In *Morgan v. Sundance*, the Supreme Court Strikes a Blow Against Arbitration Exceptionalism

By Karla Gilbride*

For a court that hears only around 80 argued cases each term,[1] the U.S. Supreme Court has had a great deal to say in the past forty years about arbitration, deciding over 180 cases on that topic since 1982. Many articles have been written about the Court's arbitration jurisprudence over these decades, but for the sake of brevity, it can be boiled down to the following key themes: the Federal Arbitration Act ("FAA") covers lots of contracts[2] and applies in lots of courts,[3] requiring arbitration of all types of disputes.[4] And if a state law, whether of legislative or judicial origin, limits arbitration or interferes with one of its fundamental attributes, then the FAA probably preempts it.[5]

But in the past three years, a shift in the Supreme Court's approach to arbitration under the FAA has begun to emerge, rooted in the strong textualist leanings of many of its current members. First, in 2019, Justice Gorsuch wrote an opinion for a unanimous Court, with Justice Ginsburg writing a separate concurrence, in which he held that the exemption in the FAA for "contracts of employment" of transportation workers applied regardless of whether the person performing the work was an employee or an independent contractor.[6] In rejecting the employer's argument that the exemption should be read more narrowly because the FAA embodies a "liberal federal policy favoring arbitration agreements," Justice Gorsuch noted that courts may not "pave over bumpy statutory text in the name of more expeditiously advancing a policy goal."[7]

Then, earlier this year, in another unanimous opinion, this time written by Justice Kagan, the Court knocked this federal pro-arbitration policy off of its pedestal once and for all. Though that case, *Morgan v. Sundance*, was about the rules governing waiver of the right to compel arbitration, it will have implications far beyond that context. That's because it reconciled two tenets of the Supreme Court's FAA jurisprudence that have sometimes seemed at odds with one another: that agreements to arbitrate must be placed on the same footing as other contracts,[8] and that there is a liberal federal policy favoring arbitration.[9] Justice Kagan explained that these two concepts are not in tension with each other at all, but instead are two different ways of saying the same thing.[10]

Waiver and the Prejudice Requirement: An Arbitration Exceptionalism Case study

Waiver is the "intentional relinquishment or abandonment of a known right."[11] While the concept may be most familiar in the context of Constitutional rights, rights afforded by contract can be waived as well. And when most courts analyze waiver of most contractual rights, they impose a two-part test: did the waiving party know about the right at issue, and did he or she act in a manner inconsistent with an intent of enforcing it—in other words, did the statements or actions indicate an intent to relinquish the right?[12]

But when the contractual right at issue was the right to require disputes to be resolved in arbitration rather than court, most federal and many state courts had added a third element to the waiver test. Even if a defendant knew of its right to compel arbitration and acted inconsistently with that right by filing dispositive motions and engaging in discovery in court, none of this would constitute a waiver of that party's right to later insist on compliance with an arbitration agreement *unless* the plaintiff could also prove that the defendant's inconsistent actions in court had caused the plaintiff harm or prejudice. And the party asserting waiver had the burden of proving they had been prejudiced. This was a marked departure from the common-law standard of contractual waiver outside the arbitration context, which courts and commentators both describe as a unilateral inquiry focused only on the actions of the waiving party.[13]

In explaining why they were treating waiver of the right to arbitrate differently from waiver of other contractual rights, courts cited over and over again to the liberal federal policy favoring arbitration embodied by the FAA. They reasoned that because of that pro-arbitration policy, it should be harder for parties to waive the right to insist on arbitration than to waive other contractual rights.[14]

This legal landscape was already well-established when Robyn Morgan began working for Taco Bell franchise Sundance Inc. as an hourly employee in 2015.[15] After realizing that Sundance was manipulating her and other workers' time records by moving hours from one pay period to another so that the federal threshold for overtime was never triggered, regardless of how many hours they actually worked, Morgan filed suit under the Fair Labor Standards Act.[16]

Sundance had required Morgan to commit, as part of her job application, that she would resolve any disputes with the company in arbitration, but once Morgan filed her lawsuit Sundance did not promptly invoke that provision and move to compel arbitration under the FAA. Instead Sundance moved to dismiss the lawsuit or combine it with an earlier lawsuit filed in Michigan; answered the complaint (listing fourteen affirmative defenses, none of which mentioned arbitration); and tried to settle the lawsuit on a nationwide basis.[17] Only after all of these tactics failed, eight months into the litigation, did Sundance move to enforce its arbitration provision.[18]

Morgan responded that Sundance had waived its right to compel arbitration by actively engaging in litigation for months, and the district court agreed. But the Eighth Circuit reversed, because like eight other federal courts of appeals and many state high courts, it had previously adopted the arbitration-specific prejudice requirement for waiver, and concluded that Morgan failed to prove she was prejudiced.[19]

And so, the stage was set for the petition for certiorari my colleague Leah Nicholls and I filed in 2021.[20] In that petition, we argued that the arbitration-specific prejudice requirement violates the text of the FAA. In November of 2021, the Court took the case, and I argued it in March of 2022.

Equal Means Equal: The FAA Does Not Permit Special Rules to Favor Arbitration

Section 2 of the FAA states that written agreements to arbitrate "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of *any contract*."[21] The Supreme Court has described this language in § 2 as "the FAA's substantive command that arbitration agreements be treated like all other contracts."[22] So, we argued in our opening brief on behalf of Ms. Morgan, the Eighth Circuit and other courts that require prejudice as an element of waiver for arbitration agreements but not for other types of contracts were violating this substantive command of the FAA, which has often been described as its "equal-treatment" or "equal-footing" principle.[23]

Sundance responded that the equal-treatment principle was in fact

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simply a command that arbitration agreements not be treated *worse than* other types of contracts.[24] Indeed, Sundance reasoned, because the Supreme Court's opinion in *Concepcion* described the equal-footing principle as being "in line with" the liberal federal policy favoring arbitration, § 2 should be understood as adopting a "most-favored-nations-clause approach to arbitration, rather than a strict regime of equal treatment."[25] In other words, Sundance's view was that § 2 provides only a floor below which treatment of arbitration agreements cannot sink. And because of the liberal policy favoring arbitration, courts could craft any arbitration-favoring rules at all, including the arbitration-specific prejudice rule at issue in *Morgan*, without running afoul of the FAA.

In its opinion, the Supreme Court soundly rejected the notion that the FAA could justify such arbitration-favoring rules. In the process, it abrogated numerous federal court opinions from nine circuits that explicitly required prejudice as an element of waiver in the arbitration context.[26]

This, in itself, is a significant change in the law. It means that from now on, when parties know they have arbitration clauses but think they might want to litigate in court for a while to see if they can get a dispositive ruling on the merits or gain additional information through discovery not available in arbitration, they will have to think carefully about whether to engage in such tactics in court, lest they risk waiving their right to insist on arbitration later. In short, parties will no longer be able to use their arbitration provisions as a get-out-of-court-free card to be played only when things go badly in the judicial forum, counting on the prejudice requirement as the ripcord that will ensure their parachute to the arbitral forum deploys successfully. Arbitration rights will be treated like all other contractual rights, subject to waiver based on the inconsistent actions of the waiving party alone.

But what's even more significant about the opinion in *Morgan* is what it said about why the federal courts that had crafted this "bespoke rule of waiver for arbitration"[27] were wrong to do so. Justice Kagan explained that the federal policy favoring arbitration, on which these courts had relied, "' "is merely an acknowledgment of the FAA's commitment to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate and to place such agreements upon the same footing as other contracts.'"[28] In other words, arbitration had been disfavored as a method of dispute resolution prior to the FAA's enactment, and the FAA was intended to end that least-favored-nation status by placing arbitration agreements on terms of equality with other contracts. Understood in this context, the "policy favoring arbitration" that the FAA embodies is a policy to end the historical stigma against arbitration, thus favoring it more than it had been favored previously; it is neither a policy favoring arbitration over litigation nor a policy favoring arbitration agreements over other types of contracts.

In case the historical explanation and the extended quotation from *Teamsters* hadn't made this point about the federal policy favoring arbitration and its limits sufficiently clear, Justice Kagan repeated it, several times, in different eminently quotable formulations. "The federal policy is about treating arbitration contracts like all others, not about fostering arbitration."[29] And "a court may not devise novel rules to favor arbitration over litigation."[30] Finally, lifting up a line from an earlier Supreme Court opinion that had previously been relegated to relative obscurity in a footnote, the Court in Morgan put an end, once and for all, to the idea that the FAA confers most-favored-clause status on agreements to arbitrate: rather, the federal policy of the FAA "is to make 'arbitration agreements as enforceable as other contracts, *but not more so*.'"[31]

Defendants seeking to enforce agreements to arbitrate have relied heavily on the federal policy favoring arbitration over

the years, and have sometimes imbued it with talismanic powers to overcome other evidentiary or legal shortcomings. Questions about whether there was sufficient notice of an online arbitration agreement or whether the ambiguous act of clicking a "continue" or "subscribe" button manifested assent? Liberal federal policy favoring arbitration![32] Doubts about whether an ambiguously worded arbitration clause covers a particular dispute? Liberal federal policy favoring arbitration![33] The defendant debt collector wasn't a party to the original loan agreement and can't enforce it through traditional, generally-applicable doctrines like agency or third-party beneficiary status! Make up a new, arbitration-specific rule, pair it with the liberal federal policy favoring arbitration, and call it something like "direct benefits estoppel" or "intertwined claims estoppel!"[34]

In the wake of the Supreme Court's opinion in *Morgan*, with the liberal federal policy favoring arbitration explained as merely another formulation of the equal-treatment principle, defendants will still be able to use the FAA's substantive command in § 2, along with generally-applicable contract principles, to seek enforcement of their arbitration provisions. But they will no longer be able to use the liberal federal policy as an all-powerful tie-breaker, or a mechanism for throwing out existing contract rules and creating new ones specific to the arbitration context. Arbitration clauses are neither most-favored nor least-favored but must be equally-favored to other contract provisions, treated no worse but also no better. And if a court—whether federal or state, trial or appellate—seems inclined to lose sight of this teaching from *Morgan*, it should be reminded that "a court may not devise novel rules to favor arbitration over litigation."[35]

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1 https://www.supremecourt.gov/about/courtatwork.aspx (last visited Aug. 23, 2022).

2 *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 119 (2001) (FAA covers employment contracts, except those of transportation workers); *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 282 (1995) (FAA covered contract for termite extermination because Congress invoked the far limits of its Commerce Clause power in enacting the FAA).

3 *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984) (FAA applies in state as well as federal court).

4 *E.g.*, *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 27 (1991) (requiring arbitration, under contract governed by FAA, of federal civil rights claims); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985) (requiring arbitration, in accordance with contract, of Sherman Act antitrust claims).
5 *E.g.*, *Kindred Nursing Ctrs. Ltd. P'Ship v. Clark*, 137 S. Ct. 1421, 1428 (2017) (Kentucky court rule that required "clear statement" before an agent could sign contracts that waived principal's Constitutional rights was preempted by FAA); *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 342-44 (2011) (California court rule prohibiting class-action waivers in consumer contracts was preempted because it interfered with arbitration's fundamental attribute of streamlined, bilateral proceedings).
6 *New Prime Inc. v. Oliveira*, 139 S. Ct. 532, 539-41 (2019).
7 *Id.* at 543.
8 *E.g.*, *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 475 (1989).
9 *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983).
10 *Morgan v. Sundance Inc.*, 142 S. Ct. 1708, 1713 (2022).
11 *United States v. Olano*, 507 U.S. 725, 733 (1993).
12 *See Loan Mountain Prod. Co. v. Nat. Gas Pipeline Co. of Am.*, 984 F.2d 1551, 1557 (10th Cir. 1992) ("Waiver can be express or implied, and exists when one has an intent not to require strict compliance with a contractual duty[.]").
13 *E.g.*, *Best Place, Inc. v. Penn Am. Ins. Co.*, 920 P.2d 334, 353 (Haw. 1996) ("Waiver is essentially unilateral in character, focusing only upon the acts and conduct of the [waiving party]."); *Old Republic Ins. Co. v. FSR Brokerage, Inc.*, 80 Cal. App. 4th 666, 678 (Cal. Ct. App. 2000) ("*pivotal* issue in a claim of waiver is the intention of the party who allegedly relinquished the known legal right" as waiver "does not require any act or conduct by the other party" (emphasis in original)); 28 Am. Jur. 2d Estoppel and Waiver § 35 (2011) ("The intent to relinquish a right is a necessary element of waiver but not of estoppel while detrimental reliance is a necessary element of estoppel but not of waiver.").
14 *Carcich v. Rederi A/B Nordie*, 389 F.2d 692, 696 (2d Cir. 1968) (first federal court opinion to impose a prejudice requirement and attributing that new requirement to the "overriding federal policy favoring arbitration"); *Carolina Throwing Co. v. S & E Novelty Corp.*, 442 F.2d 329, 331 (4th Cir. 1971) (describing prejudice requirement as "[t] he modern rule based on a liberal national policy favoring arbitration"); *Perry Homes v. Cull*, 258 S.W.3d 580, 594-95 (Tex. 2008) (requiring prejudice for waiver by litigation conduct of right to arbitrate) (noting that Texas law does not require prejudice for waiver of other contractual rights but requiring it for arbitration); *David v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 440 N.W.2d 269, 274 (N.D. 1989) ("More is required [for waiver] than action inconsistent with the arbitration provision" because of the "federal policy favoring arbitration").
15 *Morgan*, 142 S. Ct. at 1711.
16 *Id.*
17 *Id.*
18 *Id.*
19 *Id.* at 1712 (citing 992 F.3d 711, 713-715 (2021)).
20 2021 WL 3931342 (Aug. 27, 2021). Also available at https://www.scotusblog.com/case-files/cases/morgan-v-sundance-inc/ (last visited Aug. 24, 2022).
21 9 U.S.C. § 2 (emphasis added).
22 *Buckeye Check Cashing v. Cardegna*, 546 U.S. 440, 447 (2006).
23 2021 WL 6286090 (Dec. 30, 2021). Also available at https://www.scotusblog.com/case-files/cases/morgan-v-sundance-inc/ (last visited Aug. 24, 2022).
24 2022 WL 41395 8(Feb. 4, 2022). Also available at https://www.scotusblog.com/case-files/cases/morgan-v-sundance-inc/ (last visited Aug. 24, 2022).
25 *Id.* ("As long as arbitration agreements are enforced *at least as favorably* as other contracts, Section 2 is not offended.") (emphasis added).
26 *Morgan*, 142 S. Ct. at 1712 and n.1.
27 *Id.* at 1713.
28 *Id.* (quoting *Granite Rock Co. v. Int'l Bhd. Of Teamsters*, 561 U.S. 287, 302 (2010)).
29 *Id.*
30 *Id.*
31 *Id.* (quoting *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967)) (emphasis added).
32 Courts have actually held for some time that the federal pro-arbitration policy has no bearing on whether a contract to arbitrate was formed in the first place or whether that contract was valid, *see Fleetwood Enters. Inc. v. Gaskamp*, 280 F.3d 1069, 1073 (5th Cir. 2002)*, but this has not stopped litigants from invoking it to attempt to place a thumb on the scale in such contract formation disputes.,*
33 *Calderon v. sixt Rent a Car LLC*, 5 F.4th 1204, 1215-20 (11th Cir. 2021) (Newsom, J., concurring).
34 *Hays v. HCA Holdings, Inc.*, 838 F.3d 605, 609-10 (5th Cir. 2016) (applying Texas law).
35 *Morgan*, 142 S. Ct. at 1713.