point, they must allege with specificity the nature of the misrepresentation when making a claim for fraud. *United States ex rel. Grenadyor v. Ukrainian Village Pharmacy, Inc.*, 772 F.3d 1102, 1105-06 (7th Cir. 2014). Therefore, to merely allege that the arbitration clause was included to further a fraudulent

scheme is insufficient. *Ragan v. AT&T Corporation*, 355 Ill. App. 3d 1143, 1158 (2005) (determining the issue under federal law). "[T]here must be facts alleged from which it might be concluded that the party resisting arbitration never intended to agree to arbitrate the issues raised in the proceedings or that its assent to the agreement to arbitrate was the product of wrongful coercion." *Id.*

¶ 16 The Kaufmans argue that BDO deceived them into agreeing to the terms at issue, including the arbitration terms, "by failing to disclose material facts regarding the purpose and effect of the arbitration provisions" and seek to further this fraud "through a court order enforcing the arbitration provisions." The Kaufmans allege that they relied on these representations when they agreed to the arbitration provisions. They do not argue, however, that they never would have agreed to the arbitration provision without BDO's representations, nor is there any evidence that BDO coerced the Kaufmans into agreeing to the provisions. As such, plaintiffs' claims of fraud relating to the arbitration provisions are insufficient to enable a court to consider the issue.

¶ 17 Plaintiffs next contend that the trial court erred in granting the stay pending arbitration because their claims arise from defendant BDO's investment and legal advice, and such claims are expressly excluded from arbitration by the contracts signed by the parties. We also visited this issue in *Coe*, in which we analyzed the case of *Khan v. BDO Seidman, LLP*, 404 Ill. App. 3d 892, 912 (2010), cited by the trial court. The consulting agreement in *Khan*, as the agreements in *Coe* and here, required that " ' [i]f any dispute, controversy or claim arises in connection with the performance or breach of the agreement and cannot be resolved by facilitated negotiations (or the parties agree to waive that process) then such dispute, controversy or claim shall be settled by arbitration ***.' " *Id.* at 913. Pursuant to our determination in *Khan*, we determined in *Coe*

that the scope of plaintiffs' arbitration clause is "narrower" than clauses referring to claims generally arising out of or relating to the agreement, and encompassed only claims relating to the performance of the consulting agreement. *Coe*, 2015 IL App (1st) 142215, ¶ 22. Therefore, to determine whether a claim falls within the narrower arbitration provision, the court must first "determine what performances BDO promised to render in the consulting agreements." *Id*. at 914.

¶ 18 In *Khan*, we found that the services provided by BDO that are subject to the arbitration clause did not include legal or tax opinions expressed in the preparation of tax forms or in investment planning. *Id*. at 919. However, unlike the situation in *Khan*, the consulting agreement here and in *Coe* includes a provision explicitly stating that "the Services to be provided in connection with this Agreement include the issuance of an opinion regarding the federal income tax consequences of the Transactions. In this regard, BDO accepts responsibility for the opinion BDO will provide to Client." According to the plain and clear language of the consulting agreement, BDO's services "include the issuance of an opinion." Therefore, plaintiffs' claims based on the opinion letters fall within the arbitration provision of the agreement.

¶ 19 The claims in plaintiffs' complaint here alleged that BDO conspired to design, develop, market, sell, and implement investment strategies it knew the IRS would disallow. It further alleged that BDO made these representations to convince the Kaufmans to enter into the consulting agreement and participate in BDO's distressed debt strategy. Relying on BDO's misrepresentations, the Kaufmans executed the agreement and implemented the investment strategies. These claims arise from representations BDO made in its opinion letters "regarding certain federal income tax consequences of the investment transactions."

¶ 20 Plaintiffs, however, disagree and argue that including the legal and tax advice contained in the opinion letter would render the agreement's legal and investment advice disclaimers superfluous. In *Coe*, we found that the consulting agreement provides that BDO's services include the issuance of an opinion letter regarding federal tax implications of the investment strategies, but it also states that BDO "does not assume any responsibility whatsoever, and shall not be held liable for, any legal and/or tax opinions regarding any strategies that may be implemented by Client during the term of this Agreement" and advised clients "to retain a law firm for legal as well as tax opinions on any strategies or Transactions in which Client engages during the term of the Agreement." 2015 IL App (1st) 142215, ¶ 27. We determined that these seemingly contradictory provisions can be harmonized, however, so that both are given effect. *Id.* Generally, if contractual provisions conflict or create an ambiguity, the more specific provision controls. *Grevas v. United States Fidelity & Guaranty Company*, 152 Ill. 2d 407, 411 (1992).

¶ 21 Here, as in *Coe*, the consulting agreement specifically carved out an exception expressly stating that "the Services to be provided in connection with this Agreement include the issuance of an opinion regarding the federal income tax consequences of the Transactions. In this regard, BDO accepts responsibility for the opinion BDO will provide to Client." In other words, although claims arising from general legal and tax opinions resulting from the implementation of the consulting agreement are excluded from arbitration, claims based on BDO's opinions regarding the federal income tax consequences of the transactions are arbitrable. The more specific provision referring to opinions outlining federal income tax consequences therefore controls.

¶ 22 Plaintiffs argue that even if their claims fall within the scope of the agreement's arbitration clause, the clause itself is unenforceable because it is unconscionable. Plaintiffs contend that the arbitration provision is both procedurally and substantively unconscionable.

¶ 23 Procedural unconscionability addresses issues in contract formation such as whether one party lacked any meaningful choice in entering the contract, taking into account the party's experience and education, whether the contract contained "fine print," and whether high-pressure tactics were used. *Brower v. Gateway 2000, Inc.*, 676 N.Y.S. 2d 569, 573 (N.Y. Sup. Ct. 1998).[2] Plaintiffs argue that the arbitration provision is procedurally unconscionable because there was a disparity in bargaining power between the parties, plaintiffs had no knowledge that the investment strategies BDO would utilize under the agreement were fraudulent, and BDO failed to explain that they would be giving up or limiting their rights to a jury trial, discovery, punitive damages and appeal, should a controversy arise. Plaintiff Kaufman is a sophisticated and successful business person who sought the services of BDO. The arbitration provision was plainly visible in the agreement, and the meaning of its terms was clear. There is no evidence that BDO forced Kaufman to enter into an agreement for services, and he was free to seek the services of another company if he did not like the terms of BDO's services. See *Ranieri v. Bell Atlantic Mobile*, 759 N.Y.S. 2d 448 (2003) (inequality of bargaining power does not invalidate a contract as unconscionable if the complaining party could have made its purchase elsewhere).

¶ 24 Plaintiffs argue that "[n]o amount of education or business acumen could have protected the Kaufmans from the undisclosed criminal conduct of BDO and the lengths it was willing to go to cover up its activity." As discussed above, courts can only address the issue of whether the

[2] Plaintiffs cite to New York law in their brief, acknowledging that the law on this issue is the same under New York, Michigan, and Illinois law.

arbitration clause itself was fraudulently induced. The question of whether fraud permeated the entire contract, including the arbitration clause, is one for the arbitrator. *Prima Paint*, 388 U.S. at 403-04.

¶ 25 An arbitration provision is substantively unconscionable "where its terms are unreasonably favorable to the party against whom unconscionability is claimed." *Brennan v. Bally Total Fitness*, 198 F. Supp. 2d 377, 381 (S.D.N.Y. 2002). Such terms must be "so grossly unreasonable or unconscionable in the light of the mores and business practices of the time and place as to be unenforceable according to its literal terms." *Gillman v. Chase Manhattan Bank*, 73 N.Y. 2d 1, 10 (N.Y. 1988). Plaintiffs contend that the arbitration provision is substantively unconscionable because its prohibition on pre-hearing discovery heavily favors BDO and serves only to further BDO's fraudulent scheme, and its limitations on damages is unfair and one-sided. Plaintiffs do not cite authority for their argument in violation of Illinois Supreme Court Rule 341(h)(7) (eff. Feb. 6, 2013), and have thereby forfeited this issue on appeal.

¶ 26 In any event, New York courts have rejected the contention that such a discovery limitation renders the provision unconscionable. See *Stewart v. Paul, Hastings, Janofsky & Walker, LLP*, 201 F. Supp. 2d 291, 292 (S.D.N.Y. 2002) ("[t]he suggestion that an arbitration clause is unconscionable because discovery either is unavailable or more limited in arbitration than in litigation is preposterous"). There is also no indication that the limitations on damages provision was "so grossly unreasonable or unconscionable in the light of the mores and business practices of the time" or not bargained for by the parties. In fact, the record shows that plaintiffs were represented by independent counsel, and counsel engaged in detailed negotiations concerning the 2002 consulting agreement. Furthermore, under New York law arbitration clauses need not reflect "mutual promises creating identical rights and obligations in each party"

to be enforceable. *Sablosky v. Edward S. Gordon Company*, 73 N.Y. 2d 133, 136 (N.Y. 1989). Instead, whether consideration exists for the entire agreement is the determining factor. "If there is consideration for the entire agreement that is sufficient; the consideration supports the arbitration option, as it does every other obligation in the agreement." *Id*.

¶ 27 For the foregoing reasons, the judgment of the circuit court is affirmed.

¶ 28 Affirmed.