

Insights

THE ABSENCE OF A UNIFORM ARBITRATION WAIVER TEST IN THE SECOND CIRCUIT POSES LITIGATION CHALLENGES

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SUMMARY

Defendants considering whether to seek dismissal of a complaint or to compel arbitration have to consider when failing to compel arbitration waives their right to arbitration. Since the Supreme Court's 2022 decision in *Morgan v. Sundance, Inc.*, 596 U.S. 411, defendants litigating in the Second Circuit face an additional challenge, namely, the differing arbitration waiver rules district courts are applying.

BACKGROUND

Before *Morgan*, federal appellate courts disagreed about when a party waived its arbitration rights and, correspondingly, whether a party opposing a motion to compel and arguing waiver had to show prejudice by the delay. In the Second Circuit, this prejudice requirement was quite favorable to defendants who waited to move to compel arbitration.

But *Morgan* rejected a requirement to show prejudice, holding that courts could not create arbitration-specific rules, and, instead, should treat arbitration contracts like any other contract. This means that courts must treat waiver of a right to compel arbitration like they would any other waiver of a contractual right—generally focusing on the actions of the party who holds the right (rather than any impact on the non-moving party). The focus of the inquiry is whether a party holding a right “knowingly relinquish[ed] the right . . . by acting inconsistently with that right[.]”

POST-MORGAN ARBITRATION WAIVER TESTS IN THE SECOND CIRCUIT

In the Second Circuit, *Morgan's* requirement that courts treat arbitration rights like other contract rights, along with its direction that courts not consider prejudice in resolving waiver, has led to three tests for arbitration waivers.

For example, Judge Valerie Caproni in *Boustead Sec., LLC v. Leaping Grp. Co.*, 656 F. Supp. 3d 447 (S.D.N.Y. 2023) adopted an analysis that evaluates waiver based on: (1) the time elapsed between

the start of litigation and the request for arbitration; and (2) the amount of litigation until that arbitration request. This analysis adapted the pre-*Morgan* arbitration waiver test in the Circuit by stripping the prejudice requirement.

By contrast, Judge Brian Cogan in *Deng v. Frequency Elecs., Inc.*, 640 F. Supp. 3d 255 (E.D.N.Y. 2022) instead applied a waiver analysis asking whether the party moving to compel arbitration intentionally relinquished its known right to arbitrate.

Finally, Judge Gregory Woods in *Herrera v. Manna 2nd Ave. LLC*, 2022 WL 2819072 (S.D.N.Y. 2022) has employed a test that is the combination of the first two, and analyzes all the factors together. Most other district courts have adopted this approach.

The Second Circuit has not yet resolved which of these tests is most faithful to the Supreme Court's holding in *Morgan*, although most district courts currently employ the final version of the test, which considers all factors.

IMPLICATIONS OF ARBITRATION WAIVER ANALYSIS

In the absence of a uniform framework to analyze arbitration waivers, uncertainty persists over which test will apply in a given case, and litigants will have to spend considerable time and effort to be wary of all possible waiver pitfalls. The difference among these approaches can lead to "significant (and, in some cases, possibly dispositive) difference[s]" in outcome, as one district court noted. *See Herrera*, 2022 WL 2819072, at *8.

Some post-*Morgan* district court decisions on arbitration waiver are now on appeal. While it is impossible to predict which test (or combination of tests) the Court of Appeals will endorse, it has hinted previously that it may be inclined to adopt the first test. *See Nicosia v. Amazon.com, Inc.*, 2023 WL 309545, at *4 n.2) (noting that *Morgan* "fully supports" its pre-*Morgan* decision that a party had not waived its right to arbitrate because that determination rested "not merely because there was no prejudice" to the non-movant but also because the movant "had not engaged in litigating any substantial merits questions before seeking arbitration.").

Regardless of which test the Court adopts, a decision, when it is forthcoming, can be expected to have a significant impact on future litigation involving the waiver of the right to arbitration in the Second Circuit.

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