

# The Montana Supreme Court's continued, not-so-subtle assault on arbitration

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It is no secret that the Montana Supreme Court has historically been skeptical, if not hostile, toward arbitration agreements obligating Montana individuals and corporations to arbitrate disputes. As put by University of Montana Law School Professor Scott Burnham, “In Montana, arbitration is the legal equivalent of the wolf, a critter much despised except by a fringe group that would spread it widely.”<sup>1</sup>

Former Montana Supreme Court Justice Terry Trieweiler’s outspoken concurrence in *Doctor’s Associates Inc. v. Casarotto*, on remand from the U.S. Supreme Court, admonished federal judges for self-servingly using arbitration to uncrowd dockets at the expense of individuals’ rights. This made Montana the poster child for “arbitration-resistant” state courts.<sup>2</sup>

Recent Montana caselaw confirms that the Court has joined with other state courts nationwide in finding indirect ways to invalidate arbitration agreements. The Court unabashedly applies general contract-law principles differently when interpreting arbitration provisions from other contract provisions. The result is the emergence of unspoken “arbitration definitions” and “non-arbitration definitions” for contract law principles such as contracts of adhesion, reasonable expectation, and unconscionability. Attorney James M. Gaitis – in an April 2005 article in *The Montana Lawyer*, “The Ongoing Federalization of Commercial Arbitration in Montana,” – wrote that “it would appear that the court is on the brink of creating a narrowly crafted common law unconscionability-adhesion doctrine that applies solely to arbitration provisions.”

The Court’s approach is not sustainable since practitioners rely on the Court’s interpretation of these doctrines in cases involving arbitration clauses in non-arbitration contract disputes, and this creates a schism in contract rules that results in conflicting caselaw. Eventually, the Court will have to call a spade a spade and admit its unequal treatment of arbitration provisions and non-arbitration provisions when utilizing contract law doctrines.

While the Court’s concern for the David-like consumer versus Goliath-esque corporations that draft one-sided arbitration clauses is admirable, hijacking traditional contract law principles at the expense of predictability in their application is a

high price to pay for redress in such cases.

This article analyzes four ways in which the Court indirectly voids arbitration clauses:

- Utilizing the unconscionability doctrine to void arbitration provisions.
- Judicial usurpation of the arbitrator’s role in determining the validity of the underlying contract.
- Narrowly defining arbitration agreements.
- Utilizing a truncated choice-of-law analysis in contracts with arbitration agreements.

In each of these areas, I point out ways in which the Court’s analysis is contradictory to its use of the applicable contract law doctrines in non-arbitration cases.

**THE MONTANA SUPREME COURT** is one of a number of state courts nationwide that has started utilizing unconscionability to void arbitration agreements to get around the U.S. Supreme Court’s prohibition on arbitration-specific state law requirements in *Doctor’s Associates Inc.* discussed in more detail below. A recent New York University law review article discusses this recent trend in depth and highlights Montana’s “arbitration resistant” caselaw as an example.<sup>3</sup> Another scholar recently pointed out that in Montana and other states, “judges are . . . circumventing the Federal Arbitration Act and permitting litigation by parties to arbitration agreements through expansive, arbitration-specific uses of unconscionability.”<sup>4</sup>

Montana’s history with arbitration is well known based on the *Doctor’s Associates* litigation in the mid-1990s. In that case, the U.S. Supreme Court invalidated MCA 27-5-114’s requirement that arbitration agreements be in bold letters on the first page of contracts. The Supreme Court ruled that arbitration agreements may only be invalidated by “generally applicable contract defenses, such as fraud, duress, or unconscionability.”<sup>5</sup> The MCA provision at issue, MCA 27-5-114, violated this rule by imposing a “special notice requirement” on arbitration agreements “not applicable to contracts generally.”<sup>6</sup> MCA 27-5-114 was subsequently amended to comply with this rule by removing the notice requirement and setting forth the rule that arbitration agreements are “valid and enforceable except upon grounds that exist at law or in equity for the revocation of a contract.”

In order to successfully challenge an arbitration agreement

before a court, a party must allege that the arbitration provision, and not the contract as a whole, suffers from a defect, such as fraud, duress, or unconscionability. When determining whether to enforce a provision in a contract of adhesion, Montana courts will not enforce such provision against the “weaker party” if it is “(1) not within their reasonable expectations, or (2) within their reasonable expectations, but, when considered in its context, proves unduly oppressive, unconscionable or against public policy.”<sup>7</sup>

This is the test the Court has repeatedly used to invalidate arbitration agreements in a wide range of contracts involving both consumers and merchants.

After the Court’s tussle with the U.S. Supreme Court in *Doctor’s Associates*, the next Montana Supreme Court decision regarding arbitration agreements in arbitration contracts was *Iwen v. U.S. West Direct*.<sup>8</sup> *Iwen* invalidated an arbitration agreement giving the drafter the unilateral right to bring an action for collecting a debt against the other contracting party, while requiring the party to arbitrate any dispute against the drafter. The Court made clear that “generally applicable contract law defenses may be used to set aside arbitration agreements,” in contracts of adhesion that are either “not within the reasonable expectations” of the weaker party or “unduly oppressive, unconscionable or against public policy.”<sup>9</sup> *Iwen* sparked the beginning of the Court’s broad interpretation of contracts of adhesion and liberal use of unconscionability when analyzing arbitration agreements. In discussing this case, University of Montana Professor Scott Burnham pointed out that “the Montana Supreme Court, having found the concepts of reasonable expectations and unconscionability useful for avoiding arbitration clauses, seemed poised to unleash those new-found weapons rather freely.”<sup>10</sup>

In *Kloss v. Edward D. Jones & Co.*,<sup>11</sup> the Montana Supreme Court solidified its post-*Doctor’s Associates* approach to arbitration agreements by invalidating an arbitration agreement found in a standard investment agreement between an investor and brokerage company as outside the investor’s “reasonable expectations.” *Kloss* reasoned that the plaintiff investor had no “meaningful choice in accepting or rejecting” the arbitration agreement because such agreements were industry practice.<sup>12</sup> Interestingly, the industry practice of including arbitration agreements in investment agreements was relied upon by the Court 14 years earlier in *Passage v. Prudential-Bache Securities, Inc.*<sup>13</sup> to conclude that the arbitration agreement was within the investor’s “reasonable expectations” and therefore, enforceable. Gaitis also pointed out that “*Kloss* represents a marked departure from the court’s [] decision in *Passage*.” *Kloss*’s half-hearted attempt to distinguish *Passage* is, at best, unconvincing given the marked similarities in the contracts and facts at issue.<sup>14</sup>

*Kloss* also found salient that the plaintiff “did not read the contract and was not aware of the arbitration provision in the contract.”<sup>15</sup> This is strange logic given the Court’s repeated mantra that “one who executes a written contract is presumed to know the contents of the contract and assent to those specified terms.”<sup>16</sup>

Perhaps the most useful aspect of *Kloss* came in the form of dicta – eight factors the Court set forth to use in determining

“the issue of conscionability in the context of arbitration provisions.”<sup>18</sup> These provisions included:

1. Whether potential arbitrators are “disproportionately employed” in one party’s profession.
2. Whether arbitrators favor “repeat players” to continue getting their business.
3. Arbitration filing fees relative to district court fees.
4. Arbitrator’s fees and whether such fees are prohibitive for consumers or “workers of modest means.”
5. Secrecy of arbitration proceedings “so as to conceal illegal, oppressive or wrongful business practices.”
6. & 7. The extent to which arbitrators are “bound by the law” and “bound by the facts.”
8. Claimants’ opportunities for discovery to support claims.

Following *Kloss* the Court continued to establish a presumption that an arbitration agreement in a standardized contract is not within the weaker party’s reasonable expectations. In *Zigrang*,<sup>19</sup> the Court said, “The mere presence of an arbitration provision in an investment agreement, though conspicuous, does not bring the provision within the reasonable expectations of an investor in every instance.”

**THE COURT’S MOST RECENT** assault on arbitration is *Woodruff v. Bretz, Inc.*,<sup>20</sup> in 2009 in which the Court refused to enforce an arbitration clause between a mobile home purchaser and supplier, despite the fact that the purchaser initialed a contract provision acknowledging her acceptance of an arbitration agreement, because such agreement was outside her “reasonable expectations.” Ironically, these cases suggest that the Court is more likely to void an arbitration agreement indirectly today through the unconscionability doctrine than it was prior to *Doctor’s Associates*.

In the late 1980s and early 1990s, the Court repeatedly enforced arbitration agreements in contracts of adhesion.<sup>21</sup> The Court has broadly defined “contract of adhesion” as “a standardized form of agreement” in which the weaker party’s choice is either to accept or reject the contract without negotiation of its terms.<sup>22</sup> A good example of the Court’s willingness to define contracts with arbitration agreements as “contracts of adhesion” is *Bretz*, in which the Court found a contract of adhesion exists despite the drafting party’s stated invitation to discuss the terms of the agreement, including the arbitration provision.<sup>23</sup> The Court does not differentiate between consumers and non-consumers when defining a contract of adhesion in cases involving arbitration provisions. This finding is contrary to Montana Supreme Court caselaw in which the court was less willing to find a contract of adhesion existed where the non-drafting party was a “sophisticated business person.”<sup>24</sup>

The Court is more willing to find arbitration clauses unconscionable than other types of contract provisions, even outside the consumer context. As James Gaitis pointed out, “If the Court applied the new unconscionability standard established in *Iwen* and *Kloss* to contracts in their entirety, rather than solely to arbitration provisions, the Court would render unenforceable most contracts Montanans sign every day.”<sup>25</sup>

This willingness to find arbitration agreements unconscionable is part of a larger trend by state courts nationwide

that disproportionately find arbitration clauses unconscionable. Despite the Court's last decade of caselaw consistently finding arbitration agreements unconscionable, it has rarely invalidated any other contract provision on the same grounds. Indeed, the Court has repeatedly resisted finding contract provisions unconscionable, even in contracts of adhesion.<sup>26</sup>

Given the Court's approach post-*Doctor's Associates*, it is not surprising that the only case in which the Court has affirmed a lower court's enforcement of an arbitration agreement in a contract of adhesion is one in which – in keeping with the MCA's arbitration-specific statutory requirements that the U.S. Supreme Court in *Doctor's Associates* voided – the arbitration agreement was on the first page of the contract in bold conspicuous lettering.<sup>27</sup>

Another way the Court has indirectly voided arbitration agreements is by chipping away the well-established rule that it is for an arbitrator, and not a court, to determine whether a contract exists that contains an arbitration agreement. Where a contract as a whole is challenged before a court and that contract contains an arbitration agreement, the court must refer the matter to an arbitrator. However, if a party challenges only the validity of the arbitration agreement, this is a question for courts.<sup>28</sup> The Court recently eroded this rule by holding that a court can hear a claim challenging the existence of a contract that contains an arbitration agreement, as opposed to a challenge to a contract. *Thompson v. Lithia Chrysler Jeep Dodge of Great Falls, A.B.N.*,<sup>29</sup> found in 2008 that a court may decide a claim that a contract containing an arbitration agreement never came into existence because condition precedent was not satisfied. The current state of law, therefore, allows a court to determine both whether an arbitration agreement or the underlying contract containing such agreement exists as long as the claimant artfully challenges either the existence of the underlying contract or specifically challenges the arbitration provision at issue.

When faced with a challenge to an arbitration provision specifically, the Court narrowly construes the definition of a valid arbitration agreement, and has repeatedly found no arbitration agreement exists despite the plain language of the contract specifying arbitration. In *Kingston v. Ameritrade, Inc.*,<sup>30</sup> in 2000, the Court found no arbitration agreement existed despite the plain language in the contract between parties because the plaintiffs “had no indication that they were agreeing to binding arbitration or that arbitration was their exclusive remedy in resolving disputes.” In *Hubner v. Cutthroat Communications, Inc.*,<sup>31</sup> in 2003 the Court found that an employee did not agree to arbitrate disputes by signing a form agreeing to be bound by an employee handbook, which contained an arbitration provision. Similarly, the Court has repeatedly held that courts, not arbitrators, decide whether a particular dispute is within the scope of the parties' arbitration agreement.<sup>32</sup>

**A FINAL WAY** the Court has voided arbitration agreements is through a truncated choice-of-law analysis. The well-established rule used to determine whether a choice-of-law provision specifying a law other than Montana requires the choice of law provision be followed unless “1. applying the chosen law would be contrary to a fundamental Montana poli-

cy,” 2. Montana has a “materially greater interest” in resolving the dispute than the chosen state, and 3. Montana law would apply in the absence of the choice-of-law provision.<sup>33</sup>

The Court has repeatedly found that Montana law applies to determine the validity of an arbitration agreement even in the face of choice-of-law provisions specifying another state because applying the law of the other state would violate Montana public policy against arbitration agreements.<sup>34</sup> Some opinions have gone as far as to link the policy disfavoring foreign arbitration clauses to the constitutional rights of access to courts, trial by jury, due process, and equal protection.<sup>35</sup> Within this framework, arbitration agreements don't stand a chance because Montana law will always apply to determine the validity of arbitration agreements. This again contradicts the Court's more nuanced, fact-specific choice-of-law analyses in cases not involving arbitration.<sup>36</sup>

**THE MORAL OF THIS STORY** for practitioners is this:

- When drafting an arbitration agreement in a standardized contract, the agreement must be part of the larger contract, but be separated from other contract provisions through bolder and more conspicuous font, preferably on the first page of the contract.

- The arbitration provision should require separate signature, and specify that by signing, the contracting party understands that it is knowingly waiving both its right to a jury trial and its right to access the courts to resolve disputes and knowingly agreeing to binding arbitration as the exclusive remedy available.

- The arbitration clause should be discussed directly between the contracting parties, and such discussion should be acknowledged in writing.

- If practicable, the non-drafting party should be given the opportunity to negotiate the arbitration provision.

- The arbitration clause should be written broadly to include any dispute relating to the contract, including all statutory and common law claims.

With all of these safeguards in place, an arbitration agreement still may not be enforced by the Court, but it will have to come up with a new justification for not enforcing it.

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## NOTES

1. 66 Mont. L. Rev. 139, 156 (2005).
2. See 268 Mont. 369, 382, 886 P.2d 931 (1994).

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