BY CHARLES E. RUMBAUGH

Having Trouble Getting to the Negotiation Table? Try Baseball Arbitration

(Part Two of a Two-Part Series)

The last ADR Corner ended with the promise that Part Two would cover where and how to apply "baseball arbitration." But, first let's re-visit the topic and set the stage.

Mini-Recap

Last month's article focused on designing a mechanism to "incentivize" the parties to negotiate or mediate their differences/disputes. For example, Part 1 stated,

> Some may be of the belief that parties must have an incentive—real or perceived—to commence the negotiation or mediation process. This thought emanates from the notion that negotiation/mediation is a voluntary process, whereby the parties always remain in control of the outcome. But how can the negotiating atmosphere, or alternative dispute resolution (ADR) process, such as mediation, be designed or structured to provide an "incentive" for the parties to move toward closure?

And, it was suggested that the parties view it from the possible "end," which could result in the parties knowing "that the 'final' resolution could be within a range of possibilities, or that the ultimate resolution will only be one possibility or another, i.e., an 'either/or' resolution. [And, this]… may 'assist' in getting the parties to the dance, but will they dance?"

Finally, it was recommended to look at baseball arbitration as "the" ADR agreement/clause that may be the vehicle to provide the incentive for the parties to participate in that "dance" in a good faith manner. It is/was the "open-ended" nature of some differences/disputes that precludes the parties from participating in (some) good faith negotiations. There must be an acknowledged alternative that will be the solution, or end, that positively relates to their best alternative to a negotiated agreement (BATNA). Knowing that the other party's offer is unacceptable as your BATNA "drives" the process and, thus, when offers and counteroffers narrow the gap and result in entering the realm of "acceptability," the dance is over and the parties settle!

Getting on First Base

The essence of a baseball arbitration agreement/clause could start with something like the following, "The parties shall exchange with each other and submit to the arbitrator(s) their last best offer to the other. The arbitrator(s) shall select only one or the other of such two offers that are submitted and shall award such selection."

Back to the original inquiry, where could this "incentivizing" tool be applied? The first illustration is where dollars, or contract formation issues, are involved. For example, let's assume that one of the parties is a buyer of a particularly critical item which, under the circumstances, is from a sole-source supplier—there is no effective alternative item available within the constraints of the buyer's needs. What incentive is there to negotiate in that situation? In particular, why would a supplier (as a policy of doing business) accept a letter contract/subcontract for a production item, when there is no incentive for the buyer to definitize an open price in a timely manner? What are the bounds in an unregulated market, where the buyer/seller has the freedom to contract? What "drives" the parties to arrive at the ultimate price under the circumstances of a particular sale?

Recently, the U.S. government buyers, to fulfill a congressional mandate to expand purchasing to commercial items where practicable, have had to call upon a multitude of "pricing"

tools or techniques, to assist them in their analysis of determining a "fair and reasonable" price for commercial items. This "fair and reasonable" price standard is the usual benchmark for pricing those items in the government or commercial sector. When confronted with the sole-source situation, where user requirements dictate that particular source of supply, however, those buyers face the not too uncommon dilemma—"how to motivate the seller to negotiate."

The U.S. General Accounting Office (GAO), in a report titled "DOD Pricing of Commercial Items Needs Continued Emphasis," stated exactly the nature of the problem:

> DOD officials noted that one difficulty facing contracting officers is that some contractors take advantage of their position as sole-source commercial item providers. Further, one official stated that some contractors refuse to negotiate what the government would consider fair and reasonable prices. DOD officials noted that in these situations contracting officers do not have enough leverage…. [The GAO found that negotiations by an agency] with one sole-source supplier resulted in a…negotiated price (that) was about three times the price previously paid." (italics for emphasis)

It may be unreasonable to expect parties facing critical sole-source price negotiations to truly negotiate, since the "end" may not be in sight.

Details of the Game

In a commercial type transaction that has limits upon reasonable alternatives, baseball arbitration is a viable alternative that may bring a little focus to the parties' field-of-sight. Further, by analogy, how can one obtain meaningful product/prior pricing information (fact-finding) from sole-source suppliers in order to facilitate "negotiations"? In some cases, those buyers cannot obtain any desired information, and the buyer may find that some of these sellers have no incentive to provide it.

Consequently, there is no (real) incentive for that sole-source supplier/seller to provide the information, or for that matter, "negotiate" at all, unless later in the "process" that supplier/seller would look "unreasonable" if they had neither provided the information nor participated with good faith offers/counteroffers expected in price negotiations. Baseball arbitration provides an answer to this "process" dilemma, by "incentivizing" these sellers to look "reasonable," providing reasonable product/pricing information, and— most importantly—"requiring" negotiations in good faith.

Otherwise, in the absence of making realistic offers/counteroffers (i.e., "movement"), their price may ultimately be deemed unfair/unreasonable by the arbitrator. This risk is normally unacceptable to sellers and, thus, they are "compelled" to dance-the-(negotiating) dance. A (unreasonable and potential) BATNA mandates that a seller provide data and offers to the buyer, which likewise, causes the buyer to reevaluate its negotiating position—with resulting counteroffers, due to the same phenomenon.

Power Application: Working for the Home Run

In addition to "pricing" or contract formation-related actions in the commercial sector, baseball arbitration has been considered in a spectrum of other applications. Here are a few of them.

- Governance situations where there is an equally split board of directors or general partners on a particular commercial/international issue with a strategic alliance, and where time is of the essence. The parties may need to be "incentivized" to negotiate over and through that impasse, realizing that if they don't, the arbitrator(s) may "select" the other "solution" through baseball arbitration.

- Franchise disputes involving a multitude of issues, e.g., encroachment, level of franchisor support, territorial expansion, use/misuse of proprietary information, or other "breach" issues could similarly be structured, such that the parties are "incentivized" to negotiate in good faith with baseball arbitration as the ADR method of choice.

- Major construction project disputes—with the perennial problems associated with performance or statement of work issues, extras, payments, substantial completion, or punchlists—could be addressed in a similar manner. Other real estate-related transactions also could benefit from having an "either/or" baseball approach.

- Industrial/production areas calling for just-in-time decisions over quality, acceptance, warranty, and customer issues, as well as supply chain performance/delivery questions, could be managed through an effective ADR system design that "motivates" the parties to negotiate in good faith.

- Finally, B2B/B2C Internet transactions, where "speed" of the deal is crucial, have been good candidates.

Perhaps you may find that the incentive to negotiate/mediate in good faith is seasonal in nature. Consider baseball arbitration as a technique that never is out of season. ***CM***

This is adapted from an "ADR Tip" column by Charles Rumbaugh, Esq., and Michael Powell published in the October-December 2000 issue of the Dispute Resolution Times by the American Arbitration Association.

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