

**Waiver of Right of Arbitration
Upon Participation in Litigation**

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The right of arbitration has a solid foundation in American jurisprudence but parties often lose the right through waiver. One particular hotbed of litigation is whether waiver of arbitration has occurred when the party seeking arbitration has already engaged in trial-oriented activity in court. This article examines the circumstances under which a party may be found to have waived its right to arbitrate when having already participated in litigation. Not surprisingly, the results are all over the map, being highly driven by the facts and the court's leanings.

Federal Arbitration Act

The Federal Arbitration Act established that “as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.” *Moses Cone Hosp. v. Mercury Constr.*, 460 U.S. 1, 24-25 (1983). The substantive law of the Act is applicable in both federal courts and state courts, and requires all courts to “rigorously enforce agreements to arbitrate.” *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221, (1985). However, a litigant may waive its right to arbitration under the Federal Arbitration Act “by so substantially utilizing the litigation machinery that to subsequently permit arbitration would prejudice the party opposing the stay.” *Maxum Found., Inc. v. Salus Corp.*, 779 F.2d 974, 981 (4th Cir. 1985). The party opposing arbitration bears the “heavy burden” of proving waiver. *American Recovery Corp. v. Computerized Thermal Imaging*, 96 F.3d 88, 95 (4th Cir. 1996).

States have their own statutory arbitration provisions such as the Uniform Arbitration Act or the Revised Uniform Arbitration Act. North Carolina has now adopted the Revised Uniform Arbitration Act, which applies to agreements to arbitrate entered into on or after January 1, 2004. *N.C. Gen. Stat. § 1-569.1 et seq.* Similar principles about waiver of arbitration apply under these state statutes and case law. There exists in north Carolina a strong public policy in favor of settling disputes by arbitration. *Prime S. Homes, Inc. v. Byrds*, 102 N.C.App. 255, 401 S.E.2d 822 (1991). An agreement to arbitrate “is valid, enforceable and irrevocable except upon a ground that exists at law or in equity for revoking a contract.” *N.C. Gen. Stat. § 1-569.6.* “If the court finds that there is no enforceable agreement to arbitrate, it shall not ... order the parties to arbitrate.” *Id. at § 1-569.7(c).* A party waives arbitration when it engages in conduct inconsistent with arbitration which results in prejudice to the party opposing arbitration. *Servomation Corp. v. Hickory Constr. Co.*, 316 N.C. 543, 342 S.E.2d 853 (1986).

Prejudice

The majority of jurisdictions require a finding of prejudice to the party opposing arbitration before the right is waived. *E.g., Rush v. Oppenheimer & Co.*, 779 F.2d 885, 887 (2nd Cir. 1985); *Chandler v. Blue Cross Blue Shield of Utah*, 833 P.2d 356, 358 (Utah 1992). In other jurisdictions, prejudice is not a prerequisite to a finding of waiver. *E.g., St. Mary’s Med. Ctr. of Evansville, Inc. v. Disco Aluminum Prods. Co.*, 969 F.2d 585, 590 (7th Cir. 1992) (when it is clear that a party has foregone its contractual right to arbitrate, a court may find waiver without a showing of prejudice); *Raymond James Fin. Serv., Inc. v. Saldukas*, 851 So.2d 853, 858 (Fla. Dist. Ct. App. 2003) (a finding of prejudice is not required to establish waiver); *Nat’l Found. for Cancer Research v. A.G. Edwards & Sons, Inc.*, 821 F.2d 772, 777 (D.C. Cir. 1987) (waiver may be found absent a showing of prejudice).

In jurisdictions requiring prejudice, once the party seeking arbitration has participated in the litigation to a point inconsistent with arbitration – – “substantially invoked the litigation machinery” – – the determination of waiver rests solely on a finding of prejudice. *Chandler*, 833 P.2d at 359. The prejudice must result from the delay in the assertion of the right to arbitrate and not from factors inherent in arbitration itself, such as the severance of a claim or limitations on remedies. *Id.* The party claiming waiver bears the burden of establishing that it was prejudiced by the delay. *Id.*

Whether waiver has occurred is dependant on the facts of each case. *E.g., Chandler*, 833 P.2d at 358. Thus, where courts applying the same approach have reached seemingly disparate results as to whether a waiver has occurred, the fact-specific nature of a finding of prejudice generally accounts for the disparity. *Id.* Examples of facts leading to a finding of prejudice due to delay are where the party opposing arbitration is forced to bear the expense of a long trial, loses helpful evidence, takes steps in litigation to its detriment, or expends significant amounts of money on the litigation, or the party seeking arbitration makes use of judicial discovery procedures not available in arbitration. *Servomation Corp. v. Hickory Constr. Co.*, 316 N.C. 543, 544, 342 S.E.2d 853, 854 (1986).

Due to the strong public policy favoring arbitration, courts are reluctant to find waiver. They generally rely on some combination of delay, expense, detriment to the party opposing arbitration, and use of discovery procedures not available in arbitration to support a finding of prejudice and, thereby, waiver. For example, in *Price v. Drexel Burnham Lambert, Inc.*, the Fifth Circuit Court of Appeals affirmed the district court’s holding of waiver where the party seeking arbitration “initiated extensive discovery, answered twice, filed motions to dismiss and for summary judgment, filed and obtained two extensions of pre-trial deadlines, all without

demanding arbitration” and the “mounting attorneys fees,” “seventeen-month delay,” and “disclosure which [] resulted from the numerous depositions and production of documents” constituted prejudice sufficient to prevent Drexel from invoking arbitration. 791 F.2d 1156, 1160 (5th Cir. 1986) (internal quotation marks omitted).

Length of Delay

In determining whether a party would be prejudiced by allowing arbitration, courts will consider the length of delay before arbitration is sought and the extent of the trial-oriented activity of the party seeking arbitration. *E.g., Fraser v. Merrill Lynch Pierce, Fenner & Smith, Inc.*, 817 F.2d 250, 252 (4th Cir. 1987). A mere delay in demanding arbitration does not result in waiver, but such delay does bear on the question of prejudice and will be considered along with other factors. *Rush*, 779 F.2d at 887 (“It is beyond question that defendants’ delay in seeking arbitration during approximately eight months of pretrial proceedings is insufficient by itself to constitute a waiver of the right to arbitrate, for in addition, prejudice [] must be demonstrated.”). In *Herco v. Metro. Life Ins.*, 978 F. Supp. 141, 148 (W.D. N.Y 1997), the court found no waiver where the defendant answered the complaint without asserting the right to arbitration and delayed eighteen months before seeking the right to arbitrate. *See also, Sweater Bee by Banff, Ltd. v. Manhattan Indus., Inc.*, 754 F.2d 457, 461 (2d Cir. 1985) (no waiver despite two year delay before filing answer raising right to arbitration); *Tenneco Resins v. Davy Int’l*, 770 F.2d 416, 419-21 (5th Cir. 1985) (no waiver despite eight month delay before moving that proceedings be stayed pending arbitration, but desire to arbitrate was stated in original answer).

In *Price*, the court noted that “where a party fails to demand arbitration during pretrial proceedings, and, in the meantime, engages in pretrial activity inconsistent with an intent to arbitrate, the party later opposing a motion to compel arbitration may more easily show that its

position has been compromised, i.e., prejudiced.” 791 F.2d at 1161. Thus, the court found that the party’s seventeen-month delay in demanding arbitration contributed to the finding of waiver. *Id.*

Incurring Litigation Expenses

The mere fact that the party opposing arbitration has incurred expenses in the litigation is generally not sufficient to prove prejudice. In *Servomation Corp.*, the North Carolina Supreme Court stated “we are of the opinion that evidence of expenses related to defendant’s interrogatories would have been irrelevant since plaintiff has failed to demonstrate that the judicial discovery procedures used by defendant, or their equivalent, would be unavailable in arbitration.” 316 N.C. at 544, 342 S.E.2d at 854. Thus, where a party might have incurred the same expenses during arbitration, there is no showing of prejudice. *See also Smith v. Young Moving and Storage, Inc.*, 141 N.C. App. 469, 473, 540 S.E.2d 383, 386 (2000), *aff’d* 353 N.C. 521, 546 S.E.2d 87 (2001) (no waiver where the “prejudice described by plaintiff . . . consist[ed], for the most part, of inconveniences and expenses consistent with normal trial preparation”).

Only where similar expenses would not have been incurred through arbitration is a party more likely to be prejudiced. In *Companion Life Ins. Co. v. Whitesell Mfg., Inc.*, the Alabama Supreme Court found that the party opposing arbitration would have been substantially prejudiced where it had incurred fees of \$4,175 to have the case remanded to state court after the party seeking arbitration removed the case to federal court in an attempt to have the claims disposed of under ERISA. 670 So.2d 897, 899 (Ala. 1995). The court rejected the argument that the same expenses would have been incurred if arbitration had been sought at the outset of the action and noted that although the applicability of ERISA may have been an issue during arbitration, the expense and delay involved in contesting the removal to federal court would not

have occurred. *Id.* The court affirmed the lower court's finding of waiver based, in part, on the prejudicial nature of the expenditures. *Id.* See also *Prime South Homes, Inc. v. Byrd*, 102 N.C. App. 255, 261, 401 S.E.2d 822, 826-27 (1991) (finding waiver where a sizeable portion of \$10,000.00 in legal fees was incurred because of delay in demanding arbitration).

Filing of Pleadings

“The mere filing of a complaint or answer does not result in waiver of arbitration absent evidence showing prejudice to the adverse party.” *Servomation Corp.*, 316 N.C. at 544, 342 S.E.2d at 854. Even where the party seeking arbitration failed to assert the arbitration right prior to filing an action, the right is not waived absent a showing of prejudice. In *American Recovery Corp.*, the Fourth Circuit declined to find that a party had waived its right to arbitration where it had instituted two consecutive, identical declaratory judgment actions in another jurisdiction and fought a motion to dismiss one of those actions. 96 F.3d at 96. The court noted that discovery was not initiated in those actions and concluded that the mere filing of the prior actions did “not constitute legally sufficient prejudice for CTI to have waived its rights to arbitration.” *Id.* See also *Lawrence v. Comprehensive Bus. Serv.*, 833 F.2d 1159, 1164 (5th Cir. 1987) (filing prior suit and obtaining judgment not enough to warrant waiver); *Maxum Founds., Inc.*, 779 F.2d at 981 (general contractor did not, by filing a third-party action against owner or by its discovery, waive its right to arbitration of plaintiff subcontractor's claim); *Realco Enters. v. Merrill Lynch*, 738 F. Supp. 515, 518 (S.D. Ga. 1990) (filing of suit in another state not enough to find waiver: “Intuitively, one would think that the act of filing suit is in itself a ‘substantial invocation of the litigation process,’ thus constituting a waiver of the right of arbitration. The great weight of the authority, however, is to the contrary.”); *Marlin Oil Corp. v. Colorado Interstate Gas Co.*, 700 F.

Supp. 1076, 1080-81 (W.D. Okla. 1988) (finding no waiver where party instituted declaratory judgment action and defended against a motion to dismiss).

However, the Seventh Circuit, recognizing that its position is the minority one, has deemed “an election to proceed in court a waiver of a contractual right to arbitrate, without insisting on evidence of prejudice beyond what is inherent in an effort to change forums in the middle (and it needn’t be the exact middle) of a litigation.” *Cabintree of Wisconsin, Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 390 (7th Cir. 1995) (citing *Ohio-Sealy Mattress Mfg. Co. v. Kaplan*, 712 F.2d 270, 273-74 (7th Cir. 1983); *Midwest Window Sys., Inc. v. Amcor Indus., Inc.*, 630 F.2d 535, 537 (7th Cir. 1980)).

While the mere instigation of legal action will generally not constitute waiver, some courts have held that once the party seeking arbitration invokes the court’s discretionary power, prior to a demand for arbitration, the right is waived. *Wood*, 96 N.M. at 527-28, 632 P.2d at 1165-66. In *Wood*, the party moving to compel arbitration did so only after the court denied its motion to dismiss. *Id.* at 527, 632 P.2d at 1165. The New Mexico court held that by doing so it waived the right of arbitration, noting that “[t]o hold otherwise would permit a party to resort to court action until an unfavorable result is reached and then switch to arbitration.” *Id.* at 528, 632 P.2d at 1166. The court noted that prejudice to the opposing party is necessary to find waiver, although the court did not specifically mention how the opposing party in *Wood* was prejudiced. *Id.*

Other courts have held that a motion to dismiss filed prior to an answer does not, alone, waive the right to arbitrate. *See Rush*, 779 F.2d at 888; *Sweater Bee by Banff*, 754 F.2d at 465-66. A court is more likely to find waiver where the party seeking arbitration has already filed a motion for summary judgment. *See Jones Motor Co., Inc. v. Chauffeurs, Teamsters and Helpers*

Local Union No. 633 of New Hampshire, 671 F.2d 38, 44 (1st Cir. 1982), cert. denied, 459 U.S. 943 (1982) (right of arbitration waived where party delayed one year, engaged in considerable discovery, filed motion for summary judgment on the merits and did not advocate for the propriety of arbitration until the district court decided on its own that the case was subject to arbitration and should be dismissed); *Weight Watchers of Quebec v. Weight Watchers Int'l*, 398 F.Supp. 1057, 1060-61 (E.D. N.Y. 1975) (finding waiver where party asserted arbitration rights only after the court's decision on its motion for summary judgment); *Companion Life Ins. Co.*, 670 So.2d at 899 (waiver where, *inter alia*, party invoked the arbitration clause only after an adverse ruling in federal district court). But in *Media Edge v. W.B. Doner*, 112 F. Supp. 2d 383, 385 (S.D. N.Y. 2000), no waiver was found despite removal to federal court, an answer being filed, document requests being served, documents being reviewed, witnesses being interviewed, and a pre-trial conference occurring. Key to the court's ruling of no waiver was that no discovery was produced and no substantive motions on the merits were filed. *Id.*

Discovery

There is some disagreement among courts as to the prejudicial nature of discovery. *Chandler*, 833 P.2d at 359 n.17. However, it is important to keep in mind that factual differences, such as the size and complexity of each case, the degree of discovery that would be available under the particular arbitration contract, and the degree of discovery available under the particular jurisdiction's arbitration statute may explain some of the apparent discrepancies. *Id.*

Courts appear to agree that no prejudice results where the discovery relates to nonarbitrable claims that will be severed and separately litigated. *Id.* See *Rush*, 779 F.2d at 889; *Dickinson v. Heinold Sec., Inc.*, 661 F.2d 638, 642 (7th Cir. 1981). Also where discovery has been minimal, the party asserting waiver of arbitration often fails to establish prejudice. See

Brown v. E.F. Hutton, 610 F. Supp. 76, 79 (S.D. Fla. 1985) (no prejudice because discovery – deposition, interrogatories, document request – not extensive and no motions on the merits).

However, other courts have found that even the initial stages of discovery may be prejudicial. *Chandler*, 833 P.2d at 360 n.17. *See Price*, 791 F.2d at 1159-60 (when determining prejudice, discovery initiated by the party claiming waiver should be considered); *Bd. of Educ. Taos Mun. Sch. v. The Architects*, 103 N.M. 462, 709 P.2d 184, 185-86 (1985) (initial stages of discovery found to be prejudicial where party seeking arbitration benefited from discovery and forced party opposing waiver to undergo expense). *Contra Sweater Bee by Banff*, 754 F.2d at 464 (no prejudice because discovery can be used in arbitration). Further, where the party seeking arbitration takes advantage of a discovery procedure that would not have been available for arbitration, prejudice may be found. *See Chandler*, 833 P.2d at 361; *Prime South Homes, Inc.*, 102 N.C. App. at 260-61, 401 S.E.2d at 826 (holding that right to compel arbitration was impliedly waived where contractor took advantage of a discovery procedure not available for arbitration to gain pre-trial access to defendants' evidence and delay in seeking arbitration resulted in homeowners incurring in excess of \$10,000 in legal fees).

Typical Split Decision

It is not uncommon for majority and dissenting opinions to highlight the tension in court decisions concerning waiver. For example, in *Chandler*, the Supreme Court of Utah first adopted its standard for a finding of waiver of a right of arbitration after analyzing the standards and decisions of other jurisdictions. 833 P.2d at 360. As stated by the majority, “[w]e adopt the principle that waiver of a right of arbitration must be based on both a finding of participation in litigation to a point inconsistent with the intent to arbitrate and a finding of prejudice.” *Id.* The majority affirmed the lower court’s finding that Blue Cross participated in litigation to a point

inconsistent with arbitration and that such participation prejudiced plaintiffs. *Id.* at 361. To support the lower court's finding that Blue Cross's actions manifested an intent to proceed to trial, the majority noted that before Blue Cross moved to compel arbitration, it filed an answer and a cross-claim, participated in discovery for five months, and reviewed discovery that had taken place prior to it being joined as a defendant. *Id.* at 360. The court also found that the record supported the finding of prejudice. *Id.* at 361. First, the information learned by Blue Cross through its participation in extensive discovery procedures related to its co-defendant's liability, could be used in arbitration to the detriment of plaintiffs. *Id.* Second, there is only a limited degree of discovery available in arbitration and the discovery relating to Blue Cross's co-defendant was far more advanced than that relating to Blue Cross. *Id.* Thus Blue Cross obtained a benefit from its delay in asserting the right to arbitrate that would not have been available otherwise. *Id.* Third, plaintiffs incurred expenses in conducting discovery and preparing to respond to Blue Cross's discovery request. *Id.*

The dissenting Justice agreed with the legal standard applied by the majority, but disagreed with the holding that the facts supported a finding of prejudice. *Id.* at 362. The dissent pointed out that neither the majority nor plaintiffs were able to show any real prejudice from Blue Cross's participation in the litigation for four and one-half months before seeking arbitration. *Id.* He noted that (1) Blue Cross was merely a passive participant in depositions initiated by plaintiffs directed primarily at the other defendant; (2) it is hard to see how plaintiffs were significantly prejudiced by Blue Cross producing documents at plaintiffs' request and answering plaintiffs' interrogatories; and (3) Blue Cross's discovery requests to plaintiffs were never answered and no evidence was in the record that plaintiffs expended time or effort on those requests. *Id.* Thus, in the dissenting Justice's view, the passage of close to five months and

mostly passive participation of Blue Cross as a newly joined party in ongoing litigation could not sustain a finding of prejudice sufficient to constitute waiver. *Id.* Based on the different application by the majority and the dissent of the same facts to the question of prejudice, it is easy to see how discrepancies arise among courts even where cases involve similar facts.

Waiver Rescinded

Even where a party has been found to have waived its right to arbitration, courts may rescind the waiver where unexpected developments in the case alter the nature of an action to a significant degree. *See Envirex, Inc. v. K.H. Schussler Fur Umwelttechnik GMBH*, 832 F. Supp. 1293, 1296 (E.D. Wis. 1993). In *Envirex*, the plaintiff filed amendments to its complaint alleging a new basis for its fraud count and a new breach of warranty count. *Id.* The court stated that even if defendants had defaulted on their right of arbitration before these amendments and before the time when the litigation began to heat up, “the new allegations in the amended complaints rejuvenate their right to demand arbitration.” *Id.* (citing *Dickinson*, 661 F.2d at 641-42 for the proposition that the addition of arbitrable claims to potentially non-arbitrable claim revives right to arbitration as to all arbitrable claims despite delay and discovery). *See also Cabintree*, 50 F.3d at 391 (“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.”).

In *Gilmore v. Shearson/American Express Inc.*, the Second Circuit held that where a party had expressly waived its right to arbitration by withdrawing its motion to compel arbitration, such right was not automatically revived by the submission of an amended complaint. 811 F.2d 108, 112 (2nd Cir. 1987). The court stated that in order to revive its right to move to compel arbitration, the party must show that the amended complaint contained charges

that should nullify the earlier waiver and allow the party to reassess its strategy. *Id.* at 113.

Thus, an amended complaint that alters the scope or theory of the complaining party's claims may warrant revival of the right to compel arbitration. *Id.* at 114.

Conclusion

There is no rigid rule setting forth the facts necessary to establish waiver of the right to arbitrate, but courts recognize the strong federal public policy favoring arbitration and generally require the party arguing for waiver to meet a heavy burden. Most courts consistently apply the same legal principles, requiring the party claiming waiver to prove both substantial participation in litigation and prejudice. Courts are reluctant to find waiver, and therefore a finding of prejudice sufficient to constitute waiver is generally based on several actions of the party seeking arbitration. A minority of jurisdictions do not require a finding of prejudice and, as a result, find waiver more easily. Yet, even those jurisdictions have recognized that a waiver may be rescinded where the scope or theory of the case is altered to a significant degree. There is some disagreement over what facts are sufficient to constitute waiver even among courts applying the same legal principles. One conclusion is clear from this survey of waiver cases: the decisions are highly fact-specific, case-by-case determinations, and one court's waiver of arbitration is another court's non-waiver.

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