ADR Techniques/Part 2 of 2

Putting Final Offer/Baseball Arbitration to Use

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In Part 1 of this article, we discussed the historical development of final offer arbitration—also called baseball arbitration and referred to as FOA—and the psychological underpinnings that explain its success.

Since its development in labor negotiations in the 1960s, FOA has been used in a wide variety of disputes and has been proven to enhance settlement prospects. See Erin Gleason & Edna Sussman, "Final Offer/Baseball Arbitration: The History, The Practice, and Future Design," 37 *Alternatives* 1 (January 2019) (available at https://bit.ly/2LQCjrB).

Implementing this settlement-inducing, cost-saving, and efficiency-enhancing technique requires attention to process design. In this Part 2, we offer practical guidance, including a review of the various forms of FOA, best practices for drafting FOA provisions before and after the dispute arises, and guidance for structuring and facilitating an effective FOA process.

FOA VARIATIONS

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:

i. *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.

ii. *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 that the final award value would be 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.

iii. *High-Low Arbitration.* Under this variation, parties agree on a range for the arbitral award: an award that is higher than the bracketed amount is reduced to the higher number amount; an award that is rendered under the lower amount is increased to that amount. And any award within the agreed range receives no adjustment. The arbitrator is not informed as to what the offers are. Under another variation of high-low, the arbitrator is informed of the offers but limited to issuing an award within the range.

iv. *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. 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). 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.

The first issue that must be considered is the objective of including an FOA procedure in the clause. 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.

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

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International Centre for Dispute Resolution's Final Offer Arbitration Supplementary Rules provide such a structure and can be incorporated into the arbitration agreement. (The rules are available at https://bit.ly/2rgjdRW.)

If the objective is to manage risk, a high-low 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 it is to streamline the proceeding, 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." 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).

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. Parties wishing to pursue an ad hoc process may wish to include the CPR Non-Administered Arbitration Rules (available at https://bit.ly/2IZtBs7) in their contract while noting the FOA modification to the Non-Administered Rules.

Offering Plan

The technique demonstrated: How to settle cases with final offer/baseball arbitration.

The details: They are plentiful. The simple high/low technique of the arbitrator picking one of the offers isn't so simple. Check out the variations.

The incentive: The fine print on these doesn't hamstring, for example, night baseball processes. They are all designed to make parties get real about their situations, and produce numbers and settlement points that they can live with … and accept the consequences if they have to live with the other party's assessment.

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 pricing, quantum, or other specific aspects of the dispute). FOA is often leveraged 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 quantum.

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, which is viewed as more "reasonable," a somewhat vague term which 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 dictated?

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, 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 which 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 standard elements—history of the case, recitation of facts, and discussion of the applicable law, etc.—but also an explanation of the FOA process within the procedural section and the arbitrator's analysis of why the winning final offer was selected.

Sample clauses

We provide here some sample FOA clauses which the authors have encountered in their practice. They do not purport to provide guidance for all process choices or to include all necessary provisions but should serve to provide some ideas as to how these clauses can be drafted and the nature of the language that might be employed. Here are the examples:

> The arbitrator shall choose one of the Party's positions based solely upon the written presentation of the [Claimant] on the one hand, and of the [Respondent] on the other hand. … It is the desire and intent of the Parties that the arbitrator has no ability to … apply rules that conflict with these provisions.

> The arbitration will be conducted in a "baseball format" with each party selecting and presenting a monetary "offer" to the Arbitration Panel, but not to the other party, at the close of the arbitration hearing. [Respondent's] offer will constitute the most it is offering to pay, in the context of the arbitration proceeding, and [Claimant's] offer will constitute the amount it is offering to accept, in the context of the arbitration proceeding. The Arbitration Panel must award whichever of the parties' two "offers" the Panel members believe is more reasonable in light of the facts and the applicable law. The Arbitration Panel must, as its award, select and award one of the Parties' offers and may not award any other amount.

A post-dispute high-low stipulation in which liability is conceded but damages remain in dispute might provide:

> The parties agree that the Arbitrator's award shall not be above a "High" of ___ or below a "Low" of _____. The Arbitrator shall issue an unreasoned award subject to the minimum/Low and maximum/High limits set forth in this stipulation; The Arbitrator's unreasoned award shall be in writing and shall be signed. Subject to the minimum/Low and maximum/High limits set forth, the Arbitrator's award is binding in all respects upon all parties and may be entered as a final judgment in any court of competent jurisdiction. No challenge or petition to vacate the arbitrator's award will be lodged based on the minimum/Low and maximum/High limits set forth in this Stipulation.

GUIDANCE FOR PARTIES

In an FOA arbitration, the selection of the final offer to be proposed by a party is perhaps the process's most critical aspect.

Careful thought must be given to providing a final offer to the arbitrator 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 to given the concessions the party is willing to make to maximize the chances that it will have the prevailing final offer.

As was observed in the research on FOA discussed in Part 1 of this article, party over-confidence, lack of preparation, or hostility toward counter-parties can not only hinder settlement but 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.

Arbitrator selection is important as always. Parties may wish to ensure that the arbitrators selected understand 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 of arbitrators, or conduct interviews, inquiring as to familiarity with FOA and whether the arbitrator has served in other FOA processes.

GUIDANCE FOR ARBITRATORS

As always, 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.

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 law, does the arbitrator have any recourse?

If he or she 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.

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Various iterations of FOA have emerged since the process was adopted for collective bargaining disputes. FOA processes are adopted by parties to foster settlement, manage cost, increase efficiency and/or reduce risk. While FOA may not be appropriate for every dispute, careful drafting, planning and case analysis can produce a fruitful process.