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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION FIVE

SIAMAK KATAL et al., Plaintiffs and Appellants, v. INTEGRATED PRODUCTS AND SERVICES INC. et al., Defendants and Respondents.	B236288 (Los Angeles County Super. Ct. No. BC424791)

APPEAL from a judgment of the Superior Court of Los Angeles County, Michael L. Stern and James C. Chalfant, Judges. Affirmed.

Valle Makoff, Jeffrey T. Makoff, Ellen Ruth Fenichel; Bla Schwartz, Irwin B. Schwartz, John V. Komar; Nagler & Associates, Lawrence Nagler, Charles Avrith for Plaintiffs and Appellants.

Kirkland & Elllis, C. Robert Boldt, Elizabeth M. Kim, Sasha K. Danna for Defendants and Respondents.

I. INTRODUCTION

Plaintiffs are the former owners of a fire and security services company. Plaintiffs sold their company to the defendants pursuant to a purchase agreement requiring the arbitration of disputes arising out of the agreement.

Plaintiffs filed an action for breach of contract claims against defendants alleging defendants failed to provide reasonable access to accounting information related to the defendants' claim of a post-closing purchase price adjustment. Defendants moved to compel arbitration. The motion was granted. Defendants then brought several accounting related breach of warranty claims against the plaintiffs.

The arbitrator found in defendants' favor and awarded them damages. Plaintiffs petitioned the trial court to vacate or correct the award. The trial court denied the petition, confirmed the award and entered judgment. The plaintiffs filed this appeal.

II. BACKGROUND

The Kayne Anderson plaintiffs were shareholders of a fire and security services company, Detection Logic Fire Protection, Inc. ("DLFP") from 2005 to 2008. Mack Katal was a founder and manager of DLFP and the Katal Revocable Trust (the "Katal Trust") was his inter vivos trust. Both Mack Katal and the Katal Trust were shareholders in DLFP when it was sold in 2008.

Defendant Integrated Products & Services, Inc. ("IPS") purchased all of the outstanding shares and warrants in DLFP under a Securities Purchase Agreement ("SPA") signed on December 12, 2008 with a closing effective on December 30, 2008. Defendant United Technologies Corp. ("UTC") is the parent company of IPS and a guarantor of IPS's SPA obligations. The purchase price was approximately $140 million. For ease of reference, plaintiffs will hereafter be referred to as sellers and defendants will be referred to as buyers.

In the complaint, the sellers alleged that the SPA set forth a formula to establish the price due the sellers for the DLFP shares, which price was subject to a working

capital adjustment based on changes in DLFP's financial condition in the fourth quarter of 2008 as reflected on a final closing balance sheet and a statement of working capital. Basically, if DLFP's working capital decreased in the fourth quarter of 2008, the purchase price would be reduced. If the working capital increased, the purchase price would increase. Sellers assert claims against buyers for breach of contract based on the buyers' alleged failure to deliver final and complete closing working documents thereby waiving rights to the working capital purchase price adjustment and for breach of the implied covenant of good faith and fair dealing based on buyers' failure to provide sellers access to documents and information relevant to the closing working documents.

Buyers claimed that sellers sold DLFP to buyers for approximately $140 million, a price paid by buyers based on a multiple of 8.7 times DLFP's earnings for the period beginning January 1, 2008 and ending September 30, 2008. Sellers represented the September financials to be correct and complete in all material respects and to be presented in accordance with Generally Accepted Accounting Principals ("GAAP").

Buyers also contended that when buyers acquired DLFP, they not only expected the company to earn income at the rate reflected in the September income statement but also expected that DLFP would have roughly $24.5 million in net current assets on its balance sheet as of December 30, 2008.

Buyers claimed that after the purchase was completed, they discovered that DLFP's financial statements, which formed the basis for the purchase price for the sale were inaccurate and overstated earnings. Buyers sought to recover the excess amount it paid for DLFP based on overstated and inaccurate financial statements. Buyers asserted claims against the sellers for breach of contract arising from the representations and warranties in the SPA about DLFP's financial statement and for fraud in the inducement of the SPA based on alleged misrepresentations and omissions concerning DLFP's financial statements and earnings. Relying on the arbitration provision in the SPA, buyers filed a petition to compel arbitration and a motion to stay the case pending the outcome of the arbitration.

The SPA's arbitration provision stated in part: "12.13 Dispute Resolution. All claims, controversies or disputes arising under or in connection with this Agreement, whether sounding in contract or tort, including arbitrability and any claim that this Agreement was induced by fraud, but not including claims or disputes arising under Article 2 hereof ('Covered Claims') shall be resolved by binding arbitration in Los Angeles, California in accordance with the following terms and conditions: [¶] (a) Administrator. The arbitration of all Covered Claims will be administered by the Los Angeles offices of JAMS (the 'Arbitration Administrator'). [¶] (b) Procedural Law. Except as otherwise provided herein, the arbitration of all Covered Claims will be governed by California procedural law (including the Code of Civil Procedure, Civil Code, Evidence Code and Rules of court (excluding local rules) as if the Covered Claims had been brought in a Superior Court of the State of California; provided, however that (i) the parties waive any right to jury; (ii) there shall be no interlocutory appellate relief (such as writs) available; and (iii) discovery will be limited to matters which are directly relevant to the issues in the arbitration.). [¶] (c) Arbitrator. The arbitration shall be conducted by a single, neutral arbitrator ('Arbitrator') who shall be a retired judge in the Los Angeles office of the Judicial Arbitration and Mediation Service ('JAMS') to be selected as follows: . . . . [¶] (i) Jurisdiction/Venue/Enforcement of Award. The Parties consent and submit to the exclusive personal jurisdiction and venue of the Superior Court and the Federal District Court, located in the County of Los Angeles, State of California, to compel arbitration of Covered Claims in accordance with this Agreement, to enforce any arbitration award granted pursuant to this Agreement, including, but not liability to, any award granting equitable or injunctive relief, and to otherwise enforce this Agreement and carry out the intentions of the Parties to resolve all Covered Claims through arbitration."

The SPA further provided "12.12 Governing Law. This Agreement and any disputes hereunder shall be governed by and construed in accordance with the internal laws of the State of California without giving effect to any choice or conflict of law provision or rule (whether of the State of California or any other jurisdiction) that would

cause the application of laws of any jurisdiction other than those of the State of California."

Article 2 of the SPA described the working capital adjustment and procedure for resolving disputes between buyers' and sellers' respective calculations of working capital. Working capital adjustment was a computation of current assets and current liabilities on the company's balance sheet as of December 30, 2008. The SPA set forth specific accounting matters and items to be included in the calculation of DLFP's working capital. If the company's working capital on the closing balance sheet exceeded an agreed upon $24,548,628.63 amount of target working capital, then buyers would pay the difference to sellers. If closing working capital was less than $24,548,628.63, then sellers would pay the difference to the buyers.

Buyers were to prepare a closing working capital analysis calculated as of December 30, 2008 and to provide it to sellers by March 30, 2009. The SPA gave sellers access to information in control of DLFP and buyers to investigate buyers' closing working capital calculations. After investigating, sellers were to notify buyers of any dispute about the closing working capital and to provide the dollar amount of each disagreement and supporting documentation.

If the parties were unable to resolve the closing working capital disputes, the SPA provided a mechanism to resolve the disagreement. Article 2.2(b) of the SPA provided "If Buyer and the Seller Representative are unable to resolve all disagreements properly identified by the Seller Representative pursuant to Section 2.2(a) within thirty (30) days after delivery to the Seller Representative of written notice of such disagreements, then such disagreements shall be submitted for final and binding resolution to a Neutral Accounting Firm to resolve such disagreements (the 'Accounting Arbitrator'). . . . The Accounting Arbitrator shall only consider the briefs and oral presentations of the parties, and shall not conduct any independent review, in determining those items and amounts disputed by the parties. The Accounting Arbitrator shall select either the position of Buyer or the Seller Representative as a resolution for each item or amount disputed and may not impose an alternative resolution with respect to any item or amount disputed and

must resolve the matter in accordance with the terms and conditions of this Agreement. . . . The Accounting Arbitrator shall make its determination based solely on presentations and supporting material provided by the parties and not pursuant to any independent review. The determination of the Accounting Arbitrator shall be final and binding. . . ."

On February 3, 2010, the trial court granted the buyers' petition to compel arbitration of all claims and motion to stay. It ordered that "[p]ursuant to the arbitration clause in the parties' Securities Purchase Agreement, the entire matter is going to JAMS, including the accounting issue to be resolved. . . ." The Hon. Haley Fromholz (Ret.) of JAMS was selected as the arbitrator.

On May 10, 2010, SS&G Financial Services, Inc. was appointed as a neutral accounting firm to act as an accounting arbitrator to resolve disagreements as to proposed working capital adjustments. The accounting arbitration was conducted before Lewis Baum of SS&G Financial Services, Inc. On August 10, 2010, Mr. Baum issued a report, in which he awarded buyers a $6,082,000 purchase price adjustment plus accrued interest of $326,460.

From October 11, 2010 through October 22, 2010, an arbitration hearing was conducted by Judge Fromholz of JAMS. On July 26, 2011, he issued his final award. Judge Fromholz found that buyers established sellers' breach of the representation and warranty that the financial statements attached to the SPA were correct and complete in all material respects and were prepared and maintained according to generally accepted accounting principles. Buyers also established that they were entitled to damages in the amount of $27,536,767.09 which represents the difference between what they paid and the fair market value of DLFP at the time of the sale. He further found that buyers were entitled to interest on that amount. Judge Fromholz also found that sellers did not establish a breach of the SPA for buyers providing late and inaccurate closing working capital documents. He further found that sellers did not establish a breach of the SPA based on buyers' alleged refusal to give full access to DLFP books and personnel in connection with the accounting arbitration.

Sellers filed a petition to vacate or correct the arbitration award issued by Judge Fromholz. They did not file a petition to vacate or correct the accounting arbitration award issued by Lewis Baum. On August 24, 2011, the trial court denied the sellers' petition and confirmed the arbitration awards of Judge Fromholz and of Lewis Baum. The trial court entered judgment. The sellers appealed.

III. DISCUSSION

The parties in this case submitted their dispute to arbitrators pursuant to the SPA which was their written agreement. "The principles governing review of an arbitration award are well established. An arbitration award is final and conclusive because the parties–as here– 'have agreed that it be so.' [Citation.] Only limited judicial review is available; courts may not review the merits of the controversy, the validity of the arbitrator's reasoning, or the sufficiency of the evidence supporting the award. [Citation.] Thus with 'narrow exceptions,' an arbitrator's decision is not reviewable for errors of fact or law. [Citation.] This is so even if the error appears on the face of the award and causes substantial injustice. [Citation.]" (*Shahinian v. Cedars-Sinai Medical Center* (2011) 194 Cal.App.4th 987, 999-1000.)

Under the California Arbitration Act, the grounds for vacating an arbitration award are stated in Code of Civil Procedure section 1286.2. One of those grounds — the one asserted by the sellers — requires the court to vacate an arbitration award if the court determines "The arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted." (§1286.2, subd. (a)(4)).

Sellers contend that Judge Fromholz exceeded his powers when: (1) he decided buyers' fraud/breach of warranty claims under Delaware law, contrary to the SPA's express California law selection; (2) he awarded buyers a $6,082,000 double recovery in violation of the SPA's express prohibition; (3) he awarded buyers a prohibited "double

dip" indemnification award on working capital items; and (4) he failed to decide the access issue.

An arbitrator exceeds his powers by acting without subject matter jurisdiction, deciding an issue that was not submitted to arbitration, arbitrarily remaking the contract, upholding an illegal contract, issuing an award that violates a well-defined public policy or a statutory right, fashioning a remedy that is not rationally related to the contract, or selecting a remedy not authorized by law. (*Jordan v. Department of Motor Vehicles* (2002) 100 Cal.App.4th 431, 443.) None of these circumstances exist in this case.

Sellers contend that Judge Fromholz did not apply California law. The language in the SPA stated that "This Agreement and any disputes hereunder shall be governed by and construed in accordance with the internal laws of the State of California. . . ." We need not make any determination whether the arbitrator did or did not apply California law in resolving this claim. In *Gravillis v. Coldwell Banker Residential Brokerage Co.* (2010) 182 Cal.App.4th 503, 519 the court stated "We now make it explicit: Neither 'apply' nor 'in accordance with,' when used in an arbitration provision to identify the governing substantive law, evinces an agreement that an award be reviewed for legal error."

As to the sellers' other contentions of error by the arbitrator, there is no explicit reference in the SPA to a broadened scope of judicial review of the arbitration award. "A provision requiring arbitrators to apply the law leaves open the possibility that they are empowered to apply it 'wrongly as well as rightly.' [Citations.] As we recently observed: 'When parties contract to resolve their disputes by private arbitration, their agreement ordinarily contemplates that the arbitrator will have the power to decide any question of contract interpretation, historical fact or general law necessary, in the arbitrator's understanding of the case, to reach a decision. [Citations.] Inherent in that power is the possibility the arbitrator may err in deciding some aspect of the case. Arbitrators do not ordinarily exceed their contractually created powers simply by reaching an erroneous conclusion on a contested issue of law or fact, and arbitral awards may not ordinarily be vacated because of such error for "'[t]he arbitrator's resolution of

these issues is what the parties bargained for in the arbitration agreement.'" [Citation.]' [¶] Therefore, to take themselves out of the general rule that the merits of the award are not subject to judicial review, the parties must clearly agree that legal errors are an excess of arbitral authority that is reviewable by the courts. . . . [W]e emphasize that parties seeking to allow judicial review of the merits, and to avoid an additional dispute over the scope of review, would be well advised to provide for that review explicitly and unambiguously. [Citation.]" (*Cable Connection, Inc. v. DIRECTV, Inc.* (2008) 44 Cal.4th 1334, 1360-1361.)

The language of the SPA is direct and unambiguous. Article 2.2(b) states "The determination of the Accounting Arbitrator shall be *final* and *binding*." (Emphasis added.) Article 12.13 states "Dispute Resolution. All claims, controversies or disputes arising under or in connection with this Agreement, whether sounding in contract or tort, including arbitrability and any claim that this Agreement was induced by fraud, but not including claims or disputes arising under Article 2 hereof ('Covered Claims') shall be resolved by *binding* ARBITRATION in Los Angeles, California . . ." (emphasis added.) There are no provisions providing for judicial review. The parties negotiated the SPA which provided the mechanism for dispute resolution. The parties bargained for binding arbitration to resolve any disputes that they may have had.

We conclude that the trial court properly denied the petition to vacate or correct the award, granted the petition to confirm the award, and entered judgment in favor of the buyers.

IV. DISPOSITION

The judgment is affirmed. The parties are to bear their own costs on appeal.

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FERNS, J.[*]

We concur:

TURNER, P. J.

KRIEGLER, J.

[*] Judge of the Los Angeles Superior Court, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.