Kluwer Arbitration Blog

Waiving the Right to Arbitrate in the United States: Should the Prejudice Requirement be Discarded?

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The Sixth Circuit Court of Appeals recently ordered a fund management committee ('SBC') to arbitrate its dispute with Navistar International ('Navistar') – at Navistar's request – despite the fact that Navistar refused SBC's own request for arbitration, ignored SBC's formal notice of arbitration, and then litigated SBC's claim in court for over a year (*Art Shy v Navistar International Corporation*, 781 F.3d 820, 2005).

This decision confirms the uncertain state of U.S. law regarding waiving the right to arbitrate. The Federal Arbitration Act ('FAA') provides that a court shall stay a court action commenced in the face of a valid arbitration agreement provided that "the applicant for the stay is *not in default* in proceeding with such arbitration" (9 U.S.C. § 3).

The majority of U.S. circuit courts interpret the FAA as requiring that the party seeking to compel arbitration must not have caused its opponent "prejudice." This most commonly arises in the form of undue cost or delay. Yet the amount of prejudice required differs greatly from circuit to circuit. The Sixth Circuit's decision in *Art Shy* illustrates the difficulties in applying the prejudice standard, and raises the question of whether arbitration waiver should require prejudice at all.

A dispute over data

The dispute between SBC and Navistar arose in 2009 over data provided by Navistar to SBC under an agreement that contained an arbitration clause ('the Agreement'). Negotiations continued until August 2009 when SBC first requested that Navistar engage in arbitration to resolve the dispute. Navistar demurred, causing SBC to send a formal notice of dispute to Navistar in May 2010. Navistar did not respond. Further requests for information from SBC, and objections by Navistar continued throughout 2011.

By March 2012 SBC had decided to resort to litigation. It sought to intervene in on-going litigation against Navistar in the District Court for the Southern District of Ohio. This litigation had been commenced by the beneficiaries of the fund that SBC managed. SBC's motion to intervene alleged that Navistar had withheld data that SBC was entitled to under the Agreement. Navistar resisted SBC's motion, arguing that SBC should commence an independent action. The District Court allowed SBC's intervention in February 2013, and SBC duly filed its complaint soon thereafter.

In March 2013 Navistar filed its response to SBC's complaint. The response obliquely referred to

the Agreement's dispute resolution clause. It did not, however, mention the word 'arbitration,' not did it allege that the clause was binding. The District Court duly rejected Navistar's arguments, ordering Navistar to provide the information that SBC sought. In light of the information received from Navistar, SBC amended its complaint in August 2013. Navistar then moved to dismiss the amended complaint on the grounds that it was subject to the Agreement's arbitration clause.

In March 2014 the District Court found that Navistar had waived its right to arbitrate under the Agreement through its behaviour before and during the litigation. Specifically, the District Court emphasised that Navistar had ignored SBC's initial request for arbitration; failed to respond to SBC's formal dispute notice; and failed to raise arbitration as a defence to SBC's motion to intervene. Navistar appealed.

The Sixth Circuit, which covers Michigan, Ohio, Kentucky and Tennessee, allowed Navistar's appeal. The majority held that none of Navistar's actions, taken individually or as a whole, amounted to waiver of its right to arbitrate under the Agreement.

Addressing the District Court's concerns, the majority explained Navistar's silence in respect of SBC's request for arbitration, and subsequent formal notice of dispute, was a mere litigation strategy: an attempt to "stare down" SBC. To the extent that Navistar's delay caused prejudice to SBC, the majority found that SBC was at least partly to blame, reasoning that SBC should have sought a court order compelling Navistar to arbitrate.

The majority also acknowledged that Navistar did not raise the arbitration clause in a timely manner, and that it waited until after its first substantive submission in the District Court litigation to do so. However, the majority held that Navistar's failure to raise the arbitration clause while resisting SBC's intervention was reasonable, as Navistar could have raised the arbitration clause at the beginning of any fresh litigation between it and SBC.

Should waiver require prejudice?

The decision in *Art Shy* raises many issues about the application of the prejudice standard. Most notably, the majority failed to consider *at all* the prejudicial effect on SBC of Navistar's failure to raise arbitration in a timely manner; namely, three additional procedural skirmishes and a delay of 16 months. If this delay and expense did not sufficiently prejudice SBC so as to amount to waiver by Navistar, it is difficult to imagine the level of prejudice that would. Yet, despite the flaws in this decision, the bigger question remains whether waiver should require prejudice at all.

Increasing the requirements for a party to waive its right to arbitrate may be viewed as supportive of arbitration in the United States. But reading extra requirements, such as prejudice, into the FAA does not support arbitration. Rather, it creates uncertainty that is anathema to the efficient resolution of disputes.

First, the prejudice requirement encourages parties to try to litigate disputes first. If the litigation does not appear to be going their way, they can then resort to arbitration. This reinforces out-dated notions of arbitration as a subsidiary form of dispute resolution, to be used only when litigation is not possible or not desirable. Further, if an opposing party challenges recourse to arbitration, the varying prejudice standards applied across (and within) U.S. circuit courts give parties ample grounds on which to allege waiver.

Second, the prejudice standard imposes systemic costs. The desirability of the U.S. as an arbitral

seat is not helped by a non-uniform interpretation of the FAA. Yet introducing a normative requirement such as prejudice into the FAA can only serve to fragment arbitration law across U.S. jurisdictions.

Ultimately, the prospect of waiving their right to arbitrate should compel parties to choose a forum at the earliest possible stage. Allowing a party to participate in litigation until they cause prejudice to an opposing party only serves to create expense and delay for all parties.

Conclusion

The *Art Shy* decision demonstrates that even pro-active plaintiffs who raise arbitration at an early stage cannot always avoid a subsequent, mid-litigation change of forum. More generally, the decision illustrates how the prejudice standard creates uncertainty and hinders arbitration. For these reasons, it should be discarded.

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