Kluwer Arbitration Blog

“Final-Offer Arbitration”: A Procedure to Save Time and Money?

Danilo Ruggero Di Bella (Bottega Di Bella) · Friday, January 25th, 2019

This is an introduction to the so-called “Final Offer Arbitration” (FOA), sometimes also referred to as pendulum or baseball arbitration. FOA is a model of arbitration that originated in the late 1940s and consolidated in the 1970s in the USA to resolve labour disputes in the public sector and the baseball league, hence the name. FOA differentiates itself from conventional arbitration owing to the incentives it sparks in parties’ conduct to reach a mutually agreeable settlement, its celerity in issuing an award and, accordingly, its overall ability of keeping proceedings costs in check.

As arbitration hubs are stepping on the gas of creativity to *a)* compete among themselves in providing their prospective users with the most efficient and innovative ways to solve their disputes, and *b)* not lose market share in favour of blooming regional arbitration centres, FOA may deserve consideration since it is a relatively unknown model of arbitration, and yet it aims at achieving the very same goals and implementing the same principles (procedural economy, swiftness, and fairness) by which arbitral institutions are shaping their reforms.

After presenting FOA’s special procedure and pondering its advantages and challenges, the reader will be left with a question.

FOA proceedings

In a FOA, the tribunal is obliged to render an award by selecting in its entirety one of the parties’ final proposal on the contentious issue or issues. Arbitrators cannot seek to bridge the gap between parties’ positions by coming up with a compromise decision. Because it is the final offer of one of the parties that will be chosen inevitably over the other, this raises the fear of losing the whole case. Hence, parties are spurred to make more realistic proposals, since an unreasonable position will most likely be rejected by the tribunal in favour of the more sensible competing offer.

The procedure is quite straightforward, although there exist several variations. After the round of written pleadings and the hearing where the contradictory points are singled out and evidence is presented to sort out those very points, each party simultaneously submits its proposal of the draft award. Afterward, the tribunal must make its award in the form of either party’s draft award without amending it.

The foregoing is the “*package* FOA”, according to which parties deliver an offer addressing the

dispute as a whole, and the tribunal picks one complete package or the other. A less stringent version is the "*issue-by-issue* FOA" version, where each party submit its final offer on each separate question in dispute, and then the tribunal can mold the award by siding with one party's offer on some points and with the other party's offer on others, thus combing the two drafts. This issue-by-issue FOA obviously shares more similarities with conventional arbitration. Another variety allows each party to put forward a twofold offer so that it gives parties some leeway in presenting at least a more ambitious position together with a more moderate stance to choose from. Some other modalities also envisage its inclusion in a multi-tier process, where mediation precedes the resort to the FOA. Some forms of FOA expressly provides for tribunal's obligation to give reasons for its choice, while others do not require arbitrators to state any reason.

Pros

Several advantages flow from such a streamlined procedure. The chance of succumbing to the opposing party's draft award instils in both parties enough uncertainty as to the possibility of a devastating outcome, that it drives both parties and their respective lawyers (who are risk-averse by nature) to engage in serious negotiations to reach a satisfactory agreement before the award is even rendered. FOA strongly incentivizes fruitful negotiations to settle the dispute, as opposed to conventional arbitration where disputing parties pass the ball to a third party (the arbitrator) who will have the responsibility to resolve their conflict, so that they are free to exacerbate the dispute (since it is not up to them to settle it) by taking the most radical positions.

On the assumption that arbitrators are usually reluctant to sanction extreme arguments, FOA pushes parties to act more reasonably, since this increases their chances of having their own draft chosen over the other party's offer. So, each party makes more realistic demands and concessions to secure against the tribunal going with the other party's draft. Therefore, a party may effectively steer the tribunal in its favour by consciously being more rational and considerate towards the other party's needs, something ideal to preserve long-term business relationships.

The time between the hearing and the rendering of the award is drastically reduced and so is the tribunal's workload – who, instead of going again through the statements of claim and defence to assemble its award, will simply have to decide which of the two drafts better reflects its view of justice in that case and sign it. A shorter timeframe for the proceedings translates into a less expensive procedure and, eventually, a better service for the parties.

Counsels and quantum experts will not have to defend extreme stances, strategically adopted only because of tribunals' tendency to make compromise awards halfway between the parties' demands. Such a defusing effect positively affects the costs of the proceedings.

In sum, FOA presents a tantalizing alternative to conventional arbitration for the parties, because it appears to be more prone to productive negotiations, faster, cheaper, it helps to safeguard long-term relationships, and parties collectively retain more control over the case as they will be able to influence the outcome by simply being more reasonable, and will not be blindsided by the contents of an outrageous award or annoyed by a decision aimed merely at "splitting the difference".

Cons

The *package* FOA, with or without the obligation to give reasons, is the more transparent and more appealing variation of FOA maximizing all the benefits of this type of arbitration. However, it is also the variation of FOA which could be more exposed to possible challenges. Hence, the analysis of the main drawback of this swift type of arbitration is focused on this type of FOA assessed against the 1958 NY Convention and the UNCITRAL Model Law (and a few national arbitration laws to test the concrete validity of such an assessment).

A *package* FOA award, that does not contain any reasons why one party's offer was chosen over the other but simply ratifies the preferred offer in its entirety, might be easily subjected to a challenge at the seat of the arbitration to be set aside or to objections to its recognition and enforcement in a third country.

Even though the NY Convention does not prescribe the requirement of stating reasons upon which the award is based and Article 31(2) UNCITRAL Model Law allows the parties to agree that no reasons are to be given, in some jurisdictions the lack of reasons is *per se* a ground to annul the award. For example, Article 37 of the Spanish Arbitration Act provides that the award shall always state the grounds upon which it is based (unless it contains the settlement between the parties in the form of an award) and, pursuant to Article 823(5) of the Italian Civil Procedure Code, the award shall briefly give reasons. Conversely, other jurisdictions are silent on such a requirement (e.g. Section 31 Swedish Arbitration Act, dealing with the contents and form of an award, does not explicitly require the award to be reasoned).

Such an award could be also set aside because the arbitrators exceed their powers by choosing a draft award that fails to rule on the dispute on its entirety, (*viz. infra petita* exception, as per Article 34(2)(iii) and 36(a)(iii) UNCITRAL Model Law and Article V(1)(c) NY Convention). A consequence of having each party drafting its own award is that becomes improbable that it mention in its proposal the objections or counterclaims raised by the opposing party, unless it does so to rebut it. Hence, such an award could not fulfil arbitrator's mandate to address every relevant issue of the dispute.

By the same token, it would be hard to show that a party was able to present its case since the award (drafted by the opposing party) is unlikely to include the arguments or counterclaims of the party whose draft award was not selected, thus making the award challengeable on the ground of Article 34(2)(ii) UNCITRAL Model Law or unenforceable on the grounds of 36(a)(ii) UNCITRAL Model Law and Article V(1)(b) NY Convention.

Careful considerations should be given when drafting a *package* FOA clause whose ensuing award lacks written reasons. Attention should be paid to confining the remit of the tribunal, waiving explicitly the right of appeal against the award, and agreeing on the procedure and contents of the award.

Consequently, despite its almost instantaneous deliberative process, a *package* FOA requiring the tribunal to state at least some brief reasons should be preferred to avoid the above challenges or objections. The reasons given could be well confined to the appreciation of the evidence presented.

Final question

Undoubtedly, FOA may help arbitration institutions to regain the advantage in terms of lower costs

as compared to State courts, an edge that arbitration is ostensibly losing. Could this FOA be a new feature to be added as an alternative procedure by leading arbitration institutions or could it maybe inspire the creation of a brand-new arbitration centre characterized by this seemingly cheaper, faster, and fairer process?

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