

No. 06-35769

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JAMES HADACHEK; NANCY HADACHEK; AND CARL ANDERSON, JR.,
Plaintiffs-Appellees,

v.

UBS FINANCIAL SERVICES INC.,
Defendant-Appellant; and
WILLIAM FEELEY,
Defendant.

*On Appeal From The United States District Court
For The District Of Montana, Case No. CV-06-00017-BLG-RFC
The Honorable Richard F. Cebull, United States District Judge*

**BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS
ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANT-
APPELLANT UBS FINANCIAL SERVICES INC.**

George M. Garvey
Daniel L. Geyser
MUNGER, TOLLES & OLSON LLP
355 South Grand Avenue, 35th Fl.
Los Angeles, CA 90071-1560
Telephone: (213) 683-9100
Facsimile: (213) 687-3702

Attorneys for *Amicus Curiae*
SECURITIES INDUSTRY AND
FINANCIAL MARKETS ASSOCIATION

No. 06-35769

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JAMES HADACHEK; NANCY HADACHEK; AND CARL ANDERSON, JR.,
Plaintiffs-Appellees,

v.

UBS FINANCIAL SERVICES INC.,
Defendant-Appellant; and
WILLIAM FEELEY,
Defendant.

*On Appeal From The United States District Court
For The District Of Montana, Case No. CV-06-00017-BLG-RFC
The Honorable Richard F. Cebull, United States District Judge*

**BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS
ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANT-
APPELLANT UBS FINANCIAL SERVICES INC.**

George M. Garvey
Daniel L. Geyser
MUNGER, TOLLES & OLSON LLP
355 South Grand Avenue, 35th Fl.
Los Angeles, CA 90071-1560
Telephone: (213) 683-9100
Facsimile: (213) 687-3702

Attorneys for *Amicus Curiae*
SECURITIES INDUSTRY AND
FINANCIAL MARKETS ASSOCIATION

CORPORATE DISCLOSURE STATEMENT

The Securities Industry and Financial Markets Association is not a publicly traded corporation. It has no parent corporations and no publicly traded corporation owns more than 10% of its stock.

TABLE OF CONTENTS

	Page
INTEREST OF THE <i>AMICUS CURIAE</i>	1
INTRODUCTION AND SUMMARY OF ARGUMENT	2
BACKGROUND	3
I. A Brief History Of The FAA.....	3
II. Montana’s Experience With The FAA.....	5
A. The U.S. Supreme Court Strikes Down Montana’s Statutory Heightened-Notice Requirement For Pre- Dispute Arbitration Agreements	5
B. The Montana Supreme Court Reissues A Functionally Identical Heightened-Notice Requirement Under The Guise Of State Common Law	7
III. The District Court Below Adopts Wholesale The Montana Supreme Court’s Rulings On Federal Law.....	11
ARGUMENT	13
I. Montana’s Second Attempt To Implement The Same Anti- Arbitration Rule Struck Down In <i>Doctor’s Associates</i> Inevitably Fails For The Same Reasons	13
A. The Montana Rule, Which Requires Heightened Notice For Pre-Dispute Arbitration Agreements <i>Precisely</i> <i>Because Those Agreements Require Arbitration,</i> Impermissibly Singles Out Arbitration For Disfavored Treatment.....	13
1. The FAA preempts the Montana rule	13
2. The Montana rule falls clearly outside the FAA safe harbor for neutral state rules.....	14
3. It is irrelevant that the Montana rule purportedly applies beyond the arbitration context	18
B. Montana’s Heightened-Notice Requirement May Not Be Sustained On The Alternative (And Likewise Faulty) Grounds Set Forth In <i>Kloss</i> And <i>Willems</i>	21

TABLE OF CONTENTS
(continued)

	Page
C. The Practical Consequences Of The Montana Rule Would Undercut The Effectiveness and Efficiency Of Arbitration Under The FAA	26
CONCLUSION	27

TABLE OF AUTHORITIES

Page(s)

FEDERAL CASES

<i>Allied-Bruce Terminix Cos. v. Dobson</i> , 513 U.S. 265 (1995)	3, 5, 6, 13
<i>American Gen. Life & Acc. Ins. Co. v. Wood</i> , 429 F.3d 83 (4th Cir. 2005)	17, 18
<i>Anders v. Hometown Mortgage Servs., Inc.</i> , 346 F.3d 1024 (11th Cir. 2003)	27
<i>Bradley v. Harris Research, Inc.</i> , 275 F.3d 884 (9th Cir. 2001)	23
<i>Circuit City Stores v. Adams</i> , 532 U.S. 105 (2001)	26
<i>Circuit City Stores, Inc. v. Adams</i> , 279 F.3d 889 (9th Cir. 2002)	20
<i>Cooper v. MRM Investment Co.</i> , 367 F.3d 493 (6th Cir. 2004)	18
<i>Doctor's Associates, Inc. v. Casarotto</i> , 517 U.S. 681 (1996)	2, 3, 5, 6, 7, 13, 14, 17, 21, 22, 25
<i>EEOC v. Waffle House, Inc.</i> , 534 U.S. 279 (2002)	14
<i>Ferguson v. Countrywide Credit Indus., Inc.</i> , 298 F.3d 778 (9th Cir. 2002)	20
<i>Gilmer v. Interstate/Johnson Lane Corp.</i> , 500 U.S. 20 (1991)	25
<i>Harris v. Green Tree Fin. Corp.</i> , 183 F.3d 173 (3d Cir. 1999)	20
<i>Hunter v. Underwood</i> , 471 U.S. 222 (1985)	19
<i>Iberia Credit Bureau, Inc. v. Cingular Wireless LLC</i> , 379 F.3d 159 (5th Cir. 2004)	16, 20
<i>Ingle v. Circuit City Stores, Inc.</i> , 328 F.3d 1165 (9th Cir. 2003)	20
<i>Koveleskie v. SBC Capital Markets, Inc.</i> , 167 F.3d 361 (7th Cir. 1999)	25
<i>Mastrobuono v. Shearson Lehman Hutton, Inc.</i> , 514 U.S. 52 (1995)	20
<i>Moses H. Cone Hosp. v. Mercury Constr. Corp.</i> , 460 U.S. 1 (1983)	15, 24

TABLE OF AUTHORITIES

	Page(s)
<i>Nagrampa v. Mailcoups, Inc.</i> , 469 F.3d 1257 (9th Cir. 2006).....	20
<i>Perry v. Thomas</i> , 482 U.S. 483 (1987)	3, 4, 5, 7, 23, 25
<i>Prima Paint Corp. v. Flood & Conklin Mfg. Co.</i> , 388 U.S. 395 (1967)	15
<i>Scherk v. Alberto-Culver Co.</i> , 417 U.S. 506 (1974)	4, 19
<i>Southland Corp. v. Keating</i> , 465 U.S. 1 (1994)	4, 26
<i>Sydnor v. Conseco Fin. Servicing Corp.</i> , 252 F.3d 302 (4th Cir. 2001).....	18, 20, 25
<i>Ticknor v. Choice Hotels Int'l, Inc.</i> , 265 F.3d 931 (9th Cir. 2001).....	20
<i>Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.</i> , 489 U.S. 468 (1989)	3
<i>Wolsey, Ltd. v. Foodmaker, Inc.</i> , 144 F.3d 1205 (9th Cir. 1998).....	4

STATE CASES

<i>Kloss v. Edward D. Jones & Co.</i> , 54 P.3d 1 (Mont. 2002)	7, 8, 9, 10, 24, 25
<i>Willems v. U.S. Bancorp Piper Jaffray, Inc.</i> , 107 P.3d 465 (Mont. 2005)	10, 11

FEDERAL STATUTES

9 U.S.C. § 2	4, 5, 13, 18
--------------------	--------------

STATE STATUTES

Mont. Code Ann. § 27-5-114(4).....	6
------------------------------------	---

OTHER AUTHORITIES

H.R. Rep. No. 96, 68th Cong., 1st Sess. (1924).....	4
---	---

INTEREST OF THE *AMICUS CURIAE*

The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of more than 650 securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that expand and improve markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests in the United States and globally. It has offices in New York, Washington, D.C., and London, and its associated organization, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

The question presented here – whether the Federal Arbitration Act (FAA) permits state law to hold unenforceable an otherwise-valid arbitration agreement simply because one party did not specifically call the arbitration clause to the other's attention – is an issue of critical and recurring importance to the securities industry and its investors. It is critical because *amicus* has a vital interest in ensuring the robust enforcement of the FAA, in which Congress sweepingly preempted state rules that discriminate against arbitration. It is recurring because, notwithstanding the U.S. Supreme Court's emphatic reaffirmation of that anti-discrimination principle, some states persist in singling out, and refusing to enforce, valid arbitration agreements.

Arbitration in the securities industry is part of a well-developed system structured to benefit both securities firms and their clients. The Securities and Exchange Commission supervises the process to protect investors and the public interest, and to ensure that the rules are fair. Securities firms rely heavily on this system to provide an efficient, economical, and just means of resolving the thousands of customer disputes that arise each year. But arbitration will remain an effective alternative to litigation only if states are not permitted to erect substantive and procedural barriers to derail the arbitral process – especially where, as here, those barriers invite precisely the kind of litigation expense that arbitration is designed to avoid. Because of the critical importance of these issues to its member companies, *amicus* has a strong interest in assisting the Court in its consideration of the issues raised by this appeal.

INTRODUCTION AND SUMMARY OF ARGUMENT

It's déjà vu all over again. Having been emphatically reversed by the U.S. Supreme Court in *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996), the Montana Supreme Court has simply decided to reinstate essentially the same rule, but in immaterially different terms. In *Doctor's Associates*, the Supreme Court struck down Montana's heightened notice requirement for pre-dispute arbitration agreements. As the Court had "several times" already explained, Congress enacted the FAA to forbid states from "singling out arbitration provisions for suspect

status” (*id.* at 687); hence, “[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the FAA]” (*id.* at 685 (quoting *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987))).

Now, once again, Montana has imposed (and the court below adopted) a *heightened notice requirement for pre-dispute arbitration agreements*. Because the new rule (just like the old one) is *again* not neutral to arbitration – quite the contrary, the operative fact driving the Montana rule is that the agreement requires arbitration – the rule is invalid under federal law. The plain terms of the written contract, which the parties indisputably signed, should be enforced, and the Montana notice requirement should be held preempted (again) under the FAA.

BACKGROUND

I. A Brief History Of The FAA

In 1925, Congress enacted the FAA (codified as amended at 9 U.S.C. §§ 1-16) in order to address state-court hostility to arbitration and thus “overcome courts’ refusals to enforce agreements to arbitrate.” *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 270 (1995) (citing *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 474 (1989)). As the legislative history explains, the need for the legislation arose from an “anachronism of our American law”:

Some centuries ago, because of the jealousy of the English courts for their own jurisdiction, they refused to

enforce specific agreements to arbitrate upon the ground that the courts were thereby ousted from their jurisdiction. This jealousy survived for so long a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts.

H.R. Rep. No. 96, 68th Cong., 1st Sess., at 1-2 (1924). In passing the FAA, Congress aimed to stop this hostility and “to place such [arbitration] agreements ‘upon the same footing as other contracts.’” *Wolsey, Ltd. v. Foodmaker, Inc.*, 144 F.3d 1205, 1209 (9th Cir. 1998) (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974)).

Congress’s chosen means for enforcing that statutory purpose is most prominently found in § 2 of the FAA: “a written provision in * * * a contract * * * to settle by arbitration a controversy thereafter arising out of such contract * * * shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2 (emphasis added). In mandating that “[a]n agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*” (*Perry*, 482 U.S. at 492 n.9 (emphasis in original)), Congress effectively “withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration” (*Southland Corp. v. Keating*, 465 U.S. 1, 10 (1994)). Accordingly, “state legislation requiring greater information or choice in the

making of agreements to arbitrate than in other contracts is preempted.” *Doctor’s Associates*, 517 U.S. at 687 (citation omitted).

In fashioning this clear federal directive, however, Congress did not seek to displace state law entirely. As § 2’s plain text confirms – subjecting arbitration agreements to “grounds as exist at law or in equity for the revocation of *any* contract” (9 U.S.C. § 2 (emphasis added)) – Congress left a narrow savings clause for states to regulate contracts “under general contract law principles” (*Allied-Bruce*, 513 U.S. at 281), “if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally” (*Perry*, 482 U.S. at 492 n.9 (emphasis in original)). This careful balancing restricts the role of state law to unequivocally neutral principles: “[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2.” *Perry*, 482 U.S. at 493 n.9. The issue in this case (like the issue in *Doctor’s Associates* preceding it) turns on Montana’s improper expansion of this narrow savings clause.

II. Montana’s Experience With The FAA

A. The U.S. Supreme Court Strikes Down Montana’s Statutory Heightened-Notice Requirement For Pre-Dispute Arbitration Agreements

In *Doctor’s Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996), the U.S. Supreme Court confronted a Montana statute declaring arbitration provisions

unenforceable unless “[n]otice that [the] contract is subject to arbitration” is “typed in underlined capital letters on the first page of the contract.” Mont. Code Ann. § 27-5-114(4). In earlier state-court proceedings, the Montana Supreme Court had rejected an argument that the FAA preempted this heightened notice requirement, reasoning that the statute did not “undermine the goals and policies of the FAA.” *Doctor’s Associates*, 517 U.S. at 685 (quoting the Montana Supreme Court). The U.S. Supreme Court granted certiorari, vacated the judgment below, and remanded for the Montana Supreme Court to reconsider its decision in light of the intervening decision in *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995). See *Doctor’s Associates*, 517 U.S. at 685. Although *Allied-Bruce* confirmed that the FAA preempts state rules that would “place arbitration clauses on an unequal ‘footing,’ directly contrary to the Act’s language and Congress’s intent” (513 U.S. at 281), the Montana Supreme Court, on remand, simply “adhered to its original ruling” without even “inviting or permitting further briefing or oral argument.” *Doctor’s Associates*, 517 U.S. at 686. The U.S. Supreme Court again granted certiorari, and (again) reversed.

In striking down the Montana statute, the Supreme Court reaffirmed that, under the FAA, “Congress precluded States from singling out arbitration provisions for suspect status.” *Id.* at 682. Because the Montana provision “requir[ed] greater information or choice in the making of agreements to arbitrate

than in other contracts,” the Court declared it preempted: “Montana’s § 27-5-114(4) directly conflicts with § 2 of the FAA because the State’s law conditions the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally.” *Id.* at 687.

In the course of its decision, the Supreme Court acknowledged that § 2 provides a safe harbor for state law grounded in “generally applicable principle[s].” *Id.* at 687 n.3. But the Court was quick to “reiterat[e] * * * that a [state] court may not ‘rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what * * * the state legislature cannot.’” *Ibid.* (quoting *Perry*, 482 U.S. at 492 n.9).

In a lone dissent, Justice Thomas argued that the FAA “does not apply to proceedings in state courts.” 517 U.S. at 689 (Thomas, J., dissenting). Montana’s statutory notice requirement therefore did not attract a single vote in its favor on the merits.

B. The Montana Supreme Court Reissues A Functionally Identical Heightened-Notice Requirement Under The Guise Of State Common Law

After having been reversed (8-1) in *Doctor’s Associates*, the Montana Supreme Court revisited the issue of heightened-notice requirements in *Kloss v. Edward D. Jones & Co.*, 54 P.3d 1 (Mont. 2002). In that case, there was no

question that the parties had signed a written arbitration agreement and that it covered the dispute. The issue was whether the broker's failure to provide the client with heightened notice of the arbitration clause was sufficient to render the arbitration provision unenforceable. The court held that it was.

First, in its lead opinion, the Montana court adopted the client's argument that "the arbitration clause was part of a contract of adhesion and that waiver of her constitutional right to jury trial should not be presumed from signing a contract of adhesion." *Kloss*, 54 P.3d at 6. According to this theory, an adhesion contract "will not be enforced against the weaker party when it is: (1) not within the reasonable expectations of said party or (2) within the reasonable expectations of the party, but, when considered in its context, is unduly oppressive, unconscionable, or against public policy." *Id.* at 7. Applying the first part of this rule, the court held that the arbitration agreement was unenforceable as "clearly not within Kloss's reasonable expectations." *Id.* at 8. The court's holding was grounded entirely in the fact that her broker "did not explain the arbitration provision" – *i.e.*, the broker failed to provide heightened notice – and that the arbitration provision led Kloss to "waive[] at least two constitutional rights, *i.e.*, a right of access to the courts * * * and her right to a jury trial." *Ibid.*

Next, the majority supplemented its first holding with the alternative rationale that the broker "owed [the client] a fiduciary duty to explain the

arbitration agreement.” *Id.* at 9. The court concluded that the broker’s alleged “discretion to buy and sell securities in Kloss’ account” gave rise to a fiduciary relationship. *Ibid.* In light of that relationship, the court concluded that the broker “should have explained the arbitration clause” to the client because it “effectively waived” the client’s “constitutionally protected rights of access to court and trial by jury.” *Id.* at 9-10.

Finally, Justice Nelson filed a special concurrence, which was also joined by every justice in the majority. In this concurrence, Justice Nelson “further develop[ed]” an “additional rationale supporting our decision in this case – *i.e.*, whether Kloss effectively waived her rights to a trial by jury and to access to the courts.” *Id.* at 11.

In finding the arbitration provision invalid, Justice Nelson explicitly challenged arbitration as a method of dispute resolution: as he viewed it, the placement of an arbitration clause in a standard form contract “is at one and the same time an ‘open attack’ on the right of jury trial and a ‘secret machination’ causing forfeiture of that right that Blackstone predicted would ‘sap and undermine’ the right, and with that our ‘public and private libert[ies].” *Id.* at 13. He further alleged that, “for their own obvious economic benefit, large national and multi-national corporations are effectively privatizing an important segment of the civil justice system in this country by including fine-print, non-negotiable,

take-it-or-leave-it, mandatory, binding arbitration clauses in their standard-form contracts.” *Id.* at 14. He declared that arbitration accordingly interfered with “the sacredness and inviolability of the fundamental right to trial by jury,” and that “any contract provision that openly or subtly causes the forfeiture of the exercise of this right [to jury trial] must be rigorously examined by the courts.” *Id.* at 12.¹

In conducting that “rigorous[] examin[ation],” Justice Nelson set forth the following rule: “[f]or a fundamental right to be effectively waived, the individual must be informed of the consequences before personally consenting to the waiver.” *Id.* at 15. He explicitly reasoned that this rule survived under the FAA, because “generally applicable contract defenses, such as fraud, duress or unconscionability, may be applied to invalidate arbitration agreements,” and “Montana has long subscribed to the rule that contractual waivers of constitutional rights” are subject to a heightened notice requirement. *Id.* at 16.

Subsequently, in *Willems v. U.S. Bancorp Piper Jaffray, Inc.*, 107 P.3d 465 (Mont. 2005), the Montana Supreme Court unanimously reaffirmed its fiduciary-duty holding in *Kloss*. In doing so, the court held that “[a] fiduciary relationship is created whenever a broker has discretion to buy, sell, or otherwise control a

¹ Justice Nelson also opined that, “with due all deference to the Supreme Court of the United States, Justice Thomas’s and Scalia’s criticism of [U.S. Supreme Court precedent applying the FAA in state court] and their conclusion that these cases should be overruled to the extent that they apply the FAA in state court proceedings [are] dead right.” *Id.* at 14 n.3.

client's account" (107 P.3d at 468), and that this fiduciary duty gave rise to an obligation "to explain the arbitration provision to [the client]" (*id.* at 470). See also *id.* at 469 (noting a duty to "read and explain arbitration clauses to clients"). Because the broker purportedly failed to provide that heightened notice, "the pre-dispute arbitration provisions" were deemed "unenforceable." *Id.* at 470.

III. The District Court Below Adopts Wholesale The Montana Supreme Court's Rulings On Federal Law

In the decision below, the district court, like the Montana Supreme Court in *Kloss and Willems* – and like the U.S. Supreme Court in *Doctor's Associates* – was confronted with a claim that an otherwise binding arbitration agreement was "unenforceable" under a state-law heightened-notice requirement. E.R. 146 (asking whether, "under Montana law, arbitration agreements are unenforceable without an explicit waiver").²

First, the court followed *Kloss and Willems* to hold that "defendants had a fiduciary duty to explain to plaintiffs that, by agreeing to the arbitration provisions, plaintiffs would be giving up their rights to access to courts, to a jury trial, to reasonable discovery and to appeal." E.R. 146. Because the district court found

² Of course, there indisputably was an "explicit waiver," as that phrase is traditionally understood: it is the plain language in the signed contract that explicitly directs the parties to arbitrate rather than go to court. *Kloss and Willems* necessarily stand for the proposition that, under Montana law, a waiver is *not* "explicit" unless heightened notice is provided beyond the plain text of the written agreement itself.

that defendants had not provided this heightened notice, it declared the arbitration agreement unenforceable. See E.R. 146-47.

The court next asked whether state law was preempted by the FAA. E.R. 147. Although the district court found the agreement invalid under the fiduciary-duty rationale of *Kloss* and *Willems*, its FAA analysis rested entirely on the *different* principle set forth in Justice Nelson's special concurrence in *Kloss*: "without evidence of an explicit waiver of right to access to the courts" – *i.e.*, without evidence that the broker called the arbitration clause to the client's attention – "a valid agreement to arbitrate cannot exist." E.R. 148. Reasoning that "Montana has long subscribed to the rule" requiring heightened notice of "contractual waivers of constitutional rights," the district court believed that "the FAA does not govern this case." E.R. 147-48.

This is the decision now under review in this Court.

ARGUMENT

I. Montana's Second Attempt To Implement The Same Anti-Arbitration Rule Struck Down In *Doctor's Associates* Inevitably Fails For The Same Reasons

A. The Montana Rule, Which Requires Heightened Notice For Pre-Dispute Arbitration Agreements *Precisely Because Those Agreements Require Arbitration*, Impermissibly Singles Out Arbitration For Disfavored Treatment

1. The FAA preempts the Montana rule

“Section 2 of the FAA provides that written arbitration agreements ‘shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of *any* contract.’” *Doctor's Associates*, 517 U.S. at 686 (quoting 9 U.S.C. § 2) (emphasis in original). Under the Supreme Court’s controlling interpretation of this provision, the FAA sweeps broadly to preempt any rule (“whether of legislative or judicial origin”) that “takes its meaning precisely from the fact that a contract to arbitrate is at issue.” *Id.* at 685. States may not “decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal ‘footing,’ directly contrary to the Act’s language and Congress’s intent.” *Allied-Bruce*, 513 U.S. at 281.

This principle dooms the Montana rule applied in this case. Like the Montana statute at issue in *Doctor's Associates*, the Montana Supreme Court has

again created a rule with a “precise, arbitration-specific limitation.” *Doctor’s Associates*, 517 U.S. at 687 n.3. According to the district court, under Montana law, “in order to enforce the arbitration agreement, UBS must show that Jan explicitly agreed to the arbitration provision and waived her right to access to courts.” E.R. 146. “The ‘goals and policies’ of the FAA,” however, “are antithetical to [such] threshold limitations placed specifically and solely on arbitration provisions.” *Doctor’s Associates*, 517 U.S. at 688. The Montana judiciary, by invoking the state’s common-law authority, cannot accomplish the very result that *Doctor’s Associates* had already rejected: “‘state legislation requiring greater information or choice in the making of agreements to arbitrate than in other contracts is preempted.’” *Id.* at 687 (citation omitted).

Just like the earlier rule in *Doctor’s Associates*, its reincarnation here “directly conflicts with § 2 of the FAA because the State’s law conditions the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally.” 517 U.S. at 687.

2. The Montana rule falls clearly outside the FAA safe harbor for neutral state rules

The Montana Supreme Court attempted to shoehorn its rule into the narrow savings clause in § 2, but that clause hardly saves the rule. As explained above, the FAA is designed to “place arbitration agreements on equal footing with other contracts,” *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 293 (2002) – but not on

avored footing. See *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) (“the purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so”).³ The FAA’s savings provision accordingly preserves state-law rules that apply *neutrally* with respect to arbitration, even if their application might invalidate an agreement that (merely incidentally) contains an arbitration clause.

In this case, however, the Montana rule is hardly neutral, and the invalidation of the arbitration agreement is not merely incidental, but the very point of the rule.⁴ Because *Doctor’s Associates* made unmistakably clear that a direct attack on arbitration fails under the FAA, the Montana Supreme Court decided to implement the identical rule, but this time using an *indirect* approach. Specifically, the court’s “new” rule takes the form of a simple syllogism: (1) a heightened notice requirement applies to any waiver of constitutional rights; (2) Montana recognizes a constitutional right to go to court (as found in the rights to a jury trial

³ This is not to be confused with the different requirement that “any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration” – a necessary prophylactic to ensure that arbitration provisions *are*, in fact, treated neutrally. *Moses H. Cone Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983) (also noting this pro-arbitration presumption applies “whether the problem at hand is the construction of the contract language itself or the allegation of waiver, delay, or a like defense to arbitrability”).

⁴ Nor is there any doubt that this indeed was the intent behind Montana’s rule: Justice Nelson’s concurrence in *Kloss* (joined by all the justices in the majority) expressly gave voice to the very kind of hostility to arbitration that animated the FAA’s enactment. See *supra* at pp. 9-10.

and access to the courts); and, hence, (3) any waiver of the right to “litigate” – including, pointedly, by an arbitration agreement – fails without heightened notice. According to the district court, this syllogism saves the Montana rule: because “Montana has long subscribed to the rule that contractual waivers of constitutional rights” are subject to heightened scrutiny – which purportedly is a “generally applicable” rule – “the FAA does not govern this case.” E.R. 147-48.

The error in the district court’s reasoning, however, is readily apparent: the Montana syllogism, which necessarily depends on *both* of its premises, cannot be justified as arbitration-neutral (as the FAA requires) without reference to *each* premise. But the district court simply began with the first premise – the general reference to “constitutional rights” – and leapt immediately (and incorrectly) to the conclusion that the FAA does not apply. In doing so, the district court said nothing about the syllogism’s *second* premise, which, significantly, is dispositive on this issue. Whether or not the *first* link in the logical chain is purportedly neutral,⁵ the

⁵ That the first premise in the syllogism might be *facially* neutral is a necessary, but not sufficient, condition to pass muster under the FAA (leaving aside, for the moment, the fatal error in the rule’s *facially defective* second premise). If the rule, as applied, targets only arbitration, then it fails notwithstanding its purported neutrality. See, e.g., *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 167 (5th Cir. 2004) (“Even when using doctrines of general applicability, state courts are not permitted to employ those general doctrines in ways that subject arbitration clauses to special scrutiny.”). In this case, it is wholly unclear what *besides* arbitration is covered by this “waiver-of-constitutional-rights” rule (or if any other right, besides arbitration, will ever fall victim to it). Because Montana courts apply the same rule differently depending on whether an

second link is a direct attack on arbitration: the irreducible flip-side of a purported constitutional right to “litigate” (jury trials and access to the courts) is a purported constitutional right “*not to arbitrate*” – the two concepts are wholly synonymous. Consequently, when the district court (following the Montana Supreme Court) speaks of “an explicit waiver of right to access to the courts” (E.R. 148), it is saying exactly the same thing as “an explicit waiver of the right not to arbitrate.” Because such a statement *defines* the act of “singling out arbitration provisions for suspect status,” the second premise is *not* neutral as to arbitration and, therefore, the syllogism cannot withstand FAA preemption. *Doctor’s Associates*, 517 U.S. at 686.⁶

Indeed, other circuits already have rejected similar attempts to circumvent the FAA’s anti-discrimination principle. In *American Gen. Life & Acc. Ins. Co. v. Wood*, 429 F.3d 83 (4th Cir. 2005), for example, the Fourth Circuit rejected an argument that an “arbitration provision unconscionably abrogates [a party’s] state constitutional rights to state judicial forums and trial by jury.” 429 F.3d at 89-90.

arbitration provision is at issue, the rule is wholly pretextual and is *not*, in fact, “generally applied.” See generally Defendant-Appellant’s Opening Brief at 24-40.

⁶ The fact that the rule purportedly enforces state constitutional (as opposed to statutory) rights is irrelevant: the FAA reflects Congress’s judgment that states cannot enact *any* provision of law that sets arbitration agreements on different footing than other contracts. Put simply, had the state constitution provided that “each person shall have a right not to arbitrate,” it plainly would be preempted by the FAA. Yet, as explained above, the critical component of the Montana rule is impossible to distinguish from that hypothetical constitutional right.

“At face value,” the court explained, “Wood’s argument expresses precisely the sort of general antipathy to arbitration already considered and rejected by the Supreme Court and this Circuit.” *Id.* at 90. The Fourth Circuit accordingly held that state law may not “invalidate the Agreement based solely on the fact that it contains an arbitration provision.” *Ibid.* See also *Sydnor v. Conseco Fin. Servicing Corp.*, 252 F.3d 302, 307 (4th Cir. 2001) (rejecting the argument that “the fact that appellees waived their right to a jury trial require[s] the court to evaluate the agreement to arbitrate under a more demanding standard”; “the ‘loss of the right to a jury trial is a necessary and fairly obvious consequence of an agreement to arbitrate’”); accord *Cooper v. MRM Investment Co.*, 367 F.3d 493, 505 (6th Cir. 2004) (same).

3. It is irrelevant that the Montana rule purportedly applies beyond the arbitration context

Even if the Montana rule somehow sweeps in other contractual terms besides arbitration – by refusing, for example, to enforce a different term that waives some other constitutional right – it would still fail. Wholly apart from the very real doubt that this rule burdens anything *but* arbitration, the FAA proscribes any discrimination on the basis of arbitration – even if the state chooses to discriminate against other contract terms as well. First, as a matter of law, the plain text of the FAA’s savings clause limits its application to rules that apply to “*any contract*” (9 U.S.C. § 2) – and a state rule that singles out arbitration (even

while also singling out a few other select terms) hardly applies to “any contract.”

Second, as a logical matter, a rule that discriminates against two or more clauses – vis-à-vis all other clauses – still *discriminates*. In the same way that a state may not justify discrimination on the basis of one protected ground (say, race) because it also discriminates on the basis of some other ground (say, poverty), cf. *Hunter v. Underwood*, 471 U.S. 222, 232 (1985), Montana cannot justify its discriminatory treatment of arbitration by also choosing to disfavor at least one other discrete contractual provision. Finally, as a practical matter, the Montana rule, if allowed to stand, would offer an impermissible backdoor around the FAA’s protections. The Montana rule would always permit a state to disfavor arbitration by simply deciding also to disfavor *one* other contractual provision – while leaving the rest of the contract enforceable according to its terms. If a state may discriminate against arbitration so long as it can identify any single other provision that it also dislikes, the state could readily undermine the FAA’s statutory purpose of placing arbitration provisions ““upon the same footing as other contracts.”” *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974).

* * *

The Montana heightened-notice requirement is a sweeping and indiscriminate attack on arbitration itself. Unlike cases that challenge certain

provisions of an arbitration agreement (but not the propriety of arbitration *per se*),⁷ the new Montana rule impermissibly “singl[es] out arbitration provisions for

⁷ In *Ticknor v. Choice Hotels Int’l, Inc.*, 265 F.3d 931 (9th Cir. 2001), for example, the panel objected to a clause that “allowed [one party] to bring its claims against [the other] into state or federal court, yet forced [the weaker party] to submit all claims to binding arbitration.” 265 F.3d at 940. *Ticknor* accordingly turned on *mutuality*: the problem, according to the panel, was not too much arbitration, but too *little*. More fundamentally, the mutuality rule was applied irrespective of the fact that arbitration was at issue; under the logic of the decision, the same result would have been reached had the non-mutual arbitration clause instead addressed forum selection or choice of law (or any other contractual provision favoring the stronger party over the weaker one). *Ticknor* therefore hardly provides “license to make a ‘full-scale assault’ on arbitration.” *Sydnor*, 252 F.3d at 306. See also, *e.g.*, *Nagrapa v. Mailcoups, Inc.*, 469 F.3d 1257, 1284 (9th Cir. 2006) (en banc) (addressing the purported impropriety of certain arbitration *provisions* – for example, that “it is ‘one-sided,’ contains unconscionable fee-splitting and arbitral forum provisions, and does not counteract the ‘repeat player effect’” – but not questioning the propriety of *arbitration itself*); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1172 (9th Cir. 2003) (rejecting certain terms in an arbitration agreement as “one-sided”); *Ferguson v. Countrywide Credit Indus., Inc.*, 298 F.3d 778, 785 (9th Cir. 2002) (same); *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 894 (9th Cir. 2002) (same); cf. *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 170 (5th Cir. 2004) (“The cases do not necessarily express the impermissible view that arbitration is inferior to litigation, for a choice of remedies is better than being limited to one forum.”). *Amicus* does not necessarily endorse the holdings of these decisions, but cites them only to illustrate (by negative implication) the failings of Montana’s indiscriminate attack on arbitration *per se*. This appeal presents no occasion to comment on the narrower issue whether the FAA does, in fact, allow state law to strike any specific provisions of an otherwise valid arbitration clause. See, *e.g.*, *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 58 (1995) (the FAA ensures that arbitration agreements shall be “enforced according to [their] terms”); cf. also *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 180, 181 (3d Cir. 1999) (“[w]e know of no such doctrine of complete mutuality as a matter of federal law”; “[i]t is of no legal consequence that the arbitration clause gives Green Tree the option to litigate arbitrable issues in court, while requiring the Harrises to invoke arbitration”).

suspect status” (*Doctor’s Associates*, 517 U.S. at 687), in the very same way as did the Montana statute that preceded it. It accordingly is preempted by the FAA.

B. Montana’s Heightened-Notice Requirement May Not Be Sustained On The Alternative (And Likewise Faulty) Grounds Set Forth In *Kloss* And *Willems*

As explained above, the district court’s analysis under the FAA was based entirely on the theory set forth in Justice Nelson’s concurrence in *Kloss*: that “without evidence of an explicit waiver of right to access to the courts, a valid agreement to arbitrate cannot exist.” E.R. 148. Also for reasons explained above, that theory is plainly preempted by the FAA. This section explains why the two alternative theories offered in *Kloss*’s majority opinion (and repeated in part in *Willems*) likewise fail to support the judgment below.

Contracts involving fiduciaries: In finding the arbitration agreement invalidated, the court below cited a fiduciary-duty-based rationale that, according to *Kloss* and *Willems*, fits within § 2’s savings clause. As articulated by the district court, “the Montana Court opined that because the contracts [in *Kloss* and *Willems*] gave defendants discretion to buy and sell in Plaintiffs’ accounts, defendants had a fiduciary duty to explain to plaintiffs that, by agreeing to the arbitration provisions, plaintiffs would be giving up their rights to access to courts, to a jury trial, to reasonable discovery and to appeal.” E.R. 146. Accordingly, under this theory,

where the purported right to go to court is waived, a fiduciary must provide heightened notice “in order to enforce the arbitration agreement.” *Ibid.*

As an initial (and dispositive) matter, this theory simply covers a subset of the heightened-notice rule discussed above. Whereas the district court’s rationale – premised on Justice Nelson’s concurrence – requires *every* party to provide heightened notice when a constitutional right is waived (the first premise of the Montana syllogism, see *supra* at p. 15), the fiduciary-duty rule requires only *fiduciaries* to provide heightened notice when a constitutional right is waived. Because the latter rule is completely subsumed in the former, it inevitably fails for the same reasons. See *supra* at pp. 15-18.

In any event, the fiduciary-duty rule is otherwise deficient on its face. *Amicus* need not challenge the court’s faulty definition of a fiduciary duty (insofar as it even applies on these facts, which it does not, see Opening Brief at 18-20, 36-38). Regardless how *Kloss* and *Willems* define “fiduciary” under state law, they have no power to define a fiduciary’s obligations under *federal* law to enforce a pre-dispute arbitration agreement. On that issue, *Doctor’s Associates* is (again) controlling: because the Montana rule expressly “conditions the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally,” it “directly conflicts with § 2 of the FAA.” 517 U.S. at 687. Even if conditioned on a purported fiduciary relationship, Montana is

not permitted to discriminate between arbitration agreements and all other agreements between a fiduciary and his client.

Moreover, it is notable that the “fiduciary duty” Montana recognizes is premised on a weak form of discretion that just happens to appear in the same standard form agreement, ubiquitous in the securities industry, that uniformly requires arbitration. (Read: there is no obvious such fiduciary duty.) This fact (read together with Justice Nelson’s concurrence) casts serious doubt on any purported “neutrality” of the court’s approach. If the state rule was fashioned (as it appears) with the intent of singling out securities arbitration, then it fails for that reason as well. See, *e.g.*, *Perry*, 482 U.S. at 492 n.9 (permitting state laws that “arose to govern issues concerning the validity, revocability, and enforceability of contracts *generally*,” not those arising to govern arbitration provisions) (emphasis added).

Finally, rather than saving the fiduciary-duty rule, its narrow application (see E.R. 146-47) actually defeats it. This alternative theory applies *not* to “*any* contract,” as the plain language of § 2 requires, but rather only to the narrow subset of contracts involving purported fiduciaries. See, *e.g.*, *Bradley v. Harris Research, Inc.*, 275 F.3d 884, 890 (9th Cir. 2001) (where state law applies “only to forum selection clauses and only to franchise agreements[,] it therefore does not apply to ‘any contract’” and is “preempted by the FAA”). Because this iteration of the rule

is limited, it plainly falls outside the safe harbor in § 2. And for good reason: this “any contract” requirement is a necessary prophylactic to guard against attempts to carve out areas of the law, as here, that are prone to pretextually neutral rules that actually (in operation) disfavor arbitration. Cf., e.g., *Moses H. Cone*, 460 U.S. at 24-25.

Adhesion contracts: *Kloss* also offered an additional theory, not mentioned by the court below, involving contracts of adhesion. According to this theory, an adhesion contract “will not be enforced against the weaker party when it is: (1) not within the reasonable expectations of said party or (2) within the reasonable expectations of the party, but, when considered in its context, is unduly oppressive, unconscionable, or against public policy.” *Kloss*, 54 P.2d at 7.

Like the fiduciary-duty rule above, this rule, too, is inextricably tied to the same analysis that defeats the general heightened-notice requirement. According to the Montana Supreme Court, the very reason that an arbitration provision – absent heightened notice – falls beyond the “reasonable expectations” of a weaker party is because it results in the waiver of “at least two constitutional rights, *i.e.*, a right of access to the courts * * * and [a] right to a jury trial” – in other words, *because it involves arbitration*. *Kloss*, 54 P.3d at 8. This theory is therefore decidedly *not* neutral as to arbitration: a court decision that it is reasonable *not* to expect arbitration is a rule that, by definition, explicitly turns on arbitration. “A

state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the text of § 2].” *Doctor’s Associates*, 517 U.S. at 685.

Furthermore, to the extent the court implied that *any* arbitration clause in an adhesion contract is invalid – on the ground that it is “unduly oppressive, unconscionable, or against public policy” (*Kloss*, 54 P.3d at 7) – the court articulated an express attack on arbitration falling at the very core of FAA preemption: it is precisely these kinds of court-based judgments about the fairness or propriety of arbitration that the FAA was designed to eliminate. See, e.g., *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 30 (1991) (“Such generalized attacks on arbitration ‘res[t] on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants,’ and as such, they are ‘far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.’”). A court may not “rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what * * * the state legislature cannot.” *Doctor’s Associates*, 517 U.S. at 687 n.3 (quoting *Perry*, 482 U.S. at 493 n.9); see also, e.g., *Sydnor*, 252 F.3d at 306 (“[a]rbitration is not inherently unconscionable”); *Koveleskie v. SBC Capital Markets, Inc.*, 167 F.3d 361, 367 (7th Cir. 1999) (“Even

if Illinois law considered pre-dispute arbitration agreements unconscionable, the FAA would preempt such law.”).⁸

C. The Practical Consequences Of The Montana Rule Would Undercut The Effectiveness and Efficiency Of Arbitration Under The FAA

The Montana rule leads precisely to the kind of uncertainty and litigation expense that the FAA (and arbitration itself) is designed to avoid: a duty to provide the equivalent of an oral “*Miranda*” warning invites intractable factual disputes over what was said in a context where the contract’s plain language would otherwise prevail. The rule is hence wrong to “‘breed[] litigation from a statute that seeks to avoid it.’” *Circuit City Stores v. Adams*, 532 U.S. 105, 122-23 (2001). Moreover, the Montana rule inevitably would impose onerous *de facto* record-keeping requirements – such as recording the oral warnings to meet one’s burden of proof – that would add a cost unique to arbitration provisions in a contract. This result itself would violate the FAA. See, e.g., *Southland Corp.*, 465 U.S. at 15-16 (the FAA reflects “Congressional intent to place ‘[a]n arbitration agreement * * * upon the same footing as other contracts, where it belongs’”).

The Montana rule is as impractical as it is unsound. The district court was wrong to endorse a rule that invites even more “dispute[s] in which the parties are

⁸ As noted above, this appeal does not present the different question whether *certain terms* of an *otherwise valid arbitration agreement* are unconscionable. See *supra* at pp. 19-20 & n.7.

litigating whether or not they should be litigating.” *Anders v. Hometown Mortgage Servs., Inc.*, 346 F.3d 1024, 1026 (11th Cir. 2003).

CONCLUSION

The order denying the motion to compel arbitration should be reversed, and this matter should be remanded to the district court with instructions to compel arbitration.

DATE: March 20, 2007

Respectfully submitted,

MUNGER, TOLLES & OLSON LLP

By:



Daniel L. Geyser

*Attorneys for Amicus Curiae
Securities Industry and Financial Markets
Association*

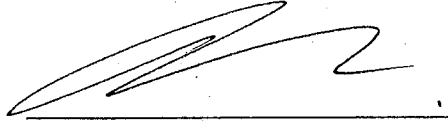
STATEMENT OF RELATED CASES

There are no known related cases pending in this circuit.

CERTIFICATE OF COMPLIANCE

I certify pursuant to Federal Rules of Appellate Procedure 29 and 32 that the attached brief is proportionately spaced, has a typeface of 14 points, and contains 6565 words.

Dated: March 20, 2007

A handwritten signature in black ink, consisting of a series of loops and a final horizontal stroke, positioned above a solid horizontal line.

Daniel L. Geyser

PROOF OF SERVICE BY FEDERAL EXPRESS

I am a citizen of the United States, over 18 years of age, employed in the City of Los Angeles and County of Los Angeles, and not a party to the subject cause. My business address is 355 South Grand Avenue, Suite 3500, Los Angeles, California 90071.

On March 20, 2007, I caused to be served via Federal Express copies of **Brief for the Securities Industry and Financial Markets Association as *Amicus Curiae* in Support of Defendant-Appellant UBS Financial Services Inc.** on the **attached service list**. I also filed the above document with the United States Court of Appeals for the Ninth Circuit by mailing it this day to the Clerk of said Court by Federal Express. *See* Fed. R. App. P. 25(a)(2)(B).

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 20th day of March 2007, at Los Angeles, California.

Robert Massing

SERVICE LIST

Hadachek, et al. v. UBS Financial Services Inc., et al.

C.A. No. 06-35769

(D. Ct. No. CV-06-00017-BLG-RFC)

David L. Charles CROWLEY LAW FIRM 500 Transwestern Plaza II 490 North 31st Street, Suite 500 Billings, MT 59101-1288 (406) 252-3441	Attorneys for Plaintiffs-Appellees James Hadachek, Nancy Hadachek, and Carl Anderson, Jr.; and Plaintiff- Intervenor-Appellee Mary Janice Anderson-Feeley, Estate
Elizabeth A. Phelan Holly Stein Sollod Robert L. Sterup HOLLAND & HART LLP One Boulder Plaza 1800 Broadway, Suite 300 Boulder, CO 80302-5234 (303) 473-2704	Attorneys for Defendant-Appellant UBS Financial Services Inc.
Mark D. Parker Casey Heitz PARKER LAW FIRM 401 North 31st Street, Suite 805 Billings, MT 59103-7212 (406) 245-9991	Attorneys for Defendant William Feeley (not a party to this appeal)
Ira D. Hammerman SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION 1399 New York Avenue, NW Washington, DC 20005-4711 (202) 434-8400	Attorney for <i>Amicus Curiae</i> Securities Industry and Financial Markets Association

