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"ARBITRATION AND MEDIATION OF COMMERCIAL LEASE DISPUTES"

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INTRODUCTION

Commercial leases often involve long-term relationships. It seems almost inevitable that disagreements will arise. In the worst case, the disagreement ends up in litigation which can be time consuming, expensive, uncertain, and disruptive. Arbitration and mediation are alternative methods for resolving disputes. By providing the parties with more control over the dispute resolution process, arbitration and mediation can be quicker, less costly, and less disruptive than litigation.

This paper will examine mediation and arbitration in the context of a commercial lease. We will start by considering some of the pros and cons of the two processes. We will look at points to consider when drafting arbitration clauses and examine the arbitration process. Finally, we will consider the enforceability of mandatory mediation clauses and discuss selecting a mediator and arbitrator.

PROS AND CONS OF MEDIATION

Mediation is essentially negotiation. With the assistance of a neutral third party (the mediator), the parties seek to negotiate a resolution to their dispute. Mediation provides the parties with a chance to meet, hear and be heard, and resolve the dispute on their own terms. The mediator cannot impose a settlement on the parties.

Timing: Mediation can take place at any time. The parties can try for an early resolution before the dispute boils over and litigation starts. Most often, mediation occurs during the litigation process. It can take place at any time right up to the start of the trail. In fact, mediation can take place while the trial is ongoing.

Cost: Compared to litigation, a one-day mediation session is relatively inexpensive. Mediators charge between $1,000 and $5,000 per day; a fee which is usually split between the parties. On the other hand, litigation can take years and cost a great deal of money. A successful litigant is entitled to recover its legal costs although they rarely recover all of their costs. The recovery is typically between 50% and 70% of actual fees incurred.

Control the Process: Mediation allows the parties to negotiate their own resolution on their own terms. The parties can "think outside of the box" and agree on a "creative solution". In many ways litigation is "the box" they want to get out of. The ability of a judge to impose a creative solution is very limited. For the most part, in a commercial dispute, a judge (or an arbitrator) can only decide who is right, who is wrong, and then award one party a sum of money or dismiss the claim.

Without Prejudice and Confidential: In order to facilitate resolution, mediation is "without-prejudice" and confidential. Anything said during mediation cannot be used outside of the mediation session. As a result, the parties can candidly address all issues. The parties can concede weaknesses in their case and acknowledge strengths in the other party's case, knowing that, should the mediation fail, they will not have compromised their legal position. Frank and honest discussion often leads to a resolution.

Failed Mediation: There is no guarantee that mediation will succeed. Where mediation fails, the parties carry on with the litigation process as though no mediation took place. The cost and time attributed to the mediation are lost. As a result, the litigation process is one step longer and one step more expensive.

Mandatory Mediation: Rule 24.1 of Ontario's *Rules of Civil Procedure*,[1] provides for mandatory mediation in most commercial cases started in Toronto, Ottawa, and London, Ontario. The mediation session is up to 3 hours and must occur 180 days after the first defence has been filed. In any event, the mediation must occur before an action can be set down for trial. Forcing parties to mediate may seem counter intuitive, however it is surprisingly successful. Under Ontario's mandatory mediation regime about 50% of cases settle during, or shortly after, the mandatory mediation session.

PROS & CONS OF ARBITRATION

Arbitration is an alternative method of dispute resolution. Where arbitration differs from mediation is that the arbitrator, like a judge, imposes a resolution on the parties. Commercial leases

[1] RRO 1990, Reg 194.

often include a clause which stipulates that some or all of the disputes which may arise under the lease must be resolved by arbitration.

Time and Costs: Arbitration is a longer process than mediation, but it can still be shorter and less costly than litigation. The parties have more control over the process and can utilize this control to implement cost effective, efficient, and stream-lined procedures.

Private and Confidential: Arbitration is a private and confidential process. It does not set a precedent and does not affect other parties. The evidence and the award are private and confidential and only available to the parties.

Control of the Process: All common law provinces have legislation which establishes rules and procedures for arbitration.[2] These statutes are substantially similar to Ontario's *Arbitration Act, 1991*, ("*Act*")[3].

Arbitration Legislation: Where the parties have agreed to arbitrate, but have not specified many of the details by which the arbitration will proceed, provincial arbitration legislation establishes the procedure. The statutes address: composition and jurisdiction of the arbitral tribunal, conduct of the arbitration, and other aspects which determine the procedure by which the arbitration is to occur.

Arbitration is a private remedy and the parties are free to customize the procedure to their needs. The *Act* permits parties undertaking non-family arbitration to contract out of any of its provisions, subject to six enumerated exceptions.[4] Section 3 of the *Act* provides that the parties to an arbitration agreement may agree, expressly or by implication, to vary or exclude any provision of the *Act* except the following:

i. Subsection 5(4) - "Scott v Avery" clauses: where a commercial contract (including a commercial lease) contains an arbitration clause, then the parties are required to arbitrate before commencing a court action.

[2] See generally: *Arbitration Act*, RSA 2000, c A-43; *Arbitration Act*, CCSM c A120; *Arbitration Act*, SNB 1992, c A-10.1; *Arbitration Act*, RSNL 1990, c A-14; *Arbitration Act*, RSNS 1989, c 19; *Arbitration Act*, 1991, SO 1991, c 17; *Arbitration Act*, RSPEI 1988, c A-16; *Arbitration Act*, 1992, SS 1992, c A-24.1; *Arbitration Act*, RSNWT 1988, c. A-5; *Arbitration Act*, RSY 2002, c 8.
[3] SO 1991 c 17 [*Act*].
[4] *Supra* note 3, s 3.1.

ii. Section 19 - Equality and fairness: all parties to an arbitration must be treated equally and fairly, and each party shall be given an opportunity to present its case and respond.

iii. Section 39 - Extension of time limits: the court may extend the time for the arbitral tribunal to make an award.

iv. Section 46 - Setting aside an award: the court may set aside an arbitration award on the basis that; the parties were not being treated fairly, fraud, or an invalid arbitration agreement.

v. Section 48 - Declaration of invalidity of arbitration: the court may declare the arbitration agreement is invalid or inapplicable to the dispute, on various grounds.

vi. Section 50 - Enforcement of award: the courts will enforce an arbitration award.

Court Intervention: Where there is an arbitration agreement in a contract (which includes a commercial lease) the parties must complete the arbitration before commencing a court action. However, as we have noted above, the court still retains supervisory jurisdiction over arbitrations. Section 6 of the *Act* permits a court to intervene in order to "assist the conducting of arbitrations"[5] and "to ensure that arbitrations are conducted in accordance with arbitration agreements"[6]. If the parties require court assistance in conducting the arbitration, many of the advantages of arbitration are lost. The arbitration is no longer private and confidential (court proceedings and court documents are public) and the proceedings can become as protracted and expensive as a regular court action.

DRAFTING ARBITRATION CLAUSES FOR COMMERCIAL LEASES

An arbitration clause may be as straight forward as providing that a specific dispute under a commercial lease is to be resolved by arbitration in accordance with the *Act*. For example:

> *The Minimum Rent for each Extension Period shall be at the fair market rent which will be agreed to by the Landlord and the Tenant, both of whom will use reasonable*

[5] *Supra* note 3, s 6.
[6] *Ibid*.

commercial efforts to negotiate the applicable Minimum Rent as expeditiously as possible. If the Landlord and the Tenant are unable to agree upon the Minimum Rent payable for an Extension Period, then it will be arbitrated pursuant to the Arbitration Act (Ontario).

***Arbitration Act* Procedures:** The above clause contains a binding arbitration agreement. It identifies the matter to be arbitrated, namely; the determination of fair market rent for the extension period. It relies on the "*Arbitration Act* (Ontario)" for the procedure to be followed. The *Act* provides a code of procedure for an arbitration. A detailed review of the procedures set out in the *Act* is beyond the scope of this paper. I will limit myself to identifying of few of the key provisions:

i. Sections 9 & 10 of the *Act* provide that where the arbitration agreement does not specify otherwise, there is to be one arbitrator who will either be selected by mutual agreement of the parties, or by the court upon application.[7]

ii. Section 23 of the *Act* provides that an arbitration may be commenced in any way recognized by law, including: serving the other party with a notice demanding arbitration under the agreement. This notice usually includes the names of two or three arbitrators satisfactory to the party demanding arbitration.

iii. Section 11 of the *Act* provides that once appointed an arbitrator shall be independent of the parties and shall act impartially.

iv. Sections 12, 13, & 14, of the *Act* provide that a party may not revoke the appointment of an arbitrator. A party may, however, challenge an appointed arbitrator on grounds of bias or non-qualification. The parties may agree to remove the challenged arbitrator. Alternatively, the challenge will be decided by the arbitral tribunal, or ultimately the court.

Appeals: Unless the agreement provides otherwise, the arbitrator's decision (referred to as an "award") is binding as between the parties.[8] Where the arbitration agreement is silent as to appeals, a party may only appeal on a question of law, with leave of the court.[9]

[7] *Supra* note 3, ss 9,10.
[8] *Supra* note 3, s 37.

The parties may agree to more extensive appeal rights in the arbitration agreement. Where the agreement so provides, the parties can appeal an award to court on a question of law or mixed law and fact.[10] All appeals must be brought within thirty (30) days after receiving the award.[11]

Additional Provisions of an Arbitration Clause: The agreement to arbitrate can alter the provisions of the *Act* by adding time frames, increasing the number of arbitrators, more precisely defining the subject of the arbitration, and adding appeal rights. Here is an example of a more detailed agreement to arbitrate:

(1) If the parties fail to agree, within three (3) months after the Tenant gives the notice to renew, as to the Minimum Rent payable during the upcoming Extension Term, the annual Minimum Rent payable during the upcoming Extension Term shall be determined using the same terms of reference described above, by arbitration.

(2) The arbitration shall be conducted before an arbitral panel of three persons; one to be appointed by each of the Tenant and the Landlord and the third to be chosen by the two arbitrators so appointed. The decision of the three arbitrators appointed as herein provided or the majority of them shall be binding upon the parties subject to any appeal rights. All costs and expenses of any such arbitration shall be borne by the Tenant and the Landlord equally, unless a majority of the arbitrators in their decision otherwise directs. Any such arbitration shall take place in the City of Toronto, in the Province of Ontario.

(3) "Fair Market Rent" means, at any given time, the then current fair market rent paid for comparable premises, as if leased to a new tenancy, without

[9] *Ibid* s 45(1).
[10] *Ibid*, s 45(2).
[11] *Ibid* s 47.

attributing any value to the Leasehold Improvements, if any, which have been effected to the Leased Premises.

There is no limit to the amount of detail which can be agreed to. In the following example the parties even seek to contract out of the requirement to arbitrate under the *Act*.

> Wherever any question or matter in dispute between the Landlord and the Tenant under this Lease cannot be determined, settled, or agreed between them, then the question or dispute shall be determined by arbitration, as follows:
>
> (1) Either party may give written notice to the other of its desire to arbitrate such dispute, and shall in such written notice give notice of the appointment of an arbitrator chosen by the party giving such notice. The party receiving such notice shall within fifteen (15) days after the receipt thereof give a written notice to the party giving the first notice of the appointment of an arbitrator chosen by the party giving the second notice. The two arbitrators so chosen shall jointly appoint a third arbitrator;
>
> (2) If a party required to appoint an arbitrator shall fail to do so within such period of fifteen (15) days, or if each party has appointed an arbitrator and such arbitrators fail to agree upon a third arbitrator within fifteen (15) days after both have been appointed, then any party not in default in so appointing may apply to a Judge of the Ontario Court (General Division), for the appointment of an arbitrator on behalf of the party in default, or the appointment of the third arbitrator, as the case may require;
>
> (3) The three arbitrators so appointed shall determine the dispute having regard to the provisions of this Lease and to any other agreements which the parties may have made respecting the arbitration or the matter in dispute and the decision of and any costs awarded by any two of them shall be final and shall bind the parties. Subject to the provisions of this

clause, the arbitration shall be conducted in accordance with the provisions (if any) of the laws of Ontario from time to time in effect pertaining to arbitration;

(4) The fees and expenses of the arbitrators and all other expenses of such proceedings shall be borne in such manner as the arbitrators may determine; and

(5) The provisions of this section regarding the determination of certain questions or matters in dispute by arbitration are acknowledged by the parties to have the intended purpose of providing, where applicable, an equitable and rapid determination, but are not intended and shall not be interpreted as excluding recourse by any party to the Courts, or recourse by any party to any of the remedies available at law or in equity including damages or injunction, and such recourse may be taken notwithstanding the provisions of this section in respect of any matter where the substantial rights of a party are involved and might be prejudiced or impaired if such recourse is not taken, notwithstanding that the determination of such matter may involve a question for determination by the Court which would otherwise fall for its determination within the provisions of this section, but in any such case any determination which has already been made pursuant to this section shall be binding upon the parties.

ENFORCEABILITY OF MANDATORY MEDIATION CLAUSES IN LEASES

As already discussed, where the parties include an arbitration agreement in a commercial lease, the parties can be required to arbitrate the dispute in accordance with the arbitration provision before commencing a court action. Does the same apply to a lease provision which requires the parties to mediate before arbitrating or commencing a court action?

In *Lougheed v Garden City Entrepreneurs Inc*[12] the plaintiff franchisor brought a claim for damages alleging breach of the franchise agreement. The Ontario Superior Court refused to address the claims given that the agreement contained a dispute resolution clause providing for mediation, and potentially arbitration. The court quoted prior judgments which enforced arbitration clauses and extended the reasoning to mediation clauses. The judgment reads "the courts are not at liberty to interfere with a condition precedent freely accepted by both parties for the purposes of limiting the conditions under which an action could be brought under the contract"[13] and "the court should respect the agreement and refuse to entertain an action in respect of the dispute"[14]. While the judge in *Lougheed* went on to stay the action, it's worth pointing out that the court did not address whether the same holding would have been reached had the clause stipulated simply that the parties would mediate prior to commencing an action. Nevertheless, the principles which the court used to enforce the intent behind the clause seem to indicate that a court could rely equally on the same principles to enforce such a clause.

In *Briones v National Money Mart Co*[15] the Manitoba Court of Queen's Bench undertook a similar analysis, at one point stating "a mediation clause is analogous to an agreement to arbitrate"[16]. The court pointed out that in order to stay the proceeding due to the mediation clause it would have to invoke its jurisdiction under section 38 of the *Courts of Queens Bench Act*[17]. In *Money Mart*, however the court denied the motion to stay the proceedings based fact-specific considerations beyond the scope of this paper.

While such clauses are enforceable, in the sense that the court can stay an arbitration or court action until after the mediation takes place, the question is – is this useful? If the parties don't want to mediate, why bother? As noted by Justice Warner in *Merks Poultry Farms Ltd v Wittenberg*, "to be meaningful, mediation requires good faith on the part of all participants"[18].

[12] (2008), 168 ACWS (3d) 762, (Ont Sup Ct) [*Lougheed*].
[13] *Ibid* at para 14.
[14] *Ibid* at para 15.
[15] 2013 MBQB 168, 295 Man R (2d) 168 [*Money Mart*].
[16] *Ibid* at para 66.
[17] CCSM c C280. In Ontario the court could invoke similar authority under section 106 of the *Courts of Justice* Act, RSO 1990, c C43.
[18] 2010 NSSC 278, 294 NSR (2d) 42 at para 282.

The experience under the Ontario mandatory mediation regime suggests that forcing unwilling parties to mediate may have some value. Particularly when they know the alternative to a negotiated agreement is a costly arbitration or litigation. Furthermore, under a long term commercial lease, the parties may be more inclined to participate in "forced mediation" in order to preserve or improve the landlord – tenant relationship which must continue after the dispute is resolved.

TEN STEPS OF A COMMERCIAL LEASE ARBITRATION

STEP 1: Identify the dispute between the Landlord and the Tenant.

STEP 2: Does your commercial lease have an arbitration clause?

- What does the arbitration clause say?
- Does the dispute fall within the arbitration clause contained in the lease?
- If there is no arbitration clause or the dispute does not fall within the arbitration clause, the parties are still at liberty to agree to arbitrate a particular dispute.

STEP 3: To start the arbitration follow the procedure set out in the arbitration provision. Where no procedure is specified, a party may serve a notice of arbitration which identifies the dispute and proposes two or more arbitrators for the other party to choose from.

STEP 4: Appoint an arbitrator or arbitral panel (if more than one arbitrator).

- Does the arbitration clause in the Lease provide a procedure for appointing the arbitrator?
- Does the arbitration clause contemplate a single arbitrator or a panel of arbitrators?
- Where the agreement does not specify the number of arbitrators, the *Act* provides that the arbitral tribunal shall be composed of one arbitrator.[19]
- Where the agreement does not provide a procedure for appointment of the arbitral tribunal, and the parties cannot agree on the arbitrator, then either party may apply to the court to make the appointment.[20]

[19] *Supra* note 2, s 9.
[20] *Ibid* s 10.

STEP 5: Once appointed, the arbitrator will hold a preliminary procedural hearing, which can be by telephone conference, to discuss the following issues:

- the arbitration agreement;
- a timetable for the arbitration;
- the procedure to be used at the arbitration;
- the location of the arbitration hearing and hearing date;
- the exchange of pleadings – arbitration claim and response;
- the exchange of documentary evidence;
- whether there will be examinations for discovery;
- a list of witnesses and exchange of witness statements;
- whether any experts will give evidence at the arbitration and exchange of expert reports;
- agreed on statement of fact for use of hearing;
- exchange of legal briefs or facta;

STEP 6: The claimant serves an Arbitration Submission setting out its claim; the respondent serves its Reply Submission.

STEP 7: The parties prepare for the arbitration in accordance with procedural order by exchanging documentary evidence, expert reports, witness statements, etc.

STEP 8: The arbitration hearing takes place, depending on the parties' agreement, the hearing may be formal or informal.

STEP 9: The arbitrator makes his or her "award". The award is usually long and detailed since the arbitrator must give the reasons on which the award is based. The arbitrator generally describes the evidence presented by each party and provides detailed reasons for reaching his or her decision. The Award may or may not include an award for costs.

STEP 10: A party may appeal the award within 30 days. Once the appeal period has expired, a party may apply to court for a judgment enforcing the award.

WHEN TO ARBITRATE AND WHEN TO LITIGATE

Arbitration works best when the parties are motivated to resolve their dispute quickly. Whether the parties disagree about market rents, operating costs, or any other term of the lease, arbitration can resolve the dispute expeditiously and with minimal disruption to the parties' ongoing relationship.

Arbitration allows the parties to select their decision maker. The parties can select an arbitrator knowledgeable in their industry, thereby avoiding the risk that their dispute comes before a judge with expertise in criminal or family law, but little experience in commercial leasing.

Arbitration is well suited for dealing with specialized issues under a commercial lease while the lease is ongoing, such as:

- determination of rent on renewal, or
- inclusions and exclusions from operating costs.

While arbitration is still available after the lease has ended, many of the advantages of arbitration (such as: keeping the dispute private, having an arbitrator who has expertise in the area of the dispute, and an efficient resolution of a dispute which preserves the relationship) are less compelling. Once the lease term has expired the parties are less willing to co-operate, or even participate, in an alternative dispute resolution process. Where the parties turn to the court to resolve disagreements relating to the conduct of the arbitration, the intended advantages of arbitration may be lost. Under these circumstances, the dispute can become as protracted and costly as any piece of litigation.

WHAT TO LOOK FOR IN AN ARBITRATOR & MEDIATOR

One of the chief benefits of selecting an alternative method of dispute resolution is that the parties can select the adjudicator or mediator. When a matter goes to court, the judge is selected by the court administrator. The parties must surrender to the absolute authority of the judge or master regarding the outcome of the case. Where the parties elect to arbitrate or mediate, they empower themselves to select a neutral third party to serve the adjudicative or facilitative role.

Selecting an Arbitrator: Unlike mediation, the outcome of arbitration is binding. When the parties agree to arbitrate they are agreeing that a neutral third party will impose a solution. It is therefore essential that the parties select an arbitrator whose decision they are willing to accept. The parties must trust that the arbitrator has an understanding of the commercial context underlying the conflict. Experience in the industry is a characteristic the parties often seek in an arbitrator. Since the arbitration award is binding, the parties must be confident that the arbitrator will make a fair and commercially reasonable decision.

Selecting a Mediator: A good mediator facilities negotiation. An arbitrator is a decision maker; a mediator is a catalyst to a mutually acceptable solution. The qualities the parties seek in a mediator may be different than those they seek in an arbitrator. Expertise in the industry may be viewed as less important than being a great mediator. Strong mediation skills and knowledge of the industry would be ideal.

Facilitative and Evaluative Mediation: Broadly speaking there are two styles of mediation: evaluative mediation and facilitative mediation. Evaluative mediators assess the relative merits of each parties' claim and attempt to lead them to what the mediator considers a fair and realistic result. The parties are more likely to accept the gradual nudging to a middle ground if they trust the meditator's assessment of what will likely occur should the matter proceed to trial. Evaluative mediation can be successful if the mediator has a strong reputation in the industry and the parties respect the mediator's assessment of their chances of success at trial.

Facilitative mediators do not focus on the outcome of potential litigation. Rather, a facilitative mediator focuses on the goals and needs of the parties; understanding why the parties take the positions they do and encouraging resolutions which satisfy the parties' interests. While an evaluative mediator tries to lead the parties to the mediator's assessment of what is fair, a facilitative mediator tries to lead the parties to what the parties think is fair. By shifting the discussion away from the disputants' respective positions, and focusing on underlying interests, a good mediator is able to assist in uncovering solutions which sufficiently satisfy both sides. Facilitative mediators rely more on their mediation skills as opposed to their knowledge of the industry.

Know your BATNA: Most mediators use a combination of facilitative and evaluative techniques during a mediation. However, one of the key elements to a successful mediation is for the

parties to have a clear understanding what their alternative is if the mediation fails to resolve the dispute. This is sometimes called your BATNA – your Best Alternative to a Negotiated Agreement. Understanding your BATNA is a key requirement before you proceed with a mediation. The parties need to understand the costs of not settling, including potential legal fees. Armed with this knowledge the parties begin to clearly see the benefits of a mediated settlement.

CONCLUSION

Arbitration and mediation can be powerful tools to resolve commercial disputes quickly and efficiently. The role of these processes continues to grow as they prove to be effective mechanisms of dispute resolution. Importantly, these processes tend to be less antagonistic than traditional litigation, and thereby increase the likelihood of continued dealings between the parties post-resolution. The preservation of business relationships is essential in commercial leasing, as landlords and tenants have often made commitments under the lease for many years to come. Agreeing to resolve disputes through arbitration or mediation gives the parties a better chance of preserving their relationship.