

Locke Lord QuickStudy: Supreme Court Clarifies Arbitration Waiver Test

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The United States Supreme Court's recent decision in *Morgan v. Sundance* eliminates a longstanding rule requiring a plaintiff to establish they would be prejudiced by arbitration to prevail when arguing that a defendant waived their right to arbitration by proceeding initially in civil court litigation. The Court's decision should cause defendants to change their litigation strategy where a mandatory arbitration agreement is involved.

Background

In *Morgan*, the plaintiff brought a nationwide collective action against her employer, a fast food franchisee, in federal court claiming the company violated the Fair Labor Standards Act by failing to properly pay overtime. At the outset of her employment, the plaintiff signed an agreement requiring her to pursue any employment claims through arbitration rather than the courts. However, the defendant did not seek initially to compel arbitration in the court proceeding.

Instead, the defendant asked the district court to dismiss the action. When that failed, it answered the complaint and raised several affirmative defenses. Notably, the defendant did not raise the mandatory arbitration agreement as an affirmative defense. The parties then attempted to mediate their dispute, but were unsuccessful.

Only after all of these steps—nearly eight months after the inception of litigation—did the defendant seek to enforce the arbitration agreement. The district court ruled in the plaintiff's favor, concluding that the defendant waived its contractual right to arbitration. The United States Court of Appeals for the Eighth Circuit disagreed, sending the case to arbitration. The courts' disagreement stemmed from the issue of whether a plaintiff must show prejudice to prevail on the arbitration waiver analysis.

Arbitration Waiver Analysis

The arbitration waiver analysis at issue in *Morgan* was used by nine of the country's twelve circuit courts of appeal. Specifically, this analysis was employed by the First, Second, Third, Fourth, Fifth, Sixth, Eighth, Ninth, and Eleventh Circuits. Under that analysis, a party waived its contractual right to arbitration only if it:

1. Knew of that right;
2. Acted inconsistently with that right; and

3. Prejudiced the other party by its inconsistent actions.

The prejudice element was adopted as a result of “the strong federal policy favoring arbitration” established by the Federal Arbitration Act (“FAA”). Notably, this analysis differs from that employed by federal courts in most other contractual waiver cases (i.e., whether a party intentionally relinquished or abandoned a known right).

The Court’s Decision

In *Morgan*, the Supreme Court considered whether federal courts may adopt an arbitration-specific waiver rule requiring a showing of prejudice.

While acknowledging the “strong federal policy favoring arbitration,” the Court noted that the FAA does not permit federal courts to establish special procedural rules giving preference to arbitration. Instead, arbitration contracts should be treated the same as other contracts. Accordingly, when considering whether a defendant has waived its contractual right to arbitration, federal courts should consider the action of that party, not the effects on the plaintiff.

Practical Implications

In light of *Morgan*, defendants should be cautious about litigating in court matters that may be subject to an arbitration agreement. Federal courts will no longer require a plaintiff to establish prejudice when asserting that a defendant waived its right to compel arbitration by participating in the litigation in court. Rather, federal courts will more likely find the defendant waived their right to arbitration by such actions. To avoid this conclusion, defendants should invoke their arbitration rights as early as possible in the course of litigation.

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