

Practical benefits of 'baseball arbitration'

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It's an all-too-common problem with commercial leases: The tenant wants renewal options, but the landlord is not willing to commit to a renewal rental rate that may be well below-market when the renewal term is set to commence.

To resolve this stalemate, parties often agree to renewal options at a fair-market rental rate. To ensure enforceability, the lease must provide a mechanism for determining the renewal rent. A renewal option at "fair market rent," without more information, effectively negates the renewal option for the tenant.

Although traditional mechanisms remain more widely used to overcome this problem, an emerging trend - "baseball arbitration" - offers significant advantages in comparison.

For many years, landlords and tenants have resolved valuation issues by using two or more "independent" advocates (whether brokers or appraisers) to assess the market and, ultimately, determine a rental rate. Some leases provide that the fair-market rent will be the average of two appraisals or, if the appraisals deviate significantly, establish fair-market value with the assistance of a third appraiser. The main problem with this method is that it provides parties with little incentive to be reasonable in their valuations or to compromise on their own. Baseball arbitration is designed to do just that.

Also known as final-offer arbitration, baseball arbitration is a form of alternative dispute resolution most widely known for its use in settling salary disputes between major league baseball teams and eligible players. In traditional arbitration, parties argue positions to the arbiter, who can then choose either party's position or decide on a compromise between the two. In baseball arbitration, the arbiter cannot select a middle ground and must choose the position of one party or the other. Although the prospect of accepting a valuation process in which an adversary's position could be chosen wholesale by the arbiter may be terrifying, that terror is exactly what makes baseball arbitration so attractive from a practical standpoint.

Leases that utilize baseball arbitration to resolve valuation disputes must spell out the details of the process. Nonetheless, the primary goal is to encourage the parties to reach agreement consensually and avoid arbitration altogether. Baseball arbitration accomplishes this by constantly reminding the parties that reasonableness is rewarded (and unreasonableness punished), because the arbiter must choose the final offer of the party that is closer to the arbiter's assessment of the fair-market rental value. A party need not be exactly right on its assessment of fair-market rent - it must simply be closer to the arbiter's fair-market valuation than the other party. As the landlord and tenant come to that realization, they will appreciate that an amicable resolution is preferable in most instances.

We were involved in litigation several years ago concerning a fair-market renewal provision in which the landlord's appraiser valued the underlying land at \$2.9 million, while the tenant's appraisal was \$600,000. As it turned out, both appraisers had made extreme assumptions based on directives from their clients. Baseball arbitration would have undoubtedly eliminated those irrational positions.

The results have been impressive in baseball salary cases, where the American Review of International Arbitration notes that nearly 90 percent of all disputes settle rather than proceed to ultimate arbitration. For lease disputes that do go through the full process, the parties' final offers presumably will be more reasonable than with traditional methods of arbitration, because each party has an incentive to come as close as possible to the objective fair-market value to avoid the arbiter's selecting the other party's valuation figure.

Even if the parties agree to the concept, simply stating in a lease that baseball arbitration will be utilized is not sufficient. The provision should specify the mechanics and timing for determining the fair-market rental value. The renewal option should require the tenant to give notice sufficiently in advance so that there is ample time to make the rental determination, whether consensually or otherwise. The lease should provide deadlines for the parties to make their initial assessments of fair-market value and exchange proposals.

The clause also should identify in detail the criteria upon which fair-market rental will be based and evaluated. In addition, the clause should require that the final offers be submitted simultaneously and encourage negotiation even after the final offers are submitted. Finally, the parties should consider requiring the "loser" to pay not only the arbiter's fees but also the prevailing party's fees for attorneys and appraisers in the event that the dispute must be resolved by the arbiter. This raises the stakes to further promote an amicable resolution without having to employ baseball arbitration.

Major league baseball clearly got it right by adopting final-offer arbitration as the process to resolve salary disputes. Similarly, baseball arbitration goes a long way toward leveling the playing field in renewal rent negotiations and similar real estate valuation disputes.

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