

# Everyone Can Be a Winner in Baseball Arbitration: History and Practical Guidance

By Edna Sussman and Erin Gleason

*“Somebody’s gotta win and somebody’s gotta lose and I believe in letting the other guy lose.”*

—Pete Rose, all time Major League Baseball leader in hits

While it may be that in baseball there has to be a winner and a loser, that is not necessarily the case in arbitration. Baseball Arbitration, also known as Final Offer Arbitration (FOA), is a process that is rarely discussed in commercial and international practice, though it offers efficiencies that would be “winners” for both parties. In FOA, parties have the opportunity to manage risk and drive settlement—features that are advantageous for both sides. It is time to focus on the application of this useful tool, which can help parties avoid the extremes of winning or losing in arbitration and perhaps enhance their chances of achieving the win-win of an agreed-upon settlement. Moreover, the FOA process generally shortens the time to the issuance of the award and opens the door for discussions about other mechanisms to streamline the proceeding and save time and costs. The following discussion provides a brief history of FOA and offers practical guidance for its application by parties and arbitrators.

## Overview

In its most basic form, FOA allows parties to submit proposed final offers/award amounts to an arbitrator. Upon the conclusion of the arbitration, the arbitrator is bound to issue an award with one of the final offers submitted as the award value.

While the process goes back to the trial of Socrates, modern-day references to FOA emerged in the 1950s in the context of collective bargaining agreements in the United States. At the time, the use of strikes as part of the dispute resolution process became too unsettling—parties needed better tools to facilitate negotiations. In this context, FOA was seen as an ideal way to resolve impasse arising from union and management disputes. It created a structured dispute resolution process, which was less disruptive and provided enhanced transparency of process.

It was not until the 1970s that the use of FOA was introduced to the world of baseball, and when FOA assumed its more popular moniker, “baseball arbitration.” After years of strife between teams and players over find-

ing the right balance of power in player contract and salary negotiations, FOA was adopted as a means for addressing power imbalances that had arisen in negotiations.<sup>1</sup>

But FOA was also seen as a way of stemming the risks associated with allowing an arbitrator to render awards without specific direction from the parties. It was almost necessarily assumed that an arbitral award, absent FOA direction from the parties, would result in splitting the difference between two numbers, another common concern expressed today despite numerous studies that have disproved this urban legend.<sup>2</sup>

FOA sought to eliminate these risks because parties could add controls to a process that otherwise felt too susceptible to compromises in decision making. It also came with the added incentive for parties to think critically about making more concerted efforts toward fruitful negotiations prior to the hearing—thus obviating the need for the arbitral process altogether.

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## The Psychology of FOA

In the years after FOA was introduced to Major League Baseball, the practice was studied by lawyers, psychologists and sociologists alike. Fascination with this process primarily stems from the effect it had on the decision-making processes of the parties and the arbitrators.

For example, in one study volunteer arbitrators were given a series of hypothetical fact patterns and were then asked to produce conventional arbitration awards and also respond to FOA scenarios for those same disputes. The purpose of the experiment was to observe the variation among arbitrators’ awards where they had free rein to make a decision versus the final offer cases where the arbitrator was forced to choose between two proposals submitted by the parties.<sup>3</sup>

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Interestingly, while there were differences in the final determinations rendered by arbitrators across the pools of hypothetical conventional arbitration and FOA cases, arbitrators' methods for making decisions demonstrated "a substantial degree of underlying consistency." The awards studied tended to show that arbitrators based their awards on the facts presented and relied less on the demands or offers made.

Years later, another study examined the negotiation patterns of parties involved in FOA processes.<sup>4</sup> This time, the research focused on why parties would allow the decision to be made by an arbitrator, instead of retaining the decision-making power themselves. The sophistication of parties to the negotiation, along with their relative optimism about their positions, were examined to understand how parties approached the process.

Controlled experiments confirmed that parties' optimistic expectations increased the distance between their final offers. The findings here demonstrate the importance of more fully informing party expectations as an effective way of improving negotiated outcomes. The study also highlighted an important consideration in managing one's expectations—the value in considering counter-party valuations and the merits of an opposing party's case. To the extent that parties are able to move toward limiting—or eliminating—the biases in their own expectations, they are more likely to reach voluntary settlements more often.

Most significantly, study after study has demonstrated that using an FOA process enhances the chances of settlement. As summarized: "Negotiators have a strong incentive to make realistic appraisals of the probable decision of the arbitrator and to submit offers and demands that are fairly close to what they really expect the arbitrator to award." It creates "an environment in which negotiators... find it in their respective self-interest to exchange reasonable offers and demands."<sup>5</sup> Thus adopting the FOA process drives parties towards conduct that facilitates settlement.

## FOA Variations

FOA is utilized in many fields other than baseball and collective bargaining disputes. International negotiations over trade and political issues, mergers and acquisitions disputes, real estate, tax, insurance, and other commercial matters are routinely submitted for FOA. Indeed scholars have suggested the process should be employed and would be particularly useful for the resolution of investor state disputes.<sup>6</sup> And baseball arbitration has recently been utilized in several states, including pursuant to a 2015 New York law, to mandate baseball arbitration to resolve disputes relating to patients' unexpected medical bills.<sup>7</sup> Recently the U.S. DC Circuit Court found that the irrevocable offer to engage in baseball style arbitra-

tion made the government's theories in its effort to block AT&T's acquisition of Time Warner "largely irrelevant."<sup>8</sup>

While all versions of FOA have in common the submission of final offers, there are several variations to consider, and the ramifications of the associated process decisions must be carefully assessed. Options include the following:

*TRADITIONAL FOA.* Under this process, the parties submit proposed final offers/award amounts to the arbitrator. Once the parties submit these figures to the arbitrator, they are usually unable to make any revisions to the number submitted. Upon the conclusion of the arbitration, the arbitrator is bound to issue an award with one of the final offers submitted as the award value.

... "most intriguing—an arbitral process that was seemingly founded to avoid arbitration altogether."

*NIGHT BASEBALL.* This process differs in that the final offers are either concealed from the other party or from the arbitrator. As with traditional FOA, parties in night baseball agree among themselves that the final award must be one of the offers proposed prior to the award's issuance. The parties may provide that their proposal is never exchanged with the other party and the arbitrator must choose one proposal. Or the parties may provide that the proposal not be shared with the arbitrator, who will issue an award, and the parties agree to select as the final award the number that is closest to the arbitrator's award amount. Or as another alternative, the parties might limit the arbitrator's power in rendering the award so that no monetary value would be specified by the arbitrator—the arbitrator would only rule in favor of one party or the other. The prevailing party's final offer would then constitute the final award amount.

*HIGH-LOW ARBITRATION.* Under this variation, parties agree to a range for the arbitral award: an award that is greater than the bracketed amount is reduced to the higher of the offers; an award that is rendered below the lower amount is increased to the lower of the offered amounts. And any award within the agreed range receives no adjustment. The arbitrator is not informed of the range. Under another variation of high-low, the arbitrator is informed of the offers but limited to issuing an award within the range.

*MEDIATION AND LAST OFFER ARBITRATION.* "MEDALOA" is yet another option. A MEDALOA process involves two steps, starting with the mediation. If mediation does not resolve the dispute, the parties submit their last offers to the mediator, who is then asked to serve as an arbitrator

and choose the award amount. Additional proceedings and presentation of evidence before the issuance of the award may or may not be provided.

## Drafting the Clause

As is always the case, careful drafting of the arbitration clause is essential. We focus here only on the aspects of the clause that pertain specifically to FOA options.<sup>9</sup> A mere reference to “baseball arbitration,” or “first-offer arbitration” is not sufficient to ensure that the process will be executed in the manner intended.

*OBJECTIVE:* The first issue that must be considered is why is an FOA procedure being adopted. Is it to promote settlement? Is it to manage risk? Is it to streamline the proceeding to provide a more cost-efficient process? Or is there some other objective? The answer to that question is central to determining the process choice.

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If it is to promote settlement, the objective for which FOA was originally devised, several exchanges of offers preceding the hearing are advisable. A night baseball process in which the offers are never shared with the opposing party would defeat the whole point of the exercise.

To promote settlement, a process that calls for two or more rounds of exchanges of final offers prior to the hearing and before the final and unchangeable offer is submitted to the arbitrator would encourage settlement. The International Centre for Dispute Resolution’s Final Offer Arbitration Supplementary Rules provide such a structure and can be incorporated into the arbitration agreement.<sup>10</sup>

If the objective is to manage risk, a high-low limit process might be most effective, but this requires a successful negotiation between the parties to arrive at a range that they are willing to accept.

If the objective is to streamline the proceeding by shortening the time to award but to otherwise have a full opportunity to present and assess the merits, a proposal made to the arbitrator at the conclusion of the hearing when the parties are better informed might be the best process choice.

But in all events, the process by which parties will exchange offers should be clear from the arbitration

clause. And while parties may hope that a settlement will be achieved, the clause must assume that an award is possible and ensure that the arbitrator and lawyers understand from the plain language of the clause how the process should be conducted. Accordingly, issues that should be considered in the drafting of the arbitration clause include:

*TIMING:* While typically the FOA is required by the arbitration agreement, it can be equally useful when proposed after the dispute has arisen. In the words of Nobel Prize economist Daniel Kahneman and his colleague Max Bazerman, who have closely studied how to manage risk through the use of FOA in business disputes: [the FOA] “strategy allows one side to encourage reasonableness on the part of the other by making a demonstrably fair offer at the outset and then, if the other side is unreasonable, challenging it to take the competing offers to an arbitrator who must choose one or the other rather than a compromise between them.”<sup>11</sup> FOA has been successfully used as a process choice after the dispute has arisen and its availability at that juncture should be kept in mind.

*RULES SELECTION:* Whether selecting an ad hoc process with the adoption of non-administered rules or an institutionally administered arbitration, it is important to specify not only the arbitral rules that will govern the dispute resolution process but also expressly state that the parties have tailored the application of those rules to include an FOA process.

*THE FINAL OFFERS:* The number of rounds of exchanges of offers, when the offers are exchanged, whether or not they will be shared among the parties, and whether they will be shared with the arbitrator may be specified and should be stated if a particular process is sought.

*SCOPE:* Parties may specify whether the FOA process they choose relates to any dispute that arises under the contract, or if the FOA process should be limited to discrete issues (including specific monetary aspects of the dispute). FOA is often most effective in the context of claim value, or where liability issues have been clarified. As discussed above, FOA may be useful post-dispute where liability is established to determine damages.

*ARBITRATOR’S AUTHORITY:* Expressly limiting the arbitrator’s authority to require that the arbitrator follow the process selected by the parties is essential.

*BASIS FOR DECISION:* Parties may wish to consider whether they want to provide some guidance to the arbitrator as to the basis upon which the arbitrator should make his or her decision. Should the arbitrator pick the offer, that is viewed as more “reasonable,” a somewhat vague term that leaves the arbitrator some discretion within the dictates of the authority granted? Or should the arbitrator be required to select the final offer that was provided by the party that the arbitrator finds would have prevailed on the merits? Or should the arbitrator

be required to select the final offer that was closer to the quantum of damages that the arbitrator concluded would have been awarded but for the FOA process?

*AWARD:* An award resulting from an FOA process may be reasoned but is frequently issued as a bare award. Parties may wish to specify their preference so there is clarity on this important point. It should be kept in mind that a bare award is not enforceable in some jurisdictions around the world,<sup>12</sup> so thought should be given to where enforcement might be sought in deciding whether an award should be reasoned or not.

The authors are not aware of any decisions that have dealt with whether an award that provides reasons on the merits but is limited in its choice of damages is enforceable as a reasoned award. But in light of the fact that consent awards are widely accepted as enforceable, and the issuance of awards based on an *ex aequo et bono* equitable decision, while rarely sought, is accepted as an alternative arbitration decision-making process, it would seem that there would be no enforcement issue with a reasoned award that adopted an FOA process.

In a reasoned award, the arbitrators' discussion would not only include the standard elements—history of the case, recitation of facts, and discussion of the applicable law, etc.—but, in addition to the explanation of the FOA process within the procedural section that would be included in any FOA award, the arbitrator's analysis of why the winning final offer was selected should be provided.

## Guidance For Parties

In an FOA arbitration, the selection of the final offer to be proposed by a party is perhaps the most critical aspect. Careful thought must be given to providing a final offer that the arbitrator will find to be the most appropriate resolution in light of the case presented. Parties would be well advised to conduct a comprehensive case evaluation process and pursue a thorough vetting of a claim's strengths, both on the merits and on damages.

The reasonableness of a counter-party's position should also be carefully evaluated. Finally, consideration should be given to the concessions the party is willing to make to maximize the chance that it will have the prevailing final offer.

As was observed in the research on FOA discussed earlier in this article, party over-confidence, lack of preparation, or hostility toward counter-parties may not only hinder settlement. It may also defeat the ability to prevail in the arbitration. These factors can cause a party to provide a final offer that the arbitrator will not find to be the better choice. Some counsel have employed the use of a mock arbitration in order to assist them in determining the number that should be provided as the final offer.<sup>13</sup>

Arbitrator selection is important as always. Parties may wish to ensure that the arbitrators selected under-

stand the parameters of their role in this unique process and are comfortable with the limitations imposed on their authority. To that end, parties may wish to issue joint questionnaires to arbitrators, or conduct interviews, inquiring as to familiarity with FOA and whether the arbitrator has served in other FOA processes.

## Guidance for Arbitrators

The parties' choice of an arbitral process guides the manner in which the arbitrator may manage the case. But in this instance, the challenges that an arbitrator may face in rendering an enforceable award are as unique as the FOA process itself. Certainly, the clause should provide that an award that follows the process shall be enforceable.

What actions can an arbitrator take if he or she feels that one or both of the offers are out of line? If the claimant's offer seems too high, but awarding the respondent's offer is too low, does the arbitrator have any recourse?

If the arbitrator deviates from the FOA process, refusing to select one of the offers submitted and inserting his or her own instead, will the award be enforceable? The short answer is that the arbitrator has little to no ability to deviate from the provisions of the arbitration agreement.

In some cases where the arbitrator feels that the process will lead to an unfair outcome in light of the facts and the law, the arbitrator may consider whether it would be appropriate to ask the parties if they are committed to following the FOA process set forth in their agreement—or, alternatively, ask whether the parties would be agreeable to switching to a high-low process. Before making any such suggestion, the arbitrator must consider whether changing the process would favor one party over another and would demonstrate partiality toward one of the parties. In the right circumstances, such a discussion may be appropriate. Unless both parties agree to a change, however, the parties' arbitration agreement dictating the FOA process governs.

## Conclusion

FOA offers parties with yet another option for streamlining arbitration. Various iterations of FOA have emerged over the past 70 years to help foster settlement, manage cost, increase efficiency and/or reduce risk in arbitrated disputes. While FOA may not be appropriate for every dispute, careful drafting, planning and case analysis can produce a winning outcome for all.

## Endnotes

1. See Benjamin A. Tulis, *Final Offer "Baseball" Arbitration: Contexts, Mechanics and Applications*, 20 Seton Hall J. Sports & Ent. L. 85 (2010), available at <https://bit.ly/2Pc2edp>.
2. See Ana Carolina Weber et.al, *Challenging the "Splitting the Baby" Myth in International Arbitration*, Vol. 31 Journal of Int'l Arbitration No. 6: 719 (2014), available at <https://bit.ly/2rh9N8N>.

3. See Henry S. Farber and Max H. Bazerman, *The General Basis of Arbitrator Behavior: An Empirical Analysis of Conventional and Final Offer Arbitration*, National Bureau of Economic Research Working Papers Series (1984), available at <https://bit.ly/2rejVF>; Max H. Bazerman and Henry S. Farber, *Divergent Expectations as a Cause Of Disagreement In Bargaining: Evidence From A Comparison Of Arbitration Schemes*, National Bureau Of Economic Research (1987), available at <https://bit.ly/2RlrdN4>.
4. See David L. Dickinson, *The Chilling Effect of Optimism: The Case of Final-Offer Arbitration*, Economic Research Institute Study Papers, Paper 259 (2003).
5. Charles Adams, *Final Offer Arbitration: Time for Serious Consideration by the Courts*, Neb. Law Rev, Vol. 66 Issue 2, p. 247 (1987) (summarizing the studies and the psychological theories).
6. Joost Pauwelyn, *Baseball Arbitration to Resolve International Law Disputes: Hit or Miss?*, FL. Tax Rev., Vol. 22 (2018)
7. John Tozzi, *Senators Borrow from Baseball Arbitration to Solve Problem of Surprise Medical Bills*, Bloomberg (February 7, 2019), available at <https://www.sfgate.com/news/article/Senators-borrow-from-baseball-arbitration-to-13597577.php>
8. *United States v. AT&T*, 2019 WL 921544 (U.S. Ct. of App. D.C. Cir. 2019).
9. For a general discussion of considerations in the drafting of an arbitration clause, see Edna Sussman and Victoria A. Kummer, *Drafting the Arbitration Clause: A Primer on the Opportunities and the Pitfalls*, Dispute Resolution Journal (February / April 2012), available at <https://bit.ly/2GXlRXG>.
10. The rules are available at <https://bit.ly/2rgjdRW>.
11. See Max H. Bazerman and Daniel Kahneman, *How to Make the Other Side Play Fair*, Harvard Business Review (September 2016), available at <https://bit.ly/2bC5r7J>.
12. See e.g. Article 37 of the Spanish Arbitration Act; Article 823(5) of the Italian Civil Procedure Code, cited in Danilo Ruggero Di Bella, *Final Offer Arbitration: A Procedure to Save Time and Money*, Kluwer Arbitration Blog (January 25, 2019), available at <http://arbitrationblog.kluwerarbitration.com/2019/01/25/final-offer-arbitration-a-procedure-to-save-time-and-money/>.
13. See Edna Sussman and James Lawrence, *Mock Arbitration for your Case: Optimizing your Strategies and Maximizing Success*, Fordham International Law Journal, Vol. 41, Issue 4 (2018).