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# Who Wants What? – Final Offer Arbitration in the World Trade Organization

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I want it all!  
I want it all!  
I want it all!  
And I want it now!  
Queen

## Abstract

*The World Trade Organization's (WTO) Dispute Settlement Understanding (DSU) favours negotiated settlements for disputes. However, arbitrations according to Article 22.6 of the DSU have been carried out as compulsory conventional arbitrations, even though such arbitrations do not offer strong incentives for the parties to reach a settlement. For quite some time, scholars have studied other forms of arbitration that may encourage settlements more strongly, such as final offer arbitration. Yet this form of arbitration has received rather limited attention in the academic discussion about dispute settlement under the WTO. This article explores to what extent final offer arbitration might make sense for settling WTO disputes and concludes that it would be suitable for arbitrations pursuant to Article 22.6 of the DSU, specifically for setting the level of suspension of obligations and, under certain circumstances, for deciding on so-called cross-retaliation pursuant to Article 22.3 of the DSU. Before negotiations start, parties to a dispute should agree on final offer arbitration if arbitration should be deemed necessary. Such an agreement might be expressed in a pre-emptive joint proposal on procedural aspects. Amendment of the DSU would then be unnecessary.*

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## 1 Introduction

Many arbitrators pursuant to Article 22.6 of the World Trade Organization's (WTO) Dispute Settlement Understanding (DSU) face a strenuous task.<sup>1</sup> They are regularly confronted with insufficient evidence and complex econometrics. Besides, parties to the dispute usually present diverging claims as to what level of concessions or other obligations should be suspended (Articles 22.4 of the DSU and Articles 4.10, 4.11, 7.9 and 9.4 of the WTO's SCM Agreement).<sup>2</sup>

This article starts with a reference to the preference that the DSU shows for negotiated settlements. Yet arbitrations pursuant to Article 22.6 of the DSU have been carried out as conventional compulsory arbitrations (CCA), despite the fact that this kind of arbitration does not necessarily favour negotiated settlements. The article offers a brief introduction to final offer arbitration (FOA), which is a tool that encourages parties to negotiate a settlement to their dispute. After a review of the literature on FOA in the WTO, the article offers some thoughts on how to implement FOA in WTO dispute settlement. Lastly, the article ends with some conclusions.

## 2 Negotiated Settlement of Disputes in the WTO

It is commonly held that the goal of arbitration is that parties should not resort to it but, rather, that it should induce them to negotiate a settlement to their dispute.<sup>3</sup> In WTO dispute settlement, negotiated outcomes play a fundamental role. Article XXIII.1 of the General Agreement on Tariffs and Trade requires parties to consult with a view to the satisfactory adjustment of the matter.<sup>4</sup> Article 3.7 of the DSU emphasizes the DSU's preference for a solution mutually acceptable to the parties to a dispute. In particular, the DSU explicitly includes negotiation phases before adjudication in the form of consultations before a Member brings a case forward (Article 4) and refers to negotiations before the claiming party requests authorization to suspend obligations (Article 22.2). In addition, there are several rules in WTO law that underscore the importance of reaching negotiated settlements.<sup>5</sup> Moreover, some procedural steps, which do not seem at face value to have been introduced to encourage negotiated settlements, may in fact do so, such as the interim report (Article 15.2).<sup>6</sup>

<sup>1</sup> In this article, arbitrators, arbitrations and arbitration decisions refer to those constituted, carried out and issued according to Article 22.6 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) 1994, 1869 UNTS 401, except when otherwise noted.

<sup>2</sup> Agreement on Subsidies and Countervailing Measures (SCM Agreement) 1994, 1867 UNTS 14.

<sup>3</sup> See, e.g., Stevens, 'Is Compulsory Arbitration Compatible with Bargaining?', 5(1) *Industrial Relations* (1966) 38, at 42–44; Crawford, 'On Compulsory-Arbitration Schemes', 87(1) *Journal of Political Economy* (1979) 131, at 132–133.

<sup>4</sup> General Agreement on Tariffs and Trade 1948, 55 UNTS 194.

<sup>5</sup> See also DSU, *supra* note 1, Arts. 3.6, 4.5, 11, 12.7, 22.1, 22.2, 22.8 and 26.1. In addition, see, e.g., Working Procedures for Appellate Review, Doc. WT/AB/WP/6, 16 August 2010, para. 30.2; Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, 1186 UNTS 204, Art. 17.4; Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994, 1235 UNTS 126 Art. 19.2; SCM Agreement, *supra* note 2, Art. 4; General Agreement on Trade in Services 1994, 1869 UNTS 183, Art. XXIII.

<sup>6</sup> J.H. Jackson, *Sovereignty, the WTO and Changing Fundamentals of International Law* (2006), at 156.

Incidentally, it is important first to consider that mutually agreed solutions must comply with Articles 3.5 and 3.6 of the DSU. Accordingly, they have to be notified, they have to be consistent with the covered agreements and their objectives and they shall not nullify or impair a Member's benefits. Second, it should also be noted that the fact that the DSU *de lege lata* prefers mutually agreed solutions is not indicative of the actual preferences of the parties to the concrete disputes.

The first formal negotiation phase in WTO dispute settlement involves consultations. Before requesting the establishment of a panel, parties to a dispute should hold consultations 'with a view to reaching a mutually satisfactory solution' (Article 4.3 of the DSU).<sup>7</sup> The Appellate Body has stated:

Through consultations, parties exchange information, assess the strengths and weaknesses of their respective cases, narrow the scope of the differences between them and, in many cases, reach a mutually agreed solution in accordance with the explicit preference expressed in Article 3.7 of the DSU. Moreover, even where no such agreed solution is reached, consultations provide the parties an opportunity to define and delimit the scope of the dispute between them. Clearly, consultations afford many benefits to complaining and responding parties, as well as to third parties and to the dispute settlement system as a whole.<sup>8</sup>

In other words, '[t]he hope is that the parties will resolve their dispute without having to invoke the formal dispute settlement procedures' and, in fact, 'a significant number of cases end at the consultation stage (either through settlements or abandonment of a case)'.<sup>9</sup> Thus, it would probably not be sensible to regard consultations as a waste of time,<sup>10</sup> since such a view would focus rather too narrowly on formal dispute settlement and would not properly acknowledge the importance of consultations and negotiations as powerful instruments for settling disputes. As mentioned earlier, the aim of arbitration is to move the parties towards reaching self-negotiated settlements. Thus, consultations may be regarded as one of the instruments that significantly augment the effectiveness of the WTO dispute settlement system. Accordingly, consultations should arguably be strengthened.

On a side note, there could be some misgivings that consultations may be disadvantageous to less powerful WTO Members when negotiating with powerful Members. However, when the less powerful Member requests that consultations be held, the right to request the establishment of a panel arguably reduces the impact that so-called power-oriented diplomacy may have during those consultations.<sup>11</sup> When the less powerful Member is the respondent, on the other hand, it cannot take advantage of this safety valve. In order to strengthen the responding Member's position in this case, it would arguably make sense that it should also have the right to request the

<sup>7</sup> The Appellate Body has ruled that holding consultations is not mandatory. WTO, *Mexico – Corn Syrup Report of the Appellate Body*, 22 October 2001, WT/DS132/AB/RW, paras 63–64, 135(a).

<sup>8</sup> *Ibid.*, para. 54.

<sup>9</sup> Jackson, *supra* note 6, at 152.

<sup>10</sup> See, e.g., Pauwelyn, 'The Limits of Litigation: "Americanization" and Negotiation in the Settlement of WTO Disputes', 19(1) *Ohio State Journal on Dispute Resolution* (2003) 121, at 133; Jackson, *supra* note 6, at 153.

<sup>11</sup> On power-oriented and rule-oriented diplomacy, see Jackson, 'The Crumbling Institutions of the Liberal Trading System', 12(2) *Journal of World Trade Law* (1978) 93, at 98–101.

establishment of a panel concerning measures affecting the operation of any covered agreement taken within its own territory. Accordingly, the responding Member would have the right to request the WTO dispute settlement organ's rule on the lawfulness of its own measures. Such a tool would admittedly be unorthodox in the WTO context, yet it would arguably strengthen the negotiating position of less powerful Members when a powerful Member requests that consultations be held, and this policy, in turn, would hopefully reinforce consultations and the whole WTO dispute settlement system. It would probably make sense to limit this right to responding Members who are developing countries.

John Jackson argues that many complaints do not go on to a panel process because, among other factors, the jurisprudence may be 'providing some predictability that promotes settlements or withdrawal of cases'.<sup>12</sup> Indeed, parties can negotiate during the consultations prior to the panel process, and the jurisprudence may be one of the many sources of valuable information that guide parties in their negotiations. The fact that WTO jurisprudence provides some predictability helps parties in estimating the probability distribution of the fair settlement of (as yet not composed) panels. Actually, Jackson not only reasons that predictability promotes settlements, but he also argues that predictability has caused a decrease in the rate of WTO appeals.<sup>13</sup> In conclusion, he seems to hold the view that the WTO dispute settlement system often provides parties with enough information about the probability distribution of a fair settlement.

The second formal bargaining phase in WTO dispute settlement involves negotiations with a view to developing a mutually acceptable compensation when a Member has failed to comply with a recommendation or ruling. WTO law prefers parties to agree on a satisfactory compensation, and only if they do not come to an understanding may the claiming party request authorization to suspend obligations (Articles 22.2 and 22.6 of the DSU). The same fundamentals that were mentioned earlier regarding consultations also apply to these negotiations. Accordingly, for example, pursuant to Article 22.8 of the DSU a mutually satisfactory solution is preferable to the suspension of obligations.

In accordance with Article 11 of the DSU, parties to a dispute may reach a negotiated settlement not only during the mandatory negotiation phases but also during the whole proceeding. This makes sense, as dispute settlement procedures are also about giving the parties a forum for sharing information on the dispute.<sup>14</sup> In fact, it seems plausible that WTO dispute settlement proceedings may actually be helping parties to share information and reach a negotiated settlement, as in *US – Stainless Steel (Mexico)*, for example, where the parties notified the Dispute Settlement Body (DSB) of a mutually agreed solution after the Panel had submitted its final report,<sup>15</sup> or in *Korea – Bovine Meat (Canada)*,

<sup>12</sup> Jackson, *supra* note 6, at 160.

<sup>13</sup> *Ibid.*

<sup>14</sup> Sykes, 'Optimal Sanctions in the WTO: The Case for Decoupling (and the Uneasy Case for the Status Quo)', in C.P. Bown and J. Pauwelyn (eds), *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (2010) 339, at 342–344.

<sup>15</sup> WTO, *US – Stainless Steel (Mexico) – Report of the Panel*, 6 May 2013, WT/DS344/RW, paras 1.7 and 1.9–1.10.

where the parties notified the DSB of their mutually agreed solution after they had provided their respective comments on the interim report.<sup>16</sup> To sum up, the DSU displays a preference for negotiated outcomes. The next section will analyse CCA and FOA in terms of the incentives they offer for the parties to reach such negotiated settlements.

### 3 A Brief Introduction to FOA

Negotiations according to a Rubinstein game can be costly. Thus, recurring to an arbitrator is often suggested to reduce negotiation costs. Choosing a suitable type of arbitration is important since '[i]t is widely understood that the form of arbitration can generate different incentives for strategic bidding by the parties to the dispute'.<sup>17</sup> This article will consider two varieties of arbitration: conventional compulsory arbitration (CCA) and final offer arbitration (FOA).

CCA means that 'the arbitrator is able to impose an award of his own choice if negotiations end in dispute, allowing him to choose freely among a continuum of potential outcomes'.<sup>18</sup> Conventional arbitration mechanisms have been subject to criticism, as explained later in this section. FOA was first proposed by Carl Stevens as an alternative to enjoy the reduced bargaining costs of arbitration, while avoiding the disadvantages of CCA.<sup>19</sup> FOA is an arbitration process 'in which the arbitrator must select, without modification, [one of the parties'] final offer on issues in dispute'.<sup>20</sup> Put differently, 'if the parties cannot agree they deserve whatever they get from the arbitrator'.<sup>21</sup>

#### A Incentives to Negotiate

As already mentioned, the goal of arbitration is that parties do not resort to it but, rather, settle their dispute through negotiation. Indeed, '[t]he effectiveness of any dispute-resolution system is judged by the frequency with which it leads to self-negotiated settlements'.<sup>22</sup> CCA may affect the negotiating process and speed it up, thus reducing bargaining costs.<sup>23</sup> However, it also has some important drawbacks. Indeed, negotiations prior to a CCA may stall for several reasons. Roy Adams argues that 'while the expenses of litigation and risk aversion produce a settlement zone, a number of forces operate to impede settlement'.<sup>24</sup> Among others, he mentions that the parties may not

<sup>16</sup> WTO, *Korea – Bovine Meat (Canada) – Report of the Panel*, 3 July 2012, WT/DS391/R, paras 20 and 22.

<sup>17</sup> Deck and Farmer, 'Bargaining over an Uncertain Value: Arbitration Mechanisms Compared', 23(3) *Journal of Law, Economics, and Organization* (2006) 547, at 549.

<sup>18</sup> Kritikos, 'The Impact of Compulsory Arbitration on Bargaining Behavior: An Experimental Study', 7 *Economics of Governance* (2006) 293, at 294.

<sup>19</sup> Even though the concept had been used before, it is usually credited to Stevens, *supra* note 3, at 45–47. For a brief historical overview, see Adams, 'Final Offer Arbitration: Time for Serious Consideration by the Courts', 66 *Nebraska Law Review* (1987) 213, at 215.

<sup>20</sup> Feuille, 'Final Offer Arbitration and the Chilling Effect', 14(3) *Industrial Relations* (1975) 302, at 302.

<sup>21</sup> *Ibid.*, at 310.

<sup>22</sup> Deck, Farmer and Zeng, 'Amended Final-Offer Arbitration Outperforms Final-Offer Arbitration', 9(2) *American Law and Economics Review* (2007) 384, at 386, n. 3.

<sup>23</sup> Kritikos, *supra* note 18, at 294.

<sup>24</sup> Adams, *supra* note 19, at 223. The author refers especially to the settlement of civil cases before US courts; however, his observations can also be applied to other contexts.

be able to find their settlement zone if their expectations are widely separated or if they try to strengthen their bargaining position by withholding information from one another, exaggerating their positions, trying to appear obstinate and delaying concessions.<sup>25</sup> In other words, when the parties hold conflicting positions, neither party will have an incentive to make concessions that would lead to a position less advantageous than the result that might be achieved with CCA.<sup>26</sup>

In addition, if the parties to the dispute expect the arbitrators to split the difference, it reduces the incentives for the parties to make concessions during negotiations prior to CCA<sup>27</sup> as ‘each side holds back in anticipation of handing the dispute to the arbitrator’.<sup>28</sup> Indeed, ‘if one assumes that the arbitrator will split the difference between opposing positions, the process will reward the obdurate, rather than those who modify their positions during negotiations’.<sup>29</sup> In other words, parties may exaggerate their demands and avoid concessions.

Put differently, conventional arbitration may reduce the incentive to bargain and lead to unyielding negotiating behaviour, thus increasing the probability of a settlement decided by arbitration. To sum up, conventional arbitration exerts a chilling or deterrence effect on the parties’ incentives to bargain in good faith: ‘If either party, the argument goes, anticipates that it will get more from the arbitrator than from a negotiated settlement, it will have an incentive to avoid the trade-offs of good faith bargaining and will cling to excessive or unrealistic positions in the hope of tilting the arbitration outcome in its favor.’<sup>30</sup> In addition, the chilling effect makes the parties believe that they will get a better result from arbitration than through negotiating.<sup>31</sup> Therefore, in general, CCA has the disadvantage of reduced settlement rates and higher dispute rates.<sup>32</sup> An additional drawback of conventional arbitration is that the parties often hide their values as a bargaining tactic.<sup>33</sup> Hence, if the objective is that the parties reach a settlement, it would arguably make sense to look for alternatives to CCA.

Thus, FOA was proposed as a solution to the weaknesses of CCA:

The overriding purpose of the final-offer procedure, however, is to induce the parties to make their own compromises by posing potentially severe costs if they do not agree. In other words, a successful final-offer procedure is one that is not used; one that induces direct agreement

<sup>25</sup> Adams, *supra* note 19, at 218–223. Other factors mentioned by Adams include principal-agent constraints and the bargaining styles and personalities of negotiators.

<sup>26</sup> Foster, ‘Final Offer Selection in National Emergency Disputes’, 27 *Arbitration Journal* (1972) 90, 90–91, quoted in Lok, ‘Final-Offer Arbitration’, 10(4) *ADR Bulletin* (2008) 1, at 1.

<sup>27</sup> Lok, *supra* note 26, at 2.

<sup>28</sup> Long and Feuille, ‘Final-Offer Arbitration: “Sudden Death” in Eugene’, 27 *Industrial and Labor Relations Review* (1974) 186, at 189.

<sup>29</sup> Feigenbaum, ‘Final Offer Arbitration: Better Theory Than Practice’, 14(3) *Industrial Relations* (1975) 311, at 312.

<sup>30</sup> Feuille, *supra* note 20, at 304.

<sup>31</sup> Lok, *supra* note 26.

<sup>32</sup> Kritikos, *supra* note 18, at 295, 303; M.A. Kuhn, *To Settle or Not to Settle: A Review of the Literature on Arbitration in the Laboratory* (2009), at 2.

<sup>33</sup> Chelius and Dworkin, ‘An Economic Analysis of Final-Offer Arbitration As a Conflict Resolution Device’, 24(2) *Journal of Conflict Resolution* (1980) 293, at 294.



during the proceedings; or, using a less rigorous definition of success, one that substantially narrows the area of disagreement. And when the procedure is used, the function of the arbitrator is to operationalize its potential costs by deciding against the party that advocated the less reasonable offer(s).<sup>34</sup>

In fact, arbitration mechanisms affect not only the arbitration phase itself but also the negotiation phase that takes place before the arbitration. Thus, the mere availability of FOA alters the behaviour of the bargainers.<sup>35</sup>

Early investigations concluded that FOA led to higher pre-arbitration settlement rates than CCA because the offers of the parties converged and, ultimately, eliminated the need for a settlement imposed by the arbitrator.<sup>36</sup> Later investigators questioned to what extent FOA fulfils this goal<sup>37</sup> and, in recent years, have tended to lower their expectations of FOA. Thus, quite a few authors consider that 'although FOA generally does not guarantee complete convergence of offers to a single point, in all cases it does at least induce more convergence than [CCA] would'<sup>38</sup> and that CCA leads to more extreme offers than FOA.<sup>39</sup> Thus, FOA seems to rather decrease the number of chilled first offers and lead to lower dispute rates than CCA.<sup>40</sup> Yet even if the parties do not agree completely, closer offers should arguably make the arbitrator's task easier, and, for instance, FOA might help settle some issues during negotiations and, as a consequence, reduce the number of issues before the arbitrator.

Other investigations have shown that the results of comparing settlement rates by CCA and FOA depend on the methodology used. For example, one investigation concluded that offers in FOA do tend to converge if one or both parties want the arbitrator to choose their offer, irrespective of the value of the settlement.<sup>41</sup> Still other authors have explored the effects of FOA in relation to the parties' risk aversion. Assuming the parties are risk neutral, 'although FOA does not completely succeed in inducing the two disputants to make convergent offers, it nonetheless leads to closer offers than any other variation of

<sup>34</sup> Long and Feuille, *supra* note 28, at 202. That a successful arbitration is one that is not used was termed the 'paradox of arbitration' by Brams and Merrill, 'Equilibrium Strategies for Final-Offer Arbitration: There Is No Median Convergence', 29(8) *Management Science* (1983) 927, at 940.

<sup>35</sup> Kritikos, *supra* note 18, at 312; Hanany, Kilgour and Gerchak, 'Final-Offer Arbitration and Risk Aversion in Bargaining', 53(11) *Management Science* (2007) 1785, at 1785.

<sup>36</sup> E.g., Long and Feuille, *supra* note 28, at 203; Chelius and Dworkin, *supra* note 33, at 294; Starke and Notz, 'Pre- and Post-Intervention Effects of Conventional versus Final Offer Arbitration', 24(4) *Academy of Management Journal* (1981) 832, at 832–850; Brams and Merrill, *supra* note 34, at 940. See also Kuhn, *supra* note 32, at 4–5.

<sup>37</sup> E.g., Long and Feuille, *supra* note 28, at 198; Brams and Merrill, *supra* note 34, at 939–941; Farmer and Pecorino, 'Bargaining with Informative Offers: An Analysis of Final-Offer Arbitration', 27(2) *Journal of Legal Studies* (1998) 415, at 429–430.

<sup>38</sup> Armstrong and Hurley, 'Arbitration Using the Closest Offer Principle of Arbitrator Behavior', 43 *Mathematical Social Sciences* (2002) 19, at 21. See also Hanany, Kilgour and Gerchak, *supra* note 35, at 1791.

<sup>39</sup> Armstrong and Hurley, *supra* note 38, at 24–25.

<sup>40</sup> Kuhn, *supra* note 32, at 4–5; Kritikos, *supra* note 18, at 304, 308–312. Adams, *supra* note 19, at 239–247, concluded that laboratory experiments confirmed that FOA promoted settlement, whereas field studies were inconclusive.

<sup>41</sup> Brams and Merrill, 'Final-Offer Arbitration with a Bonus', 7 *European Journal of Political Economy* (1991) 79, at 80–85.

[CCA] would'.<sup>42</sup> Conversely, if one party, or both, is risk averse, 'FOA creates an incentive to reach a bargained agreement'.<sup>43</sup> Negotiated settlements reached before the FOA award are skewed against the more risk-averse party because it 'can be expected to make the greatest concessions in order to avoid the risk of the hearing'.<sup>44</sup> It would therefore appear plausible, at the very least, that FOA may lead to better results than CCA.

## **B Incentives to Support Reasonable Claims during the Arbitration Phase**

If after the negotiation phase a CCA takes place, parties have an incentive to support extreme claims in order to hold more bargaining chips. In addition, if the arbitrator shows a propensity to split the difference between the claims of the two parties, they have an additional incentive to put forward extreme final positions in order to try to tilt the arbitration outcome to their own benefit.<sup>45</sup> In contrast, it is often held that one of the main advantages of FOA is that the incentive to support an extreme final position is greatly reduced, as rational parties will tend to present a final offer that is sound, reasonable, plausible and even-handed in order to maximize the chances of convincing the arbitrator to adopt their position.<sup>46</sup> This stated advantage of FOA certainly assumes that the parties know the probability distribution of the arbitrator's fair settlement.<sup>47</sup>

Risk aversion is an important aspect also in this regard. The more risk-averse party will submit a more reasonable final offer in order to increase the probability that the arbitrator will choose its offer.<sup>48</sup> In other words, analysing FOA outcomes can be a way to 'get indirect information on the risk preferences of the parties'.<sup>49</sup> It also means that if two parties recurrently subject their disagreements to FOA, and the arbitrators show a tendency to select the proposals of one of the parties, it does not necessarily mean that the arbitrators are partial. It may simply indicate that the winning party is more risk averse than its counterpart.

## **C Variations of FOA**

For quite some time, authors have discussed various sorts of procedures for FOA. This section will discuss some of the most important.<sup>50</sup>

<sup>42</sup> Armstrong and Hurley, *supra* note 38, at 25.

<sup>43</sup> Hanany, Kilgour and Gerchak, *supra* note 35, at 1786.

<sup>44</sup> Adams, *supra* note 19, at 238. See also Farber, 'An Analysis of Final-Offer Arbitration', 24(4) *Journal of Conflict Resolution* (1980) 683, at 697.

<sup>45</sup> Kritikos, *supra* note 18, at 304.

<sup>46</sup> Stevens, *supra* note 3, at 46; Long and Feuille, *supra* note 287, at 187–198; Notz and Starke, 'Final-Offer versus Conventional Arbitration as Means of Conflict Management', 23(2) *Administrative Science Quarterly* (1978) 189, at 198–200; Starke and Notz, *supra* note 36, at 842; Adams, *supra* note 19, at 223–239.

<sup>47</sup> Farber, *supra* note 44, at 688; Brams and Merrill, *supra* note 34, at 928–929.

<sup>48</sup> Farber, *supra* note 44, at 699.

<sup>49</sup> *Ibid.*, at 699.

<sup>50</sup> Early studies on FOA already mentioned variations, such as Long and Feuille, *supra* note 28, at 203. For an interesting overview, see, e.g., Kuhn, *supra* note 32; Zeng, Nakamura and Ibaraki, 'Double-Offer Arbitration', 31 *Mathematical Social Sciences* (1996) 147, at 151–154. This article will not consider



## 1 Procedural Variations

There are basically two types of FOA hearings. Both types share a first phase in which the parties negotiate directly without third-party participation. In the second phase, in one type of FOA, 'the arbitration authority makes its decision with no further hearing'.<sup>51</sup> In the other type of FOA, the arbitrator makes her award after a hearing. One advantage of the second type of FOA is that the arbitrator has more control over the outcome as she can 'induce the parties to converge on an outcome deemed by them to be appropriate'.<sup>52</sup>

There may not be sufficient time for renegotiation, especially if the offers are made during the arbitration hearing. Assuming informational asymmetry and that both players are risk neutral, some authors have held that parties should be permitted to renegotiate after bids are submitted to the arbiter.<sup>53</sup> In FOA, 'negotiations may take place after potentially binding offers have been submitted to the arbiter. Because these offers affect the arbitration outcome, they may partially reveal privately held information and thereby encourage settlement'.<sup>54</sup> In addition, some authors have suggested that after the offers of the parties are made public, the arbitrator's notion of a fair settlement should be placed in a sealed envelope, so as to further encourage bargainers to negotiate a settlement.<sup>55</sup>

In a multi-issue FOA, the arbitrator may have the authority to 'choose among the final offers on an issue-by-issue basis'.<sup>56</sup> Some authors have held that entire-package FOA seems 'to produce awards less equitable than warranted by the positions and strengths of the parties'.<sup>57</sup> More importantly, whether FOA is multi-issue or issue by issue, it changes the parties' negotiating behaviour,<sup>58</sup> and, accordingly, the choice between the two kinds of FOA should depend on whether the goal, for example, is 'to maximize the incentive to move together' or 'to minimize the chance of inequitable arbitration awards'.<sup>59</sup>

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variations such as combined arbitration, amended FOA, tri-offer arbitration and double-offer arbitration, as the findings on these variations are somewhat unclear. See, e.g., Brams and Merrill, 'Binding Versus Final-Offer Arbitration: A Combination Is Best', 32(10) *Management Science* (1986) 1346, at 1347; Brams and Merrill, *supra* note 41, at 79–92; Ashenfelter, Currie, Farber and Spiegel, 'An Experimental Comparison of Dispute Rates in Alternative Arbitration Systems' 60(6) *Econometrica* (1992) 1407; Zeng, Nakamura and Ibaraki, *supra* note 50, at 148, 152; Dickinson, 'A Comparison of Conventional, Final-Offer, and "Combined" Arbitration for Dispute Resolution', 57(2) *Industrial and Labor Relations Review* (2004) 288, at 289–290, 299–300; Deck, Farmer and Zeng, *supra* note 22, at 387–390.

<sup>51</sup> Stevens, *supra* note 3, at 45–46.

<sup>52</sup> *Ibid.*, at 47.

<sup>53</sup> Brams and Merrill, *supra* note 50, at 1353; Farmer and Pecorino, *supra* note 37, at 417–418, 429; Pecorino and van Boening, 'Bargaining and Information: An Empirical Analysis of a Multistage Arbitration Game', 19(4) *Journal of Labor Economics* (2001) 922, at 924, 944–945; Deck and Farmer, 'Strategic Bidding and Investments in Final Offer Arbitration: Theory and Experimental Evidence', 70 *Journal of Economic Behavior and Organization* (2009) 361, at 370–372.

<sup>54</sup> Farmer and Pecorino, *supra* note 37, at 430.

<sup>55</sup> Zeng, Nakamura and Ibaraki, *supra* note 50, at 169–170.

<sup>56</sup> Long and Feuille, *supra* note 28, at 202. See also Crawford, *supra* note 3, at 150–151.

<sup>57</sup> Feigenbaum, *supra* note 29, at 316.

<sup>58</sup> Feuille, *supra* note 20, at 305.

<sup>59</sup> *Ibid.*, at 309.

## 2 Dual Offers

Negotiators, as well as their constituencies, may realize that holding extreme positions leaves them with a rather slim chance for reaching an agreement, be it in a CCA or in a FOA. However, sometimes negotiators may want to recur to such a negotiating tactic for political reasons – for example, as a tip of the hat to the negotiator's constituency or audience. In such a situation, conventional arbitration may lead to better results than FOA since in the former the arbitrator can remove unreasonable proposals.<sup>60</sup>

Some authors have suggested a solution, namely that parties to a FOA may present two offers. FOA with dual offers allows an escape valve as 'the "out of the ball park" demands can be loaded in one offer, and the second offer can be made more realistic'.<sup>61</sup> In addition, when negotiators do not know the arbitrator's notion of a fair settlement, double-offer arbitration, in theory, seems to considerably improve convergence (that is, the chances of a negotiated settlement) in comparison to FOA.<sup>62</sup>

## 4 Literature on FOA in the WTO Context

Somewhat surprisingly, the possibility of using FOA in the WTO context has received little attention. Of the few authors who have dealt with this subject, arguably the best example is Reto Malacrida, who recognizes that the input of the parties to the dispute bears an influence on the output of WTO adjudicating bodies.<sup>63</sup> That is indeed a strong argument for improving the input of the parties whenever possible, and FOA may be one avenue worth exploring. The same author further maintains that '[c]urrently, the parties to Article 22.6 arbitrations arguably do not have a strong incentive to stake out reasonable positions'<sup>64</sup> and that FOA would give the parties 'an incentive to submit estimates that are reasonable'.<sup>65</sup> He further supports introducing FOA because it would ease and speed up the arbitrator's task.<sup>66</sup> He also argues that introducing FOA would require amending Article 22.6 of the DSU and mentions the possibility of FOA being optional or mandatory<sup>67</sup> (these last two issues will be discussed below). Unfortunately, it seems that Malacrida's analysis was subject to formal limitations, and he was not given more space to further develop his very interesting thoughts on introducing FOA in WTO dispute settlement.

## 5 Introducing FOA in the WTO

As mentioned earlier, the kind of procedure envisaged for the arbitration bears an influence on the negotiations that take place before the arbitration. Thus, since the

<sup>60</sup> Long and Feuille, *supra* note 28, at 201.

<sup>61</sup> *Ibid.*, at 201. See also Crawford, *supra* note 3, at 143–150.

<sup>62</sup> Crawford, *supra* note 3, at 136–143; Farber, *supra* note 44, at 688–694; Zeng, Nakamura and Ibaraki, *supra* note 50, at 148.

<sup>63</sup> Malacrida, 'Some Reflections on the Use of Economic Analysis in WTO Dispute Settlement Proceedings', in Brown and Pauwelyn, *supra* note 14, 434, at 440.

<sup>64</sup> *Ibid.*, n. 42.

<sup>65</sup> *Ibid.*, 444.

<sup>66</sup> *Ibid.*, 443–444.

<sup>67</sup> *Ibid.*, 442, 443.

DSU favours a negotiated outcome, and since Article 22.6 of the DSU is largely silent on the arbitration procedure to be followed, it is somewhat surprising that the issue of the kind of arbitration procedures in the WTO has not received more attention. In consequence, the main question of this section is whether and to what extent procedures for arbitrations pursuant to Article 22.6 of the DSU could be changed in order to foster the objective that the parties to the dispute reach a negotiated solution. Needless to say, the following thoughts can also be applied to arbitrations pursuant to Article 25 of the DSU that deal with the level of suspension of obligations.

### A Issues Subject to FOA

Many, if not most, studies on FOA have dealt with wage disputes, yet it seems that the preference for examining arbitration in that context is mainly due to historical reasons. Thus, there does not seem to be any fundamental problem with extending the main findings on this arbitration procedure to other fields, such as, for example, WTO disputes. Some empirical evidence suggests that ‘the final-offer procedure is effective in narrowing the area of disagreement around many monetary and nonmonetary issues but may be less effective in bringing the parties together on certain issues requiring “yes or no” positions’.<sup>68</sup> In more general terms, some authors have suggested that FOA may not be suitable for disputes with only two possible positions since parties would have nothing to negotiate.<sup>69</sup> In other words, FOA may be best suited for continuous, instead of binary, distributions.

WTO panels and the WTO Appellate Body deal with issues of law, and panels also deal with issues of fact (Articles 11, 12.7 and 17.6 of the DSU). They typically do not deal directly with the distribution or allocation of quantifiable resources but, rather, with providing and analysing evidence and with applying the corresponding provisions of WTO law in order to determine whether a WTO Member has infringed an obligation assumed under a covered agreement. In other words, the concrete issues that panels or the Appellate Body face are typically binary distributions, and, as a result, FOA, as a general rule, does not seem to be a suitable option for panel or Appellate Body proceedings.

Let us now consider whether it would be appropriate to recur to FOA in arbitrations pursuant to Article 22.6 of the DSU. To start with, one might ask whether introducing FOA would be useful. It is not easy to establish, after arbitration has been completed, whether FOA – had it been used – would have improved the negotiations and the arbitration. However, it seems that sometimes arbitrators have faced significant obstacles: ‘Certain data that we have requested ... has not been provided. On methodological questions, parties, in a number of respects, have retained their extreme positions and have failed to propose alternative solutions that would have taken into account the

<sup>68</sup> Long and Feuille, *supra* note 27, at 203. Other authors suggest that FOA seems to work better regarding pure economic disagreements. Foster, *supra* note 26.

<sup>69</sup> Paul Perlman, ‘Final Offer Arbitration: A Pre-Trial Settlement Device’, 16 *Harvard Journal on Legislation* (1979) 525, quoted in Adams, *supra* note 19, at 217. Adams’ reply that ‘such cases are often settled through negotiation of a compromise between the two positions’ is not really convincing since the compromise shows that at least a third position was available.

exchange of arguments.<sup>70</sup> As one author has put it, ‘these uncommonly trenchant statements suggest a breakdown in the arbitral process’.<sup>71</sup> Thus, there is anecdotal evidence that parties have probably succumbed to a chilling effect during negotiations that extended to arbitration pursuant to Article 22.6 of the DSU. To reduce the probability of such a situation occurring, FOA may be an appropriate tool.

In addition, arbitrations pursuant to Article 22.6 of the DSU are brief, and, accordingly, it is difficult for parties to revise their positions.<sup>72</sup> This also speaks on behalf of strengthening the negotiation phase that takes place before these arbitrations, and, as already explained, FOA can help precisely in this regard. In summary, it seems plausible that FOA may improve Article 22.6 arbitrations. However, this broad conclusion needs to be formulated more precisely depending on the subject at issue. According to Article 22.7 of the DSU, Article 22.6 arbitrators may examine three issues. First, they may determine whether the proposed suspension is allowed under the covered agreement. This claim relates to findings of fact and to the applicability and conformity of WTO law. Hence, it is a primordially binary distribution, and, consequently, FOA does not seem to be appropriate in this regard. Moreover, determining whether the proposed suspension is allowed is an issue with deep systemic roots and implications that affect the whole WTO membership, since it relates to express prohibitions incorporated into WTO law by the negotiating parties (see, for example, Article XXII.7 of the Agreement on Government Procurement).<sup>73</sup> Thus, it does not seem reasonable to use FOA to decide on such matters since this would force the arbitrators to choose among the parties’ offers. It would therefore constrain the arbitrators’ freedom to interpret WTO law in the way that they deem best suits the systemic aspects of the restrictions pertaining to suspension of obligations. Put differently, arbitrators should arguably examine this issue using CCA procedures.

Second, pursuant to Articles 22.6 and 22.7 of the DSU, arbitrators may examine objections to the proposed level of suspension of obligations. In other words, they determine what level of suspension of obligations corresponds to the respective standard spelled out in Articles 22.4 of the DSU and Articles 4.10, 4.11, 7.9, 7.10 and 9.4 of the SCM Agreement. Thus, arbitrators set a level of suspension of obligations, which is typically an assignment involving a continuous distribution. In addition, determining this level presents quite a strong bilateral character that is visible, for example, in the fact that the suspension affects only the responding Member (Article 3.7 of the DSU). Accordingly, FOA is suitable for determining the level of suspension in arbitrations pursuant to Article 22.6 of the DSU.

Regarding the chilling effect due to ‘conventional arbitration awards ... based on the compromise principle’,<sup>74</sup> WTO arbitration awards have often determined a level of suspension that is close to the average of the levels both parties proposed, thus

<sup>70</sup> WTO, *US – Gambling – Decision by the Arbitrator*, 21 December 2007, WT/DS285/ARB, para. 3.173.

<sup>71</sup> Lockhart, ‘Comment on Chapter 4’, in Brown and Pauwelyn, *supra* note 14, 128, at 133.

<sup>72</sup> *Ibid.*, at 133–134.

<sup>73</sup> Agreement on Government Procurement, 1235 UNTS 258.

<sup>74</sup> Long and Feuille, *supra* note 28, at 189.

seeming to split the difference between the parties' claims.<sup>75</sup> This tendency towards an average can also be observed when arbitrators have determined certain trade effect coefficients.<sup>76</sup> As mentioned earlier, one problem with splitting the difference is that it creates an incentive for the parties not to disclose information during the negotiations that take place prior to arbitration pursuant to Article 22.2 of the DSU, as this information may be used to their detriment during arbitration. Furthermore, splitting the difference offers an incentive for the parties not to support reasonable claims during arbitration. In WTO arbitrations, this possibility favours the complaining party in particular, since there is no theoretical maximum to the level of nullification or impairment that it can claim, whereas the defending party does have a quantitative limit, namely zero nullification or impairment. In addition, WTO jurisprudence has applied the *non ultra petita* principle,<sup>77</sup> which may have pushed some parties to be more vehement in holding extreme positions since they know that the arbitrator will not be allowed to go beyond what they have asked for. In FOA, on the other hand, there are stronger incentives to negotiate and to support sensible requests during arbitration since arbitrators cannot split the difference.

How is it possible to square the proposal of examining whether the suspension is allowed according to a CCA procedure (as mentioned earlier) with scrutiny of the level of suspension in line with a FOA procedure? The proceeding may perhaps be slightly more complex, yet it should not be too difficult to manage a single arbitration that involves different negotiating strategies for the parties, depending on the issues and the two different procedures for the arbitrators to reach a decision. Needless to say, it would be crucial to fit the CCA and the FOA into a single timetable (including the same meetings) because simultaneity is important in order to avoid extending the arbitration stage unnecessarily.

Third, Article 22.6 arbitrators may examine claims that the complaining party has not followed the principles and procedures on so-called cross-retaliation as set out in Article 22.3 of the DSU. This claim is closely associated with binary distributions, specifically with findings of fact and the applicability of relevant provisions of WTO law. Thus, FOA does not seem at first glance to be suitable to decide on these matters. However, there are two options, depending on whether the issues of cross-retaliation and the level of suspension are considered to be two independent issues or a single unit. Under the first option, in which they are regarded as separate subjects, the arbitrators would determine in a CCA the agreements and sectors in which suspension shall be applied, since it deals with the findings of fact and the applicability of relevant provisions of WTO law. On the other hand, they would examine the level

<sup>75</sup> Spamann, 'The Myth of "Rebalancing" Retaliation in WTO Dispute Settlement Practice', 9(1) *Journal of International Economic Law* (2006) 31, at 75–76; Bown and Pauwelyn, 'Trade Retaliation in WTO Dispute Settlement: A Multi-Disciplinary Analysis', in Brown and Pauwelyn, *supra* note 14, 1, at 13–14. See also Bernstein and Skully, 'Calculating Trade Damages in the Context of the World Trade Organization's Dispute Settlement Process', 25(2) *Review of Agricultural Economics* (2003) 385, at 389–390.

<sup>76</sup> WTO, *US – Offset Act (Byrd Amendment) (Art. 22.6 – Brazil) – Decision by the Arbitrator*, 31 August 2004, WT/DS217/ARB/BRA, paras 3.144, 3.146.

<sup>77</sup> Mavroidis, 'Remedies in the WTO Legal System: Between a Rock and a Hard Place', 11(4) *European Journal of International Law* (2000) 763, at 766–768, 774–777, 786–787, 802–804.

of suspension in a FOA. The two subjects can be regarded as unconnected, since the decision on cross-retaliation does not alter the level of permitted suspension and, conversely, the level of suspension does not affect whether cross-retaliation is allowed. (The fact that the level of permitted cross-retaliation may depend on the overall level of suspension is a separate issue.)<sup>78</sup> Therefore, the CCA on cross-retaliation and the FOA on the level of suspension could be simultaneously reviewed by the same arbitrators. As mentioned earlier, simultaneity would be important in order not to delay the arbitration unnecessarily.

The second option would be to treat the issue of cross-retaliation not as an issue of fact finding and application of law but, rather, as a resource that has to be allocated and, therefore, an integral part of the level of suspension. Both questions could then be submitted to a single FOA. For example, in a FOA proceeding, one party may propose a low level of suspension that includes so-called cross-agreement retaliation (Article 22.3(c) of the DSU), while the other party may argue for a high level of suspension limited to cross-sector retaliation (Article 22.3(b) of the DSU). However, the cross-retaliation regulation is framed in mandatory language: Articles 22.3 and 22.7 of the DSU state that the complaining party shall apply the principles and procedures on cross-retaliation. Hence, to allocate it as a resource, the arbitrators must have previously allowed cross-retaliation (and should do so under a CCA procedure, since this matter concerns findings of fact and the applicability of the relevant provisions of WTO law).

In other words, the working procedures and the timetable for the arbitration would require the arbitrators to establish a previous ruling in which they decide on cross-retaliation, and only then would the parties formulate and present their final offers to the arbitrators. Thus, the arbitrators would first find under a CCA proceeding whether the complainant may seek to suspend obligations pursuant to Article 22.3(b) or (c) of the DSU, and, subsequently, the parties would present their final offers, which might include cross-retaliation depending on the arbitrators' decision on this issue. Finally, the arbitrators would choose one of the parties' final offers. If the parties to the dispute do not mind the arbitration being slightly more complex (and perhaps also more time-consuming), there is no apparent legal or systemic reason to deny their wish to include cross-retaliation as an allocable resource.

Thus, pursuant to Article 22.6 of the DSU, the arbitrators could examine the issues before them according to CCA or FOA. It should also be borne in mind that, in more general terms, whether to introduce FOA or to stick with CCA may reflect different understandings of the arbitration process in the WTO. If WTO dispute settlement is seen as a means to settle individual disputes, extending the application of FOA may seem sensible. If, on the contrary, WTO dispute settlement is considered to have a systemic function of interpreting, clarifying and developing WTO law for all Members, CCA may arguably be preferred, as the arbitrators are free to explore avenues not pursued by the parties to the dispute. Thus, arbitrators can apply and develop WTO

<sup>78</sup> WTO, *United States – Subsidies on Upland Cotton – Decision by the Arbitrator*, 31 August 2009, WT/DS267/ARB/1 and WT/DS267/ARB/2, para. 5.230.



law in the way they think most coherent with the system, regardless of the arguments of the parties. This reasoning also supports not extending FOA to the panel and Appellate Body proceedings, since the issues before a panel and the Appellate Body (and also before arbitrators regarding whether the proposed suspension is allowed) have a very strong potential for pushing forward the systemic development of WTO law. Determination of the level of suspension, on the other hand, contains a somewhat stronger bilateral character, as mentioned earlier.

## B Implementation of FOA

Now that the subjects that may be settled through FOA are clear, the question arises as to how FOA can actually be implemented in WTO arbitrations pursuant to Article 22.6 of the DSU. As mentioned earlier, one author has argued that introducing FOA would require amending Article 22.6.<sup>79</sup> However, there is a simpler solution. Article 22.7 of the DSU is largely silent on the procedures to be followed, and, in the event of arbitration, organizational meetings are normally held to adopt a timetable and working procedures.<sup>80</sup> Hence, there is no legal constraint on recurrence to FOA in this regard. In fact, if the parties and the panel can agree on altering the panel procedures explicitly laid down in the DSU,<sup>81</sup> they should certainly be entitled to define arbitration procedures that the DSU does not expressly regulate. However, there is an intrinsic constraint. As already mentioned, the arbitration procedure has an influence on the negotiations that take place before the arbitration itself, thus the parties should know in advance which procedure will be used for the arbitration. In other words, when the party that has invoked the dispute settlement procedures requests to enter into negotiations pursuant to Article 22.2 of the DSU with the Member that has failed to comply, the parties should agree at the start of the negotiations on whether they want a FOA in case they do not develop a mutually acceptable compensation and the matter is referred to arbitration according to Article 22.6. However, there is an additional

<sup>79</sup> Malacrida, *supra* note 63, at 442.

<sup>80</sup> See the following World Trade Organization (WTO) arbitration decisions: *European Communities – Hormones (United States) – Decision by the Arbitrators*, 12 July 1999, WT/DS26/ARB, para. 5; *European Communities – Bananas III (United States) – Decision by the Arbitrators*, 9 April 1999, WT/DS27/ARB, para. 2.1; *Brazil – Aircraft – Decision by the Arbitrators*, 28 August 2000, WT/DS46/ARB, para. 2.1; *European Communities – Hormones (Canada) – Decision by the Arbitrators*, 12 July 1999, WT/DS48/ARB, para. 5; *United States – Offset Act (Byrd Amendment) – Decision by the Arbitrator*, 31 August 2004 WT/DS217/ARB/BRA, WT/DS217/ARB/CHL, WT/DS217/ARB/EEC, WT/DS217/ARB/IND, WT/DS217/ARB/JPN, WT/DS217/ARB/KOR, WT/DS234/ARB/CAN, WT/DS234/ARB/MEX, paras 1.9, 1.10, or 1.11; *Canada – Aircraft Credits and Guarantees – Decision by the Arbitrator*, 17 February 2003 WT/DS222/ARB, para. 1.8; *United States – Upland Cotton – Decision by the Arbitrator*, 31 August 2009, WT/DS267/ARB/1 and WT/DS267/ARB/2, para. 1.24; *United States – Gambling – Decision by the Arbitrator*, 21 December 2007, WT/DS285/ARB, para. 1.8. The WTO arbitration decisions on *EC – Bananas III (Ecuador) – Decision by the Arbitrators*, 24 March 2000, WT/DS27/ARB/ECU; *United States – FSC – Decision of the Arbitrator*, 30 August 2002, WT/DS108/ARB and *United States – 1916 Act (EC) – Decision of the Arbitrators*, 24 February 2004, WT/DS136/ARB) do not mention such a meeting. *United States – Section 110(5) Copyright Act – Award of the Arbitrators*, 9 November 2001, WT/DS160/ARB25/1 also mentions an organizational meeting in para. 1.5; this dispute, however, was settled via arbitration pursuant to Art. 25 of the DSU.

<sup>81</sup> Jackson, *supra* note 6, at 155.

reason why agreement on the use of FOA should be made before the arbitration starts: when the complaining party requests authorization from the DSB to suspend obligations, it must propose, in that same request, the level of suspension (Article 22.2 read in conjunction with Article 22.6). This request is not a final offer and the complaining party may later reduce the proposed level, yet it seems probable that the party's decision to propose a certain level may depend on the arbitration procedure to be followed subsequently.

As a second solution, in quite a number of disputes, parties have agreed on modifications or clarifications of WTO dispute settlement procedures – for example, concerning solutions to the sequencing issue<sup>82</sup> or expedited working procedures.<sup>83</sup> Therefore, a pre-emptive joint proposal on procedural aspects, this time on FOA, would not be something entirely ground-breaking for the WTO dispute settlement system (see also Article 41 of the Vienna Convention on the Law of the Treaties on agreements to modify multilateral treaties between certain of the parties only).<sup>84</sup> However, there is a difference with the organizational meetings where timetables and working procedures are adopted: the parties would most probably reach a pre-emptive agreement on FOA without the arbitrators, since the matter will not have been referred to arbitration yet. On the other hand, the fact that the parties reach an agreement without the arbitrators should not be too big a hurdle since parties have adopted agreements on sequencing before requesting consultations.<sup>85</sup> Moreover, it should probably be welcomed that parties agree on FOA before negotiations start, as they would be able to build the possibility of FOA into their respective negotiating strategies.

In disputes with multiple complainants, although it could not be a requirement, it would certainly be most convenient if all complainants (and obviously also the defendant) were to agree on determining the level of suspension of obligations either with FOA or with CCA (especially if they negotiate jointly pursuant to Article 22.2 of the DSU, as the defendant would most probably prefer to have one single negotiating

<sup>82</sup> See, e.g., *Understanding between Canada and the United States Regarding Procedures under Articles 21 and 22 of the DSU*, 5 January 2001, WT/DS103/14 and *Understanding between the European Communities and the United States Regarding Procedures under Articles 21 and 22 of the DSU and Article 4 of the SCM Agreement*, 5 October 2000, WT/DS108/12. On the sequencing issue, see, e.g., WTO, *EC – Bananas (US) – Decision by the Arbitrators*, 9 April 1999, WT/DS27/ARB, para. 4.11; WTO, *Brazil – Aircraft – Decision by the Arbitrators*, 28 August 2000, WT/DS46/ARB, para. 2.1–2.3; Valles and McGivern, 'The Right to Retaliate under the WTO Agreement: The "Sequencing" Problem', 34(2) *Journal of World Trade* (2000) 63, at 63–84; Mavroidis, 'Proposals for Reform of Article 22 of the DSU: Reconsidering the "Sequencing" Issue and Suspension of Concessions', in F. Ortino and E.-U. Petersmann (eds), *The WTO Dispute Settlement System 1995–2003* (2004) 61, at 61–72; Mercurio, 'Improving Dispute Settlement in the World Trade Organization: The Dispute Settlement Understanding Review – Making it Work?', 38(5) *Journal of World Trade* (2004) 795, at 826–834.

<sup>83</sup> See, e.g., WTO, *US – Shrimp (Ecuador) – Report of the Panel*, 30 January 2007, WT/DS335/R, para. III.1–III.4.

<sup>84</sup> Vienna Convention on the Law of Treaties 1969, 1155 UNTS 331.

<sup>85</sup> E.g., the agreement on sequencing in *Canada – Dairy* (WT/DS103/14) was communicated on 22 December 2000 and the request for consultations (WT/DS103/15) was communicated on 2 February 2001. In *US – FSC*, the agreement on sequencing (WT/DS108/12) was communicated on 2 October 2000 and the request for consultations (WT/DS108/14) was communicated on 17 November 2000.

strategy against all complainants). In addition, it would arguably simplify the content of the arbitrators' decision since different complaints with different arbitration procedures would probably entail parallel reports.<sup>86</sup>

Malacrida thinks that FOA could be optional or mandatory.<sup>87</sup> Mandatory FOA would require amending the DSU, as he goes on to mention. However, as argued earlier, optional FOA agreed at the organizational meeting or through a pre-emptive joint proposal would not require an amendment and, hence, seems a more feasible approach. If the parties to the dispute do not agree on a FOA, it would arguably make sense to recur to a CCA as the default option, since it has so far been the traditional procedure for arbitrations pursuant to Article 22.6 of the DSU.

Malacrida offers some very interesting thoughts about developing the WTO dispute settlement system so as to improve certainty while retaining flexibility. He mentions the possibility of a decision by the DSB that provides 'non-binding guidance' by consensus.<sup>88</sup> Parties would be allowed to depart from this decision whenever they think such flexibility is needed because the decision would not be legally binding. As an inspiration, the author mentions the Ad Hoc Group created by the WTO Committee on Anti-Dumping Practices that 'prepare[s] recommendations on issues where agreement seems possible'.<sup>89</sup> Such a group 'could study these issues in a systematic and horizontal fashion and, unlike panels and arbitrators, they could do so without being significantly time constrained'.<sup>90</sup> This author's ideas could be applied so as to ease the implementation of FOA.

### C Variations for Encouraging a Negotiated Settlement

Concerning the variations of FOA mentioned earlier, there are several procedural alternatives. This section will explore which alternatives it would be sensible to introduce in WTO arbitrations so as to induce the parties to negotiate a solution to their dispute.

FOA may be carried out with or without a hearing after the parties negotiate. So far, WTO arbitrations have included hearings, and this practice should be maintained because the hearings, as mentioned earlier, may induce convergence among parties. In fact, in most cases, arbitrators have held one meeting with the parties and have afterwards posed additional questions, to which the parties have replied in writing. Subsequently, and without a further hearing, arbitrators have issued their reports. In order to further induce the parties to reach a negotiated agreement, arbitrators might hold an additional hearing to receive the parties' replies or shortly after receiving those replies.

In arbitrations pursuant to Article 22.6 of the DSU, disputes are not settled at the arbitration hearing but, rather, through a subsequent written decision. As mentioned

<sup>86</sup> On the consequences of parallel reports, see Tijmes, 'Parallel Reports in the WTO Dispute Settlement', 10(2) *Manchester Journal of International Economic Law* (2013) 187, at 193–197.

<sup>87</sup> Malacrida, *supra* note 63, at 442.

<sup>88</sup> *Ibid.*, at 442–443.

<sup>89</sup> World Trade Organization Committee on Anti-Dumping Practices, Note from the Secretariat, Doc. G/ADP/W/399, 1996, at 1.

<sup>90</sup> Malacrida, *supra* note 63, at 442–443.

earlier, offering parties the possibility to negotiate after the hearing is arguably a valuable tool for encouraging negotiated settlements. Given the preference shown by WTO dispute settlement for bargained settlements, there is every reason to encourage such negotiations after the hearing in the WTO arbitrations, by applying the last sentence of Article 11 of the DSU by analogy, if necessary. Encouraging such negotiations would not be completely ground-breaking because, as seen earlier in this article, parties in some WTO disputes have notified a mutually agreed solution after the panel proceedings have made good progress. Furthermore, it would arguably be an avenue worth exploring if arbitrators (metaphorically speaking) placed the report in a sealed envelope: arbitrators could finish their report but not issue it immediately, waiting instead for some period of time previously agreed with the parties so as to give them a last chance (under the shadow of the report, so to speak) to reach a negotiated settlement.

On the question of whether to implement multi-issue or issue-by-issue FOA, the former is preferable in WTO arbitrations since it offers a stronger incentive for the parties to bargain. Regarding FOA with dual offers, whereas it should be neither required nor expected, it is an interesting tool for highly polarized WTO disputes where public opinion plays a crucial role. In these cases, it would perhaps be advisable if the WTO Secretariat reminded parties that they have dual-offer arbitration at their disposal.

#### D *Systemic Issues*

This section will end with some final observations. If the object is an equitable outcome between the proposals of the parties, FOA may result in a less equitable outcome than conventional arbitration. Indeed, when parties cannot reach an agreement, the arbitration award will be one-sided.<sup>91</sup> In WTO arbitrations, as mentioned earlier, the claims of the complaining party are theoretically unlimited, whereas the defending party is constrained by the natural limit of claiming zero nullification or impairment. Thus, equitable outcomes should not be a primordial objective of WTO arbitrations, since it would imply a systematic tendency to favour complaining parties.

Some authors also mention as a weakness the fact that FOA seems to require fairly sophisticated negotiators to be effective.<sup>92</sup> This may be an important issue in the WTO, especially for least developed countries. Capacity building has been, and remains, a recurring and completely justified concern for the WTO, as shown, for example, in sections II.9 and II.10 of the WTO Agreement on Trade Facilitation.<sup>93</sup> If FOA were to be implemented, the WTO Secretariat might perhaps be required to offer additional assistance to negotiators who represent least developed countries according to Article 27 of the DSU. This assistance may also be extended to developing countries and to arbitrators.

Besides strengthening the negotiation and arbitration phases, introducing FOA in Article 22.6 arbitrations would have the additional advantage that arbitrators would

<sup>91</sup> Feigenbaum, *supra* note 29, at 312.

<sup>92</sup> DeNisi and Dworkin, 'Final-Offer Arbitration and the Naive Negotiator', 35(1) *Industrial and Labor Relations Review* (1981) 78, at 86–87.

<sup>93</sup> WTO Agreement on Trade Facilitation, Doc. WT/L/931, 15 July 2014 (has not yet entered into force as of 31 July 2015).

not necessarily be required to make their own calculations to build a counter-factual but may instead rely completely on the input from the parties. This would arguably help in complying with arbitration deadlines and facilitate the arbitrators' task (especially in disputes that involve intricate technical issues). It would hopefully also assist in keeping the arbitrators out of the spotlight, as commentators and critics would probably focus more strongly on the arguments of the parties and less on the arbitrators, which, in turn, might contribute to improving the (already high) legitimacy of WTO dispute settlement.

The DSU and FOA share the basic objective of offering incentives for the parties to negotiate a settlement to their dispute. To the best of this author's knowledge, there are no studies on the attitudes of WTO Members regarding the nature of arbitrations pursuant to Article 22.6 of the DSU: do parties regard arbitrations as an extension of negotiations or do they rather consider arbitrations as contentious litigation? If the latter is the case, introducing FOA may perhaps induce a change in those attitudes towards a view of arbitrations as primarily a negotiation. However, this possible development and whether or not it should be welcomed is a topic for future research.

## 6 Conclusions

The DSU favours that parties negotiate a settlement to their dispute. The choice of the arbitration mechanism is important in this regard since it not only affects the arbitration phase but also, in fact, the negotiation phase that takes place before arbitration. However, arbitrations pursuant to Article 22.6 of the DSU have been carried out as CCA despite the fact that many authors hold that the CCA procedure does not encourage negotiated settlements to disputes because it exerts a chilling effect on the parties to the dispute. In contrast, FOA seems to significantly reduce the chilling effect and lead to higher settlement rates. Hence, FOA seems a sensible option for WTO arbitrations.

Arbitrations pursuant to Article 22.6 of the DSU may have three tasks. First, they may determine whether the proposed suspension is allowed under the covered agreement – CCA is better suited for this task than FOA. Second, arbitrators may examine the level of suspension of obligations – FOA seems most appropriate for this task. Third, so-called cross-retaliation may also be decided via FOA as long as the parties agree on considering it as an allocable resource.

To implement FOA in WTO arbitrations, a DSU amendment would be required only if FOA is mandatory; if FOA is optional, however, an amendment would not be necessary. In this case, the parties may agree on a FOA during the organizational meeting commonly held at the outset of arbitration proceedings or the parties may agree on FOA before negotiations start through a pre-emptive joint proposal on procedural aspects. A helpful tool would be a DSB decision that provided non-binding guidance. However, CCA should be kept as the default option in case parties do not agree on the arbitration procedure.

On the specific type of FOA most suitable for WTO arbitrations, it would make sense to introduce a further hearing for the parties to reply to the arbitrators' questions or shortly after they have replied. Other incentives for the parties to negotiate after the

hearing are also worth exploring. For example, arbitrators could agree with the parties not to issue the report immediately, so as to give them a last chance to negotiate. Multi-issue FOA should be preferred in WTO arbitrations over issue-by-issue FOA since the former offers stronger incentives to bargain. In WTO disputes where public opinion plays an especially important role, FOA with dual offers is an interesting option. Regarding the systemic implications, introducing FOA in WTO dispute settlement would perhaps require some capacity building. In addition, FOA would possibly ease the arbitrators' task when building the counter-factual. As a final note, FOA may also contribute to shifting the focus of critics away from the arbitrators and onto the parties, which, in turn, may further improve the already high legitimacy of WTO dispute settlement.

FOA has gone relatively unnoticed in the academic discussion about WTO dispute settlement. This article aims to contribute to closing this gap.