

STATE OF MICHIGAN
COURT OF APPEALS

GUARDIAN ALARM COMPANY OF
MICHIGAN d/b/a GUARDIAN SECURITY
SERVICES,

UNPUBLISHED
December 4, 2007

Plaintiff/Counter-Defendant-
Appellee,

v

RICHARD T. MAY, BERNARD SCHOCH,
DAVID J. MARCUS and MICRONETICS
DESIGN CORPORATION,

No. 269901
Oakland Circuit Court
LC No. 1996-525337-CK

Defendants/Counter-Plaintiffs-
Appellants,

and

MICHAEL MARKS, JOHN SMITH and DON
FAYBRICK,

Defendants.

Before: Markey, P.J., and Saad and Wilder, JJ.

PER CURIAM.

Defendants appeal the trial court's order that vacated part of an arbitration award and we reverse the trial court's order and confirm the arbitration award.

I. Nature of the Case

The narrow and dispositive question raised by the trial court's holding that the arbitration panel exceeded its powers is whether, in so ruling, the trial court exceeded its powers under Michigan law which circumscribes the judiciary's authority to reverse arbitration awards, specifically, MCR 3.602 as interpreted by our Supreme Court in *DAIIE v Gavin*, 416 Mich 407, 434; 331 NW2d 418 (1982). The trial court erred because it (1) wrongly concluded that the arbitration panel made an error of law on the face of the award, (2) improperly reexamined the evidence presented to the arbitration panel, and (3) impermissibly speculated about the panel's

reasoning in deciding to vacate part of the award. Accordingly, we reverse the trial court's order and, for the reasons set forth below, we confirm the arbitration award.

II. Facts and Procedural History

This dispute stems from a 1993 contract between Guardian Alarm Company of Michigan, a security and alarm company, and Micronetics Design Corporation, a software development company, and its agents, for the use and support of a security software program called "Genesis." Under the contract, Guardian would use the Genesis program for its security services and Micronetics would sell Genesis to other companies throughout the United States. Further, while Guardian operated the Genesis program, Micronetics agreed to provide support and maintenance for Genesis,¹ but, importantly and central to this litigation, Micronetics' obligation to provide support and service would cease if Guardian used the source code version of Genesis in locations other than Detroit.² The purpose of strictly limiting the use of the source code version of a computer program is to prevent theft or pirating of proprietary information, which would destroy the software's commercial value to Micronetics. By agreeing that Micronetics could discontinue support and maintenance of Genesis if Guardian used the source code in an unauthorized manner, the parties recognized the significance of this breach of Genesis security. The quid pro quo here is clear: unfettered use of the source code in various Guardian locations would compromise security, which could destroy Micronetics' efforts to market Genesis, while a lack of Micronetics' support and maintenance would seriously hinder Guardian's ability to provide electronic security services through the Genesis program.

Indeed, on May 16, 1996, Micronetics sent Guardian a letter and stated that Micronetics was no longer obligated to provide support and maintenance to Guardian because Guardian breached the contract by, among other things, using the source code version of Genesis outside of its Detroit location. Thereafter, Guardian filed a complaint against Micronetics and alleged that Micronetics failed to pay certain commissions under the 1993 agreement and failed to provide adequate service and support for the Genesis software. Guardian further claimed that Micronetics stopped providing support services to Guardian altogether and that Micronetics expressed its intention to transfer service and support responsibilities to a new company. Micronetics later filed a counter-complaint against Guardian and alleged that Guardian used the source code version of Genesis in Toledo and Cleveland, a violation of the "Detroit-only" provision of the contract.³

¹ The agreement also provided that Guardian would deliver certain software packages to Micronetics within 14 days of the agreement.

² Guardian was given both the "object code" and "source code" version of Genesis. An object code version is essentially a copy of the software that is not modifiable, while the source code version contains programming statements and can be modified. The source code is in human-readable form and reveals program information, designs, algorithms and other work product and is, therefore, generally made available to users in very limited circumstances.

³ Micronetics also asserted that Guardian failed to deliver its part of the software package to Micronetics as required by the contract.

Despite Micronetics' claim that its obligation to provide service and support to Guardian terminated when Guardian violated the contract, the trial court granted Guardian's request for a temporary restraining order and preliminary injunction and ordered Micronetics to continue to provide service and support.⁴ Thereafter, the parties agreed to arbitrate their claims, and, on March 25, 2005, the arbitration panel issued its opinion and award. The arbitral panel ruled that Guardian was not entitled to any commissions because Guardian failed to comply with the condition precedent in the contract that Guardian deliver all remaining software packages to Micronetics. The arbitration panel also ruled that Guardian violated the "Detroit-only" restriction by using the source code in locations other than Detroit and thus awarded Micronetics \$576,000 in "damages relating to the cost of support and maintenance," which reimbursed Micronetics for 72 months of service and support.⁵

Both Micronetics and Guardian filed motions in the trial court to confirm the arbitration award in part and to vacate the award in part. The trial court rejected Micronetics' argument that it is entitled to damages for Guardian's failure to turn over the software packages. The trial court also reversed the arbitration panel's damage award to Micronetics. For the reasons articulated below, we reverse this ruling.

III. Standard of Review and Applicable Law

This case involves a statutory arbitration in which the parties agreed that judgment would be entered in accordance with the arbitrators' decision. MCL 600.5001 *et seq.*, governs statutory arbitration and provides that parties may agree to arbitrate their claims and "agree that a judgment of any circuit court shall be rendered upon the award made pursuant to such submission." MCL 600.5001(1). Moreover, MCL 500.5025 provides that "the circuit courts

⁴ Guardian later filed a motion to amend its complaint to add a claim that Micronetics is liable for Guardian's cost to replace Genesis with another software system. According to Guardian, because it did not receive adequate updates and support for Genesis, the system became unusable. However, the trial court ruled that the issue should be litigated in a separate action because Guardian brought it late in the litigation, and the issue would require further discovery. The federal district court granted summary judgment to Micronetics on Guardian's claim for replacement costs. *Guardian Alarm Company of Michigan v May*, unpublished order of the Federal District Court for the Eastern District of Michigan, issued April 4, 2000 (Docket No. 99-74994). The United States Court of Appeals for the Sixth Circuit affirmed the district court's dismissal of Guardian's claims in *Guardian Alarm Company of Michigan v May*, unpublished opinion of the U.S. Court of Appeals for the Sixth Circuit, issued December 11, 2001 (Docket No. 00-1489). The import of these federal rulings will be discussed later in this opinion.

⁵ One of the arbitrators dissented from the panel's award. Though he agreed that Guardian breached the condition that it not use the source code outside of Detroit, he concluded that Micronetics should not be permitted to recover damages for the breach. Specifically, the arbitrator reasoned that the prohibition on the use of the source code was in the agreement for confidentiality reasons and, according to the arbitrator, "[u]nder no circumstances . . . did Micronetics ever intend to charge its joint venture partner, so to speak, with maintenance or service fees."

have jurisdiction to enforce the [arbitration] agreement and to render judgment on an award thereunder.”

Our courts rarely vacate arbitral awards precisely because the scope of review is narrow,⁶ and a court is not permitted to speculate about the panel’s reasoning or substitute its own reasoning in order to overturn an award. As our Supreme Court explained in *Gavin*, *supra* at 429:

Arbitration, by its very nature, restricts meaningful legal review in the traditional sense. As a general observation, courts will be reluctant to modify or vacate an award because of the difficulty or impossibility, without speculation, of determining what caused an arbitrator to rule as he did. The informal and sometimes unorthodox procedures of the arbitration hearings, combined with the absence of a verbatim record and formal findings of fact and conclusions of law, make it virtually impossible to discern the mental path leading to an award. Reviewing courts are usually left without a plainly recognizable basis for finding substantial legal error. It is only the kind of legal error that is evident without scrutiny of intermediate mental indicia which remains reviewable, such as that involved in these cases. In many cases the arbitrator’s alleged error will be as equally attributable to alleged “unwarranted” fact finding as to asserted “error of law.” In such cases the award should be upheld since the alleged error of law cannot be shown with the requisite certainty to have been the essential basis for the challenged award and the arbitrator’s findings of fact are unreviewable.

Here, the trial court ruled that the two arbitrators in the majority exceeded their powers when they awarded Micronetics \$576,000 for the support and maintenance Micronetics provided

⁶ The Michigan Court rules set forth how a party may challenge an arbitral award in circuit court. Specifically, MCR 3.602(J) provides:

- (1) On application of a party, the court shall vacate an award if:
 - (a) the award was procured by corruption, fraud, or other undue means;
 - (b) there was evident partiality by an arbitrator appointed as a neutral, corruption of an arbitrator, or misconduct prejudicing a party’s rights;
 - (c) *the arbitrator exceeded his or her powers*; or
 - (d) the arbitrator refused to postpone the hearing on a showing of sufficient cause, refused to hear evidence material to the controversy, or otherwise conducted the hearing to prejudice substantially a party’s rights. [Emphasis added.]

“Generally, issues regarding an order to enforce, vacate, or modify an arbitration award are reviewed de novo.” *Saveski v Tiseo Architects, Inc*, 261 Mich App 553, 554; 682 NW2d 542 (2004).

to Guardian. In reversing the award, the trial judge plainly violated Michigan law that restricts judicial review of arbitration awards:

Arbitrators exceed their power when they “act beyond the material terms of the contract from which they primarily draw their authority, or in contravention of controlling principles of law.” *DAIIE v Gavin*, 416 Mich 407, 434; 331 NW2d 418 (1982). “[W]here it clearly appears on the face of the award or the reasons for the decision as stated, being substantially a part of the award, that the arbitrators through an error in law have been led to a wrong conclusion, and that, but for such error, a substantially different award must have been made, the award and decision will be set aside.” *Id.* at 443, quoting *Howe v Patrons’ Mut Fire Ins Co of Michigan*, 216 Mich 560, 570; 185 NW 864 (1921). [*Saveski, supra* at 554-556.]

Further, the trial court violated Michigan’s restrictions on the scope of review of arbitration awards when it searched for errors in the reasoning of the arbitration panel after the panel issued an apparently valid award:

[A] trial court may not hunt for errors in an arbitrator’s explanation of how it determined who is liable under the arbitrated contract, and who owes what damages to whom. Without the authority to modify or vacate a facially valid award at will, MCR 3.602(J) and (K), the trial court erred when it ordered an expansion of the record rather than reviewing the award provided. *Gavin, supra* at 429. To hold otherwise would allow a dissatisfied court to delve deeper and deeper into an arbitrator’s factual and legal support until it finally unearthed a perceived error that could justify the court’s desired outcome. Because the arbitration award in this case lacks the kind of facial error that would allow the court to modify or vacate it, the court should have confirmed the award without demanding the production of more factual and legal support.

Moreover, the trial court impermissibly examined the evidence presented to the arbitration panel and the panel’s factual conclusions. It is well-established that “[c]laims that quarrel with a binding arbitrator’s factual findings are not subject to appellate review.” *Krist v Krist*, 246 Mich App 59, 67; 631 NW2d 53 (2001). The *Krist* Court further opined:

In *Gavin*, our Supreme Court announced that only those awards that contain an error of law discernible on the face of the very award itself are reviewable. To that end, the *Gavin* Court stated that “[i]t is only the kind of legal error that is evident without scrutiny of intermediate mental indicia which remains reviewable....” *Gavin, supra* at 429. Thus the party seeking to vacate or modify an arbitrator’s award must establish that the arbitrator displayed a manifest disregard of the applicable law “but for which the award would have been substantially otherwise.” *Id.* at 443.

IV. The Trial Court’s Ruling

In vacating the arbitration panel’s damage award, the trial court clearly violated the mandates of *Gavin*.

The trial court agreed with the dissenting arbitrator that the Detroit-only restriction is a confidentiality provision and the remedy for breach of that restriction is only that Micronetics no longer had to provide Guardian with support or maintenance of Genesis. The court also relied on the testimony of Harry Hayden, who maintained that the harm to Micronetics for use of the source code was related to confidentiality. The trial court concluded:

The Court agrees that these observations compel a finding that the majority exceeded its authority by awarding damages for breach of the “Detroit only” provisions based on costs associated with providing support. The essence of the parties’ agreement was undisputed, and compels the conclusion that such damages were not contemplated by the parties as the natural and probable result of the breach. In this context, it is manifest that the majority’s award was based on an error of law, but for which a substantially different award must have been made. Therefore, Plaintiff’s motion to vacate this portion of the award is vacated [sic], and no judgment can be entered on it.

On reconsideration, the trial court judge explained that she “reviewed the evidence presented to the arbitrators” and reached the same conclusion as the dissenting arbitrator – that the purpose of the Detroit-only provision was merely to ensure confidentiality.⁷

V. Analysis

We hold that the trial court erred when it vacated the portion of the arbitration award that reimbursed Micronetics for its costs to service and support Genesis and that the arbitration panel correctly concluded that Micronetics is entitled to \$576,000 in damages for its support and maintenance of the Genesis software. Though the trial court found that the arbitrators “exceeded their powers” by making an error of law, no error of law is apparent on the face of the award. To the contrary, the trial court’s written opinion vacating the award and its opinion on reconsideration both reveal that the trial court did not find an error on the face of the award, but instead exceeded its authority by reviewing the evidence presented to the arbitrators and reinterpreting the contract to come to the same factual and legal conclusions as the dissenting arbitrator. It was simply beyond the trial court’s authority “to delve deeper and deeper into an arbitrator’s factual and legal support until it finally unearthed a perceived error” *Saveski*, *supra* at 558.

Furthermore, in addition to seeking damages under the contract, Micronetics also asked for damages under theories of misrepresentation, quantum meruit, and unjust enrichment. The arbitration panel was not obliged to nor did it specify the precise theory of recovery, but did find that Guardian violated the Detroit-only clause and found that Micronetics incurred substantial costs to continue supporting the Guardian system. Micronetics’ theory was that Guardian lied about its use of the source code for three years, Micronetics found out about it in 1996 and stopped support services, and Guardian obtained a court order to force Micronetics to continue

⁷ The judge noted that she did not *rely* on the opinion of the dissenting arbitrator, but merely reached the same conclusions after reviewing the record before the arbitration panel.

those services until Guardian started using another software program in 1999. Thus, for six years, Micronetics incurred costs for support services that it was clearly not obligated to provide. Accordingly, the damage award would be justified under a misrepresentation, unjust enrichment, or quantum meruit theory, and it was fully within the arbitrators' powers to grant such an award when Micronetics asked for this specific relief during the arbitral hearing. Under Michigan law, if an award may be based on alternative, equally tenable grounds, there is no basis to assume the arbitrators exceeded their powers. See *Henderson v Detroit Auto Inter-Ins Exch*, 142 Mich App 203, 206; 369 NW2d 210 (1985), citing *Hayman Co v Brady Mechanical Inc*, 139 Mich App 185; 362 NW2d 243 (1984).

Again, the face of the award and the reasons given by the arbitration panel reveal no "plainly recognizable" error of law. *Gavin, supra* at 429. The trial court impermissibly speculated about why the arbitration panel ruled as it did, exceeded its authority when it scrutinized what reasoning may have led to the arbitral decision and whether the record evidence could support such reasoning. *Id.* Instead, the trial court should have confirmed the award because it could cite no error of law with "the requisite certainty to have been the essential basis for the challenged award." *Id.* And, because the arbitrators clearly did not "display[] a manifest disregard of the applicable law," the trial court's decision to vacate the award was improper. *Id.* at 443.

Moreover, the trial court's "no harm no foul" conclusion that Micronetics was not entitled to damages on the ground that the Detroit-only clause is merely a confidentiality provision runs contrary to rulings made by the United States District Court for the Eastern District of Michigan and the United States Court of Appeals for the Sixth Circuit. Guardian filed suit in federal court in an attempt to force Micronetics to pay for a replacement software program that Guardian began to use in 1999. As in this case, Guardian argued to the federal district court that the Detroit-only source code restriction under section 6.1(i) of the contract was simply a confidentiality provision and that Micronetics was never harmed by Guardian's unauthorized use of the source code outside of Detroit. The district court judge disagreed with Guardian and so did the Sixth Circuit:

Nothing in the Contract supports this limited reading of section 6.1(i), however. In fact, the Contract could hardly be more clear: Micronetics' support obligation terminates immediately if Guardian uses the central station source code anywhere other than the company's Detroit offices. Because the language of the Contract is not ambiguous or subject to more than one possible construction, Guardian may not contradict the Contract's plain meaning merely by asserting that the parties intended something else. [*Guardian Alarm Company of Michigan v May*, unpublished opinion of the U.S. Court of Appeals for the Sixth Circuit, issued December 11, 2001 (Docket No. 00-1489), slip op at 7-8.]

Thus, not only did the Oakland Circuit Court judge err when she reinterpreted the contract and speculated about the underlying intentions of the parties, her conclusion that the provision was

nothing more than a privacy term and that the breach did not harm Micronetics directly conflicts with these prior federal trial and appellate court rulings.⁸

For these reasons, we reverse the trial court's order and confirm the arbitration award.

/s/ Jane E. Markey
/s/ Henry William Saad
/s/ Kurtis T. Wilder

⁸ Guardian raises alternative grounds to affirm the trial court's decision to vacate the arbitration award and, in so doing, encourages this Court to engage in the same analysis of the record evidence as the trial court. As one example, Guardian argues that insufficient evidence supported the majority's award of \$576,000 to Micronetics. The arbitration panel ruled on this issue as follows:

There was substantial evidence to support damages relating to the cost of support and maintenance including, but not limited to, the Affidavit of Jeffrey S. Prough, which provided that upon his information and belief the servicing of the Genesis System would run approximately \$8,000.00 per month from August 1993 through September 1999, or 72 months when Guardian discontinued using the Genesis System, and could "climb higher," which he proffered was the basis of his damages in attempting to establish grounds for the issuing of a preliminary injunction by the court to continue servicing Guardian. Any attempt to establish other than his written word is mere speculation.

Guardian does not set forth any legal grounds to vacate this ruling. Guardian also claims that Micronetics waived any argument under the Detroit-only provision. Again, however, it is beyond the scope of a court's review powers to engage in an analysis of the evidence presented to the arbitrators to determine whether the award was justified.