LONDON
GROWTH HUB

Arbitration of Landlord and Tenant Disputes

Introduction

Many leases contain "Arbitration" clauses. This means that in certain circumstances, if the landlord and tenant have a dispute, that dispute is referred to a third party – an "arbitrator". The arbitrator then makes a decision (called an "award") that is binding on both parties. The idea is for certain types of dispute to be kept out of the Court process, and dealt with not just a more informal way, but by someone who has expertise in relevant matters. It is still a legal process and it has rules to be followed. It is binding on the parties (unlike mediation). An arbitrator's decision ("award") can be enforced through the Courts.

In this guide we will explain:

- What is arbitration?
- The procedures for arbitration
- The benefits and downsides of arbitration
- What to do if the landlord refuses to go to arbitration?
- The financial costs involved in arbitration

What is Arbitration?

Arbitration is used either when (a) the lease says it must be used or (b) when the parties agree to use it. Arbitration is commonly used in leases for:

- Rent reviews
- Clauses relating the rent suspension or reduction: these usually apply where a property has suffered accidental damage from fire or water, and cannot be used for a period of time
- Some service charge disputes
- If the landlord and tenant agree, they can deal with lease renewals by appointing an arbitrator. This is called "PACT" (Professional Arbitration on Court Terms)

The most common use of arbitration clauses in leases by far is to deal with rent reviews. This How To Guide will therefore concentrate on rent reviews. First of all we will explain how arbitration works generally.

Arbitration procedures:

An arbitrator is a person who is qualified to act as an arbitrator by the Chartered Institute of Arbitrators. They will have the letters "CIArb" after their name.

The arbitrator, once they are appointed, has powers under the Arbitration Act 1996. These powers include:

- The power to set out the procedure for dealing with the dispute (eg when and how the parties will put forward their evidence)
- The power to make a decision in the case (which is called making an "award"). This power to make an award includes the power to make a decision on who pays the costs of the arbitration

- The award is as binding at law on the parties as if it was a Court's decision. So if either the landlord or the tenant refuses to do what the arbitrator has decided in the award, (for example, to pay a sum of money) then the other party can get a Court to enforce the award

- Arbitrations are confidential between the parties and are usually dealt with much more quickly than in Court

Who can be an arbitrator?

People with many different areas of expertise act as arbitrators. In landlord and tenant disputes the most relevant area of expertise is obviously property. A surveyor who is qualified as an arbitrator is therefore usually appointed. The professional body for surveyors is the RICS (Royal Institution of Chartered Surveyors).

How do you Appoint an Arbitrator?

When a dispute is going to be dealt with by arbitration, the parties must choose (or "appoint") an arbitrator. The lease should specify how this is to be done. Sometimes the parties are free to choose whatever arbitrator they want, by agreement. Depending on the lease, either the landlord, or the tenant, or both, will have the right to apply to appoint an arbitrator.

Normally the arbitrator is appointed by 'applying' to a professional body who will choose a qualified arbitrator to act in the dispute. The majority of leases therefore specify that the arbitrator is someone appointed (which simply means chosen) by the President of the RICS. All that 'applying' for an 'appointment' means in practice is that one of the parties fills in a form and sends a payment for the fee to the RICS. The President then appoints an arbitrator, who will get in touch with the parties and start the arbitration process.

Sometimes the lease will specify a different professional body (for example the Institute of Civil Engineers, or "ICE") who will appoint the arbitrator. It will depend on what the dispute is about, and what the lease says.

Rent Review Arbitration Procedure: Notices

A rent review is a clause in a lease contract where, after a certain period of time, the landlord can adjust the rent. In most but not all leases this is every three years, and in most but not all leases the 'adjustment' is 'upwards only'. The procedure for doing this, and the way the rent is to be decided, is set out in the lease. Rent reviews are about finding a value. They are therefore much better suited to having an experienced valuer decide them that to be decided by a judge – who is not an experienced valuer, as that is not their job.

Not all rent review clauses are the same. But most rent review clauses work like this. The landlord sends a written notice proposing a new rent. The tenant will usually need to respond to that within a specified time with a written counter-notice. If the tenant misses the deadline then the new rent is fixed at whatever was in the landlord's notice. In that case there will be no arbitration, but the tenant will lose by default.

Assuming the tenant serves a counter-notice in time, then the parties will have to see if they can reach an agreement. If there is no agreement, the rent review will have to be decided by arbitration.

Rent Review Arbitration Procedure: The Arbitration Itself

An arbitrator in a rent review is normally a surveyor. The arbitrator will set out a timetable for the parties to present their evidence and arguments, usually in writing. The arbitrator will consider both sides' cases and decide what the new rent should be. To decide what the new rent will be, the arbitrator will look at two things:

- The assumptions and disregards in the lease,

  and

- Comparable evidence

The lease will set out a formula for how the rent is to be valued. For example, the property is usually valued as if it was in good repair (whether it is or not!). This will favour the landlord. Other assumptions or disregards may favour the tenant. For example, if the tenant has carried out lawful improvements, those are usually disregarded (otherwise the tenant is paying twice). So that will favour the tenant.

Comparable evidence is the evidence used in rent reviews. In a rent review the arbitrator will look at prices for a similar property in the market and compare it to your lease. It is up to the landlord or tenant (or their advisors) to get this evidence. No one should expect the other party or the arbitrator to do it for them. Comparable evidence should be:

- Comprehensive – lots of rentals should be considered, not just one or two
- As similar as possible to the property being valued
- Recent
- Arms' length open market transactions
- Verified
- Consistent with local market practice

The Award

Whatever the arbitration is about, once the arbitrator has considered all of the evidence, they will make their award. The award is not usually released until all of the arbitrator's fees are paid! Incidentally, when parties sign up to an arbitration, they will become "joint and severally liable" for the arbitrator's fees. That means that if one party goes bust or defaults, the other party has to pay all of the fees.

What if I don't like the Award?

Unlike a Court, there is no "appeal" from the arbitrators' award. It is usually final! There are some very limited procedural grounds to challenge an award, but the Courts very rarely intervene.

Who pays the costs after the Arbitration?

Unless the parties make a deal, the arbitrator will decide which party pays the costs. Usually it is the loser who pays the arbitrators' fees AND the other party's costs!

If you have made offers to settle the dispute in writing, then the arbitrator may take these into account when deciding who pays the costs.

Although you should think carefully about making offers, and this is encouraged, it is still up to the arbitrator what they do about it – there are no hard and fast rules.

What to do if the landlord won't go down the arbitration route

If the lease doesn't say anything about arbitration, the parties can agree to appoint an arbitrator to settle a dispute – but nobody can be forced to in that situation. In most leases, though, the lease will determine who has the power to appoint an arbitrator, when, and how.

If the lease allows either party to start the process, then if the landlord won't go down the arbitration route, the tenant simply starts the appointment process. In processes that favour the tenant (ie arguing for a rent suspension after fire or water damage) the lease will usually give the tenant that option.

Conversely, if only the landlord has the option to start the process under the lease, then the tenant won't be able to force them to. In practice, this is unlikely to favour the landlord: if the landlord wants a new higher rent fixed, for example, they will have to start the process. Otherwise the tenant can simply enjoy the lower rent!

Benefits and Downsides of Arbitration

You will have seen some of the benefits and downsides of arbitration as we have gone through the procedures. These can be summarised as:

Benefits:

- Arbitration should be quick, much quicker than going through the Courts
- The parties have some flexibility about who the arbitrator is and what the timetable should be
- Arbitration should give you an expert decision, rather than a decision made by a judge who is an expert in law rather than property or valuation
- Arbitration is confidential, which may or may not be an advantage!
- An arbitrators' award is final to all intents and purposes so you should have a final decision, quickly

Downsides:

- Arbitration can be expensive and you may end up having to pay all of the arbitrators' fees if the other side defaults
- The arbitrator has a lot of leeway so even if you make good offers to settle on costs you may not get the benefit
- It tends to be much easier for landlords to get hold of market evidence in rent reviews than tenants
- If the decision is a bad one there isn't much that the parties can do about it!

What are the financial costs involved in taking the arbitration route?

Arbitrations can be expensive. Arbitrators fees alone can be charged at several hundred pounds an hour plus VAT. An arbitration, if it goes all the way to an award, would normally cost several thousand pounds or more. The parties will also have their own representatives' costs to pay.

Surveyors and solicitors are not allowed to charge a percentage of the rent increase (or decrease), and they are also not allowed to act on any kind of 'no win no fee' agreement in rent review arbitrations.

On the other hand, you have to consider the costs and benefits of arbitration. A rent increase of £20,000 a year over five years, for example, is £100,000. (Plus the increase in business rates that will follow). If you spent £20,000 on fees to prevent the increase, you would still be £80,000 or more better off over five years.

It is highly recommended that you use professional advisors (surveyors and/or solicitors, as appropriate) to represent you in any arbitration.

Further support

The London Growth Hub has published this series of 'how-to' guides to help commercial tenants understand their legal responsibilities. This flowchart will help you identify the most relevant 'how-to' guides for your business

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