COMMERCIAL LEASING: ARBITRATION AND REMEDIES
PAPER 2.2

Final Offer Arbitration: Baseball, Boxcars & Beyond

These materials were prepared by Murray A. Clemens, QC of Nathanson, Schachter & Thompson LLP, Vancouver, BC, for the Continuing Legal Education Society of British Columbia, May 2011.

© Murray A. Clemens, QC
Final offer arbitration is a method by which a dispute between two parties is resolved by an arbitrator choosing between final offers of settlement made by each party to the dispute. The final offer chosen by the arbitrator binds the parties to the dispute and in most applications, forms the basis of an agreement between them for the provision of services.

Final offer arbitration, at least in the North American context, has its origins in American Labour Relations. For some time prior to the mid 1960s, bargaining impasses between public employers and unions were, in many instances, resolved by way of interest arbitration. Interest arbitration is a procedure by which bargaining parties submit a dispute to a neutral for final adjudication. It differs from rights arbitration in that its focus is the resolution of disputes that arise during the negotiation of new contract provisions, while rights arbitration involves the resolution of disputes that arise during the administration of an existing contract. In typical interest arbitration, the arbitrator is called upon to write a part of a new contract, as opposed to interpreting or clarifying provisions of an existing contract.

One of the major criticisms of interest arbitration has been to suggest that its availability will have a “chilling” or deterrent effect on the incentive of the parties to bargain in good faith and thereby artificially widen the gap during negotiations. That is, the union will inflate its proposal and management will lower its offer, because of the perceived tendency of an arbitrator to compromise the positions or “split the difference.” This led to a “habit forming” substitute for bargaining. The argument that conventional interest arbitration “chilled” the bargaining process led to a suggestion final offer arbitration by a labour relations practitioner in a 1966 article entitled “Is Compulsory Arbitration Compatible With Bargaining?” The author, Carl M. Stevens, argued that there were three general ways in which arbitrators determined awards:

1. splitting the difference;
2. adhering to principles; or
3. selecting one side or the other.

Where arbitrators tended to award a compromise between the parties final positions (splitting the difference), the parties had little incentive to negotiate and tended to enter the arbitration process with extreme final positions, thereby creating a “chilling” effect on the bargaining process.

Where arbitrators base their award on “principles,” the incentive to bargain before arbitration was thought to also be reduced as the principles became known and the arbitrator’s award became predictable, encouraging parties to hold out for principles.

By contrast, requiring the arbitrator to select one party’s entire final position without the possibility of compromise, raised the risk of arbitration and therefore, increased the incentives for the parties to bargain.
The theory of final offer arbitration is quite simple. It was believed that the logic of the procedure itself would force the parties, even in threatened impasses to continue moving ever closer together in search of a position that would most likely receive a neutral's sympathy. Ultimately, so the argument went, they would come so close that despite the early threat of stalemate, they would almost inevitably find their own settlement. In short, final offer arbitration would normally obviate its own use. Even if it did not, the position of the parties would be so similar when they did go to arbitration, that the range of neutral discretion would be limited severely and thus, not threaten seriously the vital interests of either party, no matter which way the decision went.

Resort to final offer arbitration has been more frequent in the US than it has been in Canada. By the early 1970s, several American States had enacted legislation requiring collective agreement bargaining impasse between public authorities such as municipalities and public employees—usually fire-fighters, police and prison guards, to be resolved by way of final offer arbitration.

In Canada, final offer arbitration has been available in only two pieces of labour legislation, the Ontario School Boards and Teachers’ Collective Negotiations Act (1975 to present) and the Manitoba Labour Relations Act (from 1988 to 1991).

I. Baseball Arbitration

The most publicized, if not notorious application of final offer arbitration, is baseball arbitration. Prior to 1974, major league baseball players had little bargaining power in salary negotiations. Once a player was drafted by a team, he could negotiate only with that team, and if he was unable to sign a contract, the “reserve clause” prohibited him from selling his services to any other team. The player was thereby perpetually tied to the team that drafted him unless he was traded. These restrictions put the owners in a virtual monopoly position, which resulted in salaries considerably below player market value.

In 1974, two things occurred in major league baseball which changed the balance. First, players with more than six years of experience and not then under contract with a team, could opt for free agency. This allowed a player to auction his services among all of the teams. The second change was the introduction of the settlement of salary negotiation impasses through final offer arbitration.

The process was quite simple. After a player files for arbitration, the player and the owner must each submit final salary figures and a hearing is scheduled before a single arbitrator chosen from a list agreed to by the major league Baseball Players Association (the “Union”) and the owners’ Players’ Relations Committee.

Negotiations between the player and his team may continue during the arbitration process. If a settlement is achieved prior to award, the case is withdrawn.

The hearings are confidential, financed equally by the Union and the owners’ Association and each party is limited to one hour of initial presentation and a half hour of rebuttal and summation. The arbitrator considers only the following criteria in deciding salary cases: player performance during the past year; length and consistency of player’s careers; salaries of compatible players; and the team’s on-field success and attendance. Team profitability and market size cannot be considered.

An arbitrator is encouraged to give a decision within 24 hours. The decision is binding and is limited to either the players’ salary request or the owners’ salary offer. The arbitrator cannot give reasons or an explanation for the salary chosen.

Statistical data evaluating the process for its first twenty years of operation (1974 to 1994), offers evidence that the process promoted bargaining efforts which often prompted the parties to resolve their differences without resorting to an arbitration hearing. In the 20 years examined, approximately half of all of the players eligible for arbitration failed to use this system. Seventy-nine percent of all
arbitrations filed resulted in negotiated settlements without hearings. The proportion of settlements to awards was lower in the early years of the process and higher in the latter years. It is now said that only one out of ten arbitration filings require an arbitrator’s decision. All of these findings support the cited advantage of final offer arbitration. When there is no compromise and the arbitrator must select one of the parties’ offers, the fear that the other party’s offer may be perceived as more reasonable, promotes sincere and intense negotiations. Compromises during negotiations lead to high settlement rates.

Notwithstanding these platitudes and at least statistically verified success rates, final offer arbitration has not met with a view in common by owners and players. Notwithstanding that owners won 56% of all arbitrations over the first 20 years, players’ salaries have escalated dramatically. Whitey Herzog, the former General Manager of the California Angels, stated that “Arbitration is the strongest vehicle the players have and it is the worst thing that happened to owners. When baseball owners gave the players right to arbitration, they sold out the house.” Indeed, the perception is that even when a player loses an arbitration, he wins, as in all cases the award has been higher than what the player received previously. It is only a question of how much more.

II. Canada Transportation Act

Prior to 1988, freight rates and in particular, railway freight rates, were set by the national railroads and published as tariffs under the National Transportation Act. Before 1988, federal railways in Canada were permitted to set rates collectively. Rates were fully transparent and competition in rate making was virtually non-existent. The National Transportation Act, 1987 (effective January 1, 1988), introduced many new provisions designed to enhance competitive access for shippers and to ensure that competition and market forces became factors in the establishment of rail freight rats. The Act eliminated collective rate making altogether and created new statutory mechanisms to encourage intra-modal rail competition such as confidential contracts, competitive line rates and extended inter-switching. Final offer arbitration was included in the 1988 reforms as a means of enhancing the bargaining power of shippers who did not have “an alternative, effective, adequate and competitive means of transporting goods …” These amendments were considered and commented on by the Federal Court of Appeal in Canadian Pacific Ltd. v. The National Transportation Agency, [1992] 1 F.C. 145 at 149-52:

This new legislation is aimed at changing the old ways by fostering more competition within the railway industry and within the transportation system generally. We prefer the analysis of section 115 offered by Mr. Rothstein, who represented CSP Foods. Basing himself squarely on the language of section 115 and on the policy of the legislation expressed in the Act, Mr. Rothstein submitted that Canadian Pacific is obligated to issue a tariff containing a rate for its portion of the movement of through traffic, if it is requested to do so by the shipper.

With the passage of the new Act, rates are no longer established collectively and publicly in all cases, they may be negotiated individually and confidentially. Rebates and specific rates are allowed, whereas they were not before. The system has been rendered more limber.

Hence, under the new scheme, market forces are the primary influence in the establishment of rates whereas under the old system rates were tightly regulated and sometimes even established by the railway themselves. The aim of all this is to foster competition so as to render the railway system more efficient by providing transportation at the lowest possible cost, consistent with the other policy goals of the act.
The final offer arbitration provisions of the *National Transportation Act*, 1987, were preserved in the *Canada Transportation Act*, S.C. 1996, c.10. The statutory framework within which final offer arbitration proceeds under the *Canada Transportation Act* is set out in Part IV, ss. 159 to 169.

Under s. 16(1) of the Act, a shipper is entitled to instigate final offer arbitration by submission to the Canadian Transportation Agency, where the shipper is dissatisfied with the rate or rates charged or proposed to be charged by a carrier or with any of the conditions associated with the movement of goods.

The submission for arbitration must follow attempts to negotiate satisfactory rates and conditions. The submission for arbitration must contain, among other things:

1. the final offer of the shipper;
2. the last offer received by the shipper from the carrier;
3. an undertaking by the shipper to ship the goods to which the arbitration relates in accordance with the decision of the arbitrator.

By s. 161(4), it is declared:

4. A final offer arbitration is not a proceeding before the Agency.

As noted, a final offer arbitration is not a proceeding before the Agency. In the writer’s view, it was the intention of Parliament to provide a means outside of the regulatory framework to inspire the parties to reach an agreement and, absent voluntary agreement, to impose one or other final offer as the parties’ agreement. This “hands off” attitude is recognized in the Agency’s decision *Re Canadian National Railway Company*, [1990] N.T.A.R. 7 at 11, where the Agency found:

The role of the Agency as regulator in the final offer arbitration process was intended to be minimal and restrictive. Specifically, the Agency must maintain a list of arbitrators, must ensure that any submission for final arbitration conforms to the requirements of section 48 of the NTA, 1987 prior to referring the matter to an arbitrator either chosen by the parties or by the Agency and may be requested to provide technical, administrative or legal assistance to the arbitrator. The information requested by the arbitrator, as well as the relevance of any material presented by the parties, is the sole responsibility of the arbitrator who is charged with deciding between the two offers.

The submission of the matter to the Agency for final offer arbitration commences the process. All of the steps required to be taken must be concluded within 60 days of the date of the process is initiated, including:

1. submission of a final offer by the carrier;
2. the appointment of an arbitrator;
3. the exchange of “information” between the shipper and the carrier “that they intend to submit to the arbitrator in support of their final offers”;
4. the delivery of interrogatories;
5. the answers to interrogatories; and
6. the decision of the arbitrator.

The decision of the arbitrator is limited to “the selection by the arbitrator of the final offer of either the shipper or the carrier ...” s. 165(1).
The only requirements for the decision is that it be in writing. By s. 165(4), the statute directs:

(4) No reason shall be set out in the decision of the arbitrator although s. 165(5) provides that the arbitrator shall give reasons if requested by both of the parties to the arbitration within 30 days after the decision is delivered.

There is virtually no guidance with respect to procedure other than s. 163 which provides:

163(1) In the absence of an agreement by the arbitrator and the parties as to the procedures to be followed, the final offer arbitration shall be governed by the rules of procedure made by the Agency.

The Agency has not established rules of procedure for final offer arbitration and accordingly, the arbitrator has to effect an agreement among the parties with respect to procedure. In this regard, I have developed a “Format For Oral Hearing On Final Offer Arbitration.” I have been successful in having the parties agree to this in past arbitrations.

As with baseball arbitration, the process of establishing which offer should be chosen by the arbitrator is quite different than traditional litigation proof.

There is nothing in the Act which requires proof of a party’s case by way of evidence.

On the 15th day after the arbitrator is appointed, the parties are required to exchange the information that they intend to submit to the arbitrator in support of their final offers. The information, typically comprises narratives describing the rail service, the business of the shipper, the nature of the shipment of the shipper’s commodity, the market for that commodity, the costs involved in the production of the commodity, the costs involved in the operation of the railroad and the particular service, together with an argument as to which parties’ offer is more reasonable in all of those circumstances. The technical information involving the economics of carriage and production of the commodity to be shipped, as well as the logistics involved in the shipment is typically the subject of reports prepared by experts in those fields. Each party is also entitled to obtain Answers to Interrogatories, which can be placed before the arbitrator to assist in determining which offer should be chosen.

The Act does not provide for rebuttal evidence. This may present a difficulty to either or both of the parties who misjudge or fail to anticipate the information submitted by the other party in support of their final offer. The only provision that provides for any relief is the statutory entitlement of the arbitrator to request additional information from the parties (s. 164(1)). In most of the arbitrations that I have conducted, one of the parties usually wants to adduce additional information. In considering the submission, the arbitrator has to balance issues of fairness (whether the party is really only attempting to split its case) with the goal of ensuring that all of the relevant information is made available to assist in arriving at the best decision.

As to the criteria to be applied by the arbitrator in making a decision, a statute offers little guidance. Section 164(2) provides:

164(2) Unless the parties agree otherwise, in rendering a decision the arbitrator shall have regard to whether there is available to the shipper an alternative, effective, adequate and competitive means of transporting the goods to which the matter relates and to all considerations that appear to the arbitrator to be relevant to the matter. (emphasis added)

Given that reasons for decision will, in all likelihood, never be requested, the parties will never know what influences an arbitrator’s decision. This raises the risk to the parties, based on the theory outlined earlier in this paper and should have an influence on achieving on more negotiated settlements. The evidence to date seems to support that thesis.
While final offer arbitrations are confidential, the Canadian Transportation Agency has published non-identifying descriptions of the results of all of the final offer arbitrations instituted under this Part since January 1, 1988. Given that there will have been hundreds of freight rates established between shippers and carriers from January 1, 1988 through to end of 1997, arbitration has been resorted to on only 13 occasions. Of those 13 applications, a final order was issued in only five arbitrations. One of those decisions was set aside upon review by the Federal Court of Appeal and referred back to the arbitrator in order to give the carrier an opportunity to respond to the supplementary information from the shipper. That matter settled before it was reheard.

III. Beyond

In my view, the advantages to this speedy dispute resolution process which focuses the parties on making reasonable offers such that voluntary agreements are inspired, could have application to other commercial disputes such as:

1. share valuation issues in shareholders’ disputes;
2. rent reviews in lease agreements;
3. claims under Construction Contracts for payments for additional work.