

AMERICAN BAR ASSOCIATION
SECTION OF DISPUTE RESOLUTION
ARBITRATION COMMITTEE
740 15th Street, NW
Washington DC 20005-1022

June 8, 2005

FFIEC, Program Coordinator
3501 Fairfax Drive, Room 3086
Arlington VA 22226
And via Fax to 703-516-5487

Re: Request for Comment, Interagency Advisory on the Unsafe and Unsound Use of
Limitation of Liability Provisions and Certain Alternative Dispute Resolution Provisions
in External Audit Engagement Letters

Dear Madam or Sir:

These comments are presented on behalf of the Arbitration Committee of the Section of Dispute Resolution of the American Bar Association. The Section encompasses some nine thousand attorneys, judges, academics and others concerned with mediation and other dispute resolution processes as well as arbitration. The Arbitration Committee includes domestic and international arbitrators, users of the arbitration process and others concerned with its use and development. The Committee is charged by the Section of Dispute Resolution with responsibility for matters within its purview relating to arbitration. Time constraints have precluded review of these Comments by any entity other than the Committee, and they therefore do not reflect any expression of policy by the American Bar Association or its Section of Dispute Resolution.

We address only that portion of the Advisory titled "Alternative Dispute Resolution Agreements and Jury Trial Waivers", appearing at page 7 of the Comment Draft.

As a general proposition, we agree that a pre-dispute agreement for arbitration or other dispute resolution should not unfairly "tilt the playing field" in favor of either party, and that in the context presented here limitations on liability, types of damages or remedies should be disfavored. However, we urge strongly that thoughtfully crafted and objectively fair pre-dispute provisions for alternative dispute resolution be part of any agreement by a financial institution for external auditor services. The Advisory fails to recognize the opportunities for constructive draftsmanship of such provisions and the substantial benefits that can be derived from properly crafted instruments.

We are constrained to observe that there is a long history of alternative dispute resolution in both the institutional financing industry and the auditing profession. This history includes mediation and other processes designed to effect expeditious, inexpensive, non-

coercive agreed-upon settlements. Banks, particularly, have pioneered in the use of ADR in both consumer agreements and in documentation of sophisticated financial transactions. Bank counsel have substantial expertise in drafting dispute resolution provisions that meet the needs of the parties to their agreements.

Accountants' external audit engagement letters frequently include in their alternative dispute resolution clauses a step procedure which calls for negotiation at the executive level as a first step, followed by mediation if negotiation is unsuccessful, and then by arbitration if the dispute cannot be mediated successfully. As you know, mediation is itself a structured negotiation during which a neutral, the mediator, attempts to facilitate an agreement. Either initial process, executive negotiation or mediation, if successful, is faster and less costly than arbitration or litigation. The Advisory, which focuses on arbitration, should also mention the advantages of these initial processes. The ABA Section of Dispute Resolution has long recognized the importance of mediation and has a parallel committee to this one, called the Mediation Committee.

Various dispute resolution processes, as alternatives or supplements to court-based litigation, have become widely established in virtually every jurisdiction. They are supported by the courts, federal and state agencies and local governments as well as the business community. Court-based mediation is mandated in many, and perhaps in a majority of court systems.

Arbitration in particular directly addresses the dispute resolution needs of financial institutions and their external auditors. It provides a decision-making neutral who has been selected by or is acceptable to the parties and who has the sophistication, training and experience required to understand and adjudicate disputes arising out of complex financial relationships. In our experience, financial institutions and accountants will not ordinarily submit disputes to lay juries unless compelled to do so for the simple reason that juries are ill-qualified to deal with the issues presented. Additionally, a well-run arbitration can very substantially expedite the final resolution of disputes, with concomitant substantial cost savings in fee and executive time and attention.

Arbitration is a creature of contract. Arbitration provisions can be – and regularly are – drafted to meet the objections advanced in the Advisory. For example, they may provide for full discovery comparable to that available in federal courts, lesser specified types of discovery, or for such discovery as the arbitrator may allow. Absent specific agreement most statutes and institutional rules allow full document discovery and limited discovery depositions appropriate to the case. Discovery limitations may or may not be tactically advantageous to the financial institution, depending on the relationship of the parties. The availability of discovery or limitations thereon reflecting the needs of the parties is properly the subject of negotiation. By entering into pre-dispute arbitration agreements parties are by no means “effectively waiving the right to full discovery.” The statement to that effect in the Advisory is not correct.

Parties to an agreement to arbitrate ordinarily waive full appellate judicial review. This is a trade-off inherent in the process. Appellate review of court decisions is rare but when it

happens it is often exceedingly protracted. It may prevent full resolution of a dispute for several years beyond trial, when finality is important.

Some jurisdictions have upheld private agreements for full judicial review of arbitral awards, including appellate review. Other jurisdictions have not. A measure of judicial review can be achieved by provisions requiring the arbitrator to follow the law of a designated jurisdiction and to submit a reasoned award. Trial and appellate review of legal issues may then be had if and to the extent that the arbitrator has exceeded his or her authority. Some arbitral tribunals, such as American Arbitration Association and CPR Institute, provide facilities for review by appellate arbitrators of awards upon agreement of the parties.

Arbitration agreements can also be drafted to provide for application of judicial rules of evidence.

Except for the matters discussed, we are unaware of any "other rights and protections available in ordinary litigation proceedings" that parties lose by invoking ADR and question the accuracy of this general statement in the Advisory.

We are particularly troubled by the statement in the Advisory that "by waiving a jury trial, the financial institution may effectively limit the amount it may receive in any settlement of its case." We recognize that in the real world financial institutions – and auditors as well – may weigh the risk of a "runaway jury verdict" in negotiating a settlement. We do not believe that the Council intends to inferentially encourage institutional attorneys to use the threat of exposure to such juries as a lever to coerce more favorable settlements.

We are aware that frequently little attention is paid to arbitration and other dispute resolution provisions in commercial and professional agreements and feel that the Council is to be commended for focusing institutional attention on the need to review such provisions with appropriate care. We are grateful for this opportunity to comment on the proposed advisory.

For the Committee:

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