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Supreme Court Holds that Courts May Not Create Arbitration-Specific Procedural Rules Favoring Arbitration

On May 23, 2022, the Supreme Court unanimously held in *Morgan v. Sundance* that arbitration-specific procedural rules are incompatible with the Federal Arbitration Act (FAA), even when those rules purport to further the FAA's federal policy favoring arbitration.

Background

The question at issue in *Morgan* is whether courts may invoke arbitration-specific rules when those rules favor arbitration. The Supreme Court has described the FAA as embodying a federal "policy favoring arbitration." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983). Section 2 provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." That provision reflects "the fundamental principle that arbitration is a matter of contract," and that courts must "place arbitration agreements on an equal footing with other contracts." *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 339 (2011). The Court has invoked Section 2 to "overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," which was often based on arbitration-specific rules. *Granite Rock Co. v. Teamsters*, 561 U.S. 287, 302 (2010) (internal quotation marks omitted).

Morgan arises in the context of Section 3 of the FAA, which allows a party to stay a lawsuit pending the outcome of arbitration where the "issue is referable to arbitration." Robyn Morgan brought wage and hour claims under the Fair Labor Standards Act against Sundance, a Taco Bell franchisee, in federal court. Rather than move to compel arbitration and stay litigation under Section 3 right away, Sundance initially engaged in the litigation—it filed a motion to dismiss or stay the suit on the ground that it was duplicative of a prior action, filed an answer and participated in a mediation in an effort to settle the claims. When the parties failed to settle the claims, Sundance filed a motion to compel arbitration. In opposing that motion, Ms. Morgan argued that Sundance had waived its right to arbitration by participating in the litigation in federal court. In determining whether a party has waived an agreement to arbitrate, the Eighth Circuit applies an arbitration-specific test requiring that the party asserting waiver show prejudice in addition to standard waiver requirements of knowledge of the right and actions inconsistent with that right. The district court, applying this test, found that Sundance had waived its arbitration rights. The Eighth Circuit reversed 2-1, finding that Ms. Morgan was not prejudiced by Sundance's failure to assert its arbitration rights earlier. Judge Colloton dissented, calling prejudice a "debatable prerequisite" for waiver.

The Supreme Court granted review to decide whether the arbitration-specific requirement that the proponent of a contractual waiver defense must prove prejudice violates the Supreme Court's instruction that arbitration agreements must be placed "on an equal footing with other contracts."

The Supreme Court's Decision

In a unanimous opinion written by Justice Kagan, the Supreme Court held that the Eighth Circuit's arbitration-specific prejudice requirement was incompatible with the FAA.

At the outset of its opinion, the Supreme Court acknowledged that the parties had raised a number of issues about whether the federal law of waiver was the proper way to determine whether a party's litigation conduct has resulted in the loss of the right to arbitrate, or whether the issue was more properly understood as a matter of state law, or whether it should be considered as involving rules of forfeiture, estoppel, laches or procedural timeliness. The Court explicitly declined to resolve those issues. Instead, the Court assumed without deciding that the federal law of waiver was the correct way to resolve these disputes.

The Court underscored that, when determining whether a contractual right has been waived, a federal court typically "focuses on the actions of the person who held the right; the court seldom considers the effects of those actions on the opposing party." The arbitration-specific rule additionally requiring prejudice in most of the courts of appeals was based on the "liberal national policy favoring arbitration." But the Court explained, as it has in previous cases, that the "policy favoring arbitration" refers to the effort to end the judiciary's historical hostility to arbitration agreements, and place those agreements on equal footing with other contracts. It is not a justification to fashion arbitration-specific procedural rules that favor arbitration.

In further support of its interpretation, the Court cited section 6 of the FAA, which provides that any application under the FAA—which would include an application to stay litigation or compel arbitration—"shall be made and heard in the manner provided by law for the making and hearing of motions." The Court interpreted this section as "a bar on using custom-made rules, to tilt the playing field in favor of (or against) arbitration." The Court concluded by vacating the judgment of the Eighth Circuit and remanding for a determination as to whether Sundance had waived its right to arbitrate, or whether a different procedural framework (such as forfeiture, estoppel or laches) is appropriate.

Implications

The Court's decision in *Morgan* reaffirms that arbitration-specific rules are impermissible under the FAA. That is true regardless of whether the rule is intended to favor arbitration or to disfavor it. The Court stressed that the federal policy in favor of arbitration is a policy of equal footing for arbitration agreements, not a policy intended to put a thumb on the scale in favor of arbitration agreements.

But there remains a significant amount of uncertainty about what comes next. Because the Court explicitly declined to determine if waiver is the right lens through which to view the disputes, it is unclear whether the various courts of appeals will treat conduct like Sundance's as an implied waiver, or whether such behavior will be analyzed under the rules governing forfeiture, estoppel or laches, which might themselves include a prejudice requirement.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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