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Think Judicial Reference Agreements Are Mandatory? In *Tarrant Bell*, the California Supreme Court Said “Think Again.”

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Typically, purchase and sale agreements between a builder and a homebuyer include alternative dispute resolution (“ADR”) provisions that require disputes to be resolved through arbitration. As a safety valve, these agreements often provide that if the arbitration clause is deemed unenforceable, the parties are to submit any disputes to judicial reference where a jury trial is not available. But is the court required to send the case to judicial reference, or may it refuse to do so in the exercise of its discretion? For example, what happens when multiple homeowners file suit against a builder, and the arbitration and reference provisions are only included in some of the plaintiffs’ agreements? Does the trial court have discretion to deny judicial reference to those homeowners having valid provisions, or must it split the plaintiffs between the haves and have nots?

The California Supreme Court recently decided this issue in *Tarrant Bell Property, LLC v. Superior Court* (2011) 51 Cal.4th 538 [2011 WL 446984], by holding that the court does have such discretion even if the agreement between the parties *requires* a judicial reference. In this case, residents of a mobile home park sued the park owners for failure to properly maintain the common areas and facilities. Many, but not all, of the plaintiffs’ lease agreements contained an ADR provision stating: “[i]f these arbitration provisions are held unenforceable for any reason . . . all arbitrable issues in any judicial proceeding will be subject to and referred on motion by any party or the court for hearing and decision by a referee (a retired judge or other person appointed by the court) as provided by California law, including [Code of Civil Procedure] section 638.”

Defendants moved to compel arbitration or, in the alternative, for appointment of a referee under section 638, which provides for appointment of a referee upon motion of a party to a written contract if the court finds a valid reference agreement exists between the parties. The trial court found the relevant arbitration provision unenforceable, but also denied the defendant’s request to compel reference, finding that to do so would not promote judicial economy. On appeal, the court held that a trial court had the discretion to refuse to enforce a judicial reference provision where some, but not all, plaintiffs had such a clause, because of the possibility of conflicting rulings on a common issue of law or fact and other circumstances related to considerations of judicial economy.

The California Supreme Court granted review, framing the issue as “whether, under Code of Civil Procedure section 638, a trial court has discretion to refuse to enforce a predispute agreement providing that, in the event of dispute, a referee may hear and decide certain contested issues.” The Supreme Court held that a trial court has such discretion and that the trial court in *Tarrant Bell* “acted well within its discretion in

basing its refusal to appoint a referee on the risk of inconsistent rulings and considerations of judicial economy.”

In reaching this decision, the Supreme Court analyzed the legislative history of section 638 and concluded that the Legislature never intended for section 638 to be mandatory. Section 638 provides in relevant part: “A referee *may* be appointed . . . upon the motion of a party to a written contract . . . that provides that any controversy *shall* be heard by a referee . . .” (Emphasis added.) Quoting from the earlier decision of *In re Richard E.* (1978) 21 Cal.3d 349, 353-345, the Supreme Court stated “When the Legislature has, as here, used both “shall” and “may” in close proximity in a particular context, we may fairly infer the Legislature intended mandatory and discretionary meanings, respectively.” In other words, even if the parties agree that if their arbitration agreement is unenforceable, the matter *shall* be decided by reference, the court nonetheless retains discretion to deny such reference and keep the matter itself. If it does so, the parties will retain their rights to a jury trial.

Under this new holding, despite the careful drafting of ADR provisions, plaintiffs’ attorneys will strive to include individual homeowners who are not bound by ADR provisions (such as secondary purchasers) with those that are in the hope that they can defeat a judicial reference clause. Because the issue is left to the discretion of trial court, the outcome will be determined on a case-by-case basis.

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