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# Drafting Considerations for Alternate Dispute Resolution

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Contractual disputes in the real estate context arise in a variety of settings, including leases, sales transactions, joint ventures and many other scenarios.

As litigation is often an expensive means of resolving disputes, counsel to parties to any real estate contract should consider the advisability of including alternative dispute resolution ("**ADR**") provisions in such agreements. Alternative forms of ADR include: (a) informal dispute resolution directly between the parties, (b) mediation, and (c) arbitration. These three means of ADR are described below, including some pros and cons of each approach.

A. Informal Dispute Resolution. As an initial step, it is often advantageous to provide for a "discussion period" wherein the parties must hold informal negotiations in an attempt to resolve any disputes (sometimes called "informal dispute resolution" or "**IDR**") before they proceed to mediation, arbitration or litigation. Most IDR provisions are "mandatory" in the sense that the parties must engage in settlement discussions before proceeding to the next stage, but are "voluntary" in the sense that the parties are ultimately free to choose whether or not to agree upon the terms of a settlement as a result of such discussions. An IDR period is best used where the parties have an ongoing commercial relationship.

   On the other hand, IDR can create a time-consuming obstacle to timely action by a judge or arbitrator, particularly where the parties have wildly differing expectations or where one of the parties has no intention of compromising on this particular dispute. (Keep in mind that the parties are always free to jointly decide to engage in informal negotiations after a dispute has arisen.) So a party that may need quick intervention from a court or arbitrator in the event of a dispute should consider not including an IDR provision in the agreement.

B. Mediation. Mediation is another technique for exploring settlement opportunities before arbitration or litigation. Mediation enlists the assistance of an experienced, neutral third party who can help facilitate the parties' settlement discussions. As with IDR provisions, mediation provisions usually provide that good faith participation in the mediation is mandatory, while actually settling the dispute is voluntary. Mediation can, in appropriate circumstances, provide an efficient and effective means for resolving disputes, especially where the commercial relationship between the parties is ongoing, such as a lease transaction.

   1. Advantages. Some of the advantages of mediation include:

      a. Mediation offers a quick form of resolution.

      b. Mediation is much less costly than arbitration or litigation.

      c. The parties may choose a neutral mediator who has relevant subject matter expertise and experience in resolving disputes.

      d. There is no public record of mediation proceedings (although counsel should ensure that appropriate confidentiality agreements are in place, including with the mediators).

e. Mediation offers the parties some measure of control over resolution of the dispute, which control is lost when the ultimate decision is put in the hands of a judge, jury or arbitrator.

2. Disadvantages. Some of the disadvantages of mediation include:

a. Like IDR, mediation can create time-consuming (and also costly) obstacles to timely action by a judge or arbitrator, particularly where the parties have wildly differing expectations or where one of the parties has no intention of compromising a particular dispute.

b. Mediation is less likely to lead to a mutually acceptable resolution if one of the parties is an unwilling participant, and parties who were willing to mediate disputes before signing a contract sometimes change their point of view once an actual dispute arises. (Note: again, the parties are always free to jointly decide to engage in mediation after a dispute arises.)

C. Arbitration. In some situations, arbitration provides a reliable alternative means for resolving disputes. Arbitration puts the ultimate decision on the merits of a dispute in the hands of a private, neutral third party, typically a subject matter expert, in lieu of a judge or jury.

1. Advantages. Some of the advantages of arbitration include:

a. Arbitration generally offers a quicker resolution than litigation.

b. Arbitration should be less costly than litigation.

c. The dispute can be decided by neutral arbitrators who have relevant subject matter expertise.

d. The American Arbitration Association ("**AAA**") is very experienced at administering arbitration disputes and selecting a qualified pool of potential arbitrators, and its Commercial Arbitration Rules are well tested and generally fair to both parties.

e. There is no public record of arbitration proceedings (although counsel again should ensure that appropriate confidentiality agreements are in place, including with the arbitrator(s)).

f. Arbitration awards are final and only appealable in limited circumstances (*e.g.*, fraud or misconduct of arbitrators or agreement of the parties). The lack of a right to appellate review is both an advantage and a disadvantage, depending on who wins.

g. Arbitration may also be helpful when the relationship of the parties is ongoing.

2. Disadvantages. Some of the disadvantages of arbitration include:

a. The inability to appeal an adverse award is a major disadvantage to the losing party. Even before an award is issued, both parties may feel undue pressure to settle a claim to avoid a potentially unfavorable, non-appealable arbitration outcome. The more important the dispute, the more the pressure builds.

b. Knowing there will be no appellate review, arbitrators may feel less bound by the evidence and the law, making their awards less predictable and less constrained.

c. Arbitrators are sometimes more impressed with factual arguments than legal arguments, so if a party's position depends on a point of law, that party may prefer court over arbitration.

d. There is typically limited discovery in arbitration, which can help reduce cost. The limitation on discovery, however, may favor a party in control of key evidence, presenting a disadvantage to the party who needs access to information to prove a claim or defense.

e. Arbitrators sometimes "split the baby" by choosing to see merit in both sides' positions and selecting a compromise outcome. This sometimes encourages the party with a weaker position to continue pressing forward with an untenable claim or defense.

3. Strategic Considerations. Below are some strategic considerations that should be considered in evaluating ADR clauses:

a. As a general proposition, counsel should consider expressly excluding the following from binding arbitration:

i. disputes that are "must-win" to your client, due to their size or materiality; and

ii. disputes that have the potential to set precedent for important, central, frequently recurring issues facing your client.

Alternatively, counsel might consider keeping such disputes within the scope of an arbitration clause but creating ***appellate rights*** within the framework of arbitration to provide extra protection from a "runaway" arbitrator.

b. When deciding whether to include arbitration provisions in an agreement, counsel should give serious consideration to whether, in the event of future disputes, your client would be more likely to be ASSERTING a claim or DEFENDING a claim. Generally, the party that is going to be asserting claims is more likely to want the leverage that comes with full access to official judicial proceedings, including a jury trial. Likewise, the party that is more likely to be defending claims usually prefers to put the dispute in the hands of an arbitrator, who is more likely to split the baby in disputes.

c. In leasing transactions where your client is a tenant and an ADR provision is appropriate, consider using only the IDR and/or Mediation provisions from the sample clause, as you may want to adjudicate in court any disputes that may involve the risk of eviction of your client.

4. Other Considerations

a. Simple Award v. Reasoned Award. Generally, a simple award, declaring in writing the arbitrator's decision without explanation, is preferable to a "reasoned award" in which the arbitrator provides a written explanation of the reasons for the decision. While an ADR clause that requires the arbitrator to provide a reasoned award has the advantage of forcing the arbitrator to explain his or her decision (which may incentivize him to stick closer to the evidence and the law), it also provides fodder for motions to vacate the award in court, in which every word of the reasoned opinion may be scrutinized, challenged as faulty, and cited as a potential basis for a court to vacate the award. Generally, the less said by the arbitrator, the better.

b. "Baseball Arbitration." Each parth should consider whether to include a "baseball arbitration" provision in an ADR clause. Baseball arbitration is a type of arbitration in which each party to the arbitration submits a proposed monetary award to the arbitrator. After a final hearing, the arbitrator must choose one award from the

submitted awards, without modification. Baseball arbitration thus limits an arbitrator's discretion in arriving at a decision – he must pick one of the proposed awards submitted by one party or the other. This helps prevent a "runaway" arbitrator and drives the parties to take less extreme positions. Baseball arbitration is best used in situations where the likely disputes will be solely monetary.

c. Injunctive Relief. Generally, the arbitrator should be given the express authority to grant interim and permanent injunctive relief and other forms of equitable relief, including (importantly for real estate contracts) "specific performance." Taking into account there is usually a lag time between when a dispute arises and when an arbitrator is appointed, however, it is advisable to include language in the arbitration clause allowing a party to seek interim injunctive relief from a court of competent jurisdiction until such time as the arbitrator has been appointed; once the arbitrator has accepted the engagement, the arbitrator gains (and the court loses) jurisdiction to decide issues involving such interim relief. Thus, a party always has one – and only one -- outlet for seeking interim relief.

d. Depositions. Consider adding a provision permitting a limited number of depositions, particularly if key information or evidence is likely to be in the hands of the other party.

A contract may provide for one or more of these forms of ADR, and may also provide that certain forms of ADR apply only to certain categories of dispute. In each case, counsel should evaluate whether ADR is advantageous to your client in the particular transaction, and how it may be structured most effectively to meet your clients objectives.