



## PRE-DISPUTE REFERENCE AGREEMENTS NOT ALWAYS ENFORCEABLE UNDER CALIFORNIA LAW

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In a published decision filed February 10, 2011 titled, *Tarrant Bell Property, LLC et al. v. The Superior Court of Alameda County*, the Supreme Court of California (the Court) affirmed the judgment from a California Court of Appeal holding that a trial court has the discretion to refuse to enforce a pre-dispute agreement under Section 638 of the California Code of Civil Procedure (Section 638)<sup>2</sup>.

The decision is yet another potentially troubling one to many companies and commercial lenders who wish to avoid jury trials in resolving their disputes being litigated in California. In the aftermath of the 2005 *Grafton Partners L.P. v. The Superior Court of Alameda County (PriceWaterhouseCoopers LLP)* decision, in which the Court held that pre-dispute jury trial waivers are unenforceable under California law, many parties, including most banks and commercial lenders, determined that incorporating alternative dispute resolution (ADR) clauses into their agreements was preferable to risking a potentially biased jury trial. Such ADR methods include arbitration, where the parties to a dispute refer it to an external party outside of the court system, as well as judicial reference, which calls for appointing a referee to help resolve disputes under a statutory framework within the traditional court system.

In *Tarrant Bell*, 120 lessees and residents of a mobile-home park in California sued the park's owners for subjecting park residents to substandard living conditions. The lease agreements between defendants and approximately 100 of the lessees provided for submission to arbitration under Section 1281.2 of the California Code of Civil Procedure, or alternatively for a referee to be appointed by the court in accordance with Section 638. The defendant-park owners moved to compel the appointment of a referee under Section 638, which provides in relevant part: "A referee **may** be appointed...upon the motion of a party to a written contract...that provides that any controversy arising therefrom **shall** be heard by a referee if the court finds a reference agreement exists between the parties..." (emphasis added).

The plaintiffs opposed the motion, arguing that because some of their lease agreements did not contain pre-dispute reference clauses, the motion should be denied in order to

avoid the risk of conflicting rulings on common issues of law and fact.

In analyzing the legislative intent of Section 638 under the rules of statutory construction, the Court concluded that the use of both "**may**" and "**shall**" in close proximity indicated the legislature intended contrasting discretionary and mandatory meanings. Therefore, use of the word "may" indicated the trial court could, but was not obligated to appoint a referee. Furthermore, the Court observed that the legislative history of Section 638 demonstrated that the state legislature's amendment of the section in 1982 consciously rejected language that would have imposed on courts a mandatory duty to enforce pre-dispute reference agreements.

Furthermore, the Court's analysis of the legislative history of Section 638 indicated the state legislature amended the section in order to, among other things, help relieve court congestion in California and to lessen judicial delays. Accordingly, the Court affirmed the Court of Appeal ruling, holding that the trial court acted well within its discretion to not appoint a referee to avoid the risk of inconsistent rulings, and for considerations of "judicial economy." In its amicus brief filed with the Court, the California Association of Realtors counter-argued that judicial economy dictates the appointment of a judicial referee when the parties explicitly and clearly agree to do so despite the mere *potential* of inconsistent rulings. Such counterarguments were rejected by the Court.

Given this recent ruling by the Court and the continuing after-effects of the *Grafton* case, it would be easy for parties who wish to avoid jury trials in resolving their disputes in California to view California as a rather unfriendly jurisdiction. The long-term outcome from this case, however, may not be as foreboding as it seems. First of all, the holding of *Tarrant Bell* is much more limited than *Grafton*. While *Grafton* held that pre-dispute jury trial waivers are unenforceable in California, *Tarrant Bell* holds that courts have the discretion to enforce a pre-dispute judicial reference provision, depending on the circumstances. Nothing in *Tarrant Bell* suggests that pre-dispute judicial reference provisions are unenforceable *per se*.



The lesson of *Tarrant Bell* is fairly straightforward: parties who wish to avoid jury trials in resolving their disputes in California should be consistent in their incorporation of pre-dispute reference clauses with their counterparties, particularly with those counterparties who are in similarly situated classes.

*Tarrant Bell* does not need to represent a post-*Grafton* aftershock that ensnares all such parties in its wake. Accordingly, in light of the *Tarrant Bell* decision, contract parties should have their dispute resolution provisions in their agreements reviewed for enforceability and appropriateness under the circumstances.



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<sup>2</sup> *Tarrant Bell Property, LLC et al. v. The Superior Court of Alameda County*, 2011 Cal. LEXIS 1354.