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California Supreme Court Rules That Pre-Dispute Jury Waiver Contracts Are Unenforceable Under California Constitution

By Paul J. Hall and Stephen E. Paffrath

In a decision dated August 4, 2005, the California Supreme Court held in *Grafton Partners L.P. v. Superior Court*, 2005 Cal. LEXIS 8586, that a pre-dispute contract waiving the right to jury trial is unenforceable under the California Constitution. In so deciding, the court overruled the 1991 decision of the Court of Appeal in *Trizec Properties, Inc. v. Superior Court*, 229 Cal. App. 3d 1616 (1991), and chose not to follow the position of what it acknowledged was the rule in the substantial majority of jurisdictions allowing pre-dispute jury waivers. The Supreme Court also rejected the request of the petitioner PricewaterhouseCoopers ("PwC") and amici curiae that a ruling invalidating such waivers be prospective only in light of the fact that businesses and other parties had made jury waiver contracts in reliance on the *Trizec* decision.¹

Before the *Grafton Partners* decision, businesses considering alternative dispute resolution (ADR) contract provisions had three main options for binding decisions: (1) arbitration (allowing parties to select the decision-maker, but providing no right of appeal on the merits); (2) jury waiver (placing the dispute within the court system without the risks of a jury award); and (3) judicial order of reference (resulting in a de facto bench trial, usually before a retired judge). In recent years after *Trizec*, many large institutions had opted for jury waivers instead of arbitration. The *Grafton Partners* decision invalidates pre-dispute jury waivers for California cases.²

¹ Neither party in *Trizec* petitioned for review of the Court of Appeal decision upholding the enforcement of pre-dispute jury waivers. In 1991 the California Supreme Court allowed the publication of the *Trizec* decision, electing neither to hear the case on its own motion (as provided for by Rule of Court 282(e)), nor to order the decision not be published (as provided for by Rule of Court 976(d)(2)).

² The court in *Grafton Partners* invalidated pre-dispute jury waivers purely as a matter of state law. Consequently, there probably is no ground for review of the decision by the United States Supreme Court. In addition, it is likely that California pre-dispute jury waivers still will be enforced in disputes heard in federal court either on the basis of federal question jurisdiction or diversity jurisdiction, including the newly expanded diversity jurisdiction pursuant to the Class Action Fairness Act. The Ninth Circuit appears to uphold knowingly entered jury waivers. See *Paracor Finance Inc. v. Cargill Financial Services Corp.*, 96 F.3d 1151, 1165 (9th Cir. 1996) ("jury waiver is a contractual right"). As a general matter, "the right to a jury trial in the federal courts is to be determined as a matter of federal law in diversity as well as other actions." *Simler v. Conner*, 372 U.S. 221, 222 (1963).



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The *Grafton Partners* Decision

The provision of the California Code of Civil Procedure addressing waiver of the right to jury trial, section 631, is ambiguous in not expressly authorizing or denying the enforcement of pre-dispute jury waivers. However, the petitioner in *Grafton Partners*, PWC, argued that section 631's provision for waiver through a "written consent filed with the clerk or judge" encompassed pre-dispute jury waivers so long as they are filed in court after the commencement of a lawsuit.

The court's decision rejecting PWC's argument and refusing to adopt what the court acknowledged was the majority rule is lengthy, with detailed discussion of legislative history dating back to the 1850s. However, its reasoning breaks down to five simple points:

First, the California Constitution's directive that waiver of the right to trial by jury must be "as provided by statute" meant that courts could only give effect to waivers in the manner specified by Code of Civil Procedure section 631.

Second, section 631 is ambiguous on its face. The provision for a "written consent filed with the clerk or judge" does not speak to whether such a "written consent" can be a written contract entered into before litigation, or whether it must be after filing of a complaint.

Third, while courts will enforce pre-dispute agreements for arbitration and judicial reference which also waive the right to trial by jury, a fact relied upon by PWC, the relevant statutes authorizing those procedures expressly provide for enforcement of pre-dispute agreements. *See* Code of Civil Procedure section 638 (referee appointed upon motion of a party "to a written contract or lease that provides that any controversy arising thereunder shall be heard by a referee") and section 1281 ("A written agreement to submit to arbitration . . . thereafter is valid, enforceable and irrevocable").

Fourth, since the Legislature could have comparably provided for pre-dispute jury waivers in section 631, the ambiguity in the statute must be construed in favor of the constitutionally protected right to trial by jury.

Fifth, many social policies issues are implicated by pre-dispute jury waivers (i.e., business-to-business contracts versus consumer form contracts, prominence of the provision in a contract, sophistication of the contracting parties, advice of counsel, etc.). Sorting out those issues and competing interests should be left to the Legislature. In concurring, one justice made a plea for legislative amendment of section 631 to allow for pre-dispute waivers.

Thus, the court's reasoning can be summed up in one sentence: since section 631 is ambiguous, the statute will be construed in favor of the constitutionally protected right to trial by jury.

In identifying the policy issues raised by jury waivers, the court was acting consistent with its position on balancing the rights of parties to ADR contracts. For at least the last decade, plaintiffs and consumer rights advocates have attacked ADR arrangements as unfair and frustrating for consumers, and the court has been sensitive to these concerns. *See Rosenthal v. Great Western Financial Securities Corp.*, 14 Cal. 4th 394 (1996) (exhaustive review of circumstances when arbitration agreement may be set aside for fraud in the inducement); *Engalla v. Permanente Md. Group, Inc.*, 15 Cal. 4th 951 (1997) (unreasonable delay and one-sided procedures may invalidate arbitration agreement); *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83 (2000) (enforcing pre-dispute arbitration agreement entered into as condition of employment, but setting new fairness limitations by requiring employer to pay arbitration fees and costs, requiring discovery, and barring

limitations on remedies); *Discover Bank v. Superior Court*, No. S113725, 2005 Cal. LEXIS 6866 (Cal. June 27, 2005) (invalidating provisions of arbitration agreements in consumer form contracts prohibiting class arbitration).

The *Grafton Partners* decision is clearly part and parcel of the above line of cases.³ If one stands back from the minutiae of legislative history discussed by the court, the animating force of the opinion is point five above – in light of the social policy and fairness questions raised, it is incumbent on the court facing an ambiguous statute to defer to the interest in protecting jury trials and leave pre-dispute jury waiver contracts for express legislative action.⁴

As a result of the *Grafton Partners* decision, businesses sued regarding matters arising under existing contracts including pre-dispute jury waiver provisions will need to give heightened attention to the possibility of removal to federal court. It is likely that pre-dispute jury waivers will still be enforced in disputes heard in federal court in California, as explained in note 2, above.

Contract Drafting In Light Of The *Grafton Partners* Decision

Pre-dispute jury waivers are now invalid in California proceedings, regardless of the executing parties' informed consent. Any business located in California that has been using jury waivers in contracts with California residents must now redraft and select either arbitration or judicial reference if it wants to provide for binding ADR. Moreover, the size and significance of the California market means the *Grafton Partners* decision will affect contracting parties throughout the country, and the influence of the California court may lead plaintiffs to push for similar rulings elsewhere. However, if businesses located outside of California that contract with California residents want to continue to utilize jury waivers, they should consider whether a choice of forum and governing law provision specifying a jurisdiction other than California would be reasonable in light of the nature of the business transaction and the parties' interactions.

As to contracts in California, the court in *Grafton Partners* specifically noted the continued viability of provisions consenting to the appointment of a referee under Code of Civil Procedure section 638 to hear and determine any issues of law or fact. Such a reference typically results in appointment of a retired judge sitting as judicial referee -- in effect a bench trial with a de facto jury waiver. Since a statement of decision issued by a referee must be adopted or modified and then entered as a judgment by the court to which the matter has been assigned, parties do not lose their right to appeal an erroneous decision as they would in an arbitration. Judicial reference pursuant to section 638 as a contract drafting alternative was underscored by the recent decisions of the California Court of Appeal in *Trend Homes, Inc. v. Superior Court*, 2005 Cal. App. LEXIS 1218 (August 2, 2005) and *Greenbriar Home Communities, Inc. v. Superior Court*, 117 Cal. App. 4th 337 (2004), ruling that pre-dispute judicial reference provisions were enforceable.

³ The court's fairness concerns here transcend party labels. It is noteworthy that four of the six justices unanimously deciding *Grafton Partners* were appointed by Republican governors.

⁴ Opposition to enforcement of contractual ADR provisions is usually voiced by consumer advocates worried that consumers are unaware of the import of the provisions hidden in fine print. That was not the case here, as the jury waiver was found in a business-to-business contract between a major accounting firm and a large and sophisticated investment partnership. Indeed, the primary operating officer of the investment partnership was himself a lawyer, so there was no lack of knowing consent.

If you have questions or need assistance in reviewing your contracts in light of the *Grafton Partners* decision, or on any other matter, please call or e-mail Paul J. Hall (phall@nixonpeabody.com 415-984-8266) or Christopher M. Mason (cmason@nixonpeabody.com 212-940-3017), the coordinating heads of our class action defense practice across our substantive litigation teams, or contact any of our attorneys listed below:

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