

“Baseball Arbitration” For Upcoming Lease Extensions

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If during lease negotiations, landlord and tenant desire that the rent be set for an extension term at fair market value, but landlord and tenant are concerned they will be unable to agree on what constitutes fair market value at such time, what type of provision should be included to determine what constitutes fair market value that is fair to both parties, while not being unduly time consuming, expensive, or adversarial?

If landlord and tenant agree that the tenant will be provided with an option to extend the lease at the end of the original term at an amount equal to the then current fair market value, including a provision should be included requiring that if the parties cannot agree as to what constitutes fair market value after a predetermined time period, e.g., 6 months from the commencement of the extension term, such amount will be determined by “baseball” arbitration.

Aptly named, “baseball” arbitration follows a similar procedure as that used in Major League Baseball when determining player salaries. Specifically, in “baseball” arbitration, both landlord and tenant provide an arbitrator with their determinations of fair market value (“FMV”) rent, i.e., the amount of fixed (or basic) rent that a willing tenant would pay and a willing landlord would accept in an arms-length lease of the premises in question as of the commencement of the extended term, assuming the same terms and conditions set forth in the lease. If the submitted determinations are very close to each other, e.g., they differ by less than 3%, the FMV rent may be calculated by taking the average of landlord’s and tenant’s FMV determinations. Otherwise, the arbitrator will choose either landlord’s or tenant’s determination of FMV as modification of either landlord’s or tenant’s FMV determination is not permitted. Because the arbitrator must pick one of the FMV determinations without modification, if neither landlord’s nor tenant’s rental determination accurately reflects the FMV, the arbitrator will pick the one that it believes comes closest to representing FMV. Consequently, a tenant that submits a “low ball” determination or a landlord that inflates its FMV determination both run the risk that their determination will be rejected in favor of the other party’s FMV determination. Thus, both landlord and tenant have incentive to submit to the arbitrator rent determinations that reflect each parties true assessment of the current FMV.

Because “baseball” arbitration is less costly and time consuming than utilizing traditional arbitration or the courts, it offers both landlords and tenants a quick, efficient and inherently fair method of determining FMV when the parties are unable to agree among themselves.