



FFIEC  
Program Coordinator  
3501 Fairfax Drive, Room 3086  
Arlington, VA 22226

Re: FIL-41-2005 Proposed External Audit Engagement Letter Advisory

Dear Program Coordinator:

The National Arbitration Forum (NAF) is one of the world's leading providers of alternative dispute resolution (ADR) services, including arbitration and mediation. We represent a distinguished panel of over 1,500 experienced attorneys located in all 50 states and 29 foreign countries. We appreciate this opportunity to respond to the Council's request for public comment on the proposed Interagency Advisory pertaining to liability limiting provisions in external auditing engagement letters.

**Summary of NAF's Comments:**

At the outset, we submit that the proposed Advisory fundamentally mischaracterizes contractual arbitration and ADR. The Advisory warns financial institutions that, by agreeing to contractual ADR, they "waive the right to full discovery, limit appellate review, and limit or waive other rights and protections available in ordinary litigation proceedings." However, ADR is not a mechanism by which parties limit their potential liability. The specification of an ADR forum to resolve auditor-client disputes is independent from and unrelated to the inclusion of terms that limit auditor liability.

The Advisory's explicit warning about the impact of limitation of liability provisions on auditor objectivity, impartiality, and performance is a valuable one. However, we encourage the Council to refine and focus this Advisory to specifically target limitation of liability provisions while remaining favorable or neutral towards the selection by financial institutions and their external auditors of an ADR forum in which to resolve their disputes. In short, please do not throw the baby out with the bath water.

Our comments respond to ten specific issues raised in the proposed Advisory regarding the use of arbitration and ADR:

1. Arbitration and ADR provide parties with their full legal rights, remedies, claims, and defenses and do not restrict liability or damages.
2. Contractual arbitration is the preferred way many businesses and individuals chose and use to resolve their legal disputes.

3. Arbitration and ADR methods provide disputing parties with fair, affordable, and accessible ways to resolve problems.
4. The use of arbitration and ADR methods instead of litigation and court procedures saves parties substantial time and money.
5. ADR and arbitration procedures help parties maintain relationships and significantly reduce their anxiety and concerns.
6. Arbitration and ADR provide parties to a dispute with the right and opportunity to exchange information and seek and obtain discovery.
7. Arbitration awards issued by neutral, expert arbitrators are reviewable by judges who make sure both the process and award are fair and enforceable.
8. The arbitration process and applicable procedural rules preserve due process protections for all parties and provide parties with the same legal rights and remedies that litigation provides.
9. Overall, the use of arbitration and ADR promotes our societal goals of fair, affordable, and ready access to civil justice for all.
10. Arbitration and ADR are an integral part of our judicial dispute resolution system, and arbitrators and judges work together to provide the very best civil justice system in the world.

**1. Arbitration and ADR provide parties with their full legal rights, remedies, claims, and defenses and do not restrict liability or damages.**

Instead of limiting liability, the arbitration rules governing proceedings conducted by the major arbitration organizations explicitly allow any claim or remedy that would be permitted in a court of law. For example, NAF Code of Procedure Rule 1(B) provides that “[p]arties may agree to submit any matter, including any Claim for legal or equitable relief, to arbitration unless prohibited by applicable law.” Likewise, parties in NAF arbitrations do not forfeit statute of limitations protections because the rules neither “extend nor shorten statutes of limitation or time limits agreed to by the Parties.” While some parties may knowingly and voluntarily agree to some liability limitations that are enforceable, arbitration does not encourage parties to restrict rights or limit recoverable damages in any way.

**2. Contractual arbitration is the preferred way many businesses and individuals chose and use to resolve their legal disputes.**

Contrary to the cautionary tone the proposed Advisory adopts toward contractual ADR, the use of techniques such as binding arbitration is increasingly endorsed not only by businesses in all sectors of the American economy, but also by the overwhelming majority of state and federal courts. See Advanced Dispute Resolution Institute for updated ADR case law summaries ([www.adrinstitute.com](http://www.adrinstitute.com)). Recent polls conducted by the American Bar Association, Ernst & Young, and the U.S. Chamber of Commerce confirm that arbitration participants—even parties who did not prevail in the arbitration—report satisfaction with the fairness, speed, and cost of the process. See [www.instituteforlegalreform.com/resources/](http://www.instituteforlegalreform.com/resources/)

ArbitrationStudyFinal.pdf (U.S. Chamber study), [http://www.ey.com/global/download.nsf/US/Outcomes\\_of\\_Arbitration/\\$file/OutcomesofArbitrationAnEmpiricalStudy.pdf](http://www.ey.com/global/download.nsf/US/Outcomes_of_Arbitration/$file/OutcomesofArbitrationAnEmpiricalStudy.pdf) (Ernst & Young study).

Financial institutions such as those targeted by this Advisory are comfortable with ADR because they already use it with their customers, employees, suppliers, service providers, and in a variety of other business transactions. The American Bankers Association (ABA), the American Financial Services Association (AFSA), and the Consumer Bankers Association (CBA) all recommend contractual arbitration to their members. These organizations recognize that arbitration allows banks to “avoid the time, expense and headache of litigation which is to the advantage of lenders and consumers alike.” ABA Banking Journal (July, 2000) (quoting Michael Crotty, ABA deputy general counsel for litigation). The FDIC itself “has long been and continues to be a strong advocate for the use of various forms of Alternative Dispute Resolution.” *Statement of Policy Regarding Binding Arbitration*, 66 FR 18632 (March 26, 2001).

The proposed Advisory relies on interpretations of SEC auditor independence rules to support its conclusion that it is inadvisable to contractually limit auditor liability. However, through its oversight of the arbitration programs operated by self-regulating organizations, such as the NASD and NYSE, the SEC has clearly signaled its approval of contractual arbitration to resolve disputes between brokerage institutions and their customers and employees. The SEC understands that liability limitations and ADR are unrelated concepts and sensibly denounces the former while endorsing the latter. We encourage the FFIEC to do the same.

Federal law and policy also soundly favors enforcing agreements to arbitration disputes. The Federal Arbitration Act, 9 U.S.C. Sections 1-16, outlines the rights of the parties to an agreement to arbitrate and guarantees that the process will be conducted fairly. The federal and state judiciaries are nearly uniform in holding that arbitration agreements should not be viewed with suspicion. Courts see contractual arbitration as a process worthy of resolving all types of disputes, even those that involve important statutory or public policy issues: “We are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternate means of dispute resolution.” Mitsubishi Motors Corp. v. Sole Chrysler-Plymouth, Inc., 473 U.S. 614, 616 (1985).

### **3. Arbitration and ADR methods provide disputing parties with fair, affordable, and accessible ways to resolve problems.**

Arbitration between financial institutions and auditors should be encouraged for many reasons, some of which are cited in the Advisory. Arbitration saves money for both parties in the form of litigation expenses and attorney’s fees and saves substantial time through the use of efficient procedures and the bypassing of overcrowded court calendars. Arbitration also provides access to well-qualified, expert arbitrators who issue prompt decisions based upon the legal merits.

**4. The use of arbitration and ADR methods instead of litigation and court procedures saves parties substantial time and money.**

As a rule of thumb, the total cost of an arbitration procedure amounts to only 25% of the cost of bringing the same action to court. Considering the delay inherent in litigation and the increasing costs of attorneys' fees and other costs, this figure illustrates why parties choose arbitration over litigation. The National Arbitration Forum is committed to establishing reasonable fees that will not deter parties from bringing or defending claims. Principle 6 of the NAF Arbitration Bill of Rights provides that "[t]he cost of an arbitration should be proportionate to the claim and reasonable within the means of the parties, as required by applicable law."

A recent survey of corporate counsel comparing arbitration to traditional adjudication confirms that the efficiency and cost savings are real. 78% of surveyed in-house counsel reported that arbitration led to a faster recovery than did traditional adjudication. 59.3% indicated that arbitration was less expensive. Finally, these efficiencies did not detract from party satisfaction with the fairness of arbitration: 83% found arbitration equally or more fair than traditional adjudication. See Michael T. Burr, *The Truth About ADR*, Corporate Legal Times (February, 2004).

**5. ADR and arbitration procedures help parties maintain relationships and significantly reduce their anxiety and concerns.**

Saving time and money are by no means the only reasons that parties elect an ADR forum to resolve future disputes that may arise. Businesses recognize that litigation can engender contentiousness and hostility that can sever valued, existing commercial relationships. In contrast, Arbitration and ADR allow for dispute resolution in a more constructive atmosphere that avoids the "trench warfare" mentality of protracted litigation. According to the United States Supreme Court, arbitration "normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties." Allied-Bruce Terminix Co. v. Dobson, 513 U.S. 265, 280 (1995) (quoting H.R. Rep. No 97-542, p. 13 (1982)). To the extent that parties see value in preserving productive relationships, arbitration and ADR are clearly preferable to litigation.

**6. Arbitration and ADR provide parties to a dispute with the right and opportunity to exchange information and seek and obtain discovery.**

Parties require information in order to assert their claims, but expansive and often abusive pretrial litigation is substantially responsible for the unwarranted duration and expense of civil litigation. Arbitration rules introduce an appropriate and measured compromise: discovery is available when (and to the extent) the information sought is relevant, the cost of production is commensurate with the value of the claim, and production is reasonable and not unduly burdensome. See NAF Rule 29. The NAF strives to ensure that parties receive adequate information. Principle 11 of the NAF Arbitration Bill of Rights states "parties should have access to the information they need to make a reasonable presentation of their case." Parties

clearly benefit from these relevancy and reasonableness limitations because they prevent abuses while allowing discovery that is appropriate within the context of the asserted claims.

It is important to note that the “right” to “full” discovery exists neither in our litigation system, nor in our arbitration and ADR system. The rules of civil procedure and court decisions permit parties to engage in reasonable discovery, and judges have substantial discretion by rule and precedent to reasonably limit and restrict discovery. Reasonable discovery is also available in arbitration and ADR. Specifically, parties in NAF arbitrations have access to the same discovery procedures they would have in litigation: depositions, interrogatories, document production, admission requests, and physical examinations. See NAF Rule 29(b)(2)-(3). Electing arbitration does not result in the waiver or forfeiture of important rights in terms of discovery and access to relevant information.

**7. Arbitration awards issued by neutral, expert arbitrations are reviewable by judges who make sure both the process and award are fair and enforceable.**

A major reason why parties choose arbitration is because it offers an “appeal” process that is reasonable and affordable. It is not nearly as lengthy and expensive as civil appeals are in litigation. Judges can review arbitration proceedings and awards to determine if the decisions comply with the law and if the rights of the parties have been maintained.

Full *de novo* review of findings of fact and legal conclusions necessitates a full second hearing and completely eliminates the benefits of choosing an arbitration forum in the first place. However, parties are free to agree to permit any degree of appellate review they deem appropriate. NAF Rule 20 requires arbitrators to “follow the applicable substantive law.” This means that, unless otherwise agreed, NAF arbitration awards are subject to appellate review as to the selection and application of the relevant law. Far from resulting in the forfeiture of an important right, this is an appropriate compromise that provides efficient dispute resolution while allowing meaningful and appropriate judicial review.

**8. The arbitration process and applicable procedural rules preserve due process protections for all parties and provide parties with the same legal rights and remedies that litigation provides.**

The proposed Advisory states that arbitration involves limitation or waiver of “other rights and protections available in ordinary litigation.” This contention is belied by the frequency with which sophisticated business entities select arbitration as the forum in which to resolve both complex and mundane commercial disputes. It is also important to note that state and federal courts have nearly uniformly determined that arbitration proceedings as conducted by the major arbitration organizations 1) are neutral and procedurally fair to all parties involved, 2) are efficient, 3) provide access to all substantive legal rights and remedies, and 4) involve reasonable fees:

- Green Tree Financial v. Randolph, 531 U.S. 79 (2000) (“[O]ther national arbitration organizations (Example: The National Arbitration Forum) have developed similar models for fair cost and fee allocation.”),
- Johnson v. West Suburban Bank, 225 F.3d 355 (3rd Cir. 2000) ([the NAF Rules] “authorize[] arbitrators to ‘grant any remedy or relief allowed by applicable substantive law and based on a Claim, Response, or Request properly submitted by a Party under this Code.’”),
- In re Currency Conversion Fee Antitrust Litigation, 265 F.Supp.2d 385 (S.D.N.Y. 2003) (“[P]laintiffs are in no worse a position under the NAF code than they would be in federal court.”),
- Lloyd v. MBNA Bank, 2001 WL 194300 (D. Del., Feb 22, 2001) (There is “no persuasive evidence that the National Arbitration Forum is anything but neutral and efficient.”).

Financial institutions should be aware of the realities of arbitration before agreeing to arbitration. However, those realities are not unpleasant and should not be actively avoided. Both financial institutions and their outside auditors are sophisticated parties with legal representation and it is inappropriate for the FFIEC to issue cautionary ADR warnings as if the parties possessed radically unequal bargaining power. Rather, the Council should encourage financial institutions to embrace the benefits of fair, efficient, and inexpensive dispute resolution in which all of the parties’ substantive rights and remedies are preserved.

**9. Overall, the use of arbitration and ADR promotes our societal goals of fair, affordable, and ready access to civil justice for all.**

Although our judicial system has numerous virtues, providing affordable resolution to smaller claims and providing efficient resolution of civil commercial disputes are not among them. For many types of disputes, individuals are advised to not even bother consulting an attorney unless the potential recovery is over \$20,000. In employment disputes and in some other areas, the minimum practicable claim amount may exceed \$60,000 in some locations. Arbitration and ADR provides mechanisms through which individual claimants can seek redress for smaller claims, with or without retaining an attorney to represent them. For these individual customers and employees, ADR likely represents their only opportunity to get their dispute resolved by an expert and neutral decision-maker within a context where they are provided with a fair and reasonable opportunity to present their claims.

Even sophisticated commercial entities may find that a judicial dispute resolution forum is not reasonably available. Dramatic recent increases in criminal, domestic relations, and juvenile caseloads in many jurisdictions mean that civil cases in some locations must wait years for resolution. Lengthy delays and contentious proceedings lead to concerns that attorney fees and other costs outstrip the recovery received by the prevailing litigant. The current state of the legal system cries out for the availability of a more efficient alternative. Parties find that alternative in arbitration and other varieties of ADR.

**10. Arbitration and ADR are an integral part of our judicial dispute resolution system, and arbitrators and judges work together to provide the very best civil justice system in the world.**

Arbitration and ADR are increasing in popularity due to the expense, delay, inefficiencies, invasiveness, and contentiousness associated with litigating matters in court. When parties have the foresight to specify a different forum in which resolve any disputes that arise between them, they most often choose contractual arbitration or some other ADR method. In this way, arbitration can be viewed as a complement to judicial dispute resolution and as an integral part of the civil justice system in the United States. Disputes occurring between parties who have not agreed to ADR can properly be heard in a court of law. However, where parties have specified a different forum, that forum choice should be respected. Where sophisticated business entities—each represented by counsel—agree to take disputes to arbitration, the Council should respect the parties' informed desire to avoid the negative consequences of litigation.

The laws of the United States make possible a myriad of non-judicial dispute resolution options and provide methods by which ADR-derived decisions can be legally enforced. Increasingly, parties are recognizing the advantage of selecting ADR and courts consistently approve the results. The FFIEC should not discourage financial institutions from opting for arbitration and ADR. Instead, the Council is better advised to encourage financial institutions to take advantage of the particular dispute resolution forum that is most advantageous under the institution's particular circumstances.

In conclusion, the National Arbitration Forum lauds the Council for its message that liability-limiting provisions in external auditor engagement letters inhibit auditor independence and performance. However, we believe that the proposed Advisory's references to ADR muddle this key message and unfairly impugn the legitimate practice of contractual arbitration. We urge the Council to revise this proposed Advisory to encourage the appropriate use of ADR between financial institutions and external auditors or, at the very least, eliminate mention of ADR in an Advisory properly focused on liability limits.

Sincerely,



Curtis D. Brown  
General Counsel  
National Arbitration Forum  
6465 Wayzata Blvd., Suite 500  
Minneapolis, MN 55426  
952-516-6400, ext. 6434  
cbrown@arb-forum.com  
www.arbitration-forum.com