

“Is Last Best Offer Arbitration the Best Method to Resolve Baseball Salary Disputes?”

By Steve Argeris* (Jan. 7, 2008)

I. Introduction

In the winter of 1921, the Chicago White Sox cut pitcher Dickie Kerr's salary by \$500. Disgusted by this, he asked for his release, which the White Sox declined to do, and after Kerr failed to agree to the team's terms, Commissioner Kenesaw Mountain Landis banned him for life. Although Landis would reinstate him five years later, Kerr complained to *Baseball Magazine* in the interim: “There ought to be some way of arbitrating disagreements like mine.”ⁱ He went on to suggest that if a particular player had a particular skill set, both the players and the owners are savvy enough to price that player's worth in the marketplace, and that a three-man arbitration committee be set up to resolve disputes---one member chosen by the player, one by the owners, and one neutral, outside observer.

It took baseball another half-century to get around to a salary dispute resolution, which pretty much resembles what Kerr suggested. In the three-plus decades since arbitration entered the oft-contentious world of the business of baseball, it has proven sturdy enough to withstand challenges to its idiosyncratic and often counterproductive format. Loathed by both parties on a micro level, it appears its appeal only becomes apparent when viewed from a distance, warts and all, or when compared to its alternatives.

The annual salary disputes between free agents and teams are flashpoints in the decades-old labor war between the millionaires and billionaires who play and control America's pastime. Given that the entire point of the salary disputes are to resolve an issue that would allow a working relationship to continue, the adversarial nature of arbitration (amplified exponentially by decades of bitterness and distrust on both sides) seems less than ideal. This paper intends to explore whether mediation in some

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form, particularly the mediation-arbitration (med-arb) hybrid, could allow for a more efficient and productive working environment.

II. Brief history of labor relations and salary arbitration in baseball.

Baseball has had a contentious labor history since its inception. The reserve clause, entered into effect in the late 19th centuryⁱⁱ, essentially bound players to their teams for the duration of their careers, with no official leverage during what amounted to one-sided negotiations. Even star players were handed nominal raises, even paycuts, at the discretion of ownership.ⁱⁱⁱ Although there were a few attempts to organize in the first half of the 20th century, and the first lasting union, the Major League Baseball Players Association, was formed in 1954, the first collective bargaining agreement did not occur until 1968, two years after it hired Marvin Miller, a veteran of labor negotiations while representing steelworkers. That agreement won the players an increase in minimum salary from \$6,000 to \$10,000.^{iv} A more important concession came in the next round of negotiations, prior to the 1970 season, in which the players won the right for all owner-player disputes not involving “the integrity of baseball” to be arbitrated before a three-man panel, similar to Dickie Kerr's suggestion, with a neutral chairman agreed upon by the players and owners.^v While free agency remained unavailable until a federal arbitrator, Peter Seitz, granted it to players in 1975^{vi}, in the agreement beginning in the 1973 season, players with two years of experience could have their salaries decided by an independent arbitrator. The system remained unchanged until 1985, when the parties agreed to begin arbitration eligibility at the three-year mark.^{vii} In 1990, after a disastrous negotiating strategy by the league, the union won the right of 17 percent of the players with more than two years but less than three years of service time to become eligible for arbitration.^{viii}

Two main groups of players are eligible for salary arbitration. Young players remain property of their club until they have accumulated six years of major league service time; in their first three years, their salary is determined exclusively by the club in accordance with collectively bargained mandatory

minimums.^{ix} Players who have between three and six years of major league service are eligible for arbitration.^x Additionally, veteran players who are free agents but do not sign with another team can remain property of their team if offered arbitration by December 1. Players have until December 7 to accept or sign with another team, which would forfeit a top draft pick to the original team if it offered the player arbitration.^{xi}

The truncated timeframe under that deadline makes for imperfect decision-making and increases the pressure on the arbitration process. By not offering a player arbitration, it forfeits its right to compensatory draft picks, which are often valued even more than the players themselves because they offer the opportunity for talented young players at cost-controlled prices.^{xii} That deadline puts clubs in a difficult position, because it is after a brief period following the World Series' conclusion (typically just before or on Halloween) when teams have an exclusive negotiating window with their prospective free agents, followed by a similarly brief period with an open market.^{xiii} It is difficult for teams to accurately gauge the market for their players or their prospective replacements during this month, exposing teams to potentially enormous risk when it comes to star players with astronomical salaries. This risk is particularly acute when a down period for revenues follows a boom period (such as the years between 2000 and 2003), when a player can compare his salary to deals signed during a more inflationary time and thus potentially secure a contract even above what the market would bear.^{xiv}

That is a relatively rare occurrence, and most free agents are not offered arbitration, and even fewer accept, because it would limit remove them from free agency. Those who do accept almost invariably sign before reaching arbitration, but the mere threat of arbitration with an established star is strong enough to coerce a high-dollar contract. When Greg Maddux unexpectedly accepted arbitration in 2003, the Atlanta Braves offered him \$14.75 million for one year. Roger Clemens put off retirement in 2005 after the Houston Astros offered arbitration, and after Clemens submitted a record figure of \$22 million, \$8.5 million more than the Astros offered. They settled for \$18 million, the highest salary a pitcher had received at that point. Additionally teams---particularly those in small- and mid-level

markets---often “buy out the arb years” of talented young players before they become free agents, giving young players long-term security in exchange for below-market, albeit lucrative, salaries.^{xv}

III. The mechanism of last best offer arbitration in baseball

In both cases, the process is the same, what is known as final or “last best offer” arbitration, and has become well-publicized enough within alternative dispute resolution world to be known as “baseball arbitration.”^{xvi} After submitting numbers to each other in January, the parties meet in early- to mid-February in a hotel conference room, typically in Los Angeles, Phoenix, Tampa or Orlando. The MLBPA and the Major League Baseball Labor Relations Department agree upon a group of about 16 arbitrators, typically lawyers and judges with American Arbitration Association certification and extensive arbitration experience, or request a list from the AAA and strike off names until enough arbitrators remain. Each party presents its case for one hour, and after a short break, each party gets 30 minutes to rebut the other side's case and then another 30 minutes to summarize their case. The panel can choose between one figure or the other, the format now standardized as “baseball” arbitration. Within 24 hours, the panel chief informs the union and the league of its decision, providing no opinion nor the voting breakdown of the panel's members, though that information is revealed later to the parties.^{xvii}

The collective bargaining agreement is very specific in what information is permitted and impermissible to present. Generally, a player's performance, his past performance, his compensation record, comparable salary information, injury history and the club's performance are allowed. The panel is not allowed to learn the financial position of the player or club, hear or read media reports, salaries in other occupations or sports, prior offers made by either party, or the cost to the parties of their representation. Witness testimony is allowed but rare.^{xviii}

The definition of comparable salary has been restricted since 1985 to players of their service time and one additional year (i.e., a third year player can only compare himself to third-year players

and fourth-year players). Players are permitted to argue under a “special accomplishment” loophole that their performances are unique enough to warrant a different comparison. While there is no restriction on how much a player may ask for in arbitration, the salaries of non-free agent players cannot be reduced to less than 80 percent of their previous year's salary or 70 percent of their salary two years prior.^{xix} Both sides often use complicated statistical evidence to prove their case, and baseball is a sport where numbers can be manipulated to the extent to prove the severity of almost anyone's value or limitations. Additionally, arbitrators are permitted to use whatever logic they see fit to reach their decision, and some cynics suggest that the arbitrators themselves are motivated to not reward one side too often and lose a steady and relatively lucrative job. These factors combine to make the decision-making process murky at best.^{xx}

IV. The counterproductive effects of baseball arbitration

The arbitration process is by its nature highly contentious. Players routinely describe it as an incredibly negative experience, even for those who win. No matter how much a player is valued by a club, the implicit indication that he is not worth the price he requested. For the teams, it jeopardizes their goodwill with their employees as they approach free agency, perhaps exacerbating an already tense relationship unnecessarily. This may be why teams go to great lengths to avoid arbitration with their star young players, handsomely rewarding them far earlier in their careers than would normally be necessary, albeit at below-market prices.^{xxi} Still, this is not without cost to the team, particularly when it comes to pitchers, whose performance and health are far more volatile than position players due to the incredible strain placed upon their pitching arms. Pitchers still make up the majority of arbitration cases, meaning teams are less inclined to offer long-term deals to young pitchers than position players.^{xxii}

In either case, teams do not pull punches in the arbitration hearing itself. During arbitration's initial years, law school-trained agents represented the players while front office members (typically

former players or coaches themselves) represented the teams, giving the players a huge advantage in what amounts to a quasi-judicial setting.^{xxiii} As time went on, teams began hiring labor attorneys to argue their side or tasking in-house personnel to specialize on the process, evening the procedures to where neither side sees an advantage. The work involved in a single hearing is considerable, with statistical data sifted through to the extreme, all pointed at a single conclusion, that a given side's position is the correct evaluation of a player's worth.^{xxiv} Considering that extraneous factors---including perhaps most importantly the club's existing pay structure and revenue---are not allowed to enter the discussion, there is little doubt that this figure is a term of art, regardless of which side proves victorious. Perhaps the idea that with greater information sharing comes greater understanding is naïve, as there is a great amount of distrust on both sides of most negotiations, and most of a club's financial information is available to both parties to some extent through secondary sources.

But more importantly than reducing animosity is reducing cost. The cost of the information-gathering and presentation of the case can exceed the difference in the salary figures, further incentivizing settlement. Kevin Gregg, then a relatively anonymous middle reliever for the Florida Marlins, disagreed with the team over \$125,000 in January 2007 and lost in arbitration. Gregg, who had joined the team just months prior to the hearing via a trade with the Los Angeles Dodgers, blossomed into the team's closer, a far more lucrative role, during the 2007 season. Whatever alienation occurred during the hearing, compounded by the cost of preparing the case for both sides, seems difficult to justify in the long term over such a relatively small amount.

V. Does salary arbitration work better as a threat than in practice?

The general consensus is that salary arbitration exerts an upward trend on player salaries, though its implementation coincides with the advent of free agency, so untangling what is correlation or causation is difficult. More accurately, arbitration may force owners to either reward players sooner than their performance dictates (via locking up young stars before they have proven durability in order

to avoid future big salary deals) as well as pay top dollar for veterans they actually wished to jettison (when a player unexpectedly agrees to an insincere arbitration offer made with draft picks in mind). In the vast majority of cases, even the team's offer represents a raise, and in most cases a significant one, over the player's previous salary. The potential exposure to big salary numbers in arbitration---and the clear precedent they set---limits owners' willingness to go through the process. The ultimate result is that relatively few cases of free agents or young players go to arbitration, as just 198 cases were heard between 1974 and 2006 out of 1,764 filed cases. Fewer and fewer cases are heard as time passes, and there have not been even 10 cases heard in a given year since 2001.

Neither side emerges from the process unscathed, even in the more low-profile cases. Players who have been through the process early in their careers almost never return. Only one veteran player has reached an arbitration hearing since 1991, second baseman Todd Walker, in February 2007. His team, the San Diego Padres, had planned on using Walker as their second baseman in 2007 before a better option, Marcus Giles, fell into their lap unexpectedly. By then, Walker had agreed to arbitration, and the Padres had no incentive to negotiate a deal with Walker. The player termed the procedure as a “trial,”^{xxv} even when facing the Padres, one of the more player-friendly front offices in all of sports. They entered arbitration with a large difference in figures, with Walker submitting \$3,950,000 to the Padres' \$2,750,000. Walker's accountant brother mounted his case, which even Walker termed a long shot, and Walker won. Ultimately, however, the Padres released him before the start of the season, saving 75 percent of his salary. The situation caused friction among the players, who suspected the motivation behind releasing Walker was motivated more by retaliation than baseball strategy, and the MLBPA ultimately filed a grievance.^{xxvi}

Perhaps the best feature of the last best offer arbitration format encourages reasonable salary requests from both sides. Since the arbitrator cannot pick a number of his own choosing, in the majority of cases, the number closest to his own estimate, whether determined instinctively or through careful analysis, is likely the most appealing. This incentivizes sensible offers from both sides, and likely

results in the compromised salary figures which limit the number of arbitration hearings.^{xxvii}

Even though the process seems to favor the players by its overall impact on salaries---though owners have won more than half of the arbitration cases decided since its implementation---and its proposed removal is often used as a bargaining chip during collective bargaining, the owners themselves prefer it to a free market for young stars due to the potentially astronomical bidding for premier players during or approaching their prime years of performance. It is also unlikely that the players' union, of which the majority of members are veterans, would like the talent market flooded with young players whose abilities approach, if not, surpass, their own.

It appears that it is the threat of arbitration which keeps a market equilibrium in place and helps maintain a labor peace. But considering the relatively small difference in salary requests and offers in the majority of arbitration---frequently amounting to as little as \$300,000---that perhaps a more modified approach incorporating other aspects of alternative dispute resolution methods could be more productive.

VI. The Mediation-Arbitration (Med-Arb) Hybrid

Mediation, a non-binding, voluntary dispute settlement method, is not a perfect substitute here. Although the short timeframe involved in salary decisions makes them difficult, it is not unavoidable. An open-ended, non-binding dispute resolution would not work, as a player's contract issues need to be resolved before he takes the field for spring training in late February. But as the mediation-arbitration hybrid, med-arb in shorthand, gains popularity in the American workplace, it is a solution worth examining.

The advantages of mediation lie in its flexibility and creativity.^{xxviii} A trained mediator can shift gears between facilitating and evaluating^{xxix}, solving problems and exploring them. While settling an issue is something achievable in either arbitration or mediation, resolving it, in the sense of a lasting understanding and agreement co-opting both sides of a dispute, seems far more likely to come from mediation. The differences---joint participation, the voluntary nature of the settlement---offer the chance for a lasting, productive relationship.

The goal of mediation-arbitration is to yield the advantages of both forms of dispute resolution, with the communication of mediation paired with the quick resolution of arbitration^{xxx}. The idea behind the process is that after an initial mediation, the parties and mediator-arbitrator would then shift to an arbitration hearing. In the classic process, it would be more efficient, as the arbitrator would already be familiar with the issues in dispute of the case^{xxxi}. This raises issues of whether one of the strengths of mediation---free and open communication is intended to prevail over pure advocacy---is mitigated by the potential morphing of the mediator from a neutral third party to the ultimate arbiter of settlement. Regardless, it is designed to preserve the idea the best settlement is one formed by the parties themselves while incorporating the superiority of mediation over pure negotiation as well adding the value of a binding resolution at the end of the process.^{xxxii}

In the proposed baseball format, it would necessitate separate mediation and arbitration hearings, with separate mediators and arbitrators. The bounds of the information allowed in arbitration are well established and time-tested. But in a non-binding session, formally bringing both sides to the table with a third-party facilitator, could help balance both parties' interests without the alienation and posturing involved in typical non-mediation negotiations and the severity of arbitration.

VII. A model for med-arb in baseball

The pre-arbitration hearing weeks co-opt many mediation techniques, however informally. The media, which is informed of the salary arbitration demands when they are filed in January, offers a de

facto sounding board for both parties' cases throughout the off-season. While arbitration results are not covered with the fervor of the free agent markets, a player's dissatisfaction with a low-ball offer (and its subsequent impact during future negotiations) is understood well. As the fan base grows more sophisticated in its understanding of both statistical analysis and the business side of baseball, ownership and players both have a vested interest in keeping up appearances by tempering their rhetoric in the public eye and even in the private negotiating sessions, as information seeps out through notoriously porous front office staffs and player-friendly "sources."

This attention paid by the media and fans approximates, roughly, the early stages of mediation. The merits of both sides' arguments largely are predictable by outside sources, thus amounting to an information-gathering period for both sides. Suggestions are bandied through negotiations---with the cudgel of arbitration looming, there is little incentive for feints when both sides understand the other's motivations so well---which approaches a lot of the goals in agenda setting and generating movement.

Now, while the negotiation-through-the-media can also come close to problem-solving and caucusing, the final portion of the BADGER method is where a modified med/arb process could bear fruit. The lingering downside of arbitration is the animosity it generates between the player and team, or employee and management. Considering the entire point of salary arbitration is to create a framework for an ongoing relationship, and that relationship is designed to last between one and three years at a minimum for young players, it would seem that pitting players and management against each other ideally would be avoidable.

Is there a role for a third-party intermediary beyond the existing backdoor diplomacy through the media? In the case of a team re-signing its own free agents, it seems unlikely, as the parties have had ample opportunity to resolve their differences beyond money, which is the sole remaining point of contention when the player submits to arbitration in the first week of December and does not reach a more nuanced agreement by an arbitration hearing in February. But for younger players, whose long-term relationship with the team is in its infant stages, it would appear that the chance for an

intermediate party could help facilitate the parties to bargain between long-term and short-term interests. By balancing neutrality and fairness, as well as managing the emotions of the party, a mandatory mediation session could produce results that reward players without unduly damaging their relationship with teams. A more direct approach than the hard bargaining and public posturing that takes place in the media could yield a more readily-reached compromise, with the teams paying a player a below-market price for their services during their arbitration-eligible years, and the players achieving a level of long-term security while not jeopardizing their free-agent rights after six years of service. Some of the better-managed teams---the Cleveland Indians have done this for almost two decades---do this already, without the need for mediation. Others, such as the New York Yankees, whose enormous revenue streams allow them the flexibility to defer signing players until they have a longer proven track record, would obviously still elect not to participate. However, the use of a mediation-arbitration system could help teams that either have more limited revenue streams or more inept management, and could help players who are still learning their craft achieve a level of security during a volatile time for their careers.

The ideal system would involve a mediation session between the dates when the parties submit salary figures and the parties meet for arbitration. Thus, the threat of binding arbitration would remain as a deterrent against unreasonable demands, thus preserving its value as a force bringing the parties together, while the owners would have an opportunity to conduct their business in private without risking immediately escalating salaries. At this point, there remains gamesmanship even with the scheduling of arbitration hearings, as the best young players (who in theory could set the market for others based on the allowed discussion of comparative salaries during arbitration hearings) are often scheduled for the end of the arbitration period, thus minimizing their impact in the given year. By giving players the space for mediation under the supervision of an experienced mediator, but also with a necessary agreement to confidentiality until, say, the end of the arbitration period, owners and players could exchange information and offers more freely without jeopardizing the benefits of the arbitration

process itself.

The confidentiality agreements could in turn allow more information exchanged during the hearings---such as greater witness testimony, information on the financial state of the players and teams, provided by the party themselves---a more participatory process would emerge. This obviously could have a suppressive impact on the players' salary---the exchange for a longer contract at a lower annual salary would seem the ideal scenario for a young player in this process---so perhaps the union could negotiate with the league to raise the minimum salary at stake to 90 or even 100 percent of the previous year's salary. Since the vast majority of arbitration cases involve a player getting a raise even if the arbitrator agreed with the owners' submitted figure, this would be a more symbolic gesture designed to protect the union's members of lesser accomplishment, which easily could be avoided by not offering arbitration to the player.

There are several potential hindrances, however. There would be a high degree of skepticism on both sides with regard to adherence to any confidentiality agreement, particularly when player agents (who would undoubtedly attend the meetings) represent multiple players negotiating with the same team or different teams. Additionally, the sheer number of people on both sides involved to some extent with the discussions would make the hazard of inappropriate usage of proprietary or confidential information prohibitive.

VIII. Conclusion

The inertia and heavy suspicion on both sides of labor relations in baseball make any significant adjustment to its relationship unlikely, particularly one which would have been in place for nearly four decades by the time the next round of collective bargaining begins in two or three years. While the owners complain about the system as a salary escalator, it does provide them an efficient mechanism for cost control, and while the star young players would like to test the market earlier, veteran players would see their salaries depressed. In other words, despite its faults, it is a system from

which both sides derive great value. The public scrutiny involved in anything baseball-related, combined with the sophistication of its fan base, could approximate the benefits of the mediation portion of the med-arb hybrid. Whatever inefficiencies exist within the system, they largely are accounted for, and the exceptions likely are not influential enough to force much change. In the end, warts and all, the arbitration process likely is not going anywhere.

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