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Supreme Court Rules on Arbitration Waiver Requirements

U.S. Supreme Court Holds That Federal Law Does Not Require a Showing of Prejudice to Waive Right to Arbitrate a Dispute

SUMMARY

The U.S. Supreme Court ruled in *Morgan* v. *Sundance, Inc.*, 596 U.S. ___, 2022 WL 1611788 (May 23, 2022), that in order to find a waiver of a litigant's right to arbitrate, federal law does not require conduct that has prejudiced the other party. In a unanimous opinion authored by Justice Kagan, the Court reversed the Eighth Circuit Court of Appeals and held that it was an error to condition a waiver of the right to arbitrate on a showing of prejudice. The Court held that the Federal Arbitration Act ("FAA") policy favoring arbitration "is about treating arbitration contracts like all others" rather than "fostering arbitration," and therefore does not authorize federal courts to "create arbitration-specific variants of federal procedural rules, like those concerning waiver," or "devise novel rules to favor arbitration over litigation."[1] The Court observed that waiver does not require a showing of prejudice outside the arbitration context, and determined that by directing federal courts to treat arbitration applications "in the manner provided by law," the text of the FAA "makes clear" that "courts are not to create arbitration-specific procedural rules."[2]

The Court's ruling resolved a circuit split on whether waiver of an arbitration right requires a showing of prejudice, as the Seventh and District of Columbia Circuit Courts of Appeals had previously held, contrary to the Eighth Circuit's ruling, that no showing of prejudice was required for waiver.[3] However, the Court expressly declined to decide what, if any, role state law may play in determining whether a litigant's conduct resulted in a waiver of a right to arbitrate.

BACKGROUND

Robyn Morgan was an hourly employee at a Taco Bell franchise restaurant owned by Sundance.[4] Like many employers, Sundance required prospective employees to sign an arbitration agreement as part of its standard employee application process.[5] The agreement read in part: "Taco Bell and I agree to use confidential binding arbitration, instead of going to court, for any claims that arise between me and Taco Bell, its related companies, and/or their current or former employees."[6] The agreement also provided that, without limitation, the claims subject to arbitration "include any concerning compensation, employment . . . or termination of employment."[7]

In spite of that agreement, Morgan filed a nationwide collective action against Sundance in federal court for violations of the Fair Labor Standard Act, seeking to recover wages and overtime pay.[8] Sundance initially defended against the lawsuit by filing a motion to dismiss (which the District Court denied) and engaging in mediation (which was unsuccessful).[9] Then—nearly eight months after Morgan filed the lawsuit—Sundance moved to stay the litigation and compel arbitration under the FAA.[10] Morgan opposed the motion, arguing that Sundance had waived its right to arbitrate.[11]

The district court denied Sundance's motion.[12] Applying Eighth Circuit precedent, the district court held that Sundance had waived its arbitration right because it had acted inconsistently with that right and prejudiced Morgan through its litigation conduct.[13] On appeal, a divided Eighth Circuit panel reversed, ruling that Morgan had not been prejudiced by Sundance's litigation strategy because the parties had not begun discovery or contested any matters on the merits, and that because prejudice is a prerequisite for waiver, Sundance did not waive its contractual right to arbitration.[14]

THE SUPREME COURT'S DECISION

The Court held that under federal law, the waiver of a right to arbitrate a claim does not require a showing of prejudice and that federal courts may not "create arbitration-specific variants of federal procedural rules, like those concerning waiver, based on the FAA's 'policy favoring arbitration.'"[15] The Court observed that outside the arbitration context, a federal court assessing waiver—contractual or otherwise—focuses on the actions of the rights holder and "seldom considers the effects of those actions on the opposing party."[16] The Court noted that the text of the FAA, which provides that any application under the statute shall be "heard in the manner provided by law for the . . . hearing of motions," is "simply a command to apply the usual federal procedural rules," and "the usual federal rule of waiver does not include a prejudice requirement."[17]

The Court further reasoned that although the rule requiring prejudice for arbitration waiver adopted in several circuits was grounded in the FAA policy in favor of arbitration, the policy itself "'is merely an acknowledgment of the FAA's commitment to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate and to place such agreements upon the same footing as other contracts,'" not to

"foster[]" arbitration.[18] The Court held, accordingly, that "a court may not devise novel rules to favor arbitration over litigation," explaining that "[i]f an ordinary procedural rule—whether of waiver or forfeiture or what-have-you—would counsel against enforcement of an arbitration contract, then so be it."[19]

In its decision, the Court expressly declined to address the parties' arguments about the proper role of state law in resolving an inquiry as to the waiver of a contractual right to arbitrate, including state law principles of waiver, forfeiture, estoppel, laches, or procedural fairness.[20] The Court explained that the Courts of Appeals have "generally resolved cases like this one as a matter of federal law, using the terminology of waiver," and in deciding the case, it would "assume without deciding they are right to do so."[21] In vacating and remanding to the Eighth Circuit, the Court directed that on remand, "the Court of Appeals may resolve [the question of waiver without the prejudice requirement]," or "determine that a different procedural framework (such as forfeiture) is appropriate."[22]

IMPLICATIONS

The Court's decision may result in federal courts being more inclined to find that a litigant has waived the contractual right to arbitrate. However, the ruling is limited in that it only addresses whether there is an arbitration-specific waiver rule under the FAA that requires a showing of prejudice. It does not address how a federal court should otherwise determine whether a waiver of the right to arbitrate has occurred. Rather, the Court left for the Eighth Circuit to decide the question of whether Sundance "knowingly relinquish[ed] the right to arbitrate by acting inconsistently with that right," or to determine that some "different procedural framework (such as forfeiture) is appropriate"[23] to resolve the waiver issue. It remains to be seen how the Eighth Circuit will address the question on remand.

In any case, when defending litigation in federal court, litigants with a contractual right to arbitration should carefully consider whether the benefits of invoking the litigation machinery and/or delaying a motion to compel arbitration outweighs the risk of waiver.

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ENDNOTES

[1] *Sundance*, 2022 WL 1611788, at *3-4.

[2] *Id.* at *4.

[3] *See St. Mary's Med. Center of Evansville, Inc.* v. *Disco Aluminum Prods. Co.*, 969 F.2d 585, 590 (7th Cir. 1992); *Nat'l Found. for Cancer Rsch.* v. *A.G. Edwards & Sons, Inc.*, 821 F.2d 772, 774, 777 (D.C. Cir. 1987).

[4] *Sundance*, 2022 WL 1611788, at *1.

[5] *Morgan* v. *Sundance, Inc.*, 2019 WL 5089205, at *1-2 (N.D. Iowa June 28, 2019).

[6] *Id.* at *2.

[7] *Id*.

[8] *Id.* at *1.

[9] *Id.* at *2-3.

[10] *Id.* at *3.

[11] *Id.*

[12] *Id.* at *8.

[13] *Id.* at *5-8.

[14] *Morgan* v. *Sundance, Inc.*, 992 F.3d 711, 715 (8th Cir. 2021).

[15] *Sundance*, 2022 WL 1611788, at *3 (quoting *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

[16] *Id.* at *4.

[17] *Id.* at *4-5.

[18] *Id.* at *4 (quoting *Granite Rock Co.* v. *Teamsters*, 561 U.S. 287, 302 (2010)).

[19] *Id.*

[20] *Id.* at *3.

[21] *Id.*

[22] *Id.* at *5.

[23] *Id.*

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