

# ISSUES AND SOLUTIONS IN REAL ESTATE APPRAISAL, ARBITRATION, AND MEDIATION PROCEEDINGS

Private party dispute resolution proceedings are useful tools for those who understand the possible dilemmas.

GERALD M. LEVY

[The] price we pay for...[unrestrained advocacy], the atmosphere of contention over trifles, the unwillingness to concede what ought to be conceded, and to proceed to the things which matter. Courts have fallen out of repute; many of you avoid them whenever you can, and rightly. About trials hang a suspicion of trickery and a sense of a result depending upon cajolery or worse. I wish I could say that it was all unmerited. After now some dozen years of experience I must say that as a litigant I should dread a lawsuit beyond almost anything else short of sickness and death.

— Judge Learned Hand

*"The Deficiencies of Trials to Reach the Heart of the Matter," Address to the Association of the Bar of the City of New York, 1921.*

**A**ppraisal involves the estimation of market value or the present value of future benefits. Inherent in the definition is the concept of willing buyers and willing sellers acting in their own interest with knowledge and without duress and with reasonable time for marketing of the property. The value is denominated in cash and is not subject to any below-market financing or special concessions. Within the context of a dispute resolution, an appraisal would gener-

---

Gerald M. Levy, MAI, CRE is managing director, Real Estate Finance Group, Chase Manhattan Bank. He has been a principal decision maker in numerous real estate investment banking, leasing, construction, real estate finance, restructuring, workout, and corporate real estate transactions. Copyright © 1996 by Gerald M. Levy.

ally be similar to a "documents only" arbitration. However, an appraisal is more subject to judicial review than is an arbitration proceeding, and leaves the liability shield less clearly defined.

Arbitration places a dispute before an outside party who is authorized to reach a legal, final, and binding decision. As civil litigation has become more time-consuming and costly and as the technical complexity of issues in commercial disputes has increased, a growing volume of conflicting claims has been settled by arbitration. As contrasted with the delays, costs, and public exposure of litigation, arbitration often provides expeditious and inexpensive resolution of disputes by arbitrators possessing expert knowledge who act in an informal process that maintains the privacy of business transactions.

The disputing parties may use mediation, a non-binding process, prior to resorting to an appraisal or arbitration process. In a mediation proceeding, a third party brings the differing parties together to facilitate dispute resolution by identifying areas of conflict, enhancing communications, and possibly suggesting a noncompulsory basis for resolving the dispute. If mediation fails, the parties may resort to appraisal or arbitration.

Landlords, tenants, and their lawyers, appraisers, and consultants occasionally may be participants in appraisal, arbitration, or mediation proceedings involving a wide range of issues in the real estate industry. Following are some of the types of disputes:

---

GERALD M. LEVY & CO. LLC

Real Estate Advisors

305 Madison Avenue • Suite 1166  
New York, NY 10165

---

RESOLUTION OVERVIEW

- Disputes about values, rates of return, and/or renewal rents for land leases;
- Disputes involving economic rent or other revenue in a space lease renewal;
- Disputes about expense escalation reimbursement in such a lease;
- Disputes about occupancy, operational, and use issues during the renewal of a space lease;
- Disputes about the market value of a fractional interest;
- Disagreement about the market value of real property subject to a purchase option at an unspecified amount;
- Disputes about commission, contract, partnership, or title issues;
- Real estate loan disputes;
- Land use and zoning disputes (usually by mediation);
- Disputes involving hotels, motels, clubs, or gambling casinos;
- Conflicts involving condominium, cooperative, or owner's associations; and even
- Tax certiorari proceedings in certain jurisdictions.<sup>1</sup>

This article examines the current state of alternative real estate dispute resolution practice, focusing on the problems inherent in private proceedings.

#### **APPRAISAL AND ARBITRATION CLAUSES AND THEIR IMPLICATIONS**

Many current legal agreements dealing with real property include an appraisal or arbitration clause to resolve potential problems. For example, the key words in a land lease agreement might be the following:

The three appraisers or arbitrators shall value the land as if vacant and unimproved and unencumbered and for its highest and best use as of a date three months prior to the commencement date of any renewal term; a percentage rate of 6% shall be applied to the value so determined and agreed to by at least two of the three appraisers or arbitrators; the resultant dollar amount so calculated shall be the annual net rental payable for the appropriate renewal term.

In addition to using specific situational language like the preceding, many agreements contain the following standard clause recommended in American Arbitration Association (AAA) publications:

Any controversy or claim arising from or relating to this contract, or the breach thereof shall

be settled by arbitration administered by the American Arbitration Association under its Arbitration Rules for the Real Estate Industry (including a Mediation Alternative) and judgment on the award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof.

Typical clauses often specify that an appraiser or arbitrator be appointed by an impartial party and/or describe the required qualifications of the decision maker. The clause may require the decision maker to meet some or all of the following criteria: accreditation by a professional appraisal organization; a number of years of experience in a certain activity; and a number of years of experience in a certain geographic area.

Some agreements specify private modes of dispute settlement; others provide for proceedings under the auspices of the AAA.

#### **Clause Omissions Cause Ambiguity**

Many clauses fail to clearly address certain issues that real estate experts, acting as appraisers or arbitrators in real estate disputes, must consider. For example, legal agreements are often silent or contain ambiguous statements about the "highest and best use" concept. Consider the problems that may be created.

**Possible Uses May Have Changed Drastically.** Arbitrators are required to value a parcel of land to establish the proper rental for the renewal term of a lease. The land has been leased to a tenant who has constructed an industrial building. In the years since the execution of the agreement, the land use trends in the neighborhood have changed and, if the parcel had been vacant today, another type of structure would now constitute the highest use of the land. It is possible that land use patterns and zoning may have changed so drastically that it may be imprudent or illegal to reproduce the existing structure.

**Basis of Valuation.** If a lease specifies that a new land rent for a renewal period is to be set by means of arbitration, but it is silent about the basis on which the land is to be valued, this issue must be decided in the proceeding. Is the value to be as improved by the current building or by another structure that would result in a more profitable use of the site?<sup>2</sup> If the land rent is predicated on the latter alternative, the existing improvement may be unable to support its economic burden.

Conversely, the value of the land may be greatly enhanced by the existing structure or improvements, which at the time of the proceeding may not legally be duplicated. Because the parties must live up to their intended bargain, they should understand clearly the meaning of words they have used in the appropriate clauses.

"As If Unencumbered." Some lawyers contend that if the clause calling for the valuation of land omits the phrase "as if unencumbered" in defining the bundle of real property rights to be valued, the panel of decision makers must consider the effect of the entire lease on the land value. Thus, for example, the length of time in renewal options could affect the practicality of constructing a postulated new, highest, and best use. Certain court decisions have so held; other rulings have taken the opposite position, concluding that the arbitrators must limit their consideration to the lease's appraisal or arbitration clause. If the drafters of such clauses decide to include the words "as if unencumbered," it is then generally clear that the effect of the existing lease on value is to be limited to the clause that created the framework for the arbitration proceeding.

**Choice of Appraisal Techniques.** Leases may create uncertainties when they neglect to treat other issues. For example, when the decision makers attempt to determine value using the income approach, they may select alternative variables for their calculations based on a number of alternative assumptions. Should they consider contract rents or market rents; actual reported expenses or typical expenses for the property type; existing financing or currently available mortgage terms? These choices may have a dramatic effect on the interests of the parties. There may be a professional consensus about the treatment of many of these issues, but if the parties to a negotiation had explicit wishes, they should have included them in the arbitration clause.

#### **Problems Caused By Clause Wording**

Sometimes, the very words and phrases within the clauses that were intended to initiate real estate dispute resolution proceedings are themselves the sources of problems. Some lawyers and business people believe that the words "appraiser" and "appraisal" are synonymous with the words "arbitrator" and "arbitration." Yet, when the first set

The least words designed to facilitate dispute resolution may become problems.

of words is used, the courts may consider the clause to be an "appraisal" clause, while the second may be considered an "arbitration" clause. Judges often give themselves greater latitude to review the decisions of appraisal proceedings than to review the decisions of arbitrations.<sup>3</sup> Consequently, an arbitration clause is generally preferable unless the parties wish to face the possibility that the decision-making process described in legal agreements will be only

the first skirmish in protracted litigation.

Parties to an agreement should be aware that words that may have certain meanings to them may have other implications to those called on to arrive at decisions in proceedings. For example, the word "value" itself can be defined in many ways and the definition that the decision makers select could have a significant impact on their estimate. Agreements should contain language that has a technical meaning consistent with the intentions of the parties who have a financial interest in the property. When there is doubt as to the significance of certain words or phrases, a recognized expert should be consulted.

Many clauses drafted years ago specify that a particular percentage rate of return be applied to current market value to derive the land rent for the renewal period. This percentage rate may have no relationship to current market rates of return. It might have been better if the clauses had instructed the decision makers to decide the current market rent and had not specified a percentage rate of return. Alternatively, they might have been better advised to specify that an appropriate market rate of return should be applied to the market value of the land at lease renewal time.

Obviously, the characteristics of different properties and the interests of individual landlords and tenants vary. Thus, it may not be possible to create ideal or standard appraisal or arbitration clauses for all real estate agreements. Indeed, it may be prudent to leave settlement of many issues to the judgment of the arbiters. The often unpredictable nature of future time and circumstances may recommend this approach. Yet in drafting appropriate covenants, attorney should consider the special interests of their client and provide for those interests in precise language whenever good judgment indicates that the advantages of specificity outweigh future risk.

## THE DECISION-MAKING APPARATUS

Appraisal or arbitration clauses often specify that when a valuation or related dispute is to be resolved, each party to the agreement will pick one decision maker, variously described as a real estate appraiser, arbitrator, expert, broker, freeholder, neutral person, or umpire. If the two persons so chosen cannot reach a decision, they must select a third decision maker. If they cannot agree on such a third person, the AAA, the judge of a certain court, the president of the local bar association or real estate board, or some other impartial person or institution is to be called on to make the selection.

### Selecting the Decision Makers

This common tripartite method for picking decision makers presents a number of concerns. The most vexing problems focus on the appropriate roles and responsibilities of each of the two party-appointed decision makers. Should a claimant in a dispute choose one of the "judges"? Can an expert who is appointed by a disputant maintain the substance or the appearance of impartiality? Can an expert be both a witness and a decision maker?

The following problems arose in an actual proceeding. The governing clause had specified that each side would pick an "appraiser," each of whom would write a report. If the first two appraisers could not agree on a common value or on the selection of a third expert, an impartial outsider would appoint a third appraiser. This clause anticipated that ultimately the third expert would persuade at least one of the first two appraisers to a compromise consensus. Note that the clause had designated the first two appointees as appraisers. The word "arbitration" did not appear in the clause. Thus, as drafted, the clause required at least one of the first two "appraisers" to certify to a valuation conclusion and then later to swear under oath to a consensus number that probably varied from the original conclusion. No professional wants to be in the position of either of the two party-appointed experts. They might have to certify in writing to one conclusion and then swear under written oath to a different result.

Realizing that the governing clause might cause an impasse, the third-party appraiser drew up a letter agreement that all parties had to sign before that expert would enter the case. The letter

The opinions of party-appointed professionals often differ by lamentably wide margins.

released the party-appointed experts from their prior reports. They indicated that they would review anew all facts and opinions they had considered in arriving at their original conclusions, but would consider new facts and opinions that might come to their attention during the contemplated proceeding. When this document was signed, a possible stalemate was averted.

The common practice of specifying that parties to a conflict are to select the decision makers who will settle disputes creates other problems. The opinions of the party-appointed professionals often differ by a wide margin. The significant differences of opinion can frequently be explained by sincerely held disparate views. Sometimes, however, unrestrained advocacy is the major reason for wide variations. Each side is likely to have chosen an expert who may favor its interests. This is a lamentable situation. A particularly unfortunate outcome could emerge if one claimant's expert is an unrestrained advocate while the other disputant's expert lives up to professional standards of practice, and the "impartial" third person subscribes to a "split-it-down-the-middle" philosophy. In this situation, the interests of the "honest" expert's client may have been inappropriately and adversely affected!

### Protecting Decision Makers From Damage Claims

The exposure of decision makers to liability is cause for some concern. Anyone who is designated to resolve a controversy should be free of all personal liability, but problems arise, particularly in private proceedings based on clauses that use the words "appraisal" and "appraiser" and do not mention "arbitration" and "arbitrator." Protection from liability is available to a decision maker who is described as an arbitrator, but that protection is less clear when the decision maker is described as an appraiser.

Suppose that, after an award is delivered, one of the claimants is upset and sues the decision makers for money damages. In an extreme case, a losing claimant initiated litigation against all three decision makers, alleging malpractice. In the original dispute, each claimant had a valuation report prepared by an expert. The disputants used a panel of three other appraisers, chosen in tripartite fashion, to resolve the disagreement. The three panel members unanimously agreed on the award. After

the award was confirmed by two appeal actions, the losing claimant initiated litigation against the panel members and called for money damages. The plaintiff asserted that the alleged damages equaled the difference between the valuation conclusion of his original expert witness and the panel's unanimous award. Subsequently, an appeals judge dismissed the malpractice action.

It is unlikely that experts will be held liable for money damages in such instances. However, they can be burdened with the payment of legal fees to defend themselves and be exposed to the possibility of harm to their professional reputations.

#### **DECISION MAKING DILEMMAS AND VARIATIONS**

Another area of concern in tripartite selection arrangements involves the dialogue and decision making process. Assume, for example, that a new rent is to be set for a renewal period of a land lease. The clause specifies that the rent is to be set at a fixed percentage of the current market value of the site. Decision maker Terra Firma, chosen by the landlord, estimates a value of \$3 million; decision maker Edifice, selected by the tenant, estimates a value of \$2 million. As a result of subsequent dialogue, Terra Firma knows or assumes that the third arbitrator's tentative estimate is \$2.7 million, a value closer to his valuation than to Edifice's. So Terra Firma is unyielding because he assumes that the third arbitrator is unlikely to agree with Edifice's low estimate of \$2 million, and he may therefore be forced to endorse Terra Firma's \$3 million conclusion. As it turns out, the third expert finds that endorsing either of the extreme estimates is inappropriate. He seeks a fairer resolution to the problem.

Under various circumstances, the third arbitrator may lead his colleagues to several different solutions:

■: If Terra Firma is inflexible at \$3 million, the third arbitrator may attempt to persuade Edifice to accept a compromise valuation of \$2.7 million. This effort may not be fruitful.

■: The operative clause in the legal agreement may specify that after the passage of a reasonable amount of time and the expenditure of conscientious effort, the third arbitrator can certify that there is no majority agreement, and he can therefore assume the power to decide the matter. A third arbitrator who possesses this prerogative has substantial leverage with the party-appointed arbitrators.

■: The operative clause may specify that in the event of a deadlock, the third arbitrator is empowered to declare an impasse. Subsequently, he would have no further obligations, and a new third expert would be chosen. Critics of this option contend that the impasse power, if widely exercised, would defeat arbitration as a timely and efficient alternative to litigations. Yet, the third arbitrator who has impasse power also has continuing leverage once he makes his tentative conclusion known to the party-appointed arbitrators.

■: The operative clause may specify that in case of deadlock, the third arbitrator is relieved of his obligations and an outside authority such as the AAA may enter the discussion. The outside agency (AAA) would first ascertain through discussions with the three decision makers whether there is any reasonable expectation that a decision could be reached by the three arbitrators. Under the "Arbitration Rules for the Real Estate Industry (Including a Mediation Alternative)", the AAA has the power to vacate the third arbitrator's appointment and appoint another arbitrator to the group.

These possibilities illustrate the difficulties inherent in the dialogue and decision making process by tripartite selection of decision makers.

#### **VARIATIONS OF THE TRIPARTITE ARBITRATION PANEL**

Numerous proposals have been advanced for reducing the difficulties of tripartite proceedings. Some suggestions deal with the method of arbitrator selection, others with the dialogue and decision making process. These proposals and some combinations of proposals are enumerated subsequently.

**Blind Selection.** Each claimant selects an arbitrator, but the selected person is notified of the appointment by an intermediary, and the name of the client is withheld from the arbitrator until the majority decision is delivered. It is not clear, however, how the parties could ensure that an arbitrator would remain ignorant of the identity of the selector.

**Witness and Arbitrator.** Each claimant selects a witness and an arbitrator, as does an impartial third party. The witnesses research, analyze, and prepare reports about the conflict, which they submit to hearings conducted by all three arbitrators. A majority decision of the arbitrators is decisive.

**Separate Data Collection Only.** Each claimant plus an independent party selects an arbitrator. Each of the first two professionals separately collects the necessary data prior to their initial meeting. All three meet and undertake analytic efforts and decision making, and a majority decision binds the parties.

**Collective Professional Work.** The three arbitrators do no research prior to their initial meeting. They subsequently engage in the collective tasks of data collection, analysis, and decision making. A majority of the three-expert panel leads to a consensus award.

**Agreement of Party-Appointed Arbitrators or Third Person's Sole Decision.** The first two party-appointed arbitrators must arrive at a common conclusion within a specified time period. If they fail to meet the deadline, all power to decide is transferred to the third person and the functions of the first two professionals are reduced to presentation and submission of evidence and opinions.

**Arithmetic Average.** All three experts write a report, and the decision consists of the arithmetic average of their three value conclusions. This method may produce capricious results because erratic estimates directly affect the average. The approach assumes that the claimants will be better served by a mathematical average than by a forced consensus or majority judgment.

**The Baseball Clause.** The third arbitrator's function is limited to choosing one of the value conclusions presented by the first or the second arbitrator. Advocates believe that this technique will compel the first two arbitrators to submit estimates that fall within a narrow "zone of reasonableness." Each professional would be concerned that the third arbitrator would choose the other's value conclusion as the more reasonable alternative. Some commentators believe that this procedure denigrates the professionalism of the two original arbitrators and the assumption that, acting in a knowledgeable and impartial manner, professionals will arrive at an equitable decision without artificial constraints.

**Arithmetic Average of the Two Conclusions That Are Closest in Dollar Amount.** Each arbitrator arrives at a separate conclusion. The binding decision consists of the arithmetic average of the two conclusions that are closest to one another. Like the baseball clause, this mechanism

discourages extreme conclusions and is an incentive to the creation of estimates that are within a "zone of reasonableness."

**Neither High Nor Low.** Each of the three decision makers arrives at an individual conclusion. The binding decision is the median conclusion. This arrangement attempts to ensure that wild or erratic determinations by individual experts will not prevail.

This lengthy list of variations on the tripartite method of selection, dialogue, and decision making is not exhaustive, and that fact highlights the potential imperfections and difficulties of the system. The ideal of arbitration is "Come, let us reason together." Unfortunately, the ideal is difficult to achieve in tripartite proceedings.

#### **PREPARATORY LETTER AGREEMENT**

A third decision maker, assigned to a private case that was triggered by an appraisal clause, generally would be wise to require all parties to the case (the claimants and the first two party-appointed decision makers) to sign a letter agreement that converts the appraisal clause into a more definitive arbitration clause. If the original clause describes the decision makers with words other than "arbitrator," the letter should specify that these professionals, nevertheless, are to be considered arbitrators. The agreement should stipulate that all legal precedents, interpretations, and protections that apply to arbitrators and arbitration will be applicable to the contemplated proceedings. It should set forth a customized set of rules to govern the specific case and attempt to deal with some of the difficulties inherent in private proceedings conducted in the tripartite selection mode that has been discussed. Following are the important elements of a typical letter agreement:

**Statement of Relevant Cause.** The letter should repeat the operative clause and, if necessary, clarify it. The parties often discover textual variations between the original clause and the clause as restated in later amendatory agreements, and it may be necessary to obtain their agreement to reconcile the variations.

**Valuation "As of" Date.** If the original agreement specifies a date of valuation, it should be restated in the letter agreement. Sometimes the original

agreement cites no date, and the parties must now agree on an appropriate date.

**Arbitration Concept.** If the operative clause does not use the words "arbitrator" and "arbitration," the letter must introduce them and emphasize that arbitration places a dispute before another party who is authorized to arrive at a legal, final, and binding decision.

#### Hearing Procedures (When Desired).

The letter should include a concise statement of the basic hearing procedures including oaths, note-taking, or full transcripts, provisions concerning the absence of a party as a witness and the order of the hearing (for example, opening statement, testimony, direct examination, cross-examination, possible reexamination and closing statements). The letter should describe the scope of interaction by the arbitrator during the hearing, and treat issues of discovery, depositions, and briefs.

**Documents Only Arbitration (Waiver of Oral Hearing).** "Documents only" proceedings generally reduce costs, reduce or eliminate scheduling conflicts (except between the decision makers), do not require the presence of claimants or their counsel, and expedite dispute resolution.

In a "documents only" proceeding, the decision makers review written submissions but hear no oral testimony, cross-examination, or advocacy by the parties or their respective counsel. The only dialogue is between the decision makers if there is more than one. Unless a "documents only" hearing is specified in the clause triggering the process, it is best to have both parties agree to this type of proceeding. In the absence of a "documents only" specification in the triggering clause, if one or both of the parties request a formal oral hearing it should usually be provided. And even if both parties want a "documents only" proceeding, the decision makers should be given the right to call an oral hearing if there are major conflicts in the "facts" provided by the respective parties and the decision makers believe an oral hearing may resolve these inconsistencies. If the parties agree to a "documents only" proceeding, the third party arbitrator may find it useful to call a preliminary meeting at which time the professionals may explain to the parties that a "documents only" proceeding requires

The evidence must be evaluated for relevant weight, preponderance, relevance, and persuasiveness.

that all expert opinions, evidence, and advocacy be submitted in written form.

**The Scope of Allowable Evidence.** The letter of agreement should specify that the arbitrators have broad latitude concerning the admissibility of evidence, although the acceptance of evidence will not be considered as endorsement of its relevance, if any. If the arbitrators disagree about the admissibility of any specific materials, the power to admit or

reject devolves upon the third decision maker. These rules assume that the arbitrators, in coming to conclusions, can distinguish between types of evidence (i.e., between materials that are relevant or irrelevant, between hearsay, nonexpert, or privileged opinion on the one hand and factual evidence or expert opinion on the other). They must rate the evidence for relevant weight, preponderance, relevance and persuasiveness.

**The Structure of the Written Decision.** The letter of agreement should specify that the written decision be brief. As is the custom in commercial arbitration proceedings, the award document usually should not detail the facts, opinions, or reasoning used in arriving at the conclusion. An arbitration decision should always be direct and conclusive and should not create any ambiguities that could be used in any attempted legal action. The exceptions to this "no reasons" decision are situations in which the clause governing the process specifies that the decision will contain the reasons or reasoning that led the arbitrators to the conclusion. Occasionally, both parties request that the arbitrators elaborate the reasons and/or reasoning in the decision, and the latter may agree. If the principals request that the process culminate in a reasoned award, they should decide whether they want merely to obtain an "education" so that they will not repeat the errors that led to the proceeding or whether they wish to use a reasoned award as a basis for bringing an appeal action. If it is the latter, the written decision will have to be extensively documented and explained, and fees will increase dramatically. Furthermore, planning an appeal in advance of the arbitration process may defeat one of the key purposes of arbitration: speedy dispute resolution.

**Waiver of Personal Liability.** The letter agreement should protect the third decision maker from sub-

sequent legal action or any other consequences flowing from actions initiated by other parties to the agreement. It should state that the arbitrator will have the same protections and immunities as enjoyed by any state or federal judge engaged in any formal legal proceeding or any subsequent action resulting from it.

**Indemnification Against Costs.** The letter should specify that if any party should, prior to, during, or subsequent to the proceedings, initiate a legal action that involves the third arbitrator as a participant, witness, or defendant, the party who brings the action must indemnify the third arbitrator against all costs. The third arbitrator is to be paid the agreed per diem fee for any additional time that he or she must expend on the new proceedings and must be paid for any money damages, as defined. If more than one party initiates such action, their obligations to the third arbitrator are to be joint and several in nature.

Before any party commences a legal action, it shall post a satisfactory surety's written indemnification to reimburse the third arbitrator for all costs, expenses, damages, and professional fees that it may incur defending against or becoming involved in the action. If the initiating party fails to pay valid bills within 30 calendar days of presentation, the surety will be used to pay its obligations within five calendar days of subsequent presentation of these bills to the surety.

**Responsibilities of Party-Appointed Appraisers/Arbitrators.** The letter should specify that the first two (party-appointed) arbitrators are released from any prior reports about the issue and they are instructed to be impartial. They may review all the facts and opinions that they used in arriving at any earlier conclusions but, in addition, they are to consider all new facts and opinions that come to their attention. They are not subject to instructions from the claimants who select them. They are granted the same waiver of personal liability, indemnification against costs, and surety's written indemnification as is granted the third decision maker.

**Statement of Absence of Conflicts of Interest.** The arbitrators each attest that they have no conflicts of interest. If any arbitrator believes that conflicts or the appearance of conflicts may exist, he or she

**An interim award could protect against a possible wasting of assets.**

must disclose them. If the arbitrator is regularly employed by an organization that may have had prior dealings with any of the parties, that arbitrator must reveal the relationship and acknowledge the possibility of a conflict.

**Procedural Authority of Third Arbitrator.** If any procedural powers are reserved to the third arbitrator alone, these prerogatives should be stated.

Such powers could include the sole right to declare an impasse and the sole right to make decisions about and special responsibilities concerning the admissibility of evidence. The third arbitrator should be authorized to set the date, time, and place of meetings and have other relevant powers.

**Third Arbitrator's Fee.** The letter should specify the amount of the arbitrator's fee and the manner of its payment. Fees may be quoted on a per hour, per diem, or lump sum basis. Generally, per hour or per diem fees compensate the arbitrator for time expended in travel, hearings, research, study, and preparation of the award. The arbitrator is compensated additionally for out-of-pocket expenses for administration, travel, hotel, and food and sundries. The fee should be paid (or an estimated sum should be paid) before the proceeding commences, and it should either be received directly or held in escrow. If it is held in escrow, the trigger for the fee's release should be described. The letter should provide for a fee for work-to-date that will be paid if the claimants reach their own settlement before the proceedings result in the formulation of an award that is served on the parties. The reason for payment of the fee in advance is to eliminate the possibility that the arbitrator will be subject to any overt, subtle, or psychological economic pressure.

**Provision for Interim Award (If Necessary).** The letter may have to specify that the arbitrators may issue an interim award to protect against the possible wasting of assets. The issuance of such an award will not waive the right or obligation of a party to further participate in an arbitration proceeding. If the body of the interim award is inconsistent with the final award, the latter decision will supersede it.

**Execution of Counterpart Forms.** The third arbitrator should sign multiple counterpart forms or copies of the letter of agreement. Two

signed copies should be delivered to each disputant and each other arbitrator. Each signatory executes both copies and returns one counterpart to the third arbitrator, retaining the second. The agreement does not become effective until every party has signed a counterpart copy and returned it to the third arbitrator and until all other conditions listed subsequently precedent to the commencement of the proceeding have been met.

**Conditions Precedent to Commencement of Proceeding.** In addition to returning the executed counterpart copies, the parties (as required) must deliver appropriate appraisal reports and other specified evidence and the appropriate checks for the third arbitrator's fee.

**Declaration of Commencement of Proceeding.** After all conditions precedent have been met, the third arbitrator provides commencement notification, sending a letter by certified mail, return receipt requested, to each of the claimants and to the other arbitrators.

**Manner of Service of Written Decision.** The decision, usually brief and without reasons or reasoning, is signed in the form of an oath and notarized. It is executed by those arbitrators who have joined in the award. The third arbitrator sends the decision by certified mail, return receipt requested, to all claimants and the other arbitrators. At this point, the responsibilities of the arbitrators are at an end. If enforcement becomes a problem, the decision can be entered as a court order in most jurisdictions.

#### **MEDIATION AS AN ALTERNATIVE**

Before initiating appraisal, arbitration, or litigation proceedings such as have been described, the parties may, by mutual consent, submit the dispute to mediation. Mediation is a nonbinding process in which a qualified and impartial person attempts to facilitate a resolution of the dispute. The parties may reach a resolution on their own with the aid of a mediator's guidance or the mediator may merely suggest (orally or in writing) the appropriate elements of a resolution. In the process, the mediator may offer evaluation of the issues and circumstances and/or may facilitate a voluntary settlement merely by aiding the communications process. Provided the parties agree to pay the costs, the mediator may obtain expert advice from technical experts.

In a mediation, common expenses including the mediator's fee are shared equally by the parties. Deposits are taken and, after all appropriate disbursements, refunds of the remaining balances are made to the parties.

The mediator sets the date, time, and place of mediation sessions and may conduct joint and/or separate mediation sessions with the parties. The parties may have representation and witnesses if they so choose. Mediation is private and confidential and the mediator does not have liability exposure. Prior to the first mediation session each party generally will provide the mediator with a briefly written outline of the issues. At the first session the parties produce the information they deem relevant to a settlement. The mediator may request additional information.

A mediation may be terminated in one of three ways: (1) the parties may execute a settlement agreement; (2) the mediator may declare that further efforts at mediation are no longer worthwhile; or (3) a party or parties may declare that the mediation proceedings are terminated.

If the parties cannot reach a settlement agreement via mediation, they may then resort to an appraisal or arbitration proceeding. Generally, it is recommended that an expert who has served as a mediator for an unresolved dispute should not serve as a decision maker in a subsequent proceeding concerning the same dispute.

#### **AAA PROCEEDINGS**

In certain circumstances, neither private mediation nor private arbitration proceedings provide the optimum environment for the resolution of disputes on real estate issues. Appropriate proceedings can also take place under the direct auspices and administrative procedures employed by the American Arbitration Association using its "Arbitration Rules for the Real Estate Industry (Including a Mediation Alternative)." A subsequent article will describe how disputes can be settled under the AAA Rules. ■

#### **NOTES**

1. Summarized from introduction, *Arbitration Rules for Real Estate Industry (including Mediation Alternative)*, American Arbitration Association, 1994. [This inventory was developed by the author. Ed.]
2. An interesting discussion of vague land valuation clauses, case histories of actual problems created and rulings of the New York courts can be found in H.K. Weiss, "Valuation of Land under Long-Term Leases," *Appraisal J.* 520-525 (Oct. 1971).
3. As to the concept of judicial law, see B.H. Goldstein, "Real Property Appraisal vs. Arbitration," *New York LJ* (June 8, 1983).