Losing the Right to Arbitrate by Engaging in Litigation

Judge Abraham J. Gafni (Ret.)
December 14, 2015

Attempts to enforce a contractual right to arbitrate are often stymied by the contention that arbitration had been waived because a party engaged in protracted litigation prior to asserting that right.

Recently, however, a federal district court in Kentucky allowed a defendant to amend its answer to include the affirmative defense of arbitration even though the parties had been actively litigating the matter for almost three years, in *Stratton v. Portfolio Recovery Associates,* USDC, E.D. Ky., Central Division, Nov. 2, 2015. The court's opinion provides both guidance and a warning to parties who wish to preserve their right to arbitrate.

The case started in 2012 in state court, where Portfolio Recovery Associates LLC (PRA) had sued Dede Stratton for collection of a credit card debt assigned to it by another creditor. Thereafter, in 2013, Stratton filed a complaint in federal court seeking certification of a class action against PRA for violating the Fair Debt Collection Practices Act. PRA's motion to dismiss was denied. Stratton filed an amended complaint to which PRA filed a second motion to dismiss. This time, however, the motion was granted. Stratton appealed, and the U.S. Court of Appeals for the Sixth Circuit reversed the dismissal and remanded for trial.

Following this reversal, on Jan. 7, PRA filed its answer to the amended complaint. Subsequently, the court issued a scheduling order permitting the parties to amend the pleadings by July 31 (over a month before the scheduled end of discovery).

Finally, on June 26, more than two years after the initial complaint had been filed, PRA sought leave to file an amended answer, which included a demand for arbitration. Stratton objected on the ground that the right to arbitration had been waived. She contended that she would suffer undue prejudice as she had already responded to two motions to dismiss as well as being compelled to file an appeal. PRA countered that the amendment should be allowed because (1) it had been unaware of the mandatory arbitration clause in the agreement, (2) Stratton would suffer no prejudice as little discovery had taken place and (3) the motion was within the scheduling order deadline.

The court first addressed the assertions of undue prejudice and substantial delay, which in appropriate circumstances would prohibit the amendment.

The factors to be considered are:

• Must the opponent expend significant additional resources in discovery or trial preparation?

• Are there significant delays in the resolution of the dispute?

• Is the plaintiff prevented from bringing a timely action in another jurisdiction?

• Is the cause of action abrogated?

Here, only the first two factors were relevant, but these were deemed insufficient by the court.

First, it concluded there was nothing to suggest that Stratton would be required to expend additional resources in discovery.

It did acknowledge, however, that the proposed amendment would likely delay resolution of the dispute by reason of further motions and appeals relating to orders compelling or denying arbitration. In addition, in the arbitration, the parties would have to re-address the very same arguments presented in the earlier motions to dismiss. However, the

court concluded, that, on balance, these were not sufficiently prejudicial because substantially more discovery was not involved, and the motion was filed within the period of the scheduling order.

But why was PRA not deemed to have waived its right to arbitrate by delaying its demand for arbitration for two years while actively litigating motions to dismiss in court?

In its ruling, the court noted initially that arbitrability and waiver are to be determined under federal law when, as here, there is no specific provision designating state law as controlling these specific issues. In addition, these determinations would be based upon the strong federal presumption in favor of arbitration, waiver of which "is not to be lightly inferred."

The Sixth Circuit's formulated test for waiver required two findings: "whether the party seeking arbitration: (i) took actions inconsistent with any reliance on an arbitration agreement, and (ii) delayed its assertion to such an extent that the opposing party incurs actual prejudice."

In deciding whether actions taken are inconsistent with reliance on an agreement to arbitrate, "courts look to the filing of responsive pleadings, the parties' actions during discovery, litigation of issues on the merits, the length of delay, and the proximity of the trial date," the opinion said. In particular, "courts typically look for substantial discovery efforts in determining whether a party has waived its arbitration rights."

Yet another indication of inconsistent action would be if parties "sit" on their known rights reflecting their intentional relinquishment.

The court did not find that PRA's level of litigation activity was inconsistent with the right to arbitrate. Here, as noted earlier, there had been little discovery. Stratton had made only two requests for admission, to one of which PRA had responded.

In addition, based solely on representations in the filed documents, the court could not find that there was any showing of an intentional relinquishment of a right by PRA because it "alleges that it was not aware of the subject arbitration clause until after it started to receive the credit card agreement from the original creditor while gathering information in response to Stratton's initial discovery requests"; and, that it acted immediately when it did become aware. Whether this contention

would subsequently be proven could not be determined at the pleading stage.

Finally, because PRA had not engaged in behavior inconsistent with defendant's right to arbitrate, which is the first of the requirements under the Sixth Circuit's two-requirement test, it need not consider the second requirement, i.e., whether Stratton incurred actual prejudice.

Surprisingly, the court did not assign much weight to all of PRA's litigation activities in this case (including the initial commencement of proceedings in state court as well as the motions it filed and appellate argument in federal court). Rather, the court in a footnote merely reflects that in the absence of substantial discovery in the state or federal court, PRA's other activities were not sufficient to reflect behavior inconsistent with the right to arbitrate.

In short, the court focused almost entirely on discovery, without considering the impact of the two-year delay resulting from the extensive litigation on the plaintiff's case by reason of PRA's failure to insist on arbitration in its original state action and subsequent federal motions.

In retrospect, it is apparent that PRA was fortunate in not having its request for arbitration denied. Indeed, I would have anticipated that two years of preliminary motions and an appeal to the court involving issues that will now have to be reargued before an arbitrator would, by themselves, reflect activities inconsistent with arbitration resulting in substantial prejudice and delay without regard to the extent of past or future discovery. Moreover, on its face, it would appear clear that this delay was occasioned solely by the failure of PRA to have secured early on the loan documents that contained the mandatory arbitration provisions and based upon which it had filed the earlier state-court action.

Nonetheless, the warning for parties seeking to ensure that they do not lose their right to arbitrate appears clear. Never file any court document until you have first examined the underlying dispute resolution provisions to determine whether arbitration is required. This inquiry should include whether the arbitrator has authority to issue preliminary orders even before the commencement of the arbitration itself.

On the other hand, if you have engaged in court litigation and subsequently discover that arbitration is mandated, do not assume that waiver is unavoidable. You may still be able to demand arbitration if you can credibly demonstrate that your actions are not necessarily inconsistent with the agreement to arbitrate, and that your delay in asserting this right has not caused actual prejudice to your adversary. •

Abraham J. Gafni is a retired judge and mediator/arbitrator with ADR Options and a professor at Villanova University School of Law.