

Alternatives

TO THE HIGH COST OF LITIGATION

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ADR Processes/Part 1 of 2

Final Offer/Baseball Arbitration: The History, The Practice, and Future Design

BY ERIN GLEASON AND EDNA SUSSMAN

It is nearly impossible to have a dialogue about arbitration that does not harken back to the problems so often decried by its users: It is expensive and it takes longer than anticipated.

In response to this user experience, numerous studies have been conducted, best practice materials published, and rules revised. One method for streamlining arbitration that is rarely discussed is final offer arbitration, or

FOA, in commercial and international practice. It is time to focus on this useful tool.

FOA has several variations but, in its most basic form, it is a process in which the parties submit specific proposals for the resolution of the dispute, and the arbitrator must pick one of the proposals.

This is the first of a two-part article. In Part 1, we provide an overview of FOA's evolution over the past 40 years and include examples of where this tool is currently used. In Part 2 next month, we will review the various forms of FOA, and offer practice pointers for parties and arbitrators to consider to assist them in designing and managing the most effective FOA process.

HOW AND WHY FOA DEVELOPED

While reports vary on when it first surfaced, modern-day references to FOA mostly 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 over the terms of collective bargaining agreements.

The process was not immediately accepted, however. In one case, a tribunal chair challenged the partisan members of his panel to both write down a figure that they each thought a fair award; the chair would then pick the number closest to his own assessment. Sadly, the wing arbitrators resigned instead of participating in this experiment. See Lon L. Fuller, *Collective Bargaining and the Arbitrator*, 1963 *Wis. L. Rev.* 1, 25 n.20 (January 1963).

It was not until the 1970s that the use of FOA became more prominent, in public employee wage disputes. Then, in 1974, FOA came into play in major league baseball. Today, FOA is widely known by its sport-inspired moniker: baseball arbitration.

FOA was introduced to the world of baseball after years of strife between teams and players over finding the right balance of power in player contract and salary negotiations. Historically, contracts between players

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pride, results in a number of cognitive biases. These are defects in thinking or rational decision making.

A false sense of self-depreciation comes off as exactly that—false. Disputants want experienced and credentialed mediators. The mediators have to quickly build rapport and trust without singing their own praises, either in falsetto or aggressively.

I believe that when mediators focus on the people and problem at hand, and are guided by their own positive emotions and virtues, especially kindness, gratitude, and humility, the authenticity creating the connections between people arises in an organic and natural manner. See “The Humble Neutral, at Your Service,” 36 *Alternatives* 55 (April 2018)(available at <https://bit.ly/2RD3ub5>).

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Even the driest of cases have emotional content.


Legal entities are comprised of sentient human beings. Conflicts are driven by decisions people make, either individually or as a group.

Unless artificial intelligence completely takes over, emotions will drive aspects of the decision making process. Maybe. Even the HAL 9000 computer in Stanley Kubrick’s 2001: A Space Odyssey displayed a range of emotions, and made a very human course of choices motivated by self-survival.

There is no right or wrong way to address emotions as they arise in the mediation room, including the mediator’s emotional reaction and response. The reality is that being tuned

into the current understanding of the science of emotion is helpful in our daily work.

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With the conclusion of the series of mediation emotions and this three-part summary, Master Mediator columnist Robert A. Creo moves this long-running monthly feature to every other month in Alternatives. He returns in March with a look at how “The Overconfidence Effect” operates in mediation. The archive of his monthly columns, beginning in November 2012, as well as earlier Alternatives articles, are available at altnewsletter.com. His previous CPR Institute Master Mediator columns, published on CPR’s website, are archived at www.cpradr.org and can be found by using the search function. 

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and teams contained reserve clauses—provisions that essentially bound players to the team they originally signed with for as long as the team wanted to keep them.

Once these clauses were pulled back, and free agency was adopted, Major League Baseball and its players sought a new method for making sure players were receiving fair market value for their salaries—and, likewise, that the teams were paying these players at the fair market rate. 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>).

FOA was adopted as a means for resolving these salary disputes. The MLB and MLB Players Association negotiated a system in which players’ arbitration rights were tied to their years of service.

For example, players who had been with a team for at least six years were entitled to free agency. But during their third through sixth years with a team, they are entitled to participate in an FOA process. Before the third year, the team mostly holds contract rights.

In this version of FOA, the player and his team submit proposed salary figures to a panel of arbitrators if the two sides cannot agree upon that figure among themselves. Based on

party presentations at a hearing, the tribunal selects the salary figure that is closest to fair market value as the arbitration award.

In collective bargaining disputes (baseball or otherwise), FOA was viewed as a fair way to address power imbalances that had arisen in negotiations. But it was also seen as a way of stemming the risks associated with allowing an arbitrator to render awards without specific direction from the parties.

In 1975, Peter Feuille wrote about the “chilling effect” of baseball arbitration—a theme that is common in our discussions of arbitration even now. In the literature of the time, it was posited that the insertion of an arbitration process would “chill” any potential for sensible negotiations between parties. See Peter Feuille, “Final Offer Arbitration and the Chilling Effect,” *Industrial Relations: A Journal of Economy and Society*, 14: 302-310 (1975) (available at <https://bit.ly/2zIKj9l>).

The theory was that parties would lobby for the respectively highest or lowest award in attempts to moderate the ultimate wild card in arbitration: the perceived whims of the arbitrator and the likelihood that the arbitrator’s award would always split the difference between the parties’ valuations.

It was almost necessarily assumed that an arbitral award would result in splitting the difference between two numbers, another common concern expressed today despite numerous studies that have disproven this urban legend. 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>).

The introduction of FOA processes sought to eliminate these risks. With FOA, parties could add controls to a process that otherwise felt too susceptible to corruption and inefficiency. It also came with the added incentive for parties to think more critically about making more concerted efforts towards fruitful negotiations prior to hearing—thus obviating the need for the arbitral process altogether.

This point is most intriguing—creating an arbitral process that was seemingly founded in order to avoid arbitration altogether. In nearly every sector that has been studied, the result of introducing FOA has been the same: the presence of a FOA clause often leads to a negotiated settlement prior to the need for a hearing.

THE PSYCHOLOGY OF FOA

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

For example, take early studies conducted by Henry Farber and Max Bazerman in the

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1980s where they sought to understand arbitrators' decision-making processes by introducing hypothetical arbitration exercises to groups of volunteer arbitrators. 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/2reJjVF>); 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>).

Chief among the concerns under review was the theory that arbitrators "split the difference" in rendering their awards, in order to stave off party anger with them and hopefully ensure the arbitrators' own future employment.

In the 1984 Farber-Bazerman 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 variance among arbitrators' awards where they had free reign to make a decision versus the final offer cases where the arbitrator was forced to choose between two proposals submitted by the parties.

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, in a study published in 2005, John D. Burger and Stephen J.K. Walters examined data from MLB arbitrations, where information was often public. John D. Burger and Stephen J.K. Walters, "Arbitrator Bias and Self-Interest: Lessons from the Baseball Labor Market," *J. Labor Res.* 26: 267 (2005)(available at <https://bit.ly/2Rqu4Vb>).

In this study, the researchers looked for

a better understanding of the equity and efficiency provided in baseball arbitration. But here, the data showed that arbitrators tended to side with teams and against players more often. An even stronger bias was found against African-American and Latin-American players.

David Dickinson studied the negotiation patterns of parties involved in FOA processes. See David L. Dickinson, "The Chilling Effect

Planning the Endgame

The process: Final Offer Arbitration. Baseball arbitration is synonymous, though the practice has variations.

The methodology: Get offers on the table. Choose one. Settle a case.

The paradox: You're 'creating an arbitral process that was seemingly founded in order to avoid arbitration altogether.' But the presence of an FOA clause often leads to a negotiated settlement prior to the need for a hearing.

of Optimism: The Case of Final-Offer Arbitration," Economic Research Institute Study Papers, Paper 259 (2003) (available at <https://bit.ly/2Ci9VeN>). This time, the research focuses on why parties would allow for a decision to be directed to an arbitrator, instead of keeping the decision-making power to 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.

One concern often expressed with FOA is

that if parties have not appropriately valued their positions, and attribute little or no credibility to the opposing side's position even where it has some merit, the fact the arbitrator is limited to selecting one of two outcomes means that 50% of the time one side will deem the finding to be unfair.

Similarly, where final offers are divergent, this risk of a dramatically different value can serve to facilitate negotiations but party overconfidence or lack of appropriate valuations can blind a party to the opportunity.

To the extent that parties are able to move toward limiting—or eliminating—the biases in their own expectations, they would most likely reach voluntary settlements more often. Where FOA is still invoked, the process will be more agreeable with more balanced approaches to evaluation because the arbitrator would be asked to choose between less extreme final offers.

TODAY'S APPLICATION

Colloquially, we know well of FOA's prominence in collective bargaining disputes. But the application of this process is much more far-reaching. International negotiations over trade and political issues, mergers and acquisitions disputes, real estate, tax, insurance, and other commercial matters are routinely submitted for FOA.

For example, the U.S. Department of Justice and the Federal Communications Commission maintain FOA programs involving media, communications, licensing, program access, and retransmission consent disputes.

The Organization for Economic Co-operation and Development (OECD) Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting also contains a default FOA provision. See <https://bit.ly/2gTnHee>. While states may opt out of the final offer-type of arbitration, favoring the "independent opinion" proceedings instead, most signatories have included the FOA provision to date.

To provide parties with guidance on how to craft a fair and efficient FOA process, some arbitral institutions now maintain rules incorporating FOA in domestic and international contexts. The CPR Non-Administered Arbitration Rules have been adapted by par-

ties to include FOA provisions. See <https://bit.ly/2IZtBs7>. [The CPR Institute publishes this newsletter with John Wiley & Sons.]

The American Arbitration Association and its International Centre for Dispute Resolution issued Final Offer Arbitration Supplementary Rules in 2015 that provide a tailored framework for the conduct of an FOA. See <https://bit.ly/2rgjdRW>.

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Various iterations of FOA have emerged since the process was adopted for collective bargaining disputes. One thing that these various processes have in common is that they are largely adopted by parties to manage cost, efficiency and the risk perceived in arbitration.

While FOA may not work for every dis-

pute, careful planning and consideration can produce a fruitful process.

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In Part 2 next month, the authors will review the various forms of FOA, best practices for drafting FOA provisions before and after a dispute is in play, and guidance for structuring and facilitating an efficient FOA process.

ADR Brief

OPTING OUT OF MEDIATION SHOWS STRONG TURKISH RESULTS

BY GIUSEPPE DE PALO & RUSS BLEEMER

There's new data indicating that requiring an initial and reasonable mediation effort is producing results in Europe.

It's not mandatory mediation, and the results are limited to one country's efforts. But Turkey's program allowing litigants to opt-out of mediation—mandatory referral but what proponents consider an easy exit, and which is seen as having more impact on litigation volume than programs that merely offer the ADR alternative—is clearly producing a lot of settlements.

Initial reports early last year, after Turkey reformed its labor law to push more mediation options, by the nation's Ministry of Justice indicated remarkable uptake in just the first month. It showed a 72% settlement rate—4,637 out of 6,423—for the mediations conducted after more than 30,000 mediation requests. See Leonardo D'Urso, "How Turkey Went from Virtually Zero to 30,828 Mediations in Just One Month," *Mediate.com* (Feb. 22)(available at <http://bit.ly/2GRW2DB>).

D'Urso noted that the number of cases was much higher than ever before in Turkey and even "since, and despite, the 2008 [European Union] Mediation Directive."

The directive, which mandates mediation options in cross-border disputes, sparked EU nations' internal mediation reforms, but hadn't produced a large increase in numbers of mediation. See, e.g., Leonardo D'Urso, "A New European Parliament Mediation Resolution

out mediation program, appears to have accelerated use and results. See Leonardo D'Urso, "Italy's 'Required Initial Mediation Session': Bridging the Gap between Mandatory and Voluntary Mediation," 36 *Alternatives* 49 (April 2018)(available at <https://bit.ly/2E8iNoD>).

Seçkin Arıkan, a Turkish attorney and an ADR expert, has provided an update about the impact of the reform, which features a required pre-trial mediation meeting of minimum two hours. During the Jan. 1-Nov. 8, 2018, period, the Turkish Ministry of Justice says 294,505 cases have been mediated. Of these, 179,576 cases, or 61%, resulted in an agreement.

While mediation has previously had high success rates in Turkey, the opt-out method has produced 15 times as many mediated settlements as opt-in, when there was no requirement for litigants to make a structured mediation attempt in front of a mediator, before filing a suit.

With the old opt-in model in place, during the period from November 2013 to November 2018, a total of 67,476 cases were mediated—around 13,500 per year. Arıkan reports that during that five-year period, the mediation settlement rate was extremely high—around 90%.

Still, he also points out that per year rate then cannot compare to a total expected to exceed 200,000 by year-end 2018.

The Turkey results accompany an active 2018 in international mediation. The European Commission for the Efficiency of Justice adopted a Mediation Development Toolkit at the end of June to aid countries in installing improved ADR programs into their court systems. See Russ Bleemer, "Summer Moves: UN, Council of Europe Seek to Install More Official Mediation Processes," 36 *Alternatives*

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More Table Talk

The objective: Increasing mediation use in Europe.

The results: As part of a long-running effort by the EU across borders, by nations in their domestic ADR schemes, and individual true believers, moves to encourage mediation are finally showing promising returns. Litigants are sent to mediation, and may opt-out if they don't want it.

The latest: Turkey installed the opt-out into a new labor law last year, and mediation sessions are booming. And opponents already are saying it's mandatory, and pushing for a rollback. A victim of its own success? Or a precursor to much wider adoption?

Call on Member States and the EC to Promote More Use," 36 *Alternatives* 19 (April 2018) (available at <https://bit.ly/2Ej8q25>).

The new Turkish law, similar to the 2013 Italy mediation law that led to that nation's opt-

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