

U.S. Supreme Court cracks down on late arbitration demands

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Does your company require employees to sign agreements to arbitrate any disputes arising from their employment contracts? Then a recent U.S. Supreme Court case serves as a cautionary tale for those of you looking to enforce agreements. The lesson is to demand arbitration as early as possible or else risk waiving the right if you try to do so later down the road.

Facts

The U.S. Supreme Court recently weighed in on the correct test to apply when deciding whether a party has waived the right to arbitrate. In the case, Robyn Morgan was an hourly employee at a Taco Bell owned by Sundance, Inc. She later filed a nationwide collective action suit against the company alleging wage and hour violations.

In the employment contract, Morgan signed an agreement to arbitrate any employment disputes. Sundance, Inc., nevertheless litigated the case in federal court for several months, making requests to dismiss, answering the complaint, and attending mediation before ultimately asking the court to compel arbitration under the Federal Arbitration Act (FAA). The issue for the Supreme Court was whether the employer had waived the right to arbitrate the matter.

8th Circuit's ruling

The case comes from the U.S. 8th Circuit Court of Appeals, where a party waives arbitration

rights if it (1) had knowledge of the right, (2) acted inconsistently with the right, and (3) prejudiced (or harmed) the other party with the inconsistent actions. Some circuit courts have adopted a similar rule, but others have rejected the prejudice requirement. The 8th Circuit reasoned the FAA's federal policy favoring arbitration supported a "prejudice" requirement for waivers.

Applying that framework, the district court found the prejudice requirement satisfied and denied Sundance's request to compel arbitration. The 8th Circuit reversed, however, finding no prejudice to Morgan because no discovery (or pretrial fact-finding) had occurred and no matters going to the claim's merits had been decided. The Supreme Court agreed to resolve the circuit split on the issue.

Supreme Court reverses

In a unanimous opinion, the Supreme Court held the 8th Circuit had erred in conditioning a waiver of the right to arbitrate on prejudice to the other party.

The Court further held that courts shouldn't create arbitration-specific federal procedural rules because of the general policy favoring arbitration. *Morgan v. Sundance, Inc.*, U.S. Supreme Court, May 23, 2022.

Bottom line

The *Morgan* holding effectively ends the prejudice requirement for waiving the right to arbitrate. That is, if a party has knowledge of

the right to arbitrate and acts inconsistently with it, they waive the right. Thus, if you try to compel arbitration after litigating the case in court, you run the substantial risk of forfeiting your right to arbitrate unless you can prove lack of knowledge (a difficult task for employers).

The takeaway is to make sure to demand arbitration early on in the litigation because it will be very difficult to compel the process later down the road without the ability to argue a lack of prejudice to the opposing party.

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