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An Analysis of Recent Developments & Trends

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Agreements to Submit Disputes to a Judicial Referee May Allow Employers to Avoid the Pitfalls of Jury Trials and Arbitration

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Summary: A California Appellate Court holds that the parties to a contract can agree that any future dispute they may have will be decided by a judicial referee, even though such an agreement serves as a predispute waiver of the right to a jury trial.

The United States Supreme Court endorsed the use of binding arbitration to resolve employment disputes in 1991. Since that time, many employers have implemented policies of binding arbitration as a way to avoid the vagaries of a jury trial. Over the years, however, the pitfalls of binding arbitration have become evident - primary among them being that there is no ground to appeal an arbitrator's decision, even when the decision is contrary to applicable law.[1] As a result, employers have been searching for alternative means of dispute resolution. One alternative was foreclosed in August 2005, when the California Supreme Court ruled that a predispute non-arbitral contractual waiver of the right to a jury trial is not enforceable in a civil action in California. (Littler's ASAP on that decision can be found here.)

On August 21, 2006, California's Third District Court of Appeal published its opinion in *Woodside Homes of California, Inc. v. Superior Court (Wheeler)* (Case No. C052432), upholding a contract in which the parties agreed to submit any future disputes to a judicial referee rather than a jury. While the pros and cons of resolving disputes via judicial reference require careful consideration, the procedure does represent a possible alternative for employers who want to avoid the possibility of a jury trial yet preserve their ability to appeal an adverse decision.

The Facts of *Woodside Homes*

In 2003, Kimberly Wheeler purchased a new home from Woodside Homes. The written real estate purchase contract for the transaction contained a provision that stated, in pertinent part, as follows:

> JUDICIAL REFERENCE OF DISPUTES. If either BUYER or SELLER commences a lawsuit for a dispute arising under this Agreement or relating to the condition, design or construction of any portion of the Property, all of the issues in such action, whether of fact or law, shall be submitted to general judicial reference pursuant to California Code of Civil Procedure sections 638 and 641 through 645.1 or any successor statutes thereto.

In May of 2004, Ms. Wheeler filed an action against Woodside Homes in superior court alleging harm

[1] A recent development muddies even that issue. On August 25, 2006, Division Three of the Second District Court of Appeal concluded that parties can expand judicial review of arbitration awards by expressly providing for such expanded review in their arbitration agreement. Thus, according to the court, a properly worded agreement, providing that an arbitrator's award is reviewable for errors of law would be enforceable. *Baize v. Eastridge Companies*, No. 185823 (Aug. 25, 2006). The decision all but states that what had been the leading California case, *Crowell v. Downey Community Hospital Foundation*, 95 Cal. App. 4th 730 (2002), was inconsistent with prior Supreme Court authority. *Crowell* held that parties could not expand the scope of judicial review in their arbitration agreements. *Crowell* came out of the Second District Court of Appeal, Division Two.
The California Supreme Court has not yet spoken definitively on the issue. *Crowell* and *Baize* interpret the same Supreme Court authority as supporting their respective opposing positions. Therefore, in California, at least, incorporating language in an arbitration agreement expanding the right of judicial review is not necessarily a viable option. See also *Kyocera Corp. v. Prudential-Bache Trade Services, Inc.*, 341 F.3d 987, 1000 (9th Cir. 2003) (expanded judicial review clause in arbitration agreement unenforceable).

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from construction defects. Woodside Homes filed a motion for appointment of a referee for all purposes, pursuant to the contract. That motion was granted.

In August 2005, the California Supreme Court issued the opinion of *Grafton Partners v. Superior Court*, 36 Cal. 4th 944 (2005), which held that predispute jury trial waivers are unlawful and unenforceable in California. Shortly thereafter, Ms. Wheeler made a motion to "invalidate" the reference provision in the contract on the ground that it was a predispute jury trial waiver, which was unenforceable under *Grafton*. The trial court granted the motion and vacated the reference order. Woodside Homes filed a writ petition with the Court of Appeal, which was granted.

The Court's Analysis

The court of appeal distinguished the *Grafton* decision on the ground that it addressed "the question of [the] validity of a contract provision that the parties 'agree not to demand a trial by jury in any action, proceeding or counterclaim arising out of or relating to [the subject of the contract],'" *not* the validity of a judicial reference agreement. The enforceability of the agreement at issue in *Grafton* was analyzed under California Code of Civil Procedure section 631, which sets forth the circumstances under which the right to a jury trial may be waived. The court in *Grafton* concluded that the Legislature had determined that the right to a jury trial could only be waived by the parties to an existing dispute; hence, predispute waivers were unenforceable.

In the course of reaching its conclusion, the court in *Grafton* noted that "when the Legislature has authorized waiver of the right to trial in a court of law prior to the emergence of a dispute, it has done so explicitly.... [F]or example ... [Code of Civil Procedure] Section 638, authorizing courts to transfer a dispute to a referee upon the agreement of the parties ... was amended in 1982 to include predispute agreements." The court in *Woodside Homes* deemed the quoted language from the *Grafton* decision to be "unmistakable statements that a predispute reference agreement is not governed by the rationale of *Grafton*" and held that the judicial reference agreement between Ms. Wheeler and Woodside Homes was thus enforceable even though it "unambiguously result[ed] in a waiver of 'jury trial' without the need to use those words."

The Mechanics of Judicial Reference

When the parties to a contract have voluntarily agreed that any dispute between them will be resolved by judicial reference and one of the parties files a lawsuit against the other, the court will appoint a referee "[t]o hear and determine any or all of the issues in [the lawsuit], whether of fact or of law" and to issue a decision. Cal. Code of Civ. Proc. § 638. A referee may be chosen by the parties or, if they cannot agree, by the court. If chosen by the parties, the referee can be any person mutually acceptable to them and does not need to be a judge or a lawyer. If the court is required to select a referee, it must obtain up to three nominees from each party and then choose from among the nominees against whom there is no legal objection.

The appointed referee is required to disclose to the parties any matter subject to disclosure under the Code of Judicial Ethics as well as any "significant personal or professional relationship the referee has or has had with a party, attorney, or law firm in the ... case, including the number and nature of any other proceedings in the past 24 months in which the referee has been privately compensated by a party, attorney, law firm, or insurance company in the ... case for any services ...." The parties then have the opportunity to object to the appointment of the referee on certain specified grounds, including that he or she has an "interest in the event of the action, or in the main question involved in the action," has "formed or expressed an unqualified opinion or belief as to the merits of the action," or has "a state of mind ... evincing enmity against or bias toward either party." Cal. Code of Civil Procedure § 641.

Once a referee has been appointed, he or she oversees the resolution of the case including, if necessary, conducting a trial on all the issues of fact and law. The rules of evidence apply in a referee's hearing and the referee must conduct the trial in the same way a court would. The trial takes place at private facilities away from the courthouse. However, "[f]or all matters pending before privately compensated referees, the clerk [of court] must post a notice indicating the case name and number as well as the telephone number of a person to contact to arrange for attendance at any proceeding that would be open to the public if held in a courthouse." Cal. Rule of Court 244.1(e). Furthermore, the judge, "on request of any person or on the judge's own motion, may order that a case before a privately compensated referee must be heard at a site easily accessible to the public and appropriate for seating those who have made known their plan to attend hearings." Cal. Rule of Court 244.1(f).

After all testimony and evidence have been taken, the referee must issue a written statement of decision. The court then enters judgment on the decision of the referee, just as if the action had been tried by the court itself. Cal. Code of Civ. Proc. § 644(a). Review of the referee's decision can be obtained through a motion for a new trial (directed to the referee) or by appeal to the court of appeal.

The referee's fees are paid as agreed by the parties to the contract. If the parties do not agree on the payment of fees and request that the matter be resolved by the court, the court may order the parties to pay the referee's fees "in any manner determined by the court to be fair and reasonable including an apportionment of the fees among the parties." Cal. Code of Civ. Proc. § 645.1.

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Judicial Reference v. Binding Arbitration

Judicial reference has some similarities to binding arbitration. Both methods allow the parties to choose the individual who will resolve their dispute, both are relatively speedy procedures, and both allow the parties to avoid a jury trial. The obvious advantage that judicial reference has over arbitration is that the parties by statute have full appellate rights from a decision by a referee whereas, in contrast, the decision of an arbitrator likely cannot be reversed even for a clear error of law. As a common complaint about arbitrators is that they will consider virtually any piece of evidence, regardless of whether it would be admissible in court, the fact that a referee must comply with the rules of evidence and other court procedures may also be viewed as an advantage by some.

Disadvantages of judicial reference as compared to arbitration include the fact that the proceedings before the referee must be open to the public and the location of the proceedings advertised by the court clerk. In contrast, arbitration hearings are much more likely to be entirely private and to proceed without the participation of anyone unaffiliated with the parties to the dispute.

Drafting a Judicial Reference Agreement

Although there are no cases expressly analyzing the enforceability of a judicial reference agreement in the context of an employment case, the courts "recognize that a binding judicial reference is substantially similar to nonjudicial arbitration, and a similar approach is therefore justified in evaluating the enforceability of the provisions." *Woodside Homes of Cal., Inc. v. Superior Court*, 107 Cal. App. 4th 723, 727 (2003). Thus, an agreement to submit employment disputes to judicial reference would be analyzed in the same manner as an agreement to submit such disputes to binding arbitration - the court would enforce the judicial reference agreement provided it was not substantively and procedurally unconscionable under established principles of contract law. *Trend Homes, Inc. v. Superior Court*, 131 Cal. App. 4th 950, 956 (2005) ("The validity and enforceability of a judicial reference provision in a…contract must be determined on a case-by-case basis" in accordance with the principles of unconscionability.)

The California Supreme Court's decision in *Armendariz v. Foundation Health Psychcare Servs.*, 24 Cal. 4th 83 (2000), offers guidance on the elements that must be in a pre-dispute arbitration agreement in order for that agreement to be enforceable with regard to an employee's unwaivable statutory employment claims (*e.g.*, claims for harassment, discrimination, retaliation, *etc.*) Specifically, the court indicated that in order to avoid a finding of unconscionability, such an arbitration agreement must: 1) provide for a neutral arbitrator; 2) have a modicum of bilaterality; 3) not limit the parties' ability to recover statutorily imposed remedies; 4) provide for adequate discovery; 5) require the arbitrator to issue a written decision that explains the essential findings and conclusions on which the award is based; and 6) not require the employee to bear any type of expense that the employee would not be required to bear if he or she were free to bring the action in court. Those requirements were subsequently held to also apply to agreements to arbitrate claims for wrongful termination in violation of public policy.

A judicial referee is required by statute to issue a written decision. An employer drafting an agreement for judicial reference that may apply to its employees' statutory employment or public policy claims should ensure that the agreement complies with the other four *Armendariz* criteria. See *Trend Homes, Inc., supra*, 131 Cal. App. 4th at 961 (holding that an agreement for judicial reference was not substantively unconscionable because it was mutual and did "not limit the amount or type of relief [the] parties [could] obtain"); *Greenbriar Homes Communities, Inc. v. Superior Court*, 117 Cal. App. 4th 337, 345 (implying that the California Supreme Court's "categorical rule" that an arbitration agreement cannot require an employee suing to enforce a non-waivable statutory right to bear any costs greater than they would bear if they filed the same complaint in court would also apply to an agreement that required the employee to submit such a claim to judicial reference). Where the claims being submitted to judicial reference are contractual or torts other than public policy claims, the agreement for judicial reference could require the employee to pay some portion of the referee's fees. In that case, any referee fees paid by the prevailing party would be recoverable as costs at the conclusion of the litigation.

As with arbitration, any agreement for judicial reference should also be written in plain language, preferably in a stand-alone document and should clearly explain both the nature of judicial reference and the fact that the employee is waiving his or her right to a jury trial.

Finally, the case law suggests that a waiver of the right to pursue class actions contained in a judicial reference agreement may be permissible to the same extent as such waivers are permissible in arbitration agreements. By way of background, in June 2005, the California Supreme Court held in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005), that "at least under some circumstances," class action and class arbitration waiver clauses in consumer contracts are not enforceable. Although the Court invalidated the agreement at issue in that case, it left open the possibility that class action and class arbitration waiver clauses might be enforceable in the employment contest. (Littler's ASAP on *Discover Bank* can be found here.) Seven months later, the Second District Court of Appeal published its opinion in *Gentry v. Superior Court*, 135 Cal. App. 4th 944 (2006), upholding a clause contained in a pre-dispute arbitration agreement that precluded class arbitrations.

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The clause, as applied, required all employees bound by the arbitration agreement to (a) bring their covered disputes to arbitration instead of court and (b) bring those disputes only as individuals and not as part of or representing a class. As the plaintiff in Gentry was seeking to file a class action case on behalf of a group of customer service managers he claimed were misclassified as exempt employees, the class action waiver contained in the defendant's arbitration policy effectively ensured that any misclassification claims would have to be brought individually, rather than as a class. (Littler's ASAP on Gentry can be found here.)

The California Supreme Court has granted review of the *Gentry* decision, so the question of whether and to what extent class action waivers contained in arbitration agreements will be ultimately enforceable in California remains undecided. However, in *Discover Bank*, the Court analyzed the enforceability of the class action waiver under general principles of contract law and made it clear that special rules did not apply simply because the waiver was contained in an arbitration agreement. Given that the courts have repeatedly recognized the similarities between arbitration and judicial reference and have analyzed the viability of both types of agreements under the same principles of California contract law, it is likely that whatever decision the California Supreme Court makes in *Gentry* about the enforceability of class action waivers in arbitration agreements will apply with equal force to class action waivers contained in agreements for judicial reference.

Conclusion

Employers who want to avoid the uncertainty of a jury trial but are dissatisfied with the nature of binding arbitration should consider whether judicial reference might be a preferable procedure for resolving employee disputes.

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