Chapter 6

Baseball Arbitration in Comparison to Other Types of Arbitration

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6.1. Introduction

The growth and development of a nation, especially a developing country, is often accelerated by foreign investments. Protection of such investments is one of the primary concerns of any foreign investor and, in the absence of any protection mechanism, foreign investors are reluctant to invest in countries, especially those suffering from legal and political instability. With a view to addressing this concern, several mechanisms have been developed over the last few decades to protect investors and encourage foreign investment.

The most important mechanism is without doubt the network of bilateral tax treaties, the aim of which is to prevent double taxation of cross-border operations of individuals and companies. While the conclusion of double tax treaties (DTTs) has meant an important step forward in encouraging the access of foreign investors to the domestic market, it is the proper functioning of the treaties that is of paramount importance. More specifically, any disputes arising between the two contracting states on the interpretation and application of DTTs must be quickly and efficiently resolved, since they will otherwise likely result in double taxation. The past few years have witnessed a significant increase in such disputes.

DTTs include mechanisms for conflict resolution, in the form of the mutual agreement procedure (MAP) and, in some cases, arbitration clauses. Unfortunately, the MAP does not always lead to the (satisfactory) resolution of the dispute. Thus, arbitration clauses are becoming increasingly important as a mechanism for dispute resolution.

Arbitration procedures and clauses have been implemented under many different fields of law. This chapter will provide an overview of the different types of arbitration currently in place in the field of tax law. Since the conventional arbitration under the OECD Model Convention (OECD Model) and the UN Model has already been analysed in a previous chapter,[1] the focus of this chapter will be placed on the so-called "baseball arbitration" (and other forms of last offer arbitration), typically included in the DTTs concluded by the United States (*see* section 6.2.). Nevertheless, section 6.3. will briefly introduce the conventional arbitration under the OECD and UN Models and, finally, section 6.4. will compare baseball arbitration with the OECD and the UN conventional arbitration.

6.2. Baseball arbitration in tax treaties

6.2.1. Historical development

6.2.1.1. Salary arbitration in major league baseball

Baseball arbitration, also known as "high-low arbitration" or "final offer arbitration",[2] was developed as a result of salary disputes involving US major league baseball (MLB) players. In 1954, the players founded a union, the Major League Baseball Players Association (MLBPA), in order to fight back against the owners of the teams, who exerted almost complete control over the movement and salaries of players by means of so-called "reserve clauses" inserted into their employment contracts. Salary arbitration was adopted in a 1973 agreement between

1. *See* chapter 2.
2. These terms will be used interchangeably in this paper.

the owners and the MLBPA, as a result of a proposal made by the owners in the hope of salvaging the reserve system. It has remained largely unchanged since then.[3]

In the MLB salary arbitration format, the player and the team each submit a single number to an arbitrator. This is followed by a hearing, during which both the player and the team have the opportunity to make a presentation. The arbitrator then chooses one of the two numbers as the player's salary for the upcoming season.[4] Any player who fulfils the conditions[5] may submit his salary to final and binding arbitration. The consent of the club is not required. The same is true for the club. In other words, the arbitration proceedings can be unilaterally requested by either party. The system provides for strict deadlines by which time the issue must be submitted to arbitration and, subsequently, by which time the two sides must exchange notification of the proposed salary for the next season. It is important to note that the time span between these two deadlines is very short in an attempt to minimize the duration of the dispute. Moreover, the hearings themselves have strict timelines: each side has only 1 hour to present its case and half an hour for rebuttal. The arbitrators are encouraged to issue a decision within 24 hours of the hearing. The decision is not accompanied by a written opinion. The factors that may be taken into consideration by the panel in reaching its decision are laid out in detail, along with the evidence it is prohibited from considering.[6] All these factors contribute to the desired speedy resolution of the dispute.

On the other hand, the two sides may continue their negotiations even after the arbitration process has commenced. The arbitration panels which preside over the hearings are composed of three arbitrators. The arbitrators are elected for a 1-year term and are selected jointly by the MLBPA and the MLB Labor Relations Department (LRD), which represents the owners.[7]

According to Monhait, salary arbitration has contributed to significant increases in compensation for the players. At the same time, it preserves a part of the revenue the player's performance generates for the owners.[8]

6.2.1.2. Application of baseball arbitration in tax treaties

The introduction of baseball arbitration in tax treaties is due to the United States, which also spearheaded the use of arbitration for the resolution of tax disputes.[9] The 2006 US Model Income Tax Convention and its Technical Explanation, however, do not include an arbitration provision, since the United States was opposed to mandatory arbitration until 2006.[10] The change in attitude of the United States towards mandatory arbitration was one of the contributing factors for the introduction of the arbitration clause in the OECD Model in 2008.[11] As a result of this, the OECD acknowledged that competent authorities have the option to use the final offer approach instead of the independent opinion approach provided for in the *Sample Mutual Agreement on Arbitration*.[12]

The United States is currently the state with the most arbitration clauses in its DTTs.[13] More significantly, the only arbitration clauses not based on the OECD Model with detailed procedural rules are those to which the

3. *See* J. Monhait, *Baseball Arbitration: An ADR Success*, 4 Harvard Journal of Sports & Entertainment Law (2013), p. 105 et seq. (108-112) and B. A. Tulis, *Final Offer "Baseball" Arbitration: Contexts, Mechanics and Applications*, 20 Seton Hall Journal of Sports and Entertainment Law (2010), p. 85 et seq. (91).
4. *See* Monhait, id., p. 112.
5. I.e. a certain number of years (currently between 3 and 6) played in the Major League.
6. *See* Monhait, *supra* n. 3, p. 118 et seq.
7. Id., p. 119.
8. Id., p. 121.
9. The first arbitration clause in a modern double tax convention was included in the DTT between Germany and the United States of 1989, with the amending protocol signed on 17 August 2006.
10. *See* chap. 7 in this volume; *see also* H. Ault & J. Sasseville, *2008 OECD Model: The New Arbitration Provision*, Bull. Intl. Taxn. (2009), p. 208 et seq. (209). The arbitration clauses it included in its tax treaties before that date provided for voluntary arbitration.
11. More precisely, it was the introduction of a mandatory arbitration clause in the protocol to the US-Germany DTT in 2006; *see* Ault & Sasseville, id., p. 209.
12. OECD Model Commentary 2014, Annex to art. 25, para. 3.
13. Twelve as of 2014; see H.M. Pit, *Arbitration under the OECD Model Convention: Follow-Up under Double Tax Conventions: An Evaluation*, Intertax (2014), p. 445 et seq. (448).

United States is a contracting party.[14] The United States uses final offer arbitration in all the DTTs with mandatory arbitration provisions to which it is a contracting state.[15]

6.2.2. Characteristics of final offer arbitration

6.2.2.1. The "single choice" mechanism

The main feature of baseball arbitration, which distinguishes it from "independent opinion" arbitration, is that the authority of the arbitrators is severely restricted. They are not allowed to reach an independent decision on the case. Instead, their decision only involves the choice between the two options for resolution offered by the contracting states.

This aspect has several significant effects. Firstly, it greatly increases the speediness with which the dispute is resolved and lowers the costs. This is due not only to the decreased complexity of the decision-making process, but also to the incentives the parties receive. One of the most frequent arguments in favour of baseball arbitration is that it encourages the parties to take up reasonable initial positions. The reasoning is that since the panel must choose between the two figures submitted by the contracting states, whichever state submits a figure that appears broadly consistent with the correct transfer price will win the dispute. Thus, parties are less likely to submit aspirational numbers.[16] Some authors have therefore argued that efficiency is the ultimate goal of final offer arbitration.[17]

Final offer arbitration evolved in part due to the criticism directed at conventional arbitration. It was argued that conventional arbitrators were "splitting the difference", i.e. finding a middle ground between the positions of the parties, regardless of the evidence brought forward in the case. There were concerns that this might lead to a "chilling effect" in the sense that parties would be more likely to take extreme positions during negotiations in an attempt to skew the compromise in their favour.[18]

The counter-argument is that the single-choice model constrains the arbitrator. If both contracting states submit unreasonable figures, the arbitrator must still pick one of them, leading to a potentially significant and unjustified loss of tax revenue for one of the parties.[19]

Moreover, the "chilling effect" has been called into question by some studies. Keer and Naimark have questioned the conventional wisdom that arbitrators tend to split the difference. In their empirical study of international business arbitration cases, they found that the majority of awards (66%) resulted in outright wins or losses and the other awards covered a wide range of distributions. They also cite other studies reaching the same conclusion.[20]

Dickinson reports surprising findings as a result of the comparison he conducted between conventional and final offer arbitration, as well as a third alternative, which is a mixture of the two.[21] His results suggest that conventional arbitration is more successful at minimizing disputes than final offer arbitration and that the average final offers are not different across arbitration procedures.[22] In other words, final offer arbitration does

14. Pit, id., p. 463.
15. E.g. *see* the DTTs between the United States and Belgium, Canada, France and Germany. These DTTs were all signed or amended after 2006.
16, Monhait, *supra* n. 3, p. 132; Tulis, *supra* n. 3, p. 89.
17. *See* Tulis, id., p. 89.
18. Id., p. 88.
19. *See* Monhait concerning a similar critique relating to salary arbitration, *supra* n. 3, p. 140.
20. *See* S.E. Keer & R. W. Naimark, *Arbitrators Do Not "Split the Baby" – Empirical Evidence from International Business Arbitrations*, Journal of International Arbitration (2001) Volume 18 Issue 5, p. 573 et seq.
21. This third approach, called "combined arbitration", is of a merely theoretical nature. It operates on the basis of final offers of the parties, similar to baseball arbitration. If the arbitrator's notion of a fair settlement lies between these two offers, then the decision is rendered based on the baseball arbitration principle, i.e. one of the offers is chosen. If, however, the fair settlement lies outside the final offers, then the decision is rendered by the arbitrator himself, independently of the opinions of the parties. *See* D.L. Dickinson, *A Comparison of Conventional, Final-Offer and "Combined" Arbitration for Dispute Resolution*, 57 Industrial & Labour Relations Review (2004), p. 288.
22. Id., p. 295 et seq.

not lead to more reasonable negotiating positions for the parties. Instead, more disputes were settled within the framework of conventional arbitration.

Nevertheless, it should be kept in mind that the incentives offered by the final offer approach must be complemented by the possibility for the parties to settle, as is the case in MLB salary arbitration. Optimal success is only achieved if the procedural rules allot time for bargaining and encourage settlement prior to the hearing.[23] Under the OECD arbitration clause in article 25(5) of the OECD Model, the competent authorities are free to continue their efforts to reach a mutual agreement as long as the arbitrators have not yet rendered their decision.

Secondly, baseball arbitration could serve to placate criticism relating to the loss of sovereignty pursuant to arbitration. Since the arbitrators are forced to adhere to the view of one of the contracting states, the latter have an increased control over the process as opposed to traditional arbitration, where the arbitral award does not necessarily reflect the position of either country. The loss of sovereignty argument is closely linked to concerns about the potential bias of arbitrators. While it is true that the single choice mechanism leaves less room for bias in the sense that the powers of the panel are restricted, this might not be sufficient to alleviate these concerns.[24]

6.2.2.2. No written decisions

A side effect of the limited authority is that the "decision" is in fact, just a number, without any additional information or comments by the arbitrators.[25] As such, it cannot create a precedent for future decisions.[26] Moreover, this form of arbitration is not suited to cases where the exact monetary value is not the primary issue. This stems from its development as a means to solve salary disputes. While most arbitration cases are related to transfer pricing issues and therefore revolve around the determination of the correct transfer price, the use of final offer arbitration in other cases, especially those where complex decisions are required, might be limited. For instance, baseball arbitration could prove less useful if the interpretation of a particular treaty term or provision is at issue instead of merely a numerical figure. This is due to the fact that the exact financial impact of the interpretation (especially for future periods) cannot always be accurately determined. Additionally, the fact that arbitrators issue no written opinions makes individual decisions more opaque, which could cause the perception of bias and increase the risk of actual bias since no justification is required.

6.2.2.3. Package vs issue-by-issue arbitration

In addition, the form in which the decision is rendered also raises the issue of how to deal with cases where multiple issues have been submitted for arbitration, e.g. if multiple fiscal years are still open to assessment and the appropriate transfer price must be determined for each year in turn. Broadly speaking, there are two possible procedural variations: arbitration issue-by-issue and package deals. Package final offer arbitration has drawn criticism because it apparently creates an incentive for parties to mix in a small number of outrageous offers in an otherwise reasonable package. This in turn increases the difficulty of reaching a decision for the arbitrator, since the offers are more difficult to weigh against each other. Thus, package deals may undermine the most significant advantage of baseball arbitration, namely that it is conducive to reasonable bargaining.[27]

On the other hand, if each issue is arbitrated separately, the dispute resolution process becomes more time-consuming because each issue will require a separate hearing and a separate decision. More importantly, it may give the arbitrator a greater discretion to follow his own opinion, possibly even split the difference by deciding

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23. *See* Monhait, *supra* n. 3, p. 133.
24. Some authors support the opposing view, that baseball arbitration leads to an increase in (the perception of) bias. *See* section 6.2.2.2.
25. Such is the case for arbitration proceedings pursuant to the US-Canada tax treaty, as established in the Arbitration Board Operating Guidelines (hereinafter Guidelines), available at http://www.irs.gov/pub/irs-utl/2010_-_arbitration_-_board_operating_guidelines_nov_8-10_final.pdf. *See* no. 13 of the Guidelines; for further details, *see* chap. 7 in this volume.
26. And, in fact, the US approach generally entails a prohibition on precedential value for any arbitration decision. For example, this is laid down in the Memorandum of Understanding (hereinafter MOU) between the US and Canada, *see* no. 16 of the Memorandum of Understanding Between The Competent Authorities of Canada and The United States of America, http://www.irs.gov/pub/irs-utl/2010_arbitration_mou_nov_8-10_-_final.pdf; for further details, *see* chap. 7 in this volume.
27. *See* Tulis, *supra* n. 3, p. 103.

half of the issues in favour of one party and the other half in favour of the other party. This could negate the intention of baseball arbitration and legitimize the concerns about the loss of sovereignty. Nevertheless, the bargaining required in relation to each disputed issue should force the parties to submit reasonable offers on each issue. It may also encourage the settlement of some, maybe even most, of the issues before the hearing, which would of course provide for a speedier decision. Tulis argues that the "chilling effect" would not occur in issue-by-issue arbitration and that it is thus preferable to package deals.[28]

In practice, the United States and Canada have agreed on issue-by-issue arbitration. While the Proposed Resolutions and Position Papers submitted by the competent authorities must deal with all the issues in a case, the board will make separate decisions on each issue. An exception is provided by the US-Canada MOU for interrelated issues, according to which competent authorities may agree to present the issues as package deals.[29]

6.2.2.4. Timing of final offers

The timing of offers is also essential for the good functioning of the arbitration process. As previously mentioned, in MLB salary arbitration, the procedural rules allot time for negotiations between the parties. One of the methods used is by leaving sufficient time between the hearing and the offers for the parties to take up bargaining based on the proposals they have submitted.[30] Tulis argues that the optimal solution would be to permit final offers as early as possible prior to the hearing in order to encourage the parties to act more reasonably. In addition, the offers should be adjustable for a certain period of time. This creates an incentive for the parties to engage in "a battle of reasonable offers", which would bring them closer to a consensus, even if the original offers were extreme. However, this grace period should be restricted to a narrow window and end well in advance of the hearing.[31]

Such a system has not yet been implemented in practice. Indeed, it seems as though the opportunity for the contracting states to negotiate a settlement has been drastically restricted in favour of a speedy resolution of the arbitration. The procedural rules implemented by the United States in its tax treaties provide for an accelerated schedule. The process is expected to be concluded within 1 week.[32] One could argue that more time for negotiations is unnecessary since the (at least partially) unsuccessful MAP prior to the arbitration will have afforded the competent authorities ample time to come to an agreement. More specifically, arbitration only commences after the MAP has lasted at least 2 years. However, on the one hand, there have always been concerns that this 2-year period is too short.[33] On the other hand, the looming prospect of an arbitration procedure that has already commenced and the existence of final offers could serve to focus the discussions on the issues at hand. In the authors' opinion, the inclusion of a grace period during which offers can be adjusted is desirable, since the contracting states can adapt to the offers of the other party and possibly even rethink their strategy prior to the hearing. Most importantly, this would not have any negative impact and competent authorities would not be obliged to make use of it. For instance, the option to decline the grace period could be included if both parties have decided on their respective figures and are intent on a speedy decision.

6.2.2.5. Selection of arbitrators

Another noteworthy feature of MLB salary arbitration concerns the selection of arbitrators, more specifically, the existence of a pool of pre-vetted arbitrators who have been selected in advance by the parties to the dispute.[34] A similar system exists in the European Union for disputes pursuant to the EU Arbitration Convention, under which the individual countries each nominate a number of arbitrators and the panel for each case is selected from this common pool.

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28. Id., p. 103 et seq.
29. *See* MOU, *supra* n. 26 at no. 11.
30. *See* Tulis, *supra* n. 3, pp. 118 et seq. and 104 et seq.
31. Id., p. 105.
32. *See* chap. 7, n. 8 in this volume, citing M. Gunguly, *Tribunals and Taxation: An Investigation of Arbitration in Recent U.S. Tax Conventions*, 29 Wis. Int'l L. J. 735, 752 (2012).
33; This is probably why the United Nations opted for a 3-year period when it introduced its own arbitration clause in 2012 in art. 25B(5) of the UN Model. *See also* chap. 7 in this volume.
34. *See* Monhait, *supra* n. 3, p. 119.

Such a mechanism has several advantages. Firstly, the selection of arbitrators for each dispute takes up a significant amount of time. Pursuant to the Sample Mutual Agreement on Arbitration it may take up to 3 months.[35] If the competent authorities are given a pre-agreed list to choose from, this time frame can be significantly reduced. Secondly, it would help alleviate concerns relating to the objectivity of arbitrators, since the other party would have an insight into potential candidates and the opportunity to form an opinion on their appropriateness.

The United States has implemented a similar mechanism in its tax treaty with Canada. The contracting states are required to develop and maintain a list of qualified persons from among their nationals.[36]

Nevertheless, before such a list of arbitrators can be developed, it is necessary to first establish (and ideally agree upon) which qualifications authorize a person to become an arbitrator. The basis for the determination of the ideal features should be the requirements for obtaining a sound award. For instance, it stands to reason that both contracting states would desire a thoughtful, unbiased and coherent award, which in turn can only be rendered by arbitrators who are experts in the field and independent.[37]

For instance, the MOU stresses the independence of board members. Competent authorities are not allowed to appoint current or former government employees during a 1-year period following their departure from government employment. Moreover, all factors that could cast doubts on their impartiality must be disclosed in advance to both competent authorities. Board members must also have significant international tax experience.[38]

6.2.2.6. Criteria that may be taken into account by the arbitrator

The limitation of the criteria that arbitrators may consider in reaching their decision during MLB salary arbitration plays an important role in ensuring the efficiency of the process. Firstly, it simplifies the decision-making process by reducing the variables that must be considered. Secondly, it restricts the arguments a party can bring. While negotiating between themselves, the parties may consider all factors they deem pertinent to the issue, whereas before the arbitral panel only certain predetermined aspects count. If the parties therefore consider an aspect particularly relevant and this is not reflected in the criteria, they have an additional incentive to reach a private settlement. Tulis argues that the criteria constitute a means of mimicking an active market, since the purpose of baseball arbitration is to determine an appropriate market value.[39]

Predictably, the criteria used in the MLB process have been subject to frequent criticism. It may prove difficult, if not impossible, to provide criteria that suit all disputes equally, but the authors would argue that this is not the point. The usefulness of this instrument is that it establishes the parameters of the dispute resolution process in advance – each party is at least vaguely aware of the lines along which the argument of the other party will proceed and can prepare accordingly.

Moreover, it prevents unnecessary cluttering of the parties' submissions and increases the efficiency of the hearing. Taxpayers would also benefit from seeing which factors the competent authorities deem to be relevant in such cases, since they can better assess the chances of success. Decisions might become more consistent, since each case would receive the same treatment, at least with respect to the issues taken into account. Finally, the concerns relating to objectivity and loss of sovereignty might be alleviated, since this constitutes a further restriction on the authority of arbitrators. In tax treaty practice, the criteria to be considered have not yet been agreed upon.

Tulis attempts to establish some guidelines concerning the appropriate number of criteria, as well as the detail and weight of each criterion. For instance, he argues that when any two criteria have the potential to conflict, the arbitration agreement should outline how such a conflict can be resolved in order to increase predictability for

35. OECD Model Commentary, Annex to art. 25, para. 1 sec. 5.
36. *See* MOU, *supra* n. 26 at no. 8. Additionally, they must agree on at least 10 people suitable and willing to serve as Chairs to the board. For further details, *see* chap. 7 in this volume.
37. For in-depth considerations on the subject, *see* chap. 12 in this volume.
38. *See* MOU, *supra* n. 26 at nos. 6d, 6e and 6f.
39. *See* Tulis, *supra* n. 3, p. 117.

the parties.[40] An agreement could exclude non-essential factors in an effort to promote a pre-hearing settlement. The list of criteria for baseball arbitration should be short in order to increase the effectiveness of negotiation and very detailed in order to limit arbitrator discretion.[41]

Of course, the approach used by MLB salary arbitration cannot be adopted directly for tax arbitration cases, since the contexts of the procedures differ significantly. It would be exceedingly difficult to restrict the type of evidence admissible in tax arbitration cases to certain types of data, even if the procedure was restricted to transfer pricing cases. It is much more difficult to even contemplate such rules for other issues (e.g. interpretation issues).

Nevertheless, the United States has followed an interesting approach in this regard in its tax treaty with Canada. While there are no specific evidence rules, there are detailed guidelines on the submissions that can be made by the parties, not only providing clear deadlines, but even a maximum page count for each individual document.[42] Additionally, the powers of the chair to request additional information are limited.[43] These procedural rules ensure the efficiency of the process and the timeliness of the resolution.

6.3. Arbitration pursuant to the OECD and UN Models

The arbitration clause of article 25(5) of the OECD Model was introduced in 2008 in order to provide a solution when the competent authorities are unable to reach an agreement within 2 years from the presentation of the case. It is important to note that arbitration was conceived as an integral part of the MAP and not an alternative to it. As a result, the taxpayer only has access to arbitration if a MAP pursuant to article 25(1) of the OECD Model has been initiated and not completed within the required time frame. While there are no procedural rules within the OECD Model itself,[44] the OECD Commentary on article 25 contains an Annex where a Sample Mutual Agreement on Arbitration is outlined. The Sample Agreement provides for a multi-step process which commences with the written request for arbitration submitted by the taxpayer. This is followed by the appointment of arbitrators and the rendering of the arbitral award, which must finally be implemented into domestic law.

The United Nations also introduced an arbitration provision in article 25B(5) of the UN Model in 2012. This provision is broadly patterned after article 25(5) of the OECD Model, with the exception of three major differences:[45]

- the time span is increased from 2 to 3 years;
- the request must come from one of the competent authorities instead of the taxpayer; and
- the competent authorities may depart from the decision if they reach a different mutual agreement within 6 months.[46]

In the following, the most important features of the arbitration clauses in the Models will be outlined. For ease of reference, this section will follow a structure similar to that of section 6.2. Arbitration as provided for in the OECD Model favours the conventional, or "independent opinion", approach,[47] whereas the UN Model currently prefers baseball arbitration, but also allows the contracting states the option to choose an "independent opinion approach".[48] This section will focus on the "independent opinion approach" and the general procedural rules laid down in the two Models.

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40. Id., p. 118.
41. Id., p. 128 et seq.
42. *See* MOU, *supra* n. 26 at no. 9.
43. *See* MOU, *supra* n. 26 at no. 10.
44. Art. 25(5) merely states that the procedural rules will be established by mutual agreement between the competent authorities.
45. UN Model Commentary art. 25 para.1.
46. A fourth difference concerns the absence of a footnote and is due to the existence of art. 25A as an alternative in the UN Model. It was not considered as important for the purposes of this paper.
47. *See* OECD Model Commentary 2014 art. 25, Annex para. 1(15) and para. 12. Nevertheless, the Sample Mutual Agreement allows the use of baseball arbitration as an alternative, see art. 25, Annex para. 1 sec. 6 and para. 13. The implementation of the streamlined process is suggested primarily for transfer pricing cases.
48. See UN Model Commentary 2011 art. 25 (B) Annex para. 1 sec. 11.

One of the main characteristics of the "independent opinion approach" is that it allows the consideration of questions of either law or fact, as well as of mixed questions of law and fact.[49] This means that arbitrators are called upon to interpret the relevant laws and apply them to the facts of the case as they have determined them. In other words, the panel plays a very important role in the proceedings. It is not only called to establish the facts, but also the applicable laws and the result of their application. Instead of deciding to adhere to one of the opinions presented by the competent authorities, they can decide independently on the solution to the case and are not restricted in any way in reaching their conclusions.

Another significant difference compared to baseball arbitration is the existence of a written opinion. The OECD Commentary even stresses the importance of the written award, arguing that it might help ensure acceptance of the decision if the method through which it was reached is known. Therefore, the arbitration decision must not only indicate the sources of law that it relies upon, but also the reasoning which led to the result.[50] The arbitral decision must be presented in writing to both the competent authorities and the taxpayer within 6 months from the date on which the chair notifies both the competent authorities and the taxpayer that he has all the information necessary to consider the case. Within 6 months of the communication of the decision, it has to be implemented by the competent authorities through a MAP.[51]

Moreover, while final offer arbitration is generally characterized by a strict adherence to confidentiality, the OECD Commentary allows the decision of the arbitral panel to be made public, provided that the taxpayer and both competent authorities give their permission.[52] Nevertheless, as is the case for baseball arbitration, the decision does not have formal precedential value. It is reached by a simple majority and thus dissenting opinions are not expressed.[53] Due to the nature of the arbitral award, the procedural rules for independent opinion arbitration need not concern themselves with how multiple issues will be decided.[54]

The Sample Mutual Agreement does not provide detailed guidelines on how and when the statements of the two competent authorities must be submitted or what they are required to include. Such guidelines can be agreed upon (on a case-by-case basis or in a protocol to the treaty) by the contracting states themselves, or they can be adopted by the arbitrators as they deem necessary.[55] The Sample Mutual Agreement requires the competent authorities to agree on the so-called "Terms of Reference" for each case in turn. These include not only the questions to be decided by the panel,[56] but also the briefing and hearing schedule.

This vagueness is to be expected in the Model Commentary; however, the bilateral tax treaties with arbitration clauses also seem to lack essential procedural and evidentiary rules in this regard.[57] Thus, there is no final submission deadline that would require competent authorities to reconsider their positions and there are no restrictions on the evidence that may be submitted to the panel for consideration or on the length of the arguments presented by the two parties.[58]

The selection of arbitrators and composition of the board pursuant to the OECD Model Commentary is fairly straightforward. Both parties each select one of the arbitrators, who then appoint the chair. There are additional provisions to prevent undue delay.[59] What is of note in this regard is that 3 months are allotted to the contracting states to propose their candidates. This time period is granted on top of the 3 months at the end of which the competent authorities are required to agree on the Terms of Reference. Thus, 6 months can pass before the board has even been selected.

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49. OECD Model Commentary 2014 art. 25, Annex para. 1 sec.15 and para. 12.
50. OECD Model Commentary 2014, art. 25, Annex para. 1 sec. 15 and para. 12.
51. Id., Annex para. 1 sec. 19.
52. Id., Annex para. 1 sec. 15 and 16.
53. Id., Annex para. 1 sec. 15.
54. The panel will decide on all issues as it sees fit.
55. OECD Model Commentary 2014 art. 25, Annex para. 1 sec. 3 and sec. 10.
56. The issues to be decided must be agreed upon for each individual case even when the treaty provides for baseball arbitration; however, there are restrictions as to the type of issues (i.e. they must be monetary in nature) due to the decision-making process, (*see* section 6.4.).
57. *See* Pit, *supra* n. 13.
58. The only provision concerns evidence that has only come up after the request for arbitration was submitted and which may not be taken into account during the proceedings unless both competent authorities agree otherwise; *see* OECD Model Commentary 2014 art. 25, Annex para. 1(10).
59. Id., Annex para. 1(5).

6.4. A comparison of arbitration pursuant to the OECD and UN Models with baseball arbitration

6.4.1. Commonalities of baseball arbitration and conventional arbitration

The aim of this section is to highlight the commonalities and differences between the final offer approach and the independent opinion approach. While some of the shortcomings of these types of arbitration have already been hinted at during the discussion on their features, they are analysed in more detail below.

In order to compare baseball arbitration, on the one hand, and conventional arbitration under the OECD MC and the UN MC on the other, it is first necessary to understand the context in which they are applied. Both types of arbitration, as included in tax treaties in practice and as provided for in the Model Conventions, are an integral part of the MAP and thus use the same mechanism. As a result, important aspects like the minimum time frame for the submission of an arbitration request or the binding nature of the decision itself, are identical for both types of arbitration.

Concerning the selection of arbitrators, the US-Canada MOU applies the same approach as the OECD Commentary - each competent authority appoints one arbitrator (or board member in the case of the MOU) and the two arbitrators subsequently appoint the chair.[60] However, the streamlined process foreseen by the OECD and UN Commentaries reduces the number of arbitrators to one, which must be appointed by common consent of the competent authorities.[61]

It must also be highlighted that some of the differences between the baseball arbitration procedure as it is applied, for instance, in the United States-Canada treaty and the conventional arbitration pursuant to the OECD and UN Models are not inherent in the type of arbitration, but are instead caused by other factors. This is especially true for the detailed evidentiary and procedural rules. The fact that the United States and Canada have agreed not only on an exceedingly detailed time frame but even on comparatively minor issues such as the maximum number of pages for a written submission, is not, in itself, an advantage of baseball arbitration. Rather, the lack of such rules in the OECD Model and especially existing arbitration clauses should be criticized, since they could be equally applicable to conventional arbitration.

Nevertheless, the attention to detail and the imperative of streamlining the arbitration process can already be found in MLB salary arbitration, the tight schedule for which is an integral part of the functioning of the proceedings as a whole. The elimination of the need to agree on separate terms of reference for each case due to the MOU between the United States and Canada significantly speeds up the proceedings. The deadline for the appointment of board members is also shortened to 2 months. Under the assumption that the quick resolution of the dispute is one of the main goals of arbitration, the OECD recommendations could therefore be criticized as being too lenient with regard to the time frames they set.

6.4.2. Differences between the two approaches

The most important difference between the two types of arbitration lies in the nature of the decision to be made by the arbitral board and the means by which it is rendered. Less significant variations concern the number and nature of hearings. Two aspects must be highlighted concerning the arbitral award. Firstly, in conventional arbitration the panel has full authority to decide the open issues in any way it chooses. Secondly, the lack of restrictions means that there is a responsibility to support the decision taken with appropriate arguments.

Pursuant to the OECD and UN Models, the arbitral board is not bound to the proposals of the competent authorities. Thus, its discretion knows no limits, which might give credence to the argument of loss of sovereignty put forth by opponents of arbitration. It would exceed the scope of this paper to discuss the validity of this concern in general. Suffice it to say, it has been called into question. The issue of whether this concern is

60. OECD Model Commentary 2014 art. 25, Annex para. 1 sec. 5 and MOU, supra n. 26 at no. 6.
61. OECD Model Commentary 2014 art. 25, Annex para. 1 sec. 6 and UN Model Commentary 2011 art. 25 (B), Annex para. 1.

more or less relevant in the case of baseball arbitration cannot be easily answered. While it is true that similar reservations were voiced in the United States before the signing of the first protocols implementing arbitration and that they have not been brought up since, it cannot be concluded that this is due to the type of arbitration selected.[62]

On the other hand, the independent opinion approach offers several advantages. As detailed above,[63] baseball arbitration is only suited to address monetary disputes. This means that it is appropriate when the competent authorities are in disagreement about, say, the exact amount of the primary adjustment in a transfer pricing case. Moreover, it is most effective when addressing as few issues as possible. That is why MLB salary arbitration only concerns one amount. While it can still be effective with multiple issues at stake, this opens up the dilemma of choosing the most appropriate form (*see* section 6.2.2.3.).[64] Thirdly, baseball arbitration is most successful when the negotiation of a settlement offers additional benefits compared to an arbitral award. This is frequently the case due to the rigid nature of the award, but the procedural rules can also be tailored to limit the flexibility of the parties.[65]

In the case of baseball arbitration, the decision is merely a number and the number chosen by the panel is understood to signal broad agreement with the arguments put forth by the respective competent authority in the brief. As a result and to preserve efficiency, the arbitrators are not required to set forth their rationale in a written decision. In contrast, under the independent opinion approach arbitrators must lay out their arguments in writing. The burden of reasoning lies more heavily on them than on the parties to the dispute and therefore the burden of argumentation follows it.

This could negatively impact the length of the proceedings, since a well-reasoned argument must be crafted and rendered with the decision. Moreover, the independence of arbitrators in reaching their conclusions means that they must take more possible outcomes, and thus more variables, into account, further prolonging the time needed to reach a decision.

On the other hand, as the OECD itself has noted, the explanation of the reasons behind the decision may increase acceptance of the result.[66] Keer and Naimark have also stated that the practice of making short, non-explanatory awards provides a foothold for the myth that arbitrators split the difference, since it is easier to blame the panel.[67] Additionally, competent authorities are under less pressure to present their arguments and proposed outcomes since less depends on the numbers they put forth.

At the same time, however, this means that they might have less incentive to come up with reasonable, defensible numbers, since they have nothing to lose from inflating their claims if the arbitrators can deviate from these in any direction.[68]

Lastly, baseball arbitration typically only requires one hearing and limits the amount of evidence that can be put forward in order to expedite the decision. As a result, it is speedier and more cost efficient than conventional arbitration.

6.4.3. Preliminary findings

Baseball arbitration as a form of dispute resolution was conceived in the context of a long-term standardized relationship between the parties, where it is important to preserve amicable relations and avoid the adversarial nature of conventional arbitration. This context is essential to reaching the ultimate goal of final offer arbitration, which is a pre-hearing settlement between the parties.[69]

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62. However, Rosenbloom opines that the restriction of the authority of arbitrators is a possible response to the loss of sovereignty argument; see chap. 7 in this volume.
63. *See* sec. 6.2.2.2.
64. *See* Tulis, *supra* n. 3, p. 107.
65. Id., p. 106 et seq.
66. *See* sec. 6.3.
67. *See* Keer & Naimark, *supra* n. 20, p. 576.
68. For possible evidence to the contrary, *see* discussion in section 6.2.2.1.
69. *See* Tulis, *supra* n. 3, p. 106 et seq.

As a result, baseball arbitration requires sophisticated parties in order for it to work. Since the process is based on incentivizing the parties, they must be able to understand its functioning and outcome. If, for instance, a party does not comprehend the dangers of making an unreasonable offer, it may perceive the reasonable offer made by its opponent as a concession and refuse to adjust its own offer and may consequently react with extreme dissatisfaction when the arbitrator subsequently decides in favour of the opponent.[70]

This argument is particularly pertinent to disputes between developed and developing countries. It is a well-known fact that tax administrations in developing countries lack the resources and expertise of their counterparts in developed countries. They are frequently understaffed and underfunded.

This could make baseball arbitration very difficult to apply in these situations, since the two competent authorities may have wildly diverging views on the goal and outcome of the process and thus would be highly unlikely to come to an agreement. It seems plausible that the developing country would take a more unreasonable position and, as such, would be likely to lose the case more often, which would in turn have a negative impact on interstate relations and may further undermine the will to cooperate.[71]

Finally, it is interesting to consider the perspective provided by the OECD in its Sample Mutual Agreement on Arbitration:

> In some cases, however, the unresolved issues will be primarily factual and the decision may be simply a statement of the final disposition, for example a determination of the amount of adjustments to the income and deductions of the respective related parties. Such circumstances will often arise in transfer pricing cases, where the unresolved issue may be simply the determination of an arm's length transfer price or range of prices (although there are other transfer pricing cases that involve complex factual issues); there are also cases in which an analogous principle may apply, for example, the determination of the existence of a permanent establishment. In some cases, the decision may be a statement of the factual premises on which the appropriate legal principles should then be applied by the competent authorities. Paragraph 6 of the sample agreement provides a streamlined process which the competent authorities may wish to apply in these types of cases.[72]

The reasoning of the OECD seems to imply that some types of cases are better suited to baseball arbitration. This opens up the possibility of using both baseball and conventional arbitration, depending on the type of dispute that needs to be resolved between the competent authorities.

Another possibility is the application of "combined" arbitration, as described by Dickinson. However, while this approach should theoretically generate superior results, these expectations do not seem to be borne out by studies. Additionally, it has never before been used in practice.[73]

6.5. Conclusions

This chapter has provided an overview of the different types of arbitration currently in place in the field of tax law.

The comparison between baseball arbitration and conventional arbitration[74] identifies some features common to the two different procedures (e.g. the fact that they can be implemented only after the terms for the MAP are expired, their binding nature and the selection process for the arbitrators). However, the two types of arbitration are characterized by many substantial differences, generating advantages and disadvantages for the parties involved.

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70. Id., p. 106.
71. As a counterargument, it is often put forward that the detailed procedural rules as well as the reduced number of hearings and documents that must be submitted substantially simplify the process of baseball arbitration. Competent authorities of developing countries should thus have an easier time determining what is required of them. While this is true, it is nevertheless not a characteristic of baseball arbitration, since such procedural rules can be implemented for any type of arbitration clause; *see* sec. 6.4.1.
72. OECD Model Commentary 2014 art. 25, Annex para. 13.
73. *See* sec. 6.2.2.1. and Dickinson, *supra* n. 21, p. 288 et seq.
74. *See* sec. 6.4.

Baseball arbitration, on the one side, limits the "loss of sovereignty" for the contracting states involved by reducing the arbitrators' authority.[75] It ensures a faster (and cheaper) process and a higher degree of reasonableness of the bargaining and settlement process.[76] Additionally, it provides a more uniform and certain procedure (already established in detail in the text of the DTT), typically characterized by a lower number of hearings and a lower administrative burden.

Conventional arbitration, on the other side, enables the arbitrators with a more powerful role, in turn placing less pressure on the competent authorities of the contracting states involved and thereby not requiring such a high level of technical knowledge from their side. Moreover, the establishment of the procedure in the framework of the "terms of reference" increases the flexibility of this type of arbitration, also characterized by the taxpayer's participation and the publication of the decision reached (and of the reasoning of the panel).

In conclusion, the analysis set out in this chapter ultimately shows that a "magic formula" for a perfect arbitration procedure, applicable in all different situations, might not (and most probably would not) exist. However, by implementing some of the features of the other, each of the two existing types of arbitration employed in tax law disputes could reach more efficient and effective results. The following chapters illustrate and analyse different proposals to this end.

75. By means of the "single choice" mechanism.
76. By limiting the "chilling effect".