Affirm and Opinion Filed July 21, 2020

In The
Court of Appeals
Fifth District of Texas at Dallas

No. 05-19-01235-CV

WHITLEY PENN LLP, Appellant
V.
GACP FINANCE CO., LLC, Appellee

On Appeal from the 134th Judicial District Court
Dallas County, Texas
Trial Court Cause No. DC-19-02210

MEMORANDUM OPINION

Before Justices Partida-Kipness, Nowell, and Evans
Opinion by Justice Partida-Kipness

In this interlocutory appeal, Whitley Penn LLP contends the trial court erred by denying Whitley Penn's motion to compel arbitration of claims brought against it by GACP Finance Co., LLP (GACP). *See* TEX. CIV. PRAC. & REM. CODE §§ 51.016, 171.098(a)(1). GACP sued for negligent misrepresentation arising from Whitley Penn's financial audit of third-party Excel Corporation. Whitley Penn moved to compel arbitration under the terms of its engagement agreement with Excel. In one issue, Whitley Penn contends the trial court erred because Whitley

Penn established the existence of a valid arbitration agreement that encompassed GACP's claim. We affirm the trial court's order.

BACKGROUND

GACP alleges it is a "specialty finance lender" that "originates and underwrites senior secured loans to asset-rich companies." In November 2016, GACP entered into a Loan and Security Agreement (Credit Agreement) with Excel. In reliance on the Credit Agreement, GACP's lenders loaned Excel $13.5 million. GACP alleges that Excel breached the terms of the Credit Agreement shortly after the loan was funded, and GACP sent a Notice of Event of Default to Excel in December 2016. GACP and Excel negotiated a resolution to the default, agreeing on terms and signing a First Amendment and Waiver to Loan and Security Agreement (First Amendment) on January 26, 2017. GACP alleges that Excel continued to breach the Credit Agreement and First Amendment. Thus, GACP sent another Notice of Event of Default to Excel on March 28, 2017.

Excel retained Whitley Penn on March 8, 2017, to audit its consolidated financial statements as of December 31, 2016, and provide "an opinion on the financial statements" (the Audit Agreement). Whitley Penn was obligated under the terms of the Audit Agreement to conduct the audit "in accordance with the standards of the Public Company Accounting Oversight Board" (PCAOB). The Audit Agreement also contained the following arbitration provision:

> In the unlikely event that differences concerning our services or fees should arise that are not resolved by mutual agreement, to facilitate judicial resolution and save time and expense of both parties, [Excel] and Whitley Penn agree not to demand a trial by jury in any action, proceeding, or counterclaim arising out of or relating to our services and fees for this engagement. Any controversy, dispute, or questions arising out of or in connection with this agreement or our engagement shall be determined by arbitration conducted in accordance with the rules of the American Arbitration Association, and any decision rendered by the American Arbitration Association shall be binding on both parties to this agreement. The costs of any arbitration shall be borne equally by the parties. Any and all claims relating to or arising out of this contract/agreement shall be governed by the laws of Texas and any dispute shall be finally resolved by the Texas courts in Tarrant County.

Whitley Penn conducted the audit and issued its opinion on Excel's financial statements. GACP alleges that Whitley Penn's opinion appeared in Excel's April 2017 10-K filing with the Securities and Exchange Commission.

GACP alleges that Whitley Penn's opinion stated that "the Classification of the debt [under the Credit Agreement] as current raises substantial doubt about the Company's ability to continue as a going concern." However, Whitley Penn failed to "comply with the professional standards governing the issuance of a going concern qualification" and offered three allegedly false statements indicating that Excel had viable options to pay its debt to GACP. GACP alleges that it relied on Whitley Penn's opinion in deciding not to foreclose on the debt.

Excel continued to default on its obligations under the Credit Agreement and First Amendment. GACP sent notice to Excel on May 5, 2017, demanding repayment of the loan. GACP offered to consider a forbearance agreement if a

financial advisor were appointed and a "turnaround plan" were devised. GACP alleges that it relied on Whitley Penn's opinion when deciding to offer a forbearance agreement. GACP sent another Event of Default notice to Excel on September 27, 2017, and continued to negotiate forbearance agreements.

GACP and Excel executed a forbearance agreement on October 13, 2017, that allowed Excel's assets to be at auction. GACP held the auction but estimates it "lost at least $2.1 million."

GACP filed suit on February 13, 2019, alleging fraud against two Excel officers and negligent misrepresentation against Whitley Penn. Specifically, GACP alleges that Whitley Penn negligently misrepresented Excel's financial stability in its opinion. In doing so, Whitley Penn "failed to comply with the professional requirements governing auditors that assess and evaluate a company's ability to continue as a going concern."

Whitley Penn moved to compel arbitration of GACP's claim under the Audit Agreement's arbitration provision. Whitley Penn argued in its motion to compel arbitration that although GACP is not a signatory to the Audit Agreement, it "seeks to benefit from Excel's contractual relationship with Whitley Penn," thus direct-benefits estoppel prevents GACP from refusing to arbitrate their dispute. The trial court denied Whitley Penn's motion, and this interlocutory appeal followed.

STANDARD OF REVIEW

We review a trial court's order denying a motion to compel arbitration for abuse of discretion. *Henry v. Cash Biz, LP*, 551 S.W.3d 111, 115 (Tex. 2018), *cert. denied*, __ U.S. __, 139 S. Ct. 184, 202 L. Ed. 2d 40 (2018). We defer to the trial court's factual determinations if they are supported by evidence but review its legal determinations de novo. *Id.*; *see also Sidley Austin Brown & Wood, L.L.P. v. J.A. Green Dev. Corp.*, 327 S.W.3d 859, 863 (Tex. App.—Dallas 2010, no pet.) (in reviewing denial of motion to compel arbitration, "we apply a no-evidence standard to the trial court's factual determinations and a de novo standard to legal determinations"). A trial court abuses its discretion if it acts in an arbitrary or unreasonable manner or acts without reference to any guiding rules or principles. *Downer v. Aquamarine Operators, Inc.*, 701 S.W.2d 238, 241–42 (Tex. 1985). There is no abuse of discretion when the court's decision is based on conflicting evidence, some of which reasonably supports the decision. *RSR Corp. v. Siegmund*, 309 S.W.3d 686, 709 (Tex. App.—Dallas 2010, no pet.).

ANALYSIS

Whitley Penn contends in one issue that the trial court erred by denying its motion to compel arbitration because Whitley Penn established the existence of a valid arbitration agreement encompassing GACP's claim. According to Whitley Penn, GACP seeks the benefits of the Audit Agreement through its negligent misrepresentation claim. Thus, the trial court should have ordered arbitration under

the Audit Agreement's arbitration provision. GACP contends, however, that the arbitration provision does not apply to its claim because it was not a signatory to the Audit Agreement, and it does not seek contract benefits under the Audit Agreement but brings a common law tort claim. Thus, the parties contest whether a valid arbitration agreement exists between them.

Before a court can compel arbitration, it must first determine that a valid arbitration agreement exists between the parties. *In re AdvancePCS Health L.P.*, 172 S.W.3d 603, 605 (Tex. 2005) (orig. proceeding); *Phillips v. ACS Mun. Brokers, Inc.*, 888 S.W.2d 872, 875 (Tex. App.—Dallas 1994, no writ). This gateway matter is a question of state contract law. *Jody James Farms, JV v. Altman Grp., Inc.*, 547 S.W.3d 624, 631 (Tex. 2018); *In re Morgan Stanley & Co., Inc.*, 293 S.W.3d 182, 187 (Tex. 2009) (orig. proceeding). A party seeking to compel arbitration must establish that a valid arbitration agreement exists and that the claims at issue fall within the scope of that agreement.[1] *Henry*, 551 S.W.3d at 115; *see also J.M. Davidson, Inc. v. Webster*, 128 S.W.3d 223, 227 (Tex. 2003) (although strong presumption favors arbitration, "the presumption arises only after the party seeking to compel arbitration proves that a valid arbitration agreement exists").

[1] Although the Audit Agreement does not state whether the Federal Arbitration Act or the Texas Arbitration Act applies, both acts impose the same burden on the party seeking to compel arbitration. *See* TEX. CIV. PRAC. & REM. CODE § 171.021(a); *In re AdvancePCS Health L.P.*, 172 S.W.3d at 605; *Holmes, Woods & Diggs v. Gentry*, 333 S.W.3d 650, 654 (Tex. App.—Dallas 2009, no pet.).

Generally, "parties must sign arbitration agreements before being bound by them." *In re Rubiola,* 334 S.W.3d 220, 224 (Tex. 2011) (orig. proceeding). However, "[s]everal rules of law and equity may bind nonsignatories to a contract." *In re Labatt Food Serv., L.P.*, 279 S.W.3d 640, 644 (Tex. 2009) (orig. proceeding). Specifically, direct-benefits estoppel prevents a nonsignatory plaintiff from seeking the benefits of a contract while "simultaneously attempting to avoid the contract's burdens, such as the obligation to arbitrate disputes." *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732, 739 (Tex. 2005) (orig. proceeding). Whether a claim seeks a direct benefit from a contract containing an arbitration provision depends on the substance of the claim, not artful pleading. *In re Weekley Homes, L.P.*, 180 S.W.3d 127, 131–32 (Tex. 2005) (orig. proceeding). "[I]f liability arises solely from the contract or must be determined by reference to it," the claim must be brought on the contract and arbitrated. *Id*. at 132. "But 'when the substance of the claim arises from general obligations imposed by state law, including statutes, torts and other common law duties, or federal law,' direct-benefits estoppel is not implicated even if the claim refers to or relates to the contract or would not have arisen 'but for' the contract's existence." *Jody James Farms*, 547 S.W.3d at 637 (quoting *G.T. Leach Builders, LLC v. Sapphire V.P., LP*, 458 S.W.3d 502, 528 (Tex. 2015)).

Whitley Penn argues that GACP's negligent misrepresentation claim falls within the Audit Agreement's arbitration provision because Whitley Penn could not have performed the audit without the Audit Agreement. According to Whitley Penn,

Excel is a public company, and its audit was controlled by PCAOB standards. These standards required Whitley Penn to have an engagement agreement with Excel to perform the audit. Because it could not conduct the audit without the Audit Agreement, Whitley Penn argues that "GACP's entire claim is based on this engagement." We disagree.

A negligent misrepresentation claim may be brought against an accountant or auditor "who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions." *Grant Thornton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 919–20 (Tex. 2010) (quoting RESTATEMENT (SECOND) OF TORTS § 552); *see also Blue Bell, Inc. v. Peat, Marwick, Mitchell & Co.*, 715 S.W.2d 408, 412 (Tex. App.—Dallas 1986, writ ref'd n.r.e.); *Steiner v. Southmark Corp.*, 734 F. Supp. 269, 279–80 (N.D. Tex. 1990). This tort claim exists independently from any contract that may exist between the parties. *See McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W.2d 787, 792 (Tex. 1999) ("The theory of negligent misrepresentation permits plaintiffs who are not parties to a contract for professional services to recover from the contracting professionals."); *Plano Surgery Ctr. v. New You Weight Mgmt. Ctr.*, 265 S.W.3d 496, 502–03 (Tex. App.—Dallas 2008, no pet.) ("When a party's claim could validly sound in both tort and contract, there must be an injury independent of damages for breach of contract . . . to recover on [a] negligent misrepresentation claim.").

In its brief, Whitley Penn repeatedly contends that GACP's negligent misrepresentation claim "falls squarely within the Audit Agreement's scope." To support this contention, Whitley Penn offers only that it could not perform the audit under the PCAOB standards without an engagement agreement. Essentially, Whitley Penn argues that "but for" the Audit Agreement, it would not have performed the audit, and GACP would have no claim. This "but for" relationship, however, is insufficient to bind non-signatory GACP to the Audit Agreement's arbitration provision. *See Jody James Farms*, 547 S.W.3d at 637. And Whitley Penn fails to explain how its liability for GACP's negligent misrepresentation claim arises "solely from the [Audit Agreement] or must be determined by reference to it." *See In re Weekley Homes, L.P.*, 180 S.W.3d at 132; *see also Plano Surgery Ctr.*, 265 S.W.3d at 502–03 (negligent misrepresentation requires injury independent of damages for breach of contract).

We held that a non-signatory was not bound by a contract on similar facts in *Weaver & Tidwell, L.L.P. v. The Guarantee Company of North America USA*, No. 05-10-00557-CV, 2011 WL 635261, at *1 (Tex. App.—Dallas Feb. 23, 2011, no pet.) (mem. op.). *Weaver & Tidwell* involved a construction company, J & V, that bid on TxDOT projects. *Id*. To do business with TxDOT, J & V was required to have an annual audit. *Id*. Weaver & Tidwell, L.L.P. (Weaver) was hired to perform the audits. *Id*. The parties' engagement letters contained an arbitration provision. *Id*. TxDOT also required performance bonds before any project was started. *Id*.

Guarantee Company of North America USA (Guarantee) was the bonding company. *Id*. Guarantee relied on Weaver's audits when determining whether to issue bond on J & V's behalf. *Id*. Guarantee was not a signatory to Weaver's engagement letters. *Id*. at *2. When J & V defaulted on its TxDOT contracts, Guarantee had to take over and complete some of the TxDOT projects. *Id*. at *1.

J & V sued Weaver for breach of fiduciary duty, fraud, and accounting negligence. *Weaver & Tidwell*, 2011 WL 635261, at *1. On Weaver's motion, the trial court ordered the parties to arbitration under the engagement letters' arbitration provision. *Id*. Guarantee also sued Weaver for accounting negligence, and Weaver moved to compel arbitration based on the engagement letters' arbitration provision. *Id*. The trial court denied the motion. *Id*.

On appeal, Weaver argued that Guarantee stood in J & V's shoes as subrogee. *Weaver & Tidwell*, 2011 WL 635261, at *2. Thus, Weaver argued that Guarantee must arbitrate "any and all claims" it has against Weaver because a valid and enforceable arbitration agreement exists between J & V and Weaver. *Id*. We held, however, that Guarantee's claims were not contractual subrogation claims pursuant to the engagement letters. *Id*. Nor did the engagement letters establish Guarantee as a third-party beneficiary or even mention Guarantee. *Id*. Thus, we held that Guarantee's independent tort claim was not bound by the engagement letters' arbitration provisions. *Id*.

In its motion to compel arbitration, Whitley Penn argued that "GACP step[ed] into the shoes of Excel and insert[ed] itself into an [Audit] Agreement that requires Whitley Penn to conduct an audit." Thus, GACP's "negligent misrepresentation claim is within the scope of the [Audit] Agreement and the [trial court] must compel arbitration." Weaver made the same argument as to Guarantee's accounting negligence claim. GACP's negligent-misrepresentation allegations mirror Guarantee's accounting-negligence allegations. Specifically, both GACP and Guarantee allege the respective defendant failed to conduct the audit under recognized professional standards, provided false information for the plaintiff's guidance, and each plaintiff justifiably relied upon the false information to its detriment. Accordingly, just as we held that non-signatory Guarantee was not bound by Weaver's engagement letters' arbitration provision, we conclude that non-signatory GACP is not bound by the Audit Agreement's arbitration provision. *See Jody James Farms*, 547 S.W.3d at 637.

CONCLUSION

We conclude that Whitley Penn did not meet its burden to show that GACP's claim arises solely from the Audit Agreement or must be determined by reference to it. *See In re Weekley Homes, L.P.*, 180 S.W.3d at 132. Consequently, we overrule

Whitley Penn's sole issue and affirm the trial court's order.

/s/ Robbie Partida-Kipness
ROBBIE PARTIDA-KIPNESS
JUSTICE

191245F.P05

Court of Appeals
Fifth District of Texas at Dallas

JUDGMENT

WHITLEY PENN LLP, Appellant No. 05-19-01235-CV V. GACP FINANCE CO., LLC, Appellee	On Appeal from the 134th Judicial District Court, Dallas County, Texas Trial Court Cause No. DC-19-02210. Opinion delivered by Justice Partida-Kipness. Justices Nowell and Evans participating.

In accordance with this Court's opinion of this date, the judgment of the trial court is **AFFIRMED**.

It is **ORDERED** that each party bear its own costs of this appeal.

Judgment entered this 21st day of July, 2020.