

Kluwer Arbitration Blog

Implied Waiver Of the Right to Arbitrate

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In February 2011, the United States Supreme Court granted certiorari in *Stok & Associates, P.A., v. Citibank, N.A.* (No. 10-514). The question presented was whether, under the Federal Arbitration Act (“FAA”), a party should be “required to demonstrate prejudice after the opposing party waived its contractual right to arbitrate by participating in litigation, in order for such waiver to be binding and irrevocable” – an issue on which the United States Courts of Appeals are divided. However, the parties settled their dispute before any merits briefs had been filed and the Court accordingly dismissed the case on June 2, 2011.

Stok and Associates (“Stok”) is a small Florida law firm that holds its bank accounts with Citibank. In November 2008, Stok deposited a substantial client cashier’s check into its Trust Account with Citibank. Although Citibank granted Stok immediate credit and availability of funds (enabling Stok to wire most of the funds to its client’s foreign bank account), Citibank subsequently revoked its acceptance of the check on the basis that the check was counterfeit. Citibank charged back the funds in question from the Trust Account. Stok demanded return of the removed funds but Citibank did not accede.

The contract governing the relationship between Stok and Citibank included an arbitration provision that provided, in relevant part: “[E]ither Citibank or [Stok] may elect to require any dispute between [them] concerning the aforementioned accounts or any other Bank deposit account or line of credit be resolved by binding arbitration.” However, Stok preferred to litigate and filed suit against Citibank in Florida state court in December 2008. In January 2009, Citibank filed its Answer, which raised one affirmative defense, but made no reference to the arbitration provision.

On February 23, 2009, Citibank sent Stok a letter electing arbitration. Stok rejected Citibank’s election, so Citibank filed a motion to compel arbitration the following day, initially in state court. When it became apparent that under Florida state law, Citibank had waived its right to arbitrate by filing its Answer without expressly reserving the right to elect arbitration, Citibank withdrew its motion to compel. Instead, Citibank filed a petition to compel arbitration in the U.S. District Court for the Southern District of Florida. In May 2010, the district court denied Citibank’s petition, holding that Citibank had waived its right to arbitrate. As part of this determination, the district court found that Stok had suffered prejudice due to Citibank’s delay in demanding arbitration.

Citibank appealed to the U.S. Court of Appeals for the Eleventh Circuit. In July 2010, the Eleventh Circuit allowed the appeal. The Eleventh Circuit applied the two-part test set down in *Ivax Corp. v. B. Braun of America, Inc.*, 286 F.3d 1309 (11th Cir. 2002): “First, we decide if, ‘under the totality

of the circumstances,’ the party ‘has acted inconsistently with the arbitration right,’ and, second, we look to see whether, by doing so, that party ‘has in some way prejudiced the other party.’” *Id.* at 1315–16 (quoting *S&H Contractors, Inc. v. A.J. Taft Coal Co.*, 906 F.2d 1507, 1514 (11th Cir. 1990)).

With respect to the first element, the Eleventh Circuit assumed, without deciding, that Citibank’s participation in state court litigation was sufficiently substantial to show that it did not intend to avail itself of the arbitration provision. However, the Eleventh Circuit concluded that Stok did not satisfy the second element of the two-part waiver test set out in *Ivax* – namely the requirement to show prejudice sufficient to warrant waiver. In reaching this conclusion, the Eleventh Circuit stated that the prejudice element of the waiver test is examined by taking into account the expense incurred by the party alleging prejudice from participating in the litigation process, the use of pre-trial discovery procedures by a party seeking arbitration, and the length of delay in demanding arbitration. Applying these factors, the Eleventh Circuit held that Stok had failed to satisfy its burden on the basis that: (1) courts have declined to find waiver in cases with similar or more extensive litigation activity prior to the motion to compel arbitration; (2) Stok had failed to provide evidence of either the amount of money it spent or the number of hours it dedicated to pursuing litigation-specific activities; and (3) Citibank’s delay in invoking its right to arbitrate was brief and “when little meaningful litigation has taken place, this Court has declined to find waiver from even longer delays.” (Both the district court and the Eleventh Circuit agreed that the period relevant to the prejudice analysis was the time that had elapsed between Citibank’s filing its Answer in state court and sending a letter to Stok demanding arbitration – a period of 24 days).

Stok petitioned for certiorari, noting a circuit split regarding whether prejudice on the part of a resisting party is necessary for an opposing party’s right to compel arbitration to be deemed waived. Stok noted that the majority of circuits (namely the First, Second, Third, Fourth, Fifth, Sixth, Eighth, and Eleventh Circuits) permit parties to compel arbitration unless the parties seeking to oppose arbitration are able to demonstrate that they have suffered substantial prejudice due to the adverse party’s delay in seeking arbitration. In contrast, the Seventh, Tenth, and D.C. Circuits have held that once a party participates in litigation, it is precluded from demanding arbitration, even if the adverse party has suffered no prejudice. Even within the majority, courts had required different degrees of prejudice necessary to find a waiver of the right to compel arbitration. Stok argued that “the notion that contracting parties should be able to rely on predictability and uniformity in achieving their bargained for expectations is completely lost in the context of the divergent waiver analyses among the Circuits.”

Citibank, in its Brief in Opposition, denied that any “true” circuit split exists. It argued that even in the three circuits classified by Stok as forming the minority, prejudice is at a minimum a “relevant factor” in the applicable waiver analysis. Citibank argued “without naming prejudice as an element, [these three circuits] in varying degrees, do hold it to be a significant part of the waiver decision. This is a semantic, not a substantive difference.” However, Citibank’s position was untenable. It is simply not plausible to say there is no distinction of real import between an absolute requirement for some level of prejudice to exist before waiver will be found, and no requirement for prejudice before waiver will be found. That the minority circuits identified by Stok might take prejudice into account *if it exists* does not detract from the fact that they are still open to finding waiver *where no prejudice exists* – circumstances that would absolutely preclude a finding of waiver in the majority circuits. Indeed, as Stok rightly pointed out in its Reply Brief, the Seventh Circuit (whose Judge Richard Posner has been one of the chief proponents of the view that prejudice is not needed for a finding of waiver) expressly acknowledges that it is in the minority on

this issue.

In granting certiorari, the Supreme Court evidently agreed with Stok's analysis. Now that the case has been dismissed, it seems likely that the Supreme Court will grant certiorari the next time it finds itself presented with an appropriate opportunity to address this issue. Where, however, the Court will (or should) end up on this issue is open to debate.

Although *Stok & Associates, P.A., v. Citibank, N.A* settled before the parties had the opportunity to fully brief the substantive question at issue, Stok addressed the merits briefly in its Petition, advocating a complete abandonment of the requirement for prejudice. Pointing to the Supreme Court's holding that the purpose of the FAA was "to reverse the longstanding judicial hostility to arbitration agreements and to place [arbitration agreements] upon the same footing as other contracts," *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79, 80 (2000) (emphasis added), Stok argued that a requirement to establish prejudice before waiver will be found goes beyond this, amounting to "a contractual term ... inserted by the judiciary into every arbitration provision." Stok asserted that a bright-line rule (eradicating the prejudice inquiry entirely) is the only way to resolve the issue: "creating a simple standard for waiver of an arbitral forum whenever one participates in litigation without reservation, will [enable] the monumental waste of scarce judicial and party resources [to] subside – the very goal the FAA was supposed to realize."

While bright-line rules (and the perceived certainty that they bring) can have a certain initial appeal, the flip-side of that certainty is a lack of flexibility. The rule that Stok advanced in its Petition (that waiver of the right to arbitrate occurs whenever one participates in litigation without reservation) goes beyond merely rejecting a requirement for prejudice before waiver will be found. Rather, it also seeks to modify the first part of the two part test for waiver applicable in the Eleventh Circuit – the requirement that the party acted inconsistently with the arbitration right "under the totality of the circumstances." As formulated, Stok's proposed rule would shut the door to the possibility that parties who participate without reservation in proceedings brought against them – even in the most preliminary of ways – might still exercise their contractual right to arbitration. This is out of step with the pro-arbitration scheme of the FAA and U.S. federal jurisprudence more generally.

Tellingly, Stok's argument goes beyond the position taken even in the minority circuits. The Seventh Circuit in *Cabinetree of Wisconsin, Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 391 (7th Cir. 1995), one of the cases on which Stok relied in its petition for certiorari, held that an election to proceed with litigation is only a *presumptive* waiver of the right to arbitrate. *Id.* at 389. This is a rebuttable presumption. As the Seventh Circuit held, it is easy to imagine situations where participation in court proceedings does not signify an intention to proceed in litigation to the exclusion of arbitration: "[t]here might be doubts about arbitrability, and fear that should the doubts be resolved adversely the statute of limitations might have run. Some issues might be arbitrable, and others not. The shape of the case might so alter as a result of unexpected developments during discovery or otherwise that it might become obvious that the party should be relieved from its waiver and arbitration allowed to proceed." *Id.* at 390. In such circumstances, the Seventh Circuit permits a finding of no waiver. This essentially serves the same function that is served by the prejudice element of the two-part test followed by the majority of circuits — both provide the courts with a route to avoiding an unfair denial of a party's right to arbitrate.

There is no need (or justification) for the Supreme Court to go as far as Stok advocated. The question presented in *Stok* related solely to whether a showing of prejudice is required before an

opposing party's contractual right to arbitrate will be deemed waived. Even if the Supreme Court ultimately chooses to reject the requirement of prejudice, the federal courts should still be able to ensure that parties' rights to arbitrate are not unduly fettered, through a careful consideration and application of first part of the test for waiver, with its requirement to take into account the "*the totality of the circumstances.*"

By Gary Born & Anna Holloway


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