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Morgan v Sundance: How Taco Bell Could Impact Waiving Arbitration

March 1, 2022

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Companies in the process of determining their dispute resolution policies should keep a close eye on an upcoming U.S. Supreme Court case. On March 21, 2022, the Court is set to hear arguments in *Morgan v. Sundance*, which takes up an important question: Does the waiver of the right to arbitration require a showing of prejudice on top of acts inconsistent with arbitration?

Summary of the Case

The details on the case are technical but important to the question before the Court.

In September 2018, Robyn Morgan brought an action on behalf of herself and all similarly situated individuals against defendant Sundance, the owner of more than 150 Taco Bell franchises nationwide, in the U.S. District Court for the Southern District of Iowa, alleging violations of the Fair Labor Standards Act.

Sundance filed a motion to dismiss two months later, claiming that a lawsuit previously filed in the Eastern District of Michigan barred Morgan's Iowa lawsuit on the basis of the "first-to-file rule." The Iowa District Court denied Sundance's motion in March 2019, finding that Morgan's action involved nationwide claims and that the Michigan action was a Michigan-only collective action.

Sundance then answered the complaint involving affirmative defenses but did not mention its right to arbitration. The parties attempted a class-wide mediation involving the Michigan plaintiffs, which succeeded as to the Michigan action but failed as to Morgan's. Then, in May 2019, the Taco Bell franchisor moved to compel arbitration.

Did Sundance waive the right to arbitration because it had invoked the "litigation machinery"? It did, said the Iowa District Court in the opinion denying Sundance's motion. The 8th U.S. Circuit Court of Appeals reviewed the opinion de novo and reversed the ruling in a split decision.

The Eighth Circuit questioned whether Sundance had in fact invoked the "litigation machinery," as the motion to dismiss focused on the "quasi-jurisdictional" first-to-file rule and not the merits of the dispute. In light of the four-month period during which the Iowa District Court considered Sundance's motion to dismiss and the parallel mediation considered an alternative to litigation, the Eighth Circuit concluded that the parties spent minimal time in active litigation

and no time addressing the merits of the case.

The Eighth Circuit stated that Sundance did not materially prejudice Morgan — even if Sundance had acted inconsistently with its right to arbitration and that it did not waive its right to arbitration. The Eighth Circuit noted that Sundance's eight-month delay in moving to compel arbitration was not excessive. Half of that time consisted of the parties waiting for the Iowa District Court to dispose of Sundance's motion to dismiss. No discovery had been conducted, and no duplication of efforts was likely.

In his dissent in the Eight Circuit decision, Judge Steven Colloton found that Sundance had waived its right to arbitration because, among other things, Sundance failed to move to compel arbitration in response to Morgan's complaint, submitted an answer on the merits that enumerated affirmative defenses but did not mention arbitration, and engaged in mediation within the context of litigation.

Judge Colloton further emphasized Sundance's gamesmanship. Specifically, he argued, Sundance pursued litigation to avoid the risk of collective arbitration and reversed course only when its arbitration prospects had improved. With the caveat that "[p]rejudice is a debatable prerequisite," Judge Colloton found that Sundance had caused sufficient prejudice to Morgan by forcing her to defend against a motion to dismiss and then mediation that was inaccurately premised on the alternative of federal litigation.

Why Companies are Potentially at Risk

On Nov. 15, 2021, the U.S. Supreme Court granted Morgan's petition for certiorari on the specific question of "[d]oes the arbitration-specific requirement that the proponent of a contractual waiver defense prove prejudice violate this Court's instruction that lower courts must 'place arbitration agreements on an equal footing with other contracts'? *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 329 (2011)."

For companies with dispute resolution policies that include a possibility for litigation and arbitration proceedings to be available at the same time, the Court's findings in *Morgan v. Sundance* may have significant ramifications beyond class-litigation and/or arbitration.

If the Supreme Court goes so far as to strike prejudice as a requirement of the waiver of the right to arbitration, as inferred from the question presented, disputants run the risk of automatically waiving their right to arbitrate by acting inconsistently with such right.

What constitutes an inconsistent act can only be determined on a case-by-case basis. To that end, what's really in question before the Court is when the litigation machinery was triggered. The Eighth Circuit focused on the lack of activity relating to the merits of the dispute. By contrast, the Iowa District Court — as well as Judge Colloton — focused on Sundance's delay in moving to compel or even mention arbitration and the inclusion in its answer of affirmative defenses.

Avoiding inconsistencies, as a general rule, is sound advice. A stricter standard may be at play in the litigation context, as disputants, as a matter of law, will be required to promptly move to compel arbitration and stay litigation. Otherwise, they may be deemed to have waived their right to arbitration. The benefits of the interplay between arbitration and litigation, especially in

complex cases — and mediation — cannot be overemphasized.

If, on the other hand, the Supreme Court emboldens the prejudice requirement, disputants still may waive their right to arbitrate if their inconsistent acts cause (material) prejudice to the other side. The contours of the prejudice requirement and its relationship to the uncontroversial element of inconsistent acts are colorable. At times, prejudice flows naturally from the inconsistent acts, in various degrees.

Here, the Iowa District Court and the dissenting judge appear to have found prejudice on Morgan merely because she had to be in litigation. But the Eighth Circuit took a different view, finding no material prejudice to Morgan since the merits remained unaddressed: The litigation activity would not result in the duplication of efforts in the succeeding arbitration. The Eighth Circuit appears to have interpreted the requirement of prejudice as a floor that permits certain litigation-related conduct but perhaps not others – and that could be key to the question before the Supreme Court.

Should arbitration agreements be on equal footing with other contracts as framed? Two additional aspects must be considered.

First, while not addressed in the question presented, the policy against gamesmanship, especially when involving judicial resources, could frame — and potentially influence — the Supreme Court's ruling. In his dissent, Judge Colloton highlighted that Sundance's delay in moving to compel arbitration was a tactical decision. But rather than going to waiver, costs may be an alternative in addressing any undue imbalance there.

Second, a federal policy exists that favors arbitration. The question presented already correctly assumes that the right to arbitration differs from other contractual rights on account of the additional requirement of prejudice for the finding of its waiver. Waiver, of course, can be effected as a unilateral act, without the necessity of showing reliance and thereby prejudice.

The Supreme Court's treatment warrants scrutiny, given that the right to arbitration is a procedural right and not a substantive right, which is also why arbitration agreements are rightfully regarded as severable from the main contract and its container contract. That is especially the case when considered against the backdrop of the pro-arbitration Federal Arbitration Act.

The waiver of any right otherwise enforceable must have a high bar. In *Morgan v. Sundance*, the Supreme Court may weigh in — if so, with prejudice.

Article originally published by Thomson Reuters' Westlaw Today.