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SCOTUS displays short memory in rejecting the prejudice requirement for waivers of the right to arbitrate

by James F. Bogan III , C. Allen Garrett Jr.

Takeaway: In *Morgan v. Sundance, Inc.*, --- S. Ct. ----, No. 21-328, 2022 WL 1611788 (May 23, 2022), the Supreme Court rejected the arbitration-specific rule requiring a finding of prejudice for a waiver of the right to arbitrate – a rule long in place in most circuits to promote the pro-arbitration policy of the Federal Arbitration Act (FAA) – on the ground that an arbitration contract should be treated like any other contract. The *Morgan* decision, while seemingly straightforward, ignores a number of Supreme Court decisions that do ***not*** treat arbitration contracts like ordinary contracts, but instead have imposed arbitration-specific rules of contract interpretation favoring arbitration.

In *Morgan*, an hourly Taco Bell employee (Robyn Morgan) had signed an agreement with restaurant owner Sundance, Inc., to arbitrate any employment disputes when she applied for the job. She later filed a collective action in federal court under the Fair Labor Standards Act, alleging that Sundance engaged in a scheme to deny Taco Bell employees overtime pay.

Instead of seeking to compel arbitration, Sundance moved to dismiss the suit as duplicative of a parallel action filed by other Taco Bell employees. The district court denied that motion. Sundance then filed an answer to Ms. Morgan's complaint, asserting a number of affirmative defenses but none based on the arbitration agreement. Soon thereafter, the parties in both collective actions (including Ms. Morgan) participated in a joint mediation. The other collective action settled but Ms. Morgan's suit did not. Sundance and Ms. Morgan then began discussing a schedule for rest of the litigation.

Only at this time – almost eight months after Ms. Morgan filed her action – did Sundance move to stay the litigation and compel arbitration. In resolving that motion, the district court applied the Eighth Circuit's test, which provided that "a party waives its contractual right to arbitration if it knew of the right; 'acted inconsistently with that right'; and – critical here – 'prejudiced the other party by its inconsistent actions.'" 2022 WL 1611788, at *3 (quoting *Erdman Co. v. Phoenix Land & Acquisition, LLC*, 650 F.3d 1115, 1117 (8th Cir. 2011)).

The Southern District of Iowa found prejudice and denied Sundance's motion. *Id.* On appeal, the Eighth Circuit disagreed and ruled that the case should be arbitrated, reasoning that formal discovery had yet to be initiated and that the parties had yet to contest the merits of the case. Judge Colloton dissented, concluding that Sundance's actions forced Ms. Morgan to oppose an unnecessary motion to dismiss and to participate in an unsuccessful mediation. *See Morgan v. Sundance, Inc.*, 992 F.3d 711, 715 (8th Cir. 2021) (Colloton, J., dissenting). He further questioned the Eighth Circuit's prejudice requirement, observing that "'[o]utside the arbitration context, … prejudice is not needed for waiver.'" *Id*. at 716 (citations omitted).

The Supreme Court granted certiorari to resolve a circuit split, with nine circuits (including the Eighth) requiring prejudice to facilitate the FAA's pro-arbitration policy, while two circuits – consistent with waiver law outside the arbitration context – had rejected the prejudice requirement. 2022 WL 1611789, at *3 & nn.1-2. Siding with the minority view, the Supreme Court, in an opinion authored by Justice Kagan, jettisoned the prejudice requirement.

The parties debated the role state law should play in resolving the waiver issue, and also whether to evaluate the issue in terms of "waiver, forfeiture, estoppel, laches, or procedural timeliness." *Id*. at *3. Observing that the federal courts "have generally resolved cases like this one as a matter of federal law, using the terminology of waiver," the court "assume[d] without deciding they are right to do so." *Id*. The court considered the sole issue of whether federal courts "may create arbitration-specific variants of federal procedural rules, like those concerning waiver, based on the FAA's 'policy favoring arbitration.'" *Id*. (quoting *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

Justice Kagan first observed that, as a general matter, waiver "is the intentional relinquishment or abandonment of a known right." *Id*. at *4 (quoting *United States v. Olano*, 507 U.S. 725, 733 (1993)). Outside the arbitration context, "the court focuses on the actions of the person who held the right; the court seldom considers the effects of those actions on the opposing party." *Id*. The prejudice requirement, the court said, was nothing more than "a bespoke rule of waiver for arbitration." *Id*.

Reviewing the history of the prejudice requirement, Justice Kagan traced the requirement back to a 1968 arbitration decision by the Second Circuit (*Carcich v. Rederi A/B Nordie*, 389 F.2d 692, 696 (2nd Cir. 1968)), noting that the Second Circuit's reasoning had since "spread" over the years to most of the other circuits. *Id*.

But the FAA's pro-arbitration policy, Justice Kagan explained, "does not authorize federal courts to invent special, arbitration-preferring procedural rules." *Id*. The reason, according to Justice Kagan, is that an arbitration contract is like any other contract:

- "The policy is to make 'arbitration agreements as enforceable as other contracts, but not more so.'" *Id*. (quoting *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, n. 12 (1967)).
- "Accordingly, a court must hold a party to its arbitration contract just as the court would to any other kind. But a court may not devise novel rules to favor arbitration over litigation." *Id*.
- "If 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. The federal policy is about treating arbitration contracts like all others, not about fostering arbitration." *Id*.

Justice Kagan then cited Section 6 of the FAA to support her rejection of the prejudice requirement. Section 6 requires that any motion filed under the FAA "shall be made and heard in the manner provided by law for the making and hearing of motions." *Id*. According to Justice Kagan, Section 6's directive to resolve motions "in the manner provided by law" "is simply a command to apply the usual federal procedural rules, including any rules relating to a motion's timeliness. Or put conversely, it is a bar on using custom-made rules, to tilt the playing field in favor of (or against) arbitration." *Id*.

Accordingly, the court held that a finding of prejudice is not an element of arbitration waiver, remanding the case to the Eighth Circuit to evaluate the issue "[s]tripped of its prejudice requirement" and to resolve the simple issue of whether "Sundance . . . knowingly relinquish[ed] the right to arbitrate by acting inconsistently with that right?" *Id*. at *5.

This seemingly straightforward decision raises a number of issues that suggest it may have a far broader impact on arbitration law generally.

First, Justice Kagan repeatedly referred to the waiver issue as "an arbitration-specific *procedural* rule." *See, e.g.*, *id*. at *2 (emphasis added). But where one party claims waiver based on the other parties' conduct (as opposed to claiming waiver based on a violation of a rule of procedure), the waiver issue would appear to constitute a *substantive* – rather than procedural – rule concerning the loss of a contractual right to arbitrate. Indeed, Judge Colloton's dissent to the Eighth Circuit's decision below ultimately cited two substantive contract law treatises for the proposition that "'in ordinary contract law, a waiver normally is effective without proof of consideration or detrimental reliance.'" 992 F.3d at 716 (quoting *Cabinetree v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 390 (7th Cir. 1995) (citing E. Allan Farnsworth, *Contracts* § 8.5 (2d ed. 1990)), and citing 3A Arthur Linton Corbin, *Corbin on Contracts* § 753 (1960)).

Second, and more importantly, Justice Kagan's characterization of an arbitration agreement as being no different from any other contract ignores a number of Supreme Court decisions, including decisions as recent as *Lamps Plus, Inc. v. Varella*, 139 S. Ct. 1407 (2019). There, the court ruled that a party cannot be required to participate in a class arbitration unless the parties' arbitration agreement *explicitly authorizes* class arbitration. Indeed, the *Lamps Plus* court announced a new federal default rule for arbitration contracts displacing the "neutral" state contract rule of *contra proferentem*, stating: "[T]he FAA provides the default rule for resolving ambiguity here, …" *Id*. at 1418.

Borrowing the words of Justice Kagan, the *Lamps Plus* rule properly can be labeled a "bespoke" rule of contract interpretation for arbitration. And the *Lamps Plus* rule was preceded by other "bespoke" arbitration rules. The Supreme Court has long ruled ambiguities concerning the scope of an arbitration agreement must to be resolved in favor of arbitration. And the Court repeatedly has held courts must decide "gateway" issues of arbitrability, unless the parties "clearly and unmistakably" assign those issues to the arbitrator. *See id.* at 1416-17 (discussing presumption that parties "have *not* authorized arbitrators to resolve certain 'gateway' questions, such as 'whether the parties have a valid arbitration agreement at all or whether a concededly binding arbitration clause applies to a certain type of controversy"). Both of these unique federal rules of arbitration contract interpretation reflect the pro-arbitration policies underpinning the FAA.

Moreover, even if the specific articulation of the "prejudice" requirement can be traced to the Second Circuit's 1968 *Carcich* decision, the Supreme Court itself categorically has ruled that, "as a matter of federal law, any doubts concerning the scope of arbitrability issues should be resolved in favor of arbitrability, whether the problem at hand is the construction of the contract language itself or an allegation of *waiver*, delay, or a like defense to arbitrability." *Moses H. Cone*, 460 U.S. at 24-25 (emphasis added). Although *Morgan* cited to this exact portion of the opinion in *Moses H. Cone*, it made no effort to reconcile its ruling to the Supreme Court's 1983 decision expressly holding "waiver" to be subject to the presumption favoring arbitration, despite the fact that at least three of the Court of Appeals decisions cited in *Morgan* as recognizing the prejudice requirement themselves relied on *Moses H. Cone*'s treatment of "waiver" as an issue subject to the federal presumption favoring arbitration. *See* 2022 WL 1611788, at *3 n.1 (citing, *inter alia*, *Joca-Roca Real Estate, LLC v. Brennan*, 772 F.3d 945, 948 (1st Cir. 2014), *PaineWebber Inc. v. Faragalli*, 61 F.3d 1063, 1068-69 (3d Cir. 1995), and *Miller Brewing Co. v. Fort*

Worth Distrib. Co., 781 F.3d 494, 497 (5th Cir. 1986)).

Finally, Justice Kagan's reliance on the plain-vanilla language of Section 6 of the FAA – "in the manner provided by law" – does not resolve these questions. If Section 6 truly means what *Morgan* says it means, then there should be no basis for the "bespoke" rules of contract interpretation announced in the *Lamps Plus*, *Moses H. Cone*, and numerous other Supreme Court decisions.

On its face, the *Morgan* decision appears to constitute an increasingly rare unanimous Supreme Court decision addressing a highly-specific aspect of federal arbitration law. But the central premises of its reasoning – particularly the unexplained treatment of waiver as a federal "procedural" rule – as well as the failure to address *Moses H. Cone*'s seemingly directly contrary ruling that the federal presumption in favor of arbitration applies to "waiver," suggest that *Morgan* ultimately may generate more questions than it answers.