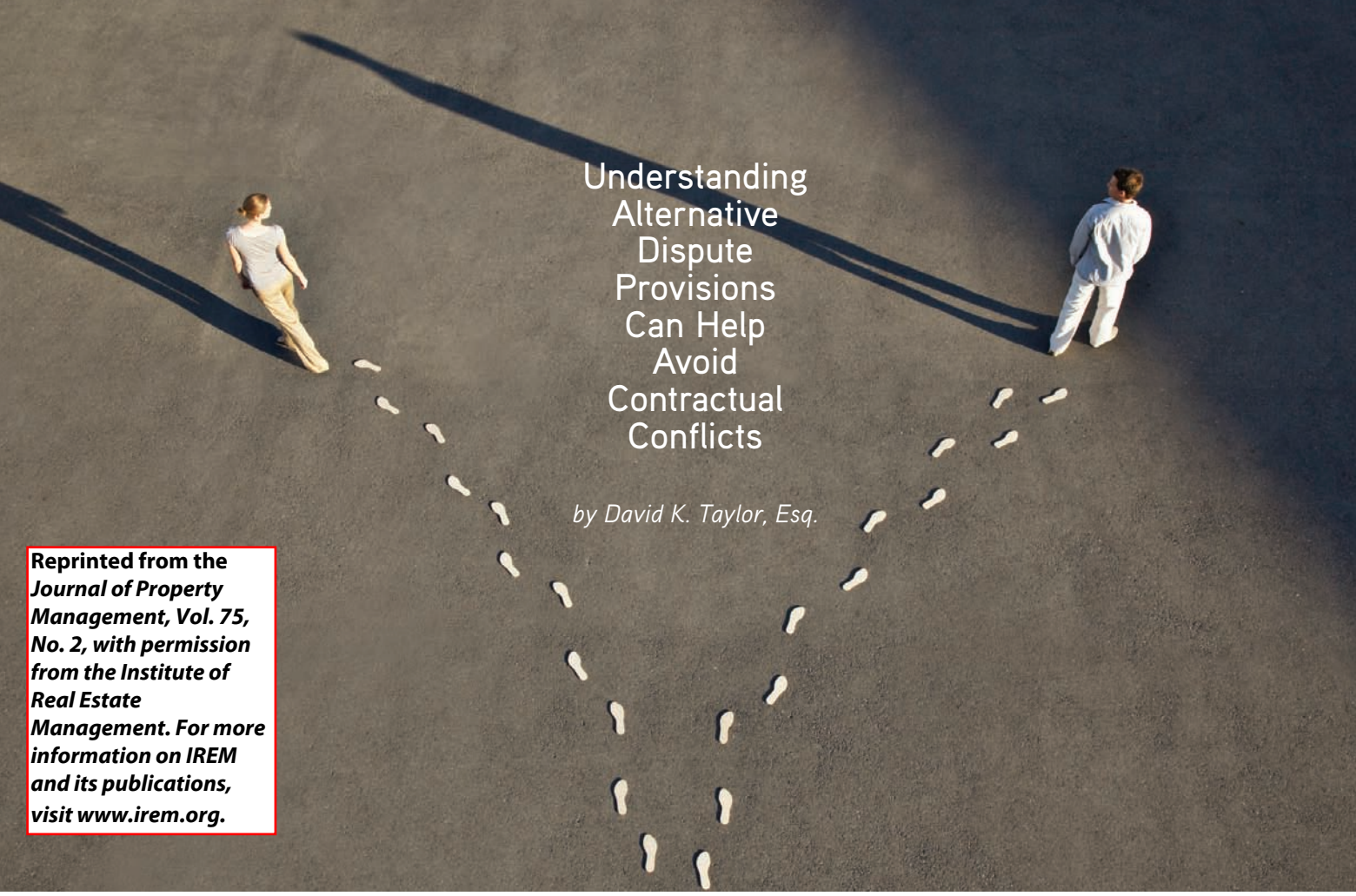

Understanding Alternative Dispute Provisions Can Help Avoid Contractual Conflicts

by David K. Taylor, Esq.

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ROAD TO RESOLUTION

The costly expense and time-draining nature of litigation is spurring change to many commercial real estate contracts, which have traditionally required any dispute be resolved through litigation in a court where the property at hand is located.

In efforts to avoid litigious headaches, placing alternative dispute provisions in commercial real estate contracts that mandate any conflict be resolved through nonbinding mediation or binding arbitration is a growing trend.

It is vital for any property manager, especially those who use "form" contracts or who review and approve any real estate-related contract (including construction contracts), to know the differences, and pros and cons of nonbinding mediation and binding arbitration.

LITIGIOUS NIGHTMARE

Any company that has gone through a trial knows the enormous amount of time and expense involved. Lawyers and experts cost a great deal of money, and even though virtually all civil cases settle before trial, settlement usually takes place on the courthouse steps after the parties have incurred the vast majority of a lawsuit's hard and soft costs.

While exceptions exist, under most state laws, legal

expenses are not recoverable—even to the winning party—unless an attorneys' fees provision is in the contract. A company may win the battle in court, but lose the war, when it realizes that after subtracting the fees, expenses and time spent by key personnel on a litigated case, even a "win"—no matter how good it feels—equals a net-zero recovery.

The substantial soft costs of a lawsuit are also not fully understood—even by attorneys. Time is money, and in any lawsuit, management and other key employees must dedicate a considerable amount of time to the legal dispute.

Additionally, lawsuits can damage reputations and give competitors leverage since court filings are public record. Rivals seeking a competitive edge or inside information can almost always review all court filings and trial testimony transcripts.

Some lawsuits may take years to get to trial, and even after the trial, the losing party has an automatic right to appeal—which may take several more years. Finally, judges and juries are unpredictable in civil cases. Therefore, the outcome is unpredictable, and it's impossible to gauge who will come out ahead. When a company places a substantial legal dispute in the hands of a judge or jury, it is taking a huge risk.

MULLING MEDIATION

A much less risky resolution to disputes is nonbinding mediation. In this situation, the parties jointly hire and share the costs of a neutral third party to help negotiate a face-to-face settlement. In fact, the sole purpose of mediation is to negotiate a settlement between the parties by breaking down the barriers to communication and encouraging offers and counteroffers.

However, no firm statistics are available to show how many disputes submitted to mediation actually settle because mediation is confidential and not open to the public. Most active mediators report anywhere between an 80 and 90 percent settlement rate.

Mediation can be set up in a matter of weeks, and can take place at any time before or after a lawsuit has been filed. Lawyers are helpful but not necessary. The role of the mediator is much different than that of an arbitrator or judge. The mediator does not make or impose a decision, whereas all a court or arbitrator can do is decide who gets money and how much.

Mediation is also nonbinding, meaning the parties do not give up any future legal rights by participating in mediation. The solutions sought in mediation can also be business solutions and not strictly legal solutions. Parties can agree to continue doing business together or settle the claim for something other than monetary payment. In contrast to the "winner take all" scenario of litigation or arbitration, parties in mediation attempt to agree upon a "win-win" scenario.

The process is not perfect, though. Many clauses contain "venue" provisions requiring the mediation take place not at the property, but at one side's home offices, which may require expensive travel. Try to negotiate a clause that calls for the mediation to take place in the city where the property is located.

Many clauses also require parties go through mediation before filing a lawsuit or even commencing an arbitration. While such clauses are not necessarily bad because they apply to both sides, it's important to be aware of such clauses and to follow the formal steps outlined in the clauses so if the case does go to court, it doesn't get thrown out based on contractual details.

Finally, everyone participating in the mediation should have full authority to resolve the dispute and sign off on any settlement agreement. These details can and should be worked out by counsel in advance. Failure to follow these rules can seriously jeopardize the chances of reaching a settlement.

A trying, 10-hour-long mediation where the parties are close to resolution can be thrown away when one party representative says he or she has to "make a call" to obtain final settlement authority.

ABITRATION IS FINAL

Binding arbitration serves as another option to litigation or nonbinding mediation. In this situation, resolutions can't be thrown away. When parties place an arbitration clause in a contract, they forego enforcing their legal

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rights in court, choosing to rely instead upon the arbitrator's sense of fair play.

The arbitrator is usually someone with knowledge and expertise in the industry, such as a real estate or construction lawyer. However, many non-attorney arbitrators exist. Properly selected arbitrators are able to focus on the real issues, and already understand industry practices and standards that are so often overlooked by judges and especially juries.

Because conforming to a crowded court docket is unnecessary, arbitration can be set for a hearing in a matter of months. In most arbitrations, the absence of prehearing motions and depositions, as well as the finality of the decision, significantly reduces the attorneys' fees and costs. One day of arbitration typically equals two to three days in court, again saving money for both parties. Finally, it is also almost impossible to successfully appeal an arbitration award. Unlike litigation, finality is the rule rather than the exception.

Still, arbitration has its drawbacks. For example, most commercial landlords do not want to arbitrate rent disputes with tenants since most states provide a quick and inexpensive procedure to evict a nonpaying tenant.

However, an arbitration clause may be efficient in deciding common area maintenance, lease options, rent escalation disputes or fights about the condition of the premises after the expiration of a lease.

For example, in a recent case, a landlord claimed that certain pieces of restaurant equipment were "fixtures" and therefore should remain on the premises. The tenant, of course, disagreed and wanted to remove the equipment. Rather than slog through an expensive and time-consuming trial in front of a judge who knew nothing about commercial real estate, the parties agreed to hire an experienced real estate lawyer. An arbitration was set up, and a decision was rendered in less than 30 days.

With arbitration, be careful of clauses that would require the arbitration take place in another state instead of the location of the property. The other side might prefer to litigate in its "home" state before a familiar judge to obtain what lawyers call a "home cooking." Also check if a "prevailing parties" attorneys' fees clause exists, which allows an arbitrator to award fees and arbitration expenses.

Some companies might prefer private arbitration as opposed to arbitrating through an administrative agency like the American Arbitration Association (AAA). This may save money on arbitration filing fees, but private arbitration has its own set of problems that should be thoroughly discussed with counsel.

An efficient and successful private arbitration takes the full cooperation of both sides and their attorneys because the parties must agree upon an arbitrator. In an administered arbitration, however, there is a selection process, much like jury selection, and an agency like the AAA chooses an arbitrator after receiving input from both sides.

Arbitration and mediation are not panaceas. Companies should think long and hard about how they would prefer to resolve future disputes for every real estate project and contract.

Any company should not charge headfirst into litigation, but should insist their counsel fully explain all available alternatives to efficiently and quickly resolve a legal dispute. With very few exceptions, going through an expensive, delay-ridden trial in court is not in the best interests of any company.

If the dispute can be resolved through mediation or arbitration, companies can be assured proceedings in most instances will be faster, confidential, more predictable and less expensive than litigation. ■

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