Nonbinding recommendations: the relative effects of focal points versus uncertainty reduction on bargaining outcomes

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Abstract This article focuses on the effects of nonbinding recommendations on bargaining outcomes. Recommendations are theorized to have two effects: they can create a focal point for final bargaining positions, and they can decrease outcome uncertainty should dispute persist. While the focal point effect may lower dispute rates, the uncertainty reduction effect is predicted to do the opposite for risk-averse bargainers. Which of these effects dominates is of critical importance in the design of alternative dispute resolution (ADR) procedures, which are increasingly utilized in a variety of settings. We theoretically examine the effects of recommendations on the contract zone using a framework which allows bargainers’ final positions to influence a binding outcome should negotiations fail. This provides a more stringent test of focal points than previously considered. We also present data from controlled laboratory experiments consistent with our model. Recommendations are empirically shown to influence final bargaining positions and negotiated settlement values. In fact, recommendations significantly reduce dispute rates, even where they are completely ignored in final-stage arbitration. This highlights a potentially significant role for the use of nonbinding procedures, such as mediation, as a preliminary stage in more efficient ADR procedures.

Keywords Bargaining · Experiments · Dispute resolution · Focal points · Arbitration
1 Introduction

A significant institutional trend of the last 20–30 years has been the increased emphasis on alternative dispute resolution (ADR) programs, such as arbitration and mediation, to help resolve disputes. ADR programs currently operate in a wide variety of contexts that include, among others, union-management negotiations, commercial contract disputes, divorce negotiations, college campus conflict, and civil/community (neighborhood) disputes. In the US, community mediation programs are estimated to have almost 20,000 active volunteer community mediators nationwide in programs that now receive over 97,000 annual case referrals. Though only available in about 15% of U.S. colleges, campus mediation programs experienced a tenfold increase during the 1990s (from around 20 to over 200). Tort reform in several states has included implementing court-annexed ADR procedures prior to litigation. Also, the Federal Mediation and Conciliation Service (FMCS)—an independent U.S. government agency created to promote labor-management peace—has an annual mediation intake of nearly 40,000 cases and receives nearly 20,000 annual arbitration panel requests.

In short, the volume of its use now makes ADR a significant institution in the US, not to mention elsewhere, and the trend toward increased ADR use appears persistent. Any improvements in ADR institutional design could significantly reduce dispute costs and promote improved bargaining relationships, which are likely to further reduce dispute rates. An examination of the key characteristics of different ADR procedures is necessary to design the most effective dispute settlement institutions.

An ADR procedure can be generally classified as binding (e.g., litigation or arbitration) or nonbinding (e.g., mediation). Binding procedures guarantee a settlement, but nonbinding procedures allow the bargainers to retain more control over the settlement, which increases bargainer satisfaction with the outcome. Some procedures are hybrids, where a nonbinding procedure is utilized initially, and then a binding procedure follows if needed. This is the case, for example, with court-annexed ADR that might compel the use of mediation prior to litigation. There is a general consensus that bargainers typically prefer mediation to binding arbitration or litigation, but it is unclear whether settlement rates are uniformly higher under mediation. In naturally occurring bargaining data, only the most serious disputes are handled with a binding procedure. The resultant sample selection implies that comparing settlement rates from field data across various ADR procedures cannot identify the most

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1 Statistics are from the National Association for Community Mediation (NAFCM), and are available at the NAFCM website at www.nafcm.org.
2 Data reported can be found on www.campus-adr.org, funded in part by a grant from the federal Fund for the Improvement of Postsecondary Education (FIPSE).
3 Data are from the annual reports available on the FMCS website at www.fmcs.gov.
4 For example, Wisconsin arbitrators for public sector labor disputes first mediate the cases, and they only use arbitration in the event that mediation fails (see Babcock and Taylor 1995). Also, Hebdon (2001) notes that New York state public policy allows certain disputes to utilize a formal fact-finder recommendation, which is nonbinding, prior to implementation of a legislated (binding) settlement. As another example, many counties in Utah and North Carolina now require that divorce and custody cases be mediated before they proceed to trial.