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How Not to Waive Your Right to Arbitrate

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If your company includes arbitration clauses in its contracts with customers or employees, then a recent U.S. Supreme Court decision provides a how-to course on enforcing your arbitration rights.

For a Supreme Court that often cannot agree on what day of the week it is, a unanimous 9-0 decision in Morgan v. Sundance, Inc. provided absolute certainty on one narrow issue and one broader issue.

The narrow lesson: A party to an arbitration agreement needs to invoke its right to arbitrate immediately when a dispute arises, rather than participating in litigation in court and later trying to enforce the arbitration clause.

The broader lesson: The Federal Arbitration Act requires courts to enforce arbitration clauses the same way that courts enforce any other contract clause, but does not actually favor arbitration by letting courts apply rules that make arbitration clauses more enforceable than other types of contract clauses.

Background

Sundance, Inc., operates Taco Bell franchises and required employees to arbitrate certain employment-related disputes. Plaintiff Robyn Morgan signed the arbitration agreement included in her employment application, but later filed a federal class action lawsuit alleging that the company did not pay employees for all overtime they worked.

Rather than immediately moving to dismiss the lawsuit and compel arbitration, Sundance first filed an unsuccessful motion to dismiss on grounds unrelated to compelling arbitration. It then filed an answer in court, without even mentioning the arbitration agreement. Sundance only moved to stay the lawsuit and compel arbitration after seven months of litigating in court.

Morgan argued that Sundance had waived its right to arbitrate by litigating in court for months. Both the trial court and the U.S. Court of Appeals for the Eighth Circuit applied the test that the Eighth Circuit had previously adopted for when a party waives its right to arbitrate. That test required both a showing that the party invoking arbitration had acted inconsistently with that right, and evidence that the other party had suffered prejudice as a result. The trial court held that Morgan had suffered prejudice, but the Eighth Circuit disagreed, holding that Sundance could still require arbitration

because the parties had not yet started discovery in the litigation or contested any matters on the merits, so no prejudice to Morgan had occurred.

The Supreme Court's Decision

But the Supreme Court reversed, holding that Sundance had waived its right to arbitration, and that the Eighth Circuit's arbitration waiver test put the prejudice shoe on the wrong foot: a determination about whether a party trying to invoke arbitration clauses has waived its contractual right to arbitrate must focus on the conduct of the party invoking the arbitration clause, not on the prejudice that the other party suffers as a result. Why? Because the Federal Arbitration Act requires courts to enforce arbitration clauses the same way as other contract clauses, but does not say that courts should actually favor arbitration. In fact, the Act contains no requirement that the conduct of the party trying to mandate arbitration resulted in prejudice to the opposing party.

Notably, every federal appellate court except the U.S. Courts of Appeals for the Seventh Circuit in Chicago and for the District of Columbia had also adopted the same (now incorrect) test as the Eighth Circuit used for determining if a party had waived their arbitration rights.

Lessons learned: 1) if your company wants to take advantage of the potential savings of time and money that arbitration offers over litigation, then don't wait to invoke your arbitration rights; and 2) the Federal Arbitration Act doesn't let courts favor arbitration over litigation – it requires that courts make arbitration clauses just as enforceable as any other contract clause.

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