Suitability of FOA for the ACCC's Mandatory Bargaining Code

Response to Commentary

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1. INTRODUCTION AND SUMMARY

1. In response to the ACCC's Concepts Paper on the forthcoming mandatory news media bargaining code, we prepared a report that recommended a bilateral bargaining regime instead of mandatory collective bargaining and raised for consideration final offer arbitration (**FOA**) as a mechanism to resolve bargaining impasses.[1]

2. In its Draft Bill for an Act to amend the *Competition and Consumer Act 2010* in relation to digital platforms, the ACCC has adopted bilateral bargaining and also FOA for resolving disputes over remuneration to be paid by digital platforms to news media businesses (**NMBs**).

3. Governments and regulatory authorities around the world are watching these Australian developments closely and considering the merits of FOA as a potential solution to bargaining impasses between digital platforms and other entities.

4. While FOA has been in use for decades, and has been employed in many jurisdictions (including the US, Canada, New Zealand and in the context of international disputes) and in a variety of contexts (including traditional regulatory contexts such as telecoms, broadcasting and transport), should the Draft Bill become an Act, it would be the first time it has been employed as a mechanism for resolving commercial disputes in an Australian regulatory context. Its performance will be closely observed, and if it is regarded as successful, it is likely to be considered for a broader regulatory role, as it offers a low cost, high speed alternative to traditional regulatory price setting functions that are widely regarded as costly and cumbersome.[2]

5. Some commentary on the ACCC's draft code has included suggestions that FOA may not be a suitable framework for the resolution of disputes between large digital platforms and NMBs over payment for content.

6. In particular, it has been suggested that FOA is usually used and is most suitable in circumstances where:

   a. The parties to the dispute are not far apart in terms of their positions;

   b. Both parties have good knowledge of the issues and there is information symmetry; and

   c. There is no debate to be had over the principles to be applied to determine the value to be exchanged.

7. Some commentators have also suggested that FOA is "untested", that empirical evidence does not support the theoretical predictions of proponents of FOA, and that FOA is "risky".

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1 See Geoff Edwards and Jennifer Fish, *Bilateral v Collective Bargaining and Arbitration Options: Response to the ACCC Concepts Paper on the Mandatory News Media Bargaining Code*, 5 June 2020.

2 At the time of the introduction of FOA for telecommunications and broadcasting disputes in Canada in 2000, the Canadian Radio and Telecommunications Commission (**CRTC**) took the view that "[p]rocesses that allow for the speedy resolution of these disputes are essential if the Commission is to minimize the strain on its resources and, more importantly, if it is to achieve its objective of fair and sustainable competition". See CRTC, *Public Notice 2000-65*, 12 May 2000 at https://crtc.gc.ca/eng/archive/2000/pb2000-65.htm.

8. In our opinion, there is no basis in any of this commentary for the ACCC to prefer conventional arbitration (**CA**) or any other dispute resolution mechanism over FOA for resolving disputes over payment for news content by digital platforms.

9. First, as we explain further in Section 2, FOA is in fact well-suited to and often used in situations where parties to a dispute are far apart in their positions, where there is information asymmetry and where there is debate to be had over the principles to be applied to determine the value to be exchanged. Indeed, FOA is likely to be least effective under the opposite conditions. One of the main advantages of FOA is that it provides strong incentives for disputes to be resolved in negotiations prior to arbitration, due to the uncertainty and risk the parties face of an arbitral outcome that cannot "split the difference" between the parties' final offers. FOA is likely to be least effective in resolving disputes prior to arbitration when the parties are already close together in their positions, when there is a high degree of information symmetry and when there is no debate over the principles to be applied, because under these conditions there is little uncertainty and limited cost to the parties of an adverse arbitral outcome (compared to what they would achieve in a negotiated settlement).

10. Second, far from being "untested", FOA has been "tested" since the early 1970s in a variety of contexts, from the resolution of commercial disputes in the transport, broadcasting and telecommunications sectors to domestic and international taxation disputes and disputes over public sector employment terms and conditions.[3] Moreover, in the vast majority of these cases, once tested FOA has remained in place for the resolution of disputes without reversion to CA,[4] suggesting satisfaction among the parties and authorities with FOA's real-world properties. The claim that FOA is "untested" can therefore only be made in relation to the context of disputes between digital platforms and NMBs over payment for content. In that context, every dispute resolution alternative (including CA and determination by a regulator) is "untested".

11. It also should not be overlooked that other "tested" dispute resolution methods, such as CA and determination by a regulator, have well-documented shortcomings, including positional negotiation, regulatory burdens and considerable delays compared to FOA. CA, in particular, has been criticised for its "chilling effect" on negotiations before arbitration and lengthier process. Therefore, even if one were to consider FOA to be relatively "less tested" (despite its use in a variety of contexts over nearly 50 years) this would not, in our view, constitute a sound reason to prefer other dispute resolution mechanisms that have been relatively "more tested" and found wanting in a number of respects.

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3 Indeed, its history is much longer than that. Historians have recorded that FOA was used as early as in Ancient Greece, during the trial of Socrates: see Ashenfelter, O., J. Currie, H.S. Farber and M. Spiegel (1992), "An Experimental Comparison of Dispute Rates in Alternative Arbitration Systems," 60 *Econometrica* pp. 1407-1433 at p. 1408. It has been reported that the jury was required to choose between the punishment proposed by the prosecutor (death) and the punishment proposed by Socrates (a fine). One can only philosophise over what might have happened had Socrates proposed a harsher punishment (short of death).

4 The only instance in which we are aware of FOA being replaced with CA is in New Jersey in the context of bargaining over public sector employment terms and conditions. A study of this event has reported that parties were further apart in terms of their final offers at arbitration after the change to CA. Of particular note is that the US Federal Communication Commission (**FCC**), having gained experience with FOA as a condition for merger clearance of *NewsCorp/DirecTV* in 2003, turned again to FOA for conditioning the merger of *Comcast/NBC Universal* in 2011, rather than to CA.

12. Third, as we explain in more detail in Section 3, the evidence available from real-world experiences with FOA suggests satisfaction with FOA where it has been implemented. In particular, there appears to be satisfaction with FOA as a procedure for resolving commercial disputes in the broadcasting sector in Canada and the United States,[5] as well as for resolving taxation disputes.[6] More generally, there has been continued use of FOA over decades in a number of contexts and, as mentioned above, there have been few instances of reversion to CA once FOA has been introduced. The limited number of empirical studies of FOA's real-world performance generally confirm the predictions of proponents of FOA: FOA has resulted in high rates of negotiated settlements, and studies of natural experiments in the public sector employment context have generally found FOA to have performed better than CA with respect to both negotiated settlement rates and convergence of the parties' positions when arbitration does occur.

13. While some laboratory experiments have found behaviour that is inconsistent with the predictions of FOA's proponents, the evidence from laboratory experiments is mixed overall. We also consider that laboratory experiments may be unreliable predictors of real-world behaviour for a number of reasons and greater weight should be placed on experience from real-world implementations in the field.

14. Finally, uncertainty and risk are key features of the FOA mechanism, as they incentivise the parties to reach agreements before arbitration and converge in their positions if arbitration proceeds. However, from a societal perspective, in the context of the need to address the bargaining imbalance between digital platforms and NMBs identified in the ACCC's Digital Platforms Inquiry Final Report and the Government's desire to support a sustainable media landscape,[7] FOA is arguably *less* "risky" than CA, which risks less genuine "good-faith" engagement in negotiations before arbitration and greater use of arbitration with concomitant costs and delays before disputes are resolved.

15. The "risk" of FOA in the case of digital platforms and NMBs in Australia is also mitigated by the proposals in the Draft Bill for arbitrated agreements to be limited to one year, for the arbitrator to consider (among other things) whether a particular payment amount would place an undue burden on the commercial interests of the digital platform, and for the arbitrator to be able to adjust the more reasonable of the two offers should both offers raise significant public interest concerns. It would also be prudent for the ACCC to propose that there be a review of the performance of FOA after a reasonable period of time has passed for experience with FOA to be gained.

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5 The CRTC has been using FOA for resolving broadcasting and telecoms disputes since 2000 and the FCC has twice imposed FOA as a condition for clearance of vertical broadcasting mergers.

6 For example, FOA is the default arbitration mechanism for the resolution of disputes under double taxation treaties between a number of countries, including Australia.

7 See: Joint Media Release by the Hon. Josh Frydenberg MP (Commonwealth Treasurer) and the Hon. Paul Fletcher MP (Minister for Communications, Cyber Safety and the Arts), *ACCC mandatory code of conduct to govern the commercial relationship between digital platforms and media companies*, 20 April 2020.

2. SUITABILITY OF FOA FOR THE RESOLUTION OF DISPUTES BETWEEN DIGITAL PLATFORMS AND NMBs

16. As mentioned in the introduction, it has been suggested that FOA is usually used and is most suitable in circumstances where:

    a. The parties to the dispute are not far apart in terms of their positions;

    b. Both parties have good knowledge of the issues and there is information symmetry; and

    c. There is no debate to be had over the principles to be applied to determine the value to be exchanged.

17. In our opinion there is no basis for this suggestion. In fact, FOA is well-suited to and has been successfully applied in contexts where the parties are far apart in their positions, where there is information asymmetry and where there is considerable room for debate over principles for valuation. Indeed, we consider that FOA is particularly well-suited to these contexts due to its incentive properties that encourage reasonable offers to be developed. It is also common for arbitration systems to include mechanisms for reducing information asymmetry and provide criteria to guide the parties and the arbitrator in resolving disputes, and mechanisms and criteria of this kind are being proposed by the ACCC in the Draft Bill. The following sub-sections elaborate.

2.1. FOA is well-suited to achieving convergence when parties are far apart in their positions

18. FOA has been successfully applied in the resolution of disputes in a number of contexts where the parties have been far apart in their positions in terms of valuation and/or other terms and conditions on which an exchange is to take place. For example:

    a. In broadcasting disputes over access to channels, channel suppliers want to charge prices that reflect the value of the exclusive content they have acquired, while distributors want to pay as little as possible to the channel providers. The differences in positions can be significant. For example, Weiss (2015) reports that during the 2013 retransmission consent negotiations between CBS and Time Warner Cable, CBS was seeking an increase in fees from about $1 to $2 per subscriber (as well as the ability to retain the digital distribution rights of the content).[8]

    b. In tax disputes, there is room for significant disagreement on the valuation of tax liabilities. FOA has been applied in this area in respect of both transfer pricing disputes and disputes involving international double taxation treaties. To give one example, in a dispute between Apple and the United States Internal Revenue Service (IRS), the IRS estimated Apple's legitimate costs to offset its tax liabilities to be just $16 million, whereas Apple estimated these to be $131 million (around 700% higher). By the time the parties arrived at FOA, they had significantly narrowed their differences, with the

8 Weiss, Daniel J., (2015), "The Bomb Keeps the Lights On: The Use of Final-Offer Arbitration in Failed Retransmission Consent Negotiations," 16 *Cardozo Journal of Conflict Resolution* pp. 685-711 at p. 686.

judge overseeing the case in the tax court noting that "Apple came down a substantial amount and the IRS came up a great amount".[9]

c. In US Major League Baseball (**MLB**), where FOA has been in continuous use for more than 40 years and has delivered high negotiated settlement rates (95% and above),[10] players and teams can be far apart in their valuations of a player's worth. Based on a study of final offers between 1990 and 1993, Farmer, Pecorino and Stango (2004) report that the final offers of players were on average 40-50% higher than the final offers of their teams,[11] despite the existence of a list of factors that arbitrators must take into account, limited information asymmetry, and the absence of incentives for positional negotiation.

19. Indeed, FOA is particularly well-suited to the resolution of disputes when parties are far apart, compared to CA. As we explained in our response to the Concepts Paper, CA has been criticised for having a "chilling effect" on commercial negotiations and increasing the length and costs of disputes. The concern with CA is that parties enter negotiations with an expectation of a likelihood that if the matter reaches arbitration the arbitrator will "split the difference" (i.e. find a middle ground) between the parties' positions. This is said to lead to "positional" negotiations: during negotiations parties have incentives to establish extreme positions in the hope of skewing the arbitrator's award in their favour, and corresponding disincentives to make compromises toward the "middle". CA is therefore seen as an obstacle to good-faith bargaining in negotiations. This is particularly problematic where the parties are far apart in their positions before entering negotiations as there is little incentive for them to converge prior to arbitration.

20. One of the purposes of FOA is to counteract the chilling effect by removing incentives for positional negotiation, instead incentivising the parties to come closer together in the negotiation stage and reach negotiated settlements more frequently. By precluding a "split the difference" outcome, parties are less likely to maintain extreme positions and are more likely to find common "middle" ground and settle the dispute before arbitration. Even if the parties do not reach a negotiated settlement and arbitration takes place, FOA provides the parties with incentives to bring reasonable "middle ground" positions to the arbitration, in the knowledge that the arbitrator is more likely to choose a reasonable offer over an extreme offer. In each respect, FOA offers benefits over CA, particularly in cases where the parties are far apart in their positions prior to negotiation.[12]

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9 Unattributed (1993), "After Successful Use of Baseball Arbitration, Apple, IRS Both Declare Themselves Winners", 11(12) *Alternatives to the High Cost of Litigation*, pp. 163 – 164, p. 163.

10 See Vishwanathan, N.S., (2019), "File and Trial: Examining Valuation and Hearings in MLB Arbitration," *Baseball Research Journal*, Spring 2019 at: https://sabr.org/research/file-and-trial-examining-valuation-and-hearings-mlb-arbitration; Monhait, J., (2013), "Baseball Arbitration: An ADR Success," 4 *Harvard Journal of Sports & Entertainment Law* pp. 105-143 at pp. 137–139; and Tulis B.A., (2010), "Final Offer "Baseball" Arbitration: Contexts, Mechanics & Applications", 20(1) *Seton Hall Journal of Sports and Entertainment Law*, pp. 85-130 at p. 90.

11 Farmer, A., Pecorino, P. and Stango, V., (2004), "The Causes of Bargaining Failure: Evidence from Major League Baseball," 47(2) *The Journal of Law & Economics*, pp. 543-568.

12 FOA also offers the prospect of quicker and more efficient resolution of disputes compared to CA. For an explanation of this, see our response to the ACCC's Concepts paper, above note 1, at paragraph 52,

2.2. FOA is well-suited to situations where there is information asymmetry, but will perform better with information disclosure rules

21. FOA is well-suited to contexts where there is information asymmetry, as FOA incentivises the parties to make reasonable offers based on the information available to them. Offers based on private information sets are more likely to be considered reasonable by the arbitrator than offers that lack a solid evidential foundation (which are more likely to occur under CA where parties are mindful of the potential for an arbitrator to arrive at a "split the difference" outcome).

22. Notwithstanding this, where information asymmetry exists, any negotiation/arbitration scheme is likely to perform better with more informed parties,[13] and there is a case for information disclosure rules to assist the parties to find common ground on the facts and converge in their positions. Reflecting this, the Draft Bill includes provisions for NMBs and digital platforms to request relevant information from each other for assessing the matters to be considered in arbitration.[14] The Draft Bill also allows for a submission by the ACCC to include additional sources of information to assist the arbitration panel.[15]

2.3. FOA is well-suited to situations where there is debate to be had over principles for valuation, but will perform better with specified criteria

23. FOA is also well-suited to contexts where debate is to be had over principles for valuation, as genuine negotiations towards "reasonable" offers can be expected more readily to lead towards agreed principles than under CA. Under CA, the parties have incentives to disagree on principles and to remain far apart with a view to a "split the difference" outcome. FOA offers the advantage of putting the onus on those best informed to develop reasonable principles (the parties) and provides them with incentives to converge, rather than imposing the challenge of arriving at reasonable principles on an arbitrator in a highly adversarial process.

24. Notwithstanding this, the articulation by the regulator of criteria by which the parties' offers will be assessed by the arbitrator (should the matter reach arbitration) can improve the effectiveness of any negotiation/arbitration scheme, and FOA is no exception. While criteria cannot be expected to fully specify all principles for valuation, they can assist in grounding the debate to be had between the parties prior to (and if necessary during) arbitration.

    a. First, criteria can help guide the parties in negotiations by creating a framework in which negotiations are to take place and putting bounds around the types of information to be taken into account.

    b. Second, the articulation of criteria allows the parties to assess the strength of their respective offers, where offer strength is judged by reference to how the arbitrator would view the offers against the criteria. This may assist in bringing the parties closer together during negotiations.

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13 Additional information is likely to ground aspirations and increase convergence between the parties.

14 Draft Bill, Section 52ZC. For the matters to be considered, see Section 52ZP.

15 Draft Bill, Section 52ZS(2).

c. Third, if the matter does go to arbitration, the articulation of criteria will assist the arbitrator in forming a view as to which offer better reflects a reasonable settlement.

25. For this reason, most applications of FOA are accompanied by criteria that the arbitrator may or must take into account (or may not take into account).

26. Criteria for arbitrators to take into account are typically not too detailed or prescriptive. They tend to consist of a list of relevant matters, without detail as to how each is to be evaluated or the weight each is to be given. This retains room for the parties to have differences of opinion as to how to evaluate their position against each criteria and which criteria are to be given more weight in any one matter. It also assists in retaining incentives under FOA to reach negotiated settlements before arbitration. After all, a fully prescriptive set of criteria would essentially represent direct regulation that would obviate the need for a negotiate/arbitrate model for dispute resolution and entail all the costs and risks of a regulatory price-setting model.

27. The ACCC has proposed a number of broad criteria in its Draft Bill that will assist the parties in their development of principles for valuation, including:

a. The direct and indirect benefits of the NMB's covered news content to the digital platform;

b. The cost to the NMB of producing covered news content; and

c. Whether the remuneration amount would place an undue burden on the commercial interests of the digital platform.

28. In our view, it would be useful for the final Bill to clarify that in relation to the benefits to the digital platform, this should be assessed as the share of the overall benefit to the digital platform from all covered news content that is attributable to the NMB, not the marginal benefit to the digital platform of the news content of the NMB assuming that the digital platform continues to be able to use news content of other NMBs. The marginal benefit is not an appropriate measure of benefit to the digital platform in this context, because such a measure would effectively re-introduce the bargaining leverage imbalance that the Bill is designed to counter.

3. EVIDENCE ON THE EFFECTIVENESS OF FOA

29. This section reviews the available evidence on the effectiveness of FOA from real-world applications of FOA and laboratory experiments. As we explain below, we would give greater weight to the real-world evidence, as laboratory experiments may be unreliable predictors of real-world behaviour for a number of reasons.

3.1. Evidence from real-world applications of FOA

30. The evidence available from real-world experiences with FOA suggests satisfaction with FOA where it has been implemented. In particular, there appears to be satisfaction with FOA as a procedure for resolving commercial disputes in the broadcasting sector in Canada and the United States, as well as for resolving taxation disputes. More generally, there has been continued use of FOA over decades in a number of contexts and there have been few instances of reversion to CA once FOA has been introduced. The limited number of empirical studies of FOA's real-world performance generally confirm the predictions of proponents of FOA: FOA has resulted in high rates of negotiated settlements, and studies of natural experiments in the public sector employment context have generally found FOA

to have performed better than CA with respect to both negotiated settlement rates and convergence of the parties' positions when arbitration does occur. The following sub-sections elaborate.

3.1.1. Commercial disputes

31. The US Federal Communications Commission (**FCC**) included FOA as part of its conditions for clearance of *Comcast/NBCU* in 2011,[16] after previously including FOA as part of its merger clearance conditions in *NewsCorp/DirecTV* in 2003.[17] Both transactions raised vertical concerns regarding the potential for prices increases in the supply of channels to pay TV distributors, and in each case, FOA was imposed as a condition to address those concerns by constraining the market power of the merged entity in its dealings with distributors.[18]

32. That the FCC turned to FOA in *Comcast/NBCU*, eight years after first doing so in *NewsCorp/DirecTV*, suggests satisfaction with FOA's performance in the context of commercial disputes. With the benefit of its experience of the condition in *NewsCorp/DirecTV*, the FCC in its Memorandum of Opinion and Order in respect of the *Comcast/NBCU* transaction presented its view of the suitability of FOA as follows:[19]

> *As in prior transactions, the arbitrator is directed to pick between the final contract offers submitted by Comcast-NBCU and the complainant MVPD based on which offer best reflects the fair market value of the programming at issue. This neutral dispute resolution forum* ***will prevent Comcast-NBCU from exercising its increased market power*** *to force Comcast's MVPD rivals to accept either inordinate fee increases for access to affiliated programming or other unwanted programming concessions, and will effectively address price increase strategies that could otherwise be used to circumvent our program access rules. …*
>
> *Our arbitration condition* ***is intended to push the parties towards agreement prior to a breakdown in negotiations****. Final offer arbitration has the attractive "****ability to induce two sides to reach their own agreement, lest they risk the possibility that a relatively extreme offer of the other side may be selected by the arbitrator****." We find that the availability of an arbitration remedy will support market forces and help to prevent this transaction from distorting the marketplace. [Emphasis added.]*

16 See FCC (2011), *Memorandum Opinion and Order, Comcast Corporation and NBC Universal*, MB Docket 10-56, 18 January 2011 (hereafter FCC (2011)), paras 49-50 at p. 22 and Section VII: Commercial arbitration remedy at pp. 127–132 at: https://www.fcc.gov/proceedings-actions/mergers-transactions/comcast-corporation-and-nbc-universal-mb-docket-10-56.

17 See FCC (2003), *Memorandum Opinion and Order, General Motors Corporation, Hughes Electronics Corporation, and The News Corporation Limited*,19 December 2003 (hereafter FCC (2003)), Section VI: Analysis of potential harms in the relevant markets, paras 172-179, pp. 80-83 at: https://www.fcc.gov/proceedings-actions/mergers-transactions/general-motors-corporation-hughes-electronics-corporation.

18 FCC (2003), paras 172–174, p. 80; and FCC (2011), paras 49–59, pp. 22–25.

19 See FCC (2011), paras 50 and 59, pp. 22 and 25

33. An expert report of Dennis Carlton in the *AT&T/Time Warner* matter records that arbitration requests following completion of the *Comcast/NBCU* merger were rare and only one arbitration was completed over the period that the FOA provisions were in effect.[20]

34. The Canadian Radio-television and Telecommunications Commission (**CRTC**) adopted FOA as (the final) part of a set of procedures for the resolution of telecommunications and broadcasting disputes in 2000. As part of a broad consultation on Canada's TV sector called "Let's Talk TV", the CRTC in 2015 reported that it had received a number of comments from stakeholders on its dispute resolution procedures, with some arguing that the procedures were too slow, too costly and too risky,[21] while others argued that FOA, while imperfect, was better than no recourse at all.[22] The CRTC concluded that the procedures have been a "helpful recourse for parties when negotiations have broken down", and declined to make any changes to the FOA element.[23]

3.1.2. Taxation disputes

35. In the *IRS v Apple* taxation matter, the trial judge overseeing the matter, Judge Julian Jacobs, is reported to have said that before the parties presented final offers "Apple came down a substantial amount and the IRS came up a great amount" and "[t]he beauty of baseball arbitration" was that in the process of deriving realistic numbers, the parties significantly narrowed their differences.[24]

36. The IRS agreed with the view of the trial judge that FOA had worked as it was intended. William E. Bonano, International Special Trial Attorney at the IRS at the time, has been quoted as saying that, although the need for the IRS to come up with a realistic number under FOA in that matter did not in itself achieve settlement, it "brought the parties closer together".[25] Apple was also reported to have been happy with the process,[26] and Apple's counsel was reported as saying the FOA process "forces the parties to be reasonable".[27]

37. FOA has also been well-regarded in the context of international tax disputes. For example, FOA has been in place for many years to resolve disputes between the US and Canada

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20 See expert report of Dennis Carlton, dated 2 February 2018, para 93 and footnote 99, p. 61 at: https://appliedantitrust.com/12_nonhorizontal_mergers/2_vertical/att_tw/2_ddc/att_ddc_carlton_expert2_2_2018.pdf.

21 It is not clear whether these comments were directed at FOA specifically or the CRTC's procedures overall. It is also not clear whether these comments were meant in absolute terms or in comparison to an alternative.

22 CRTC, Broadcasting Regulatory Policy CRTC 2015-96, Let's Talk TV, 19 March 2015, paras 93-102 at: https://crtc.gc.ca/eng/archive/2015/2015-96.pdf.

23 Ibid, para 102.

24 Unattributed (1993), "After Successful Use of Baseball Arbitration, Apple, IRS Both Declare Themselves Winners," 11(12) *Alternatives to the High Cost of Litigation*, pp. 163 – 164 at p. 163.

25 Ibid, at 163.

26 Hartl-Watters, G., (1993), "Apple: innovation in resolving tax disputes," *International Tax Review*, pp. 31 – 32. Apple's counsel was reported to have said that Apple saved around US$4-5 million in legal fees under FOA compared to litigation: Ibid, at 163.

27 Ibid, p. 32.

under the US-Canada double taxation treaty.[28] FOA has also been adopted by the Organisation for Economic Co-operation and Development (**OECD**) as the default arbitration option under the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (**MLI**).[29] A number of Australia's double taxation agreements (including those with the United Kingdom, Canada, Singapore and New Zealand) have been amended by the MLI and the parties have accepted its optional arbitration provisions that include FOA as the default option.[30]

3.1.3. Major League Baseball (MLB) salary disputes

38. Studies of FOA in the context of salary negotiations in MLB have consistently found FOA to have been successful in achieving high rates of negotiated settlements, notwithstanding the considerable differences in final offers submitted by players and their teams (discussed earlier).

39. For example, according to Tulis (2010), in the 2009 season 111 players filed for arbitration, 46 exchanged final offers with their respective teams and only three continued to a hearing (implying a settlement rate of 97%).[31] Similarly, Monhait (2013) reports that out of 119 players that filed for arbitration in 2011, only three went to hearings (again implying a settlement rate of 97%), and for the 2012 season out of 142 players that filed, only seven went to hearings (implying a settlement rate of 95%).[32] This suggests that FOA works much as intended in the MLB context, by incentivising the parties to reach negotiated settlements and avoid arbitration.[33]

3.1.4. Public sector employment disputes

40. Studies that have sought to compare the effectiveness of FOA and CA in real-world contexts using natural experiments are, to our knowledge, limited to the context of public sector employment disputes in the US, where FOA replaced CA in a number of states during the 1970s and where there was also one instance of reversion from FOA to CA.

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28 See: US Canada Double Taxation Convention, Memorandum of Understanding Between The Competent Authorities of Canada and The United States of America at: https://www.irs.gov/pub/irs-utl/2010_arbitration_mou_nov_8-10_-_final.pdf. See also Grlica, I (2018), "Baseball Arbitration: Comparison of the Rules under the U.S.-Canada Tax Treaty with the Rules under the Multilateral Instrument," Chapter 14 of *OECD Arbitration in Tax Treaty Law*: pp. 317 – 336.

29 See Article 23 of the MLI at: https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm.

30 See: https://www.allens.com.au/insights-news/insights/2020/08/Mandatory-binding-arbitration-of-tax-disputes/.

31 Tulis B.A., (2010), "Final Offer "Baseball" Arbitration: Contexts, Mechanics & Applications", 20(1) *Seton Hall Journal of Sports and Entertainment Law*, pp. 85-130 at p. 90.

32 Monhait, J., (2013), "Baseball Arbitration: An ADR Success," 4 *Harvard Journal of Sports & Entertainment Law* pp. 105-143 at pp. 138-139.

33 According to Vishwanathan (2019), over the period from 2011 to 2017 inclusive, players and teams exchanged final offers 269 times, with the parties proceeding to an arbitration hearing on only 45 occasions (i.e. negotiated settlements were reached 83% of the time after final offers were exchanged). This understates the settlement rates of FOA in MLB, as many disputes are settled before final offers are filed. See Vishwanathan, N.S., (2019), "File and Trial: Examining Valuation and Hearings in MLB Arbitration," *Baseball Research Journal*, Spring 2019 at: https://sabr.org/research/file-and-trial-examining-valuation-and-hearings-mlb-arbitration.

These "within state" changes between CA and FOA have allowed comparisons of both negotiated settlement rates and the degree of convergence of the parties' positions at arbitration, under both FOA and CA, controlling for state-level differences.

41. Studies of changes from CA to FOA during the 1970s have tended to find higher rates of negotiated settlements realised under FOA than under CA. For example, Feuille (1975) reports that in the period during which CA was available for resolution of disputes concerning public safety workers in Michigan (from 16 December 1969 to 31 December 1971), the proportion of all negotiations involving public safety workers that were determined by arbitration was 19%, whereas in the two years following the implementation of FOA (1973-1974), this proportion was around 10-12%.[34]

42. Howlett (1984), studying the same change in Michigan, reports that during the CA period 71 of 176 arbitrations that were filed were settled during the arbitration process (a negotiated settlement rate during the arbitration process of 40%), whereas in the first three years following the introduction of FOA, 126 of 172 filed arbitrations settled during the arbitration process (a negotiated settlement rate during the arbitration process of 73%).[35] Howlett also reports that negotiated settlement rates during the arbitration process remained high in later years under FOA, with 241 out of 280 filed arbitrations being settled via negotiation during the arbitration process over the years 1979-1982 inclusive (an average settlement rate during the arbitration process of 63% over these years).[36]

43. According to Lipsky and Katz (2006), a study reported by Lester (1984) of arbitration experiences in eight US states where arbitration mechanisms had been implemented (and New York City) found that arbitration usage rates were significantly lower in states with FOA than they were in states with CA.[37] Although not controlling for differences between states, this evidence is consistent with FOA being more effective than CA at achieving negotiated settlements prior to arbitration.[38] Howlett (1984) also cites the chairman of the Iowa Public Employment Relations Board to the effect that as a percentage of *all negotiations* (including negotiations that settle before filing with the arbitrator), the number of arbitrated settlements ("awards") issued in Iowa between 1976 and 1983 under FOA

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34 Feuille, P., (1975), "Final Offer Arbitration and the Chilling Effect," 13(3) *Industrial Relations*, October 1975, pp. 302-310 at p. 306.

35 Howlett, R.G., (1984), "Interest Arbitration in the Public Sector," 60(4) *Chicago Kent Law Review*, pp. 815 – 837 at p. 828.

36 Ibid, p. 828.

37 Lester, R.A, (1984). Labor Arbitration in State and Local Government: An Examination of Experiences in Eight States and New York City (Princeton, NJ: Princeton University, 1984) as reported in Lipsky, D., and Katz. H., (2006), "Alternative Approaches to Interest Arbitration: Lessons from New York City," 35(4) *Public Personnel Management*, pp. 265 – 281 at p. 267.

38 A variety of FOA models have been applied in the public sector employment context in the US. In order to deal with multi-issue disputes, some jurisdictions have employed an "issue-by-issue" approach, whereas others have employed a "whole-of-package" approach. Some allow for FOA in respect of both salary and other terms and conditions of employment whereas others allow for FOA in respect of salary only. Some jurisdictions require the parties to participate in mediation prior to arbitration whereas others do not. And some jurisdictions allow the parties to amend their final offers during the arbitration process whereas others do not.

ranged from a low of 4.5% to a high of 7.1% (implying negotiated settlement rates well above 90%).[39]

44. At least one study also suggests that FOA is more successful than CA in achieving convergence of positions brought to arbitration. In 1997, in response to dissatisfaction with what were viewed as overly generous awards being made in favour of police officers and firefighters, New Jersey switched from FOA to CA. Stokes (1999) found that following this switch from FOA to CA, the average spread between the final positions of the parties increased from 29% in 1995 and 1996 to 44% in 1997 and 55% in 1998.[40]

45. Although the empirical evidence is scant, the findings of the above studies are consistent with anecdotal evidence on the effectiveness of FOA for the resolution of employment related disputes. For example, Stern (1974) conducted interviews with arbitrators, management and union personnel involved in total package FOA in Wisconsin.[41] He found that all three parties appeared to prefer total package FOA over CA:[42]

> *…**most Wisconsin arbitrators have stated that they favor the continuance of final-offer arbitration in preference to a shift to conventional arbitration** or final-offer on an issue by issue basis. …*
>
> *Personal interviews with some parties indicate that **most managements and unions continue to favor final-offer arbitration over conventional arbitration**, although responses to written questionnaires suggest that there is a good deal of misunderstanding about the process on the part of individuals who have not yet been involved in it. As for any damage wrought by the winner-take-all aspects of the final-offer arbitration awards (and, by the way, the box score on this in Wisconsin stands 12 to 11 in favor of management) **it has not caused either the winners or the losers to condemn the procedure on this ground, nor to suggest that it be replaced by conventional arbitration**. [Emphasis added.]*

46. At around the same time, speaking in relation to the experience in both Eugene (Oregon) and Michigan, Rehmus (1974) noted that the mediation-FOA procedures in place there were preferred over CA and were conducive to negotiated settlements, in part because the parties retained a sense of direct participation in the process:[43]

> *The Eugene final-offer ordinance has prevented frequent recourse to the procedure. Its arbitration panels have had to issue relatively few awards […] bargaining or mediation, or both, take place during the arbitration hearing, and **this has frequently resulted in a settlement without the need for an award**. In both Eugene and Michigan, it appears, the interaction between the partisan panel members and the neutral member on the one hand and between both parties' bargaining committees on the other is crucial to the mediation-arbitration process.*
>
> *Some representatives of the parties may decry this evolution, and many deeply resent arbitral pressure on or permission to either party to change final offers. Yet*

39 Howlett, R.G., (1984), "Interest Arbitration in the Public Sector", 60(4) *Chicago Kent Law Review*, pp. 815 – 837, p. 828.

40 Stokes, G. (1999), "Solomon's Wisdom: An Early Analysis of the Effects of the Police and Fire Interest Arbitration Reform Act in New Jersey," 28 *Journal of Collective Negotiations*, pp. 219 – 231 at p. 228.

41 Stern, J.L., (1974), "Final Offer Arbitration - initial Experience in Wisconsin,', *Monthly Labour Review*, pp. 39 – 43.

42 Ibid, pp. 42 – 43.

43 Rehmus, C.M., (1974), "Is a final offer ever final?," *Monthly Labour Review*, pp. 43 – 45 at pp. 44 – 45.

> *many negotiators feel that the process of mediation-arbitration has considerable virtue in situations where strikes are destructive and where conventional interest arbitration by neutrals alone is repugnant. They feel that the parties retain a sense of direct participation in the bringing about of the result of the arbitration process, to a greater extent than under any other impasse resolving procedures. I should stress that mediation arbitration is not a panacea for all disputes, whether agreed to directly by the parties themselves or resulting from a final-offer arbitration procedure. But in many cases, mediation-arbitration is a constructive alternative to a strike or to conventional arbitration. It seems at the present time to be an interesting outcome of our Michigan statutory final-offer experiment,* ***simply because it helps to serve the public interest by promoting the peaceful settlement of impasses in crucial negotiations*** *in the public sector by the parties themselves. [Emphasis added.]*

47. In New Jersey, interviews with arbitrators conducted by Weitzman and Stochai (1980) suggest that while the introduction of FOA there tended to increase the parties' reliance on arbitrators (even though many reach a negotiated settlement during arbitration), it also tended to compel the parties to narrow the difference in their positions and make reasonable offers, relieving arbitrators from making unreasonable awards:[44]

> *All said it was fair and workable in that it allowed arbitrators great flexibility in their handling of cases. It has also* ***tended to compel the parties to present reasonable final offers, which was undoubtedly a major objective of the legislation*** *…*
>
> *… only three arbitrators indicated that the final offer procedure had compelled them to render what they consider to be an inequitable award. Several others reported that they had rendered awards they "didn't like" or "would not have written on my own". The general experience was, however, that* ***because the arbitrators successfully aided the parties in significantly narrowing the range of differences in their final positions, few truly inequitable awards were issued****. [Emphasis added.]*

48. Unlike the situation described in the above quote, the Draft Bill affords the arbitration panel more discretion than having to choose one or other of the final offers of the parties: under the Draft Bill, the arbitration panel is able to adjust the more reasonable of the two offers should both offers raise significant public interest concerns. The Draft Bill also contains other provisions to protect the digital platforms and NMBs from "inequitable" awards. First, agreements reached under FOA are to be limited to one year. Second, the arbitrator is required to consider (among other things) whether a particular payment amount would place an undue burden on the commercial interests of the digital platform.

49. More recently, similar observations to Rehmus (1974) and Weitzman and Stochai (1980) have been made in relation to the mediation-FOA procedures in place in New Zealand for the determination of police salaries, which have been in place continuously since 1990. Over the first 25 years (until 2015), there were only three instances in which a dispute was

44 Weitzman, J & Stochaj, J.M, (1980), "Attitudes of Arbitrators Toward Final-Offer Arbitration in New Jersey," 35 *Arbitration Journal.* pp. 25 – 34 at p. 33.

determined by arbitration, with ten negotiated settlements achieved.[45] In a recent study, Carabetta (2019) conducted interviews with personnel that had experience in collective bargaining negotiations in the police and emergency services, either as independents or as representatives of the police organisations or unions.[46] He observed that, consistent with the theoretical arguments in support of FOA, interviewees repeatedly stated that (particularly compared with CA) the "threat" of FOA not only positively influenced the parties' behaviour during bargaining, but brought them closer together and encouraged settlements. Among the interviewee statements were the following:

> *[Under FOA]* ***the more rational their proposal, the better chance they have got of getting it across the line****.* ***It mandates good behaviour****… It's much better than [conventional arbitration] where you and I are arguing and the bloke sitting in the chair says "Bugger you pricks, I'm splitting it down the middle". The problem with that is that that is absolutely arbitrary. And with final offer, it's you are going to win and I am going to lose. And then the [demoralising] impact on the people that I represent, or my side, you know, we've lost.*[47] *[Emphasis added.]*
>
> *Under conventional [arbitration] … the arbitrator is trying to please both of us and we both walk away and go, okay. But we don't own it…so let's claim eight per cent and if the employer is claiming two or three per cent maybe we'll get five. Whereas [in FOA] it's a case of the arbitrator is going to choose all of ours or all of the Police. And if we conclude, we're not sure we can live with all of the Police position [so] let's try and get closer together.* ***And you tend to move closer together [over time] and then you look at it the next day and say, well actually there's stuff all between us, we might as well settle, rather than going through all the work of preparing papers and arbitration****.*[48] *[Emphasis added.]*

3.2. Evidence from laboratory experiments

50. We are aware of eight published studies of laboratory experiments that have tested whether FOA is more effective than CA in achieving concessionary behaviour during bargaining (i.e. a narrowing of differences prior to arbitration) and/or negotiated settlements (i.e. avoiding arbitration).[49] Before reviewing these studies, we qualify that laboratory experiments may

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45 McAndrew, I., (2019), "'Med-Arb' in the New Zealand Police," in William K. Roche, Paul Teague and Alexander JS Colvin (eds), *Oxford Handbook of Conflict Management in Organisations* (OUP, 2014) 329, cited by Carabetta, G. (2019), "Final Offer as a First Choice? Police Arbitration: A New Zealand case study," 29 *Australasian Dispute Resolution Journal*, pp. 251-265, at p. 260.

46 Carabetta, G. (2019), "Final Offer as a First Choice? Police Arbitration: A New Zealand case study," 29 *Australasian Dispute Resolution Journal*, pp. 251 – 265.

47 Ibid, citing Interview with A3, n 73, p. 260.

48 Ibid, citing Interview with AU1, n 44, p. 261.

49 We do not suggest that these are the only published studies of this nature, but rather that these are the only ones we have been able to find, following an extensive search. We have not included the results of two studies by Deck and Farmer that were not, to our knowledge, published in a journal. See Deck, C. and Farmer, A. (2003), "Bargaining over an Uncertain Value: Arbitration Mechanisms Compared," Working paper, University of Arkansas; and Deck, C. and Farmer, A. (2003), "Bargaining with Asymmetric Uncertainty: Arbitration Mechanisms Compared," Working paper, University of Arkansas. These studies were very similar in nature to the study conducted by the same authors in 2007 that is discussed in this section.

be unreliable predictors of real-world behaviour.[50] For this reason we would place greater weight on the real-world evidence reviewed in the previous sub-section. In any event, the findings of these studies are mixed, reflecting differences in the designs of the experiments.

51. Johnson and Tullar (1972),[51] Grigsby and Bigoness (1982)[52] and Neale and Bazerman (1983)[53] simulated bargaining in the context of multi-issue employment disputes.

    a. Johnson and Tullar found greater concessionary behaviour among participants anticipating CA than among participants anticipating FOA under both a "face saving" manipulation and without the manipulation, although the authors suggest that participant unfamiliarity with FOA may have affected their findings.[54] As the authors acknowledge, the face saving manipulation was also unsuccessful, and so the results of Johnson and Tullar are difficult to interpret. [55]

    b. Neale and Bazerman found the opposite to Johnson and Tullar: that participants that anticipated FOA in the event of impasse demonstrated more concessionary behaviour (more issues were resolved and greater dollar value was conceded) than participants that anticipated CA.[56]

    c. Grigsby and Bigoness found that participants anticipating total package FOA resolved significantly more issues (i.e. engaged in more concessionary behaviour) than both participants anticipating CA and participants anticipating issue-by-issue FOA. The authors also interacted anticipation of mediation with the arbitration alternatives. They found that with anticipation of mediation, both forms of FOA resolved more issues than CA, but without anticipation of mediation, total package FOA resolved more issues than both CA and issue-by-issue FOA.[57]

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50 For example, bargaining over small stakes in laboratory settings may produce different behaviour to bargaining over larger stakes such as incomes and livelihoods or the stakes involved in commercial disputes (where retention or promotion of the individuals involved may depend on satisfying the expectations of employers and/or shareholders). Contexts also matter and may differ greatly between the laboratory and the real-world. See, for example, Steven D. Levitt and John List (2007), "What do laboratory experiments measuring social preferences tell us about the real world", 21(2) *Journal of Economic Perspectives*, pp. 153-174.

51 Johnson, D. F., and W. Tullar (1972), "Style of third party intervention, face-saving, and bargaining behavior," 8 *Journal of Experimental Social Psychology*, pp. 319-330.

52 Grigsby, D.W. and Bigoness, W.J., (1982), "Effects of Mediation and Alternative Forms of Arbitration on Bargaining Behavior: A Laboratory Study," 67(5) *Journal of Applied Psychology*, pp. 549 – 554.

53 Neale, M.A. and Bazerman, M.H., (1983), "The role of perspective-taking ability in negotiating under different forms of arbitration," 36(3) *Industrial and Labor Relations Review*, Vol. 36, No. 3, pp. 378 – 388.

54 Johnson, D. F., and W. Tullar (1972), "Style of third party intervention, face-saving, and bargaining behavior," 8 *Journal of Experimental Social Psychology*, pp. 319-330 at p. 329. The authors observed that FOA may have been difficult for participants to come to grips with as it was at that time unusual and rare in real life.

55 This was observed by W. Notz, and F. Starke (1978), "Final Offer versus Conventional Arbitration as Means of Conflict Management," 23, *Administrative Science Quarterly*, pp.189 – 203 at p. 190.

56 Neale, M.A. and Bazerman, M.H., (1983), "The role of perspective-taking ability in negotiating under different forms of arbitration," 36(3) *Industrial and Labor Relations Review*, Vol. 36, No. 3, pp. 378 – 388 at p. 386.

57 Grigsby, D.W. and Bigoness, W.J., (1982), "Effects of Mediation and Alternative Forms of Arbitration on Bargaining Behavior: A Laboratory Study," 67(5) *Journal of Applied Psychology*, pp. 549 – 554 at p. 553.

52. Notz and Starke (1978),[58] simulating a single-issue wage dispute, found that participants anticipating FOA demonstrated more concessionary behaviour – in particular, they were more reasonable in their starting positions and achieved greater convergence of their positions by the end of the bargaining – than participants anticipating CA. They also found that while participants anticipating FOA converged during bargaining, participants anticipating CA moved to positions further apart at the end of bargaining than before bargaining began. Overall, their results are consistent with the theory that CA tends to result in positional negotiation strategies while FOA incentivises more reasonable bargaining positions and greater convergence.

53. Ashenfelter et al. (1992)[59] also simulated bargaining in the context of a single-issue dispute over a monetary amount. Unlike the earlier studies, they mechanised the arbitrator decision-making process as a draw from a fixed distribution of potential settlements.[60] They found that one of three groups of participants that bargained under the threat of CA achieved a lower dispute rate than participants that bargained under the threat of FOA.[61]

54. Dickinson (2004)[62] observed that differences in the way subjects formed expectations under CA and FOA in the Ashenfelter et al. study could be responsible for the differences in the settlement rates those authors found.[63] Dickinson corrected for this in his own experiment. Dickinson found that the difference in the dispute rates for participants that bargained under threats of CA and FOA fell just short of conventionally defined statistical significance.[64] However, using an alternative test, he found that the use of CA increased

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58 W. Notz, and F. Starke (1978), "Final Offer versus Conventional Arbitration as Means of Conflict Management," 23 *Administrative Science Quarterly*, pp.189 – 203

59 Ashenfelter, O., Currie, J., Farber, H.S and Spiegel, M., (1992) "An Experimental Comparison of Dispute Rates in Alternative Arbitration Systems," 60(6) *Econometrica*, pp. 1407-1433.

60 Ashenfelter et al. noted that the earlier studies by Notz and Starke, Grigsby and Bigoness, and Neale and Bazerman did not mechanize the arbitrator's behavior and left participants uninformed of the distribution of arbitration decisions. In those earlier studies, participants were simply told that if no agreement was reached an arbitrator would be appointed to make a binding decision and that, under FOA, the arbitrator would choose one or the other final offer. See: Ashenfelter, O., Currie, J., Farber, H.S and Spiegel, M., (1992) "An Experimental Comparison of Dispute Rates in Alternative Arbitration Systems," 60(6) *Econometrica*, pp. 1407-1433 at p. 1409.

61 The participants that bargained under the threat of CA were split into three groups that differed in terms of the variance of the arbitrator's decisions. Dispute rates under threat of CA ranged from 28.4% for the "high variance" group to 41.4% for the "low variance group", with the dispute rate for the "medium variance" group sitting in between at 31.6%. The dispute rate of participants facing the threat of FOA was 38.1%. The authors considered it appropriate to compare the dispute rate of the FOA participants to the dispute rate of the "high variance" CA group, and on that basis considered there to be evidence that CA achieves lower dispute rates than FOA. This comparison was subsequently criticised as inappropriate: see Dickinson, D.L., (2004), "A Comparison of Conventional, Final-Offer, and 'Combined' Arbitration for Dispute Resolution," 57(2) *Industrial and Labour Relations Review*, pp. 288 – 301 at p. 290.

62 Ibid.

63 Dickinson noted that the CA and FOA dispute rates in Ashenfelter et al. are open to alternative explanations given the way arbitrator information was provided to the experimental subjects. Arbitrator information in the Ashenfelter et al. CA treatment was by means of a table of 100 draws from the distribution used to simulate the arbitrator's notion of a fair settlement. In their FOA treatment, however, participants were shown pairs of final offers along with the resultant arbitrator choice. Ibid, pp. 290 and 293.

64 Ibid, p. 294.

dispute rates over the "no arbitration" control dispute rate by an amount that was statistically significantly less than the increase in dispute rates under FOA.[65]

55. Kritikos (2006)[66] criticised the approach taken by Ashenfelter et al. and Dickinson of mechanising the arbitrator as an approach that is not realistic, and as the mechanisations did not allow the parties' behaviours and offers to influence the arbitrator's decision and did not allow for any "chilling effect". He concludes that the Ashenfelter et al. and Dickinson experiments "cannot provide any answers to the questions of whether [CA] (done by a human being) increases disputes because bargainers hope to influence the arbitrator through their respective bargaining strategy, or whether FOA (also done by a human being) eliminates this effect".[67] In his own experiment, using human arbitrators, he found that dispute rates for participants that bargained under the threat of FOA were no higher than dispute rates for participants that bargained without recourse to arbitration (where the cost of not reaching agreement was a zero payoff rather than an arbitrated outcome of some positive amount), whereas participants that bargained under the threat of CA had significantly higher dispute rates.[68] He concludes that CA increases dispute rates compared to where there is no arbitration option, while FOA eliminates this effect.[69]

56. Finally, Deck and Farmer (2007) simulated a single-issue wage dispute between a worker and a firm and found that more conflict was observed under FOA than under CA.[70]

65 Ibid, p. 295.

66 Kritikos, A.S., (2006), "The impact of compulsory arbitration on bargaining behaviour: an experimental study", 7 *Economics of Governance*, pp. 293 – 315.

67 Ibid, p. 298.

68 For the 'no payoff' group, 8% of the negotiations ended in dispute with a zero payoff. Under FOA, dispute rates were 14% and the difference from the baseline dispute rate for the no payoff group was not statistically significant. Under CA, dispute rates were significantly higher at 34%.

69 Ibid, p. 303.

70 Deck, C. & Farmer, A., (2007), "Bargaining Over an Uncertain Value: Arbitration Mechanisms Compared," 23 *Journal of Law, Economics and Organisation*, pp. 457-479.