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Arbitration Clauses in Leasing

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- **Agree to Disagree** – Disagreements happen. A landlord may believe it reasonably disapproved of a proposed tenant alteration. The tenant, however, may believe the landlord's decision was unreasonable. If the parties to a lease disagree on an issue, how is that matter resolved? Most leases start with the position that the tenant waives its right to a jury trial. And leases often contain provisions on how to determine fair market value for renewal rent (if the parties can't agree on a rate). They rarely, however, set forth a general procedure to resolve disputes.

  One way to do this is for a lease to have an arbitration clause providing for binding determinations for disputes that arise during the term of the lease.

- **Arbitration** – Arbitration is a private process where disputing parties agree that one or several individuals can make a decision about the dispute after receiving evidence and hearing arguments. Compared to litigation, arbitration is designed to be cheaper, quicker and less formal. In agreeing to an arbitration provision, both parties waive their right to litigate the particular matter and agrees to have the case heard by an arbitrator.

- **Scopes** – Parties could agree that any dispute under their lease must be resolved by arbitration. A more common approach is to specifically set forth the types of disputes that will be subject to arbitration. Some of the real estate issues that can be subject to arbitration include disputes relating to the market rent for a renewal term for a lease; disputes involving matters of reasonable consent, disputes involving revenue issues and operational use; and market value of land or improvements for purchase options.

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- **Associations** – An arbitration clause should select the organization that will conduct the arbitration. Two common groups are the American Arbitration Association (AAA) and the Judicial Arbitration and Mediation Services (JAMS). Each organization has their own set of rules as to how the arbitration will be conducted.

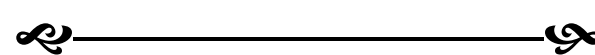
- **Forms of Arbitration** – A common form of arbitration includes three arbitrators. The landlord and tenant each pick one arbitrator and the two arbitrators choose the third. A determination is made by a majority of the arbitrators.

  Another form of arbitration is "*Baseball Arbitration*." In this type of arbitration, a single arbitrator is used and the arbitrator must select either the landlord's or tenant's determination. The arbitrator cannot "split the difference." This works well in a lease with an extension option where there is a dispute about the fair market value of rent.

- **Arbitrators** – When it comes to selecting arbitrators, each organization's rules are slightly different. For example, in the AAA arbitrators can be appointed from a national roster or the parties' lease can name the arbitrator or selection method. The arbitration clause may also delineate the qualifications of the arbitrator. As an example, the arbitrator may have to have ten years of experience leasing office space in the DC market.

- **Finality** – In arbitration, if a party does not agree with a decision, its recourse may be very limited. In litigation, a party may appeal if the judge made a mistake in the law or ruled improperly on an evidentiary matter. Such mistakes will likely not be adequate to allow an appeal in arbitration.

- **Your Transaction** – Arbitration may be an efficient and cost-effective way for parties to resolve lease disputes, provided that they have thought through the issues when drafting their arbitration clause. The issues in this article highlight some of the key points to address in lease negotiations. In all cases, we advise you to consult an experienced commercial real estate broker and experienced commercial real estate attorney to advise you in negotiating and structuring the best terms for your lease.



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