# U.S. SUPREME COURT TO ADDRESS PREJUDICE REQUIREMENT FOR WAIVER OF ARBITRATION AGREEMENTS

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**U.S. Litigation and Dispute Resolution Alert**

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Agreements to submit disputes to arbitration are commonplace, with parties attempting to avoid the time, cost, and publicity involved in litigating disputes in court. To facilitate these aims, the Federal Arbitration Act (the FAA) embodies a "federal policy favoring arbitration" and requires that "arbitration agreements [be placed] on an equal footing with other contracts."[1] In keeping with those principles, the FAA provides that arbitration agreements may be unenforceable on the same "grounds as exist... for the revocation of any contract."[2] Courts, however, have diverged on the grounds upon which a party can waive its right to arbitrate under an arbitration agreement. Some courts maintain the same standard for waiver of an arbitration agreement as for other contracts, requiring only the intentional relinquishment of a known right. Other courts graft on an additional requirement that the relinquishment of that right cause prejudice before amounting to waiver. The Supreme Court has granted certiorari to resolve this split in the current term, in *Morgan v. Sundance, Inc.*,[3] and is set to hear argument in the case 21 March 2022.

## FACTUAL BACKGROUND AND PROCEDURAL HISTORY OF *MORGAN*

From August to October 2015, Robyn Morgan worked at a Taco Bell franchise owned and operated by Sundance, Inc. (Sundance) in Osceola, Iowa. At the outset of her employment, Morgan signed an application for employment that contained a mandatory arbitration provision, which required arbitration of all disputes. During Morgan's employment, Sundance allegedly employed a method known as "hours shifting," whereby it ensured that no employee logged more than 40 hours in any given week, regardless of the number of hours the employee actually worked.[4] Morgan further alleged that Sundance instructed employees to clock out, but continue working. Using both methods, Morgan alleged that Sundance prevented employees at its more than 150 Taco Bell franchises from ever collecting overtime pay for hours actually worked.

In September 2018, Morgan filed a nationwide class action against Sundance in the U.S. District Court for the Southern District of Iowa, alleging that Sundance's practices violated the Fair Labor Standards Act (FLSA). Morgan's lawsuit mirrored a two-year-old class action, *Wood v. Sundance, Inc.*,[5] filed against Sundance in the Eastern District of Michigan, asserting FLSA claims based on the same practices. Sundance moved to dismiss or stay Morgan's lawsuit as duplicative of *Wood*, but made no mention of Morgan's agreement to submit disputes to arbitration.[6] The court denied Sundance's motion and Sundance filed an answer asserting 14 affirmative defenses which, again, made no mention of the agreement to arbitrate.

In April 2019, Morgan and the *Wood* plaintiffs met with Sundance for a joint mediation, prior to which Sundance provided Morgan with discovery including payroll data for class members and thousands of pages of emails from

Sundance's management. The mediation resulted in the settlement of the *Wood* claims, but not of Morgan's claims. On 3 May 2019, six months after filings its motion to dismiss, Sundance invoked the arbitration provision in Morgan's application for employment and moved to compel arbitration of her FLSA claims.

Morgan opposed Sundance's bid to compel arbitration, arguing that Sundance had waived its right to compel arbitration by engaging in litigation with Morgan. Applying Eighth Circuit precedent,[7] the court determined that Sundance had waived its right to compel arbitration because: 1) it had known of the right to arbitrate Morgan's claim; 2) it had acted inconsistently with that right by waiting eight months to assert its right to arbitrate and failing to mention its right to arbitrate in its motion to dismiss, answer, or in discussions with Morgan's counsel; and 3) Morgan had been prejudiced by Sundance's actions because she was forced to defend a motion to dismiss and prepare for class-wide mediation instead of individual arbitration.

On appeal, a divided Eighth Circuit panel reversed, ruling that Sundance had not waived its right to compel arbitration. The majority's decision turned on whether Morgan had shown prejudice as a result of Sundance's action, which the court concluded she had not.[8] The dissent noted that prejudice was a "debatable prerequisite" for finding waiver of an arbitration agreement, but that even if it was required, Morgan had shown prejudice through her "waste [of] time and money engaging in a fruitless mediation based on an inaccurate premise that the case would be litigated in federal court."[9]

## TRADITIONAL WAIVER STANDARD

Waiver of a right is a widely recognized principle, with implications in myriad areas of law, including, as relevant here, contractual rights. Parties can waive contractual rights "either explicitly or through an implicit course of conduct."[10] Under the law in most states, courts generally focus on only the actions of the waiving party to decide whether that party waived its contractual right. Specifically, the inquiry focuses on whether the waiving party knew of the allegedly waived right, and acted in a manner inconsistent with that right.[11]

In "ordinary" cases outside of the arbitration agreement context, courts differentiate between waiver and estoppel.[12] Unlike the above-detailed approach to waiver, in analyzing estoppel, courts generally require a showing of prejudice or detrimental reliance.[13]

## WAIVER IN THE CONTEXT OF ARBITRATION AGREEMENTS

Despite the traditional approach to waiver outlined above, only two Circuit Courts of Appeals use that approach in cases involving arbitration agreements, the Seventh and D.C. Circuits. Those courts do not require prejudice as a necessary element of waiver of an arbitration agreement.[14] The Tenth Circuit takes a similar approach, proclaiming that prejudice is not necessary to find waiver, but is a relevant factor for consideration in determining whether waiver is present.[15] On the other hand, the First, Second, Third, Fourth, Fifth, Sixth, Eighth, Ninth, and Eleventh Circuits all graft on the additional requirement of showing prejudice to find waiver of an arbitration agreement.[16]

## POTENTIAL IMPLICATIONS OF *MORGAN*

While it remains to be seen how the U.S. Supreme Court will address the issues in *Morgan v. Sundance, Inc.*, a decision from the Supreme Court on this issue will likely clarify and standardize the elements of waiver across the circuits. Regardless of how the Supreme Court decides the issue, the decision will have implications for

contracting entities trying to enforce or avoid arbitration agreements in domestic arbitrations, as well as international arbitrations seated in the United States.

If the Supreme Court sides with the majority view that prejudice is required to find waiver of an arbitration agreement, the Supreme Court will have effectively strengthened agreements to arbitrate, and arguably placed such agreements above other contracts. For parties bound by arbitration agreements, such a ruling would allow a situation like *Morgan* to repeat itself---where a plaintiff is forced to spend time and money to take discovery and participate in early motion practice, only to be forced into arbitration later.

If the Supreme Court bucks the majority position and finds that prejudice is not required to show waiver, parties seeking to enforce an arbitration agreement will have to be more diligent to preserve that right and assert it as soon as possible. Otherwise, a delay in asserting the right to arbitrate may lead to waiver, regardless of the impact of that delay. Furthermore, eliminating prejudice as an element of waiver would do away with the litigation strategy of attempting to defeat claims on a motion to dismiss, and then moving to compel arbitration if the motion to dismiss is unsuccessful.

K&L Gates will continue to monitor the Supreme Court consideration of, and eventual decision in, *Morgan v. Sundance, Inc.* and stands ready to assist clients in navigating disputes involving arbitration agreements post-*Morgan.*

## FOOTNOTES

[1] *See* AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 339 (2011) (internal quotations and citations omitted).

[2] 9 U.S.C. § 2.

[3] Morgan v. Sundance, Inc., 992 F.3d 711, 715 (8th Cir. 2021), *cert. granted*, 142 S. Ct. 482 (2021).

[4] Morgan alleges that Sundance shifted “hours that employees worked in one week and record[ed] them for the following week so that the total number of recorded hours in any given week would never exceed 40.” Brief for Petitioner at 8, Morgan v. Sundance, Inc., No. 21-328 (Dec. 30, 2021). Morgan's brief further alleges that “[e]mployees who regularly worked more than 40 hours per week—and whose overtime hours therefore could not be 'shifted'—were simply never paid, at any rate, for all the hours they worked.” *Id*.

[5] Wood v. Sundance, Inc., No. 2:16-cv-13598 (E.D. Mich. June 21, 2017).

[6] On the contrary, Sundance represented in its initial motion to dismiss or stay that Morgan could “refile her claim on an individual basis before this Court” if her class action claims were dismissed. Memo. of Law in Support of Motion to Dismiss, Morgan v. Sundance, Inc., 2019 WL 5089208, No. 4:18-cv-00316 (S.D. Iowa Mar. 5, 2019), ECF No. 9-1.

[7] As discussed below, the Eighth Circuit is one of nine circuit courts that has held that showing prejudice is required to find waiver of an agreement to arbitrate. See McCoy v. Walmart, Inc., 13 F.4th 702, 704 (8th Cir. 2021).

[8] *Morgan*, 992 F.3d at 715.

[9] *Id*. at 716–17 (Colloton, J., dissenting).

 

[10] *See, e.g.*, Toddle Inn Franchising, LLC v. KPJ Assocs., LLC, 8 F.4th 56, 64 (1st Cir. 2021).

[11] *See, e.g.*, Moon v. Bd. of Trs. of PAMCAH-UA Loc. 675 Pension Fund, 319 F. Supp. 3d 1193, 1196 (N.D. Cal. 2018).

[12] *See, e.g., In re* Ferry, 631 B.R. 790, 800–02 (Bankr. M.D. Fla. 2021) (distinguishing waiver and estoppel under Florida law and noting estoppel requires "a change in position detrimental to the party claiming estoppel"); *compare* Griffin v. Coca-Cola Refreshments USA, Inc., 989 F.3d 923, 935 (11th Cir. 2021) ("Waiver is the voluntary, intentional relinquishment of a known right."), *with* Zoroastrian Ctr. & Darb-E-Mehr of Metro. Wash., D.C. v. Rustam Guiv Found. of N.Y., 822 F.3d 739, 753 (4th Cir. 2016) ("[E]stoppel . . . [requires] '(1) a representation, (2) reliance, (3) change of position, and (4) detriment.'").

[13] *See, e.g.*, La. Pub. Serv. Comm'n v. FERC, 20 F.4th 1, 9 (D.C. Cir. 2021); Dowden, Tr. of Est. of Hugh Dana Huchingson v. Cornerstone Nat'l Ins. Co., 11 F.4th 866, 876 (8th Cir. 2021); Sosa v. Onfido, Inc., 8 F.4th 631, 641 (7th Cir. 2021).

[14] Smith v. GC Servs. Ltd. P'ship, 907 F.3d 495, 499 (7th Cir. 2018) (finding prejudice not required to constitute waiver); Khan v. Parsons Glob. Servs., Ltd., 521 F.3d 421, 425 (D.C. Cir. 2008) (same).

[15] Hill v. Ricoh Ams. Corp., 603 F.3d 766, 772 (10th Cir. 2010).

[16] *McCoy*, 13 F.4th at 704 (listing prejudice as a required element to find waiver); *Toddle Inn Franchising, LLC*, 8 F.4th at 64 (same); Int'l Energy Ventures Mgmt., LLC v. United Energy Grp., Ltd., 999 F.3d 257, 266 (5th Cir. 2021); Solo v. United Parcel Serv. Co., 947 F.3d 968, 975 (6th Cir. 2020) (same); Newirth ex rel. Newirth v. Aegis Senior Cmtys, LLC, 931 F.3d 935, 940 (9th Cir. 2019) (same); Freeman v. SmartPay Leasing, LLC, 771 F. App'x 926, 932 (11th Cir. 2019) (same); Gray Holdco, Inc. v. Cassady, 654 F.3d 444, 451 (3d Cir. 2011) (same); La. Stadium & Expo. Dist. v. Merrill Lynch, Pierce, Fenner & Smith Inc., 626 F.3d 156, 159 (2d Cir. 2010) (same); Forrester v. Penn Lyon Homes, Inc., 553 F.3d 340, 343 (4th Cir. 2009) (same).

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