



CPR Institute for Dispute Resolution

*Setting the ADR Agenda
for the 21st Century*

June 9, 2005

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

Re: 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 Sir or Madam:

We write with respect to the Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions and Certain Alternative Dispute Resolution Provisions in External Audit Engagement Letters (the "Advisory") issued for comment by the Federal Financial Institutions Examination Council ("FFIEC") on or about May 10, 2005. We respectfully ask that our comments be considered by FFIEC.

ABOUT THE CPR INSTITUTE

Since its founding in 1979 as the Center for Public Resources, the CPR Institute for Dispute Resolution has played a leading role in promoting the use of appropriate methods of managing conflict among businesses and their counsel. With the active support of a broad-based coalition of corporate counsel, senior attorneys, prominent members of the judiciary and outstanding scholars, the Institute convenes annual conferences and hosts committees addressing the spectrum of approaches to conflict. It produces and publishes information in a variety of formats, and facilitates resolution of conflicts. It provides dispute resolution services, including Panels of Distinguished Neutrals, dispute resolution procedures calling for minimal administration, and neutral selection services. Representatives of more than 4,000 companies and subsidiaries signed some form of the Institute's Commitments to resolve disputes out of court. Although the Institute's emphasis is on business-related conflict, its initiatives have included important public policy efforts supporting the efforts of courts, administrative agencies, and other institutions in the U.S. and many other countries. Effective this month, the CPR Institute will be known as the International Institute for Conflict Prevention and Resolution.

CPR Institute for
Dispute Resolution
366 Madison Avenue
New York, NY 10017
Tel (212) 949-6490
Fax (212) 949-8859
www.cpradr.org

I am President & CEO of the CPR Institute, and was formerly the William L. Matthews Professor of Law at the University of Kentucky College of Law. I have been a scholar, teacher, author and speaker on conflict resolution subjects; an experienced mediator and facilitator, and a participant in major national and international policy initiatives on ADR for more than two decades. I am the co-author of *Federal Arbitration Law*, a leading five-volume treatise on the law of arbitration and a new textbook on conflict resolution for law and business schools, as well as many articles on arbitration and other conflict resolution topics. Prior to coming to CPR, I chaired the CPR Institute's 50-member Commission on the Future of Arbitration, which produced a lengthy set of guidelines for users of arbitration, *Commercial Arbitration at Its Best* (ABA 2001) [hereafter *CPR/ABA Commercial Arbitration Guidelines*]. I chaired or advised initiatives aimed at drafting or revising many of the major standards for negotiation, mediation and arbitration, including the Uniform Arbitration Act and other statutes, leading business and consumer rules and protocols, and ethical standards in the U.S. and Europe. I have also been involved in legal reform efforts or conducted educational or mediation training programs in the United States, Russia, Ukraine, Argentina, China, and the EU.

THE ADVISORY

We thank you for the opportunity to provide comment on the Advisory. We take no position with respect to the views and recommendations offered therein and we offer comment only on that portion of the Advisory which addresses alternative dispute resolution, or "ADR." In fact, the FFIEC may wish to issue two separate advisories in recognition of the fact that the issues addressed therein are discreet, and confusion may result from treating them in a single advisory.

ADR Encompasses a Spectrum of Processes, Not Just Arbitration

First and foremost, we wish to point out that alternative dispute resolution, or "ADR," encompasses a wide range of dispute resolution processes including negotiation, mediation, non-binding evaluative processes, and non-binding and binding arbitration. (Only the last appears to be the intended subject of the FFIEC Advisory.) Our conversations with arbitrators and mediators indicate that the processes they have encountered in contractual arrangements between financial institutions and their auditors include a similar range of processes, and not just binding arbitration. Indeed, many contracts we have seen call for stepped processes that begin with negotiation, mediation and finally either litigation or mandatory arbitration. See e.g., *Drafter's Deskbook: Dispute Resolution Clauses* (CPR Institute 2002). FFIEC may wish to clarify its intention (as we perceive it) to make no recommendations in the Advisory as to negotiated dispute resolution, mediation and other non-binding forms of ADR.

It is axiomatic that arbitration, whether binding or not, is a creature of contract. It is inherent in the contractual nature of arbitration that parties are free to agree to whatever specific

procedural provisions as they deem appropriate. See generally *CPR/ABA Commercial Arbitration Guidelines* at 6. This presumes two parties that have comparable ability to negotiate their agreement.

There are of course contracts of adhesion, typically involving parties of unequal bargaining power and sophistication, as to which courts and legislatures have expressed concerns. See Comments to Revised Uniform Arbitration Act at 23 (2000) (examples of unequal bargaining power can exist in employer-employee, sellers-consumers, banks-customers, and health maintenance organizations-patients); see e.g., *Ingle v. Circuit City Stores, Inc.*, No. 04-55927 (9th Cir. May 18, 2005). Our premise is that the contracts between financial institutions and their auditors to which the Advisory refers are not such contracts of adhesion but are negotiated contracts.

Arbitration, and ADR Generally, is Supported by Supreme Court Decisions and other Government Decrees

The Federal Government and Congress have long been supporters of ADR, and specifically binding arbitration, in the realm of private contract. The Federal Arbitration Act ("FAA") embodies that support. See *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1983) (The FAA embodies a Congressional policy in favor of the strict enforcement of arbitration clauses in commercial contracts; there is a presumption in favor of arbitrability.) The Administrative Dispute Resolution Act ("ADRA"), explicitly authorizes arbitration for federal agencies. 5 U.S.C. § 575(c)(1). Moreover, Congress has approved numerous treaties that provide for the resolution of trans-border disputes, including financial disputes by ADR. See, e.g., NAFTA, ICSID Convention, and various Bilateral Investment Treaties.

The judiciary, too, has indicated its support for commercial ADR. U.S. Supreme Court precedent has unequivocally held that pre-dispute arbitration agreements should not be viewed with suspicion, but rather seen as fostering the use of a process that is worthy of resolving all types of disputes, including important statutory and 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 alternative means of dispute resolution." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 34 (1991) (quoting *Mitsubishi Motors Corp. v. Sole Chrysler-Plymouth, Inc.*, 473 U.S. 614, 616 (1985)).

Indeed, the arbitral forum has been deemed to be fully acceptable to resolve important statutory claims involving securities issues, employment issues and other important public policy matters. See, e.g., *Alexander v. Garner-Denver*, 415 U.S. 36 (1974) (Title VII); *Mitsubishi Motors Corp. v. Sole Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (antitrust); *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987) (Securities Exchange Act of 1934 and Racketeer Influenced and Corrupt Organizations Act (RICO)); *Rodriguez de Quijas v.*

Shearson/American Express, Inc., 490 U.S. 477 (1989) (Securities Act of 1933); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 21 (1991) (Age Discrimination in Employment Act (ADEA)).

The Supreme Court has made clear that it believes that judicial review of arbitral decisions will protect mandatory constitutional and statutory rights. See *Shearson/Am. Express Inc. v. McMahon*, 482 U.S. 220, 232 (1987) ("[A]lthough judicial scrutiny of arbitration awards necessarily is limited, such review is sufficient to ensure that arbitrators comply with the requirements of the statute.").

That various governmental branches support arbitration and other forms of ADR is not surprising, as commercial disputants have likewise underscored the value of ADR in planning their businesses:

"It is critical to address the management of potential conflict as a part of contract planning and negotiation. Such issues need to be considered prior to the emergence of disputes; otherwise, decisions regarding conflict resolution are likely to be hampered by a lack of cooperation between the parties. In the absence of an agreement regarding conflict resolution options, disputes will probably end up in court. Given the amount of time and money that businesses spend resolving conflicts, they should carefully consider such issues in contract planning."

CPR/ABA Commercial Arbitration Guidelines at 6.

FDIC, a constituent member of FFIEC, "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), and recognizes that the "[p]otential benefits of arbitration are its greater flexibility, potential for limited discovery and streamlined hearing process, use of panels of trained and subject-area expert arbitrators, and restricted judicial review rights." *Id.* (emphasis supplied). In the *Statement of Policy*, FDIC gives examples of where arbitration is appropriate, including complex commercial/business transactions, securities and securitization. *Id.* at 18633.

The Concerns Addressed in the Advisory

It is in this context of broad support and promotion of commercial ADR, and specifically of binding arbitration, that we offer our comments on concerns in the Advisory.

1. Waiver of the right to full discovery

The Advisory states "By agreeing in advance to submit disputes to mandatory ADR, the financial institution is effectively agreeing to waive the right to full discovery..." While it is conceivable that parties to an arbitration agreement may agree to limit the scope and type of discovery, the fact is that today it would be a rare commercial arbitration that involves no

discovery, and parties are free to incorporate procedures for information exchange and discovery akin to those available in state or federal courts. An agreement to arbitrate does not amount to a waiver of the right to discovery—that is a decision for the parties to make in the particular instance.

Thus, while some parties in order to save time and cost by agreement limit the scope of discovery in their agreements, for example, others expressly provide that their arbitration shall be governed by the Federal Rules of Civil Procedure. See *J. Barist, Commercial Arbitration Law and Clauses* (Prentice Hall 1994) at EX-12 (providing various samples of clauses with respect to discovery in arbitration.) Sophisticated parties routinely weigh the value of unlimited discovery vs. the benefit of a more expedited procedure.

2. Limit of Appellate Review

The Advisory also states that by agreeing to submit disputes to arbitration, parties are agreeing to limited appellate review. It is true that the FAA and most state arbitration statutes provide for limited review of arbitration awards. In a few jurisdictions, however, the parties may agree to an expanded judicial review of their award. This is the case, for example, in the Third, Fourth and Fifth Circuits. See, e.g. *Roadway Package Sys. v. Kayser*, 257 F.3d 287, 292-93 (3d Cir. 2000), cert. denied 534 U.S. 1020 (2001); *Syncor Int'l Corp. v. McLeland*, No. 96-2261, 1997 Lexis 21248 (4th Cir. 1997); and *Hughes Training, Inc. v. Cook*, 254 F.3d 588, 590 (5th Cir. 2001), cert. denied, 122 S. Ct. 1196 (2002). New Jersey also provides by statute that the parties may so agree. See NJSA 2A:23B-4.

Parties may also contractually agree to review by an appellate arbitral panel. CPR provides such a procedure (the "CPR Arbitration Appeal Procedure") for parties wishing to avail themselves of it. The CPR Arbitration Appeal Procedure may be invoked whether or not the original arbitration was conducted under CPR Rules. The neutrals who hear the matter are all former judges. See www.cpradr.org. The deliberations of the CPR Commission on the Future of Arbitration, which published the *CPR/ABA Commercial Arbitration Guidelines*, referred to above, led to the development of the Appeal Procedure, with the advice of Commission members.

3. Remedies and Results in Commercial Arbitration

It appears that a central concern of the authors of the Advisory is the potential forfeiture of judicial remedies by arbitrating parties—and the related concern that claimants may recover significantly less in arbitration than in court. We question, however, whether these concerns are borne out by all of the evidence.

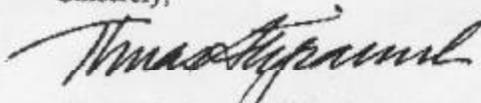
First of all, it is important to note that it is generally understood that under broad-form arbitration clauses, arbitrators may award punitive or exemplary damages as well as compensatory damages. I. Macneil, et al, *Federal Arbitration Law* §36 (1994) (We do not address the separate issue, which is not an arbitration-related issue, about whether parties may prospectively waive the right to claim punitive damages.)

Second, although we are aware of no reputable empirical studies comparing arbitration awards with court awards in the commercial sphere, recent scholarship relating to employment awards does not support the concerns of the Advisory. Professor Theodore Eisenberg of Cornell Law School recently co-authored a study comparing a randomly selected sample of AAA arbitrated employment cases with state court trial outcomes reported by the Civil Trial Court Network. The authors found no statistically significant difference in median or mean awards in trial and arbitration. Moreover, the evidence indicated that the median and mean times to resolution were much shorter in arbitration. T. Eisenberg & E. Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 Disp. Resol. J. 44, 49-51 (2004).

* * *

We hope that these comments are of use to you in formulating your final advisory. Should you wish any further information about the comments herein, please do not hesitate to contact me.

Sincerely,



Thomas J. Stipanowich
President and CEO