Legal Update Article

U.S. Supreme Court Holds Waiver of Arbitration Rights Does Not Require Showing of Prejudice

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A party is not required to show prejudice to establish that an opposing party has waived its right to arbitrate by litigating in court, the U.S. Supreme Court has held in a unanimous decision. ***Morgan v. Sundance, Inc.***, No. 21-328 (May 23, 2022).

Although numerous federal courts of appeals have cited the Federal Arbitration Act (FAA) and longstanding federal policy that favors arbitration of disputes to adopt "a rule of waiver specific to the arbitration context" that requires a showing of prejudice, the justices held that the FAA does not authorize this "bespoke rule of waiver for arbitration."

Case History

The case involved a collective action under the Fair Labor Standards Act brought by Robyn Morgan against defendant Sundance, Inc., in the Southern District of Iowa. The court denied Sundance's motion to dismiss or stay Morgan's suit on the grounds that it was duplicative of a similar collective action filed in the Eastern District of Michigan. Sundance then answered Morgan's complaint. Thereafter, the parties agreed to participate in class mediation involving the Michigan plaintiffs and Morgan.

Morgan and Sundance were unable to resolve the matter at mediation and, at that point, nearly eight months after the suit's filing, Sundance filed a motion to compel arbitration pursuant to the parties' arbitration agreement. The district court denied Sundance's motion, finding that Sundance waived the right to compel arbitration by waiting too long to do so, and that Morgan had thereby been prejudiced by the delay. According to the court, Sundance's previous motion practice and participation in mediation were inconsistent with an intent to exercise the right to arbitrate. *Morgan v. Sundance, Inc.*, No. 4:18-cv-316, 2019 U.S. Dist. LEXIS 178422 (S.D. Iowa June 28, 2019).

Sundance appealed and a divided U.S. Court of Appeals for the Eighth Circuit panel reversed. *Morgan v. Sundance, Inc.*, 992 F.3d 711 (8th Cir. 2021). The Eighth Circuit majority observed that four of the eight months of delay were not spent actively litigating the case, but waiting for the court to rule on the defendant's motion to dismiss. Moreover, the motion practice initiated by Sundance, the Eighth Circuit ruled, was jurisdictional rather than merits-based and, along with its engagement in mediation, demonstrated efforts to avoid litigation that were consistent with the right to compel arbitration. According to the Eighth Circuit, instead of focusing on Sundance's delay in asserting its right to arbitrate, the lower court should have considered the *nature* of the motion to dismiss: Sundance's motion focused on the duplicative nature of the case with another case pending in the Eastern District of Michigan, so the parties spent no time litigating the substantive merits of the case. Because no discovery was conducted, and there was no other evidence Morgan would have to duplicate her efforts during arbitration, the Eighth Circuit found Morgan was not prejudiced by Sundance's litigation strategy.

Circuit Split on Prejudice Requirement

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Under general federal waiver law, a party waives a contractual right when it is aware of the existence of that right and acts inconsistently with it. The question of prejudice is not considered in this analysis. In the context of arbitration, however, circuits have stressed the FAA's policy favoring arbitration to require the party claiming waiver to show it has been prejudiced by the other party's delay in enforcing an arbitration agreement.

In its decision, the Eighth Circuit joined eight other circuits and applied an arbitration-specific procedural rule requiring the party asserting waiver to show that the waiving party's inconsistent acts caused prejudice. Two other circuits do not require proof of prejudice to establish waiver of the right to arbitrate.

Justices: No Prejudice Showing Required

In an opinion authored by Justice Elena Kagan, the U.S. Supreme Court held that it was error for the Eighth Circuit to create an arbitration-specific procedural rule conditioning "a waiver of the right to arbitrate on a showing of prejudice." The Court found that it has long held that arbitration agreements must be "on an equal footing" with other contracts (see *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011)), and requiring an additional step to show a party waived the right to compel arbitration is inconsistent with that principle. In fact, Section 6 of the FAA disavows such arbitration-specific rules.

The U.S. Supreme Court vacated the Eighth Circuit's order and remanded the case back to the district court to consider whether, regardless of prejudice, Sundance knowingly relinquished the right to arbitrate by acting inconsistently with that right.

Takeaway

The U.S. Supreme Court clarified that the "liberal policy favoring arbitration" does not allow courts to create arbitration-specific variants of federal procedural rules, like those concerning waiver, in considering a party's right to arbitrate. Whether state courts would apply this standard is unclear. As a practical matter, the Court's finding that a showing of prejudice is unnecessary when evaluating waiver in the context of an arbitration agreement means that employers will need to promptly assert their right to arbitrate under the terms of an agreement in the event of court litigation, or otherwise take steps to avoid a known relinquishment of that right.

Please contact a Jackson Lewis attorney with any questions about this case, the FAA, or arbitration agreements.