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FFIEC Program Coordinator
3501 Fairfax Drive
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Arlington, VA 22226

Re: **Proposed interagency advisory on Unsafe and Unsound use of Limitation of Liability and Certain (Pre-dispute) Alternative Dispute Resolution Provisions in External Audit Engagement Letters**

Ladies and Gentlemen:

I am writing to provide comments concerning the proposed interagency advisory on Unsafe and Unsound use of Limitation of Liability and Certain (Pre-dispute) Alternative Dispute Resolution Provisions in External Audit Engagement Letters.

I am an attorney admitted to practice before the courts of the State of New York, the United States Court of Appeals for the Second Circuit, the United States District Court for the Southern District of New York and the United States Tax Court. In addition, I am a member of the Commercial Roster of the American Arbitration Association and the National Arbitration Forum. I am also a member of the Committee on Arbitration of the Dispute Resolution Section of the American Bar Association.

I am submitting these comments on my own behalf and do not represent any person or entity in connection with these submissions.

My comments are limited to one issue raised in the request for comment:

Are Pre-dispute Alternative Dispute Resolution (“ADR”) Agreements and Jury Trial Waivers in External Audit Engagement Letters Unsafe and Unsound Practices?

Summary

ADR provisions in external engagement audit engagement letters are not unsafe and not unsound. The rules¹ of all the major ADR facilitators are flexible permitting parties to make contractual provision for whatever procedures they want to govern. Through careful drafting of the ADR agreement, concerns about limitations under the rules can easily be overcome. Because the rules of the major facilitators vary, when selection is made of the forum for dispute resolution, it is incumbent upon the draftsman to carefully review and compare the rules.

Pre-dispute Alternative Dispute Resolution (“ADR”) Agreements and Jury Trial Waivers in External Audit Engagement Letters are not Unsafe and Unsound Practices

The text of the proposal indicates concern that pre-dispute mandatory ADR agreements present safety and soundness concerns because there is a waiver of full rights to discovery, appellate review and “other rights and protections available in ordinary litigation proceedings.” (Proposal, page 7)

These are needless concerns. There is nothing in the arbitration process that prohibits parties from contracting for whatever procedures and safe guards they deem appropriate. The rules of the four major ADR facilitators² provide the parties to an ADR agreement with the flexibility to modify the applicable rules to meet the concerns and needs of the parties³, provided that when doing so the parties do not adopt a regime that otherwise

¹ Unless otherwise indicated, rules cited are those applicable to either general arbitration and/or commercial arbitration. The American Arbitration Association (“AAA”) has a separate set of rules for arbitrations involving professional accounting. Where applicable, these comments will compare those rules to the rules of the AAA for commercial arbitration.

² AAA; Institute for Dispute Resolution (“CPR”), Judicial Arbitration and Mediations Services (“JAMS”); and National Arbitration Forum (“NAF”)

³ Rule R1 (a) of the Commercial Rules of the AAA provides:” ... The parties, by written agreement, may vary the procedures set forth in these rules. After appointment of the arbitrator, such modifications may be made only with the consent of the arbitrator.” Rule 1 of Professional Accounting Rules merely states that the parties may, by written agreement, vary the procedures set forth in the rules.

Rule 1.1 of CPR provides: “Where the parties to a contract have provided for arbitration under the CPR Institute for Dispute Resolution (“CPR”) Rules for Non-Administered Arbitration (the “Rules”), or have provided for CPR arbitration without further specification, they shall be deemed to have made these Rules a part of their arbitration agreement, except to the extent that they have agreed in writing, or on the record during the course of the arbitral proceeding, to modify these Rules. Unless the parties otherwise agree, these Rules, and any amendment thereof adopted by CPR, shall apply in the form in effect at the time the arbitration is commenced.”

JAMS Rule 2 provides: “The Parties may agree on any procedures not specified herein or in lieu of these Rules that are consistent with the applicable law and JAMS policies (including, without limitation, Rules 15(i), 30 and 31). The Parties shall promptly notify JAMS of any such Party-agreed procedures and shall confirm such procedures in writing. The Party-agreed procedures shall be enforceable as if contained in these Rules. “Parties may modify or supplement these rules as permitted by law. Provisions of this Code govern arbitrations involving an appeal or a review de novo of an arbitration by other Arbitrators.”

violates federal or state laws applicable to arbitration. This commitment to flexibility has been universally recognized by the courts. For example, one court observed:

Indeed, short of authorizing trial by battle or ordeal or, more doubtfully, by a panel of three monkeys, parties can stipulate to whatever procedures they want to govern the arbitration of their disputes; parties are as free to specify idiosyncratic terms of arbitration as they are to specify any other terms in their contract.⁴

Moreover, the rules themselves are far broader in scope than is generally understood.

Consider the following rules applicable to discovery and appeals.

A. Discovery

The discovery rules of the four major facilitators of arbitration fall into two broad categories: rules that are relatively non-specific and rules that are comprehensive.

The discovery rules of the AAA and CPR are for the most part non-specific. The AAA commercial rules⁵ focus on the exchange of documents and do not mention discovery by way of depositions or interrogatories. The AAA Professional Accounting rules permit discovery in the discretion of the arbitrator but are silent as to what types of discovery the arbitrator can order.⁶ The CPR rules⁷ give the arbitrator discretion to order discovery

⁴ Baravati v. Josephthal, Lyons & Ross, Inc., 28 F 3d 704, 709 (7th Cir 1994) Cf. Rashid v. Schenck Construction Co., 190 W. Va. 363, 438 S.E.2d 543, 547 (W. Va. 1993); Perini Corp. v. Greate Bay Hotel & Casino, Inc., 129 N.J. 479, 610 A.2d 364, 369 (N.J. 1992), overruled on other grounds in Tretina Printing, Inc. v. Fitzpatrick & Associates, Inc., 135 N.J. 349, 640 A.2d 788 (N.J. 1994); Astoria Medical Group v. Health Ins. Plan, 11 N.Y.2d 128, 182 N.E.2d 85, 87, 227 N.Y.S.2d 401 (N.Y. 1962)

⁵ Rule 21 provides:

a) At the request of any party or at the discretion of the arbitrator, consistent with the expedited nature of arbitration, the arbitrator may direct i) the production of documents and other information, and ii) the identification of any witnesses to be called.

(b) At least five business days prior to the hearing, the parties shall exchange copies of all exhibits they intend to submit at the hearing.

(c) The arbitrator is authorized to resolve any disputes concerning the exchange of information.

⁶ Rule 10 provides in part:

At the request of any party or at the discretion of the arbitrator or the AAA, a preliminary hearing with the parties and/or their representatives and the arbitrator may be scheduled by the arbitrator to specify the issues to be resolved, to stipulate to uncontested facts and to consider any other matters that will expedite the arbitration proceedings. Consistent with the expedited nature of arbitration, the arbitrator may, at the preliminary hearing, establish (i) whether discovery is required and, if so, the extent of production of relevant documents and other information, (ii) the identification of witnesses to be called, and (iii) a schedule for further hearings to resolve the dispute. Any information or material exchanged during the course of discovery, or the arbitration, shall be confidential unless

beyond the exchange of documents “taking into account the needs of the parties and the desirability of making discovery expeditious and cost-effective.”⁸

JAMS⁹ and NAF¹⁰ have rules that are quite detailed. Both schemes impose the requirement that parties must co-operate and act in good faith. But the details of discovery differ.

the parties specifically agree otherwise. With the consent of the parties, the AAA at any stage of the proceeding may arrange a mediation conference under its mediation rules, in order to facilitate settlement. The selected mediator shall not be an arbitrator previously appointed to the case. Where the parties to a pending arbitration agree to mediate under the AAA's mediation rules, no additional administrative fee is required to initiate the mediation.

⁷ Rule 11 provides:

The Tribunal may require and facilitate such discovery as it shall determine is appropriate in the circumstances, taking into account the needs of the parties and the desirability of making discovery expeditious and cost-effective. The Tribunal may issue orders to protect the confidentiality of proprietary information, trade secrets and other sensitive information disclosed in discovery.

⁸ id

⁹ Rule 17 provides:

(a) The Parties shall cooperate in good faith in the voluntary, prompt and informal exchange of all non-privileged documents and other information relevant to the dispute or claim immediately after commencement of the Arbitration.

(b) The Parties shall complete an initial exchange of all relevant, non-privileged documents, including, without limitation, copies of all documents in their possession or control on which they rely in support of their positions, names of individuals whom they may call as witnesses at the Arbitration Hearing, and names of all experts who may be called to testify at the Arbitration Hearing, together with each expert's report that may be introduced at the Arbitration Hearing, within twenty-one (21) calendar days after all pleadings or notice of claims have been received. The Arbitrator may modify these obligations at the Preliminary Conference.

(c) Each Party may take one deposition of an opposing Party or of one individual under the control of the opposing Party. The Parties shall attempt to agree on the time, location and duration of the deposition, and if the Parties do not agree these issues shall be determined by the Arbitrator. The necessity of additional depositions shall be determined by the Arbitrator based upon the reasonable need for the requested information, the availability of other discovery options and the burdensomeness of the request on the opposing Parties and the witness.

(d) As they become aware of new documents or information, including experts who may be called upon to testify, all Parties continue to be obligated to provide relevant, non-privileged documents, to supplement their identification of witnesses and experts and to honor any informal agreements or understandings between the Parties regarding documents or information to be exchanged. Documents that have not been previously exchanged, or witnesses and experts not previously identified, may not be considered by the Arbitrator at the Hearing, unless agreed by the Parties or upon a showing of good cause.

(e) The Parties shall promptly notify JAMS when an unresolved dispute exists regarding discovery issues. JAMS shall arrange a conference with the Arbitrator, either by telephone or in person, and the Arbitrator shall decide the dispute. With the written consent of all Parties, and in accordance with an agreed written procedure, the Arbitrator may appoint a special master to assist in resolving a discovery dispute

¹⁰ Rule 29 provides:

- A. Cooperative Discovery. After a Response is filed, Parties shall cooperate in the exchange of Documents and information. A Party seeking discovery shall contact other Parties and discuss discovery information and any objections and arrange for the exchange of Documents and information.
- B. Seeking Discovery.
 - 1. If the Parties are unable to resolve discovery matters under Rule 29A, a Party may seek the disclosure of Documents, sworn answers to not more than twenty-five (25) Written questions, or one or more depositions before a Hearing where:
 - a. The information sought is relevant to a Claim or Response, reliable, and informative to the Arbitrator;
 - b. The cost is commensurate with the amount of the Claim; and
 - c. The production of the information sought is reasonable and not unduly burdensome and expensive.
 - 2. The Party seeking discovery shall Deliver to all other Parties a Notice identifying the Documents to be produced, Written questions to be answered, or the Notice of deposition identifying the deponent, the proposed length of time for the deposition, and the scope of the deposition, no later than thirty (30) days before the date of a Participatory Hearing or for a Document Hearing ten (10) days from the date of the Notice of selection of an Arbitrator.
 - 3. A Party may seek other discovery, including Requests for admissions and Requests for physical or mental examinations, before a Hearing, where:
 - a. The information sought is relevant to a Claim or Response, reliable, and essential to a fair hearing of the matter;
 - b. The cost is commensurate with the amount of the Claim; and
 - c. The production of the information is reasonable and not unduly burdensome or expensive.
 - 4. The Party seeking discovery shall Deliver to all other Parties a copy of the Notice identifying the discovery sought no later than thirty (30) days before the date of a Participatory Hearing or for a Document Hearing ten (10) days from the date of the Notice of the Selection of an Arbitrator.
- C. Responding to Discovery. A Party Receiving a Notice shall Deliver to the Requesting Party:
 - 1. Within five (5) days after Receipt of the Notice of a deposition, a Written reply agreeing to the deposition or objecting to the deposition, including an explanation of the objections.
 - 2. Within twenty (20) days of the Receipt of the Notice for other discovery, a copy of the Documents Requested or a statement permitting an examination of the original Documents or property at a convenient time and place, sworn answers to the Written questions, or a Written agreement to provide other Requested discovery, or a Written objection explaining why all or some of the Documents, property or other discovery has not been provided.
- D. Request for Discovery. If a Party objects in accord with this Rule, the Requesting Party may file with the Forum and Deliver to all Parties, no later than the Scheduling Notice deadline or ten (10) days after Receiving the objection:
 - 1. A Rule 18 Request for a Discovery Order;
 - 2. A copy of the Written objections; and
 - 3. A Written statement of reasons why the Requesting Party needs the discovery.
- E. Decision. An Arbitrator shall promptly determine whether sufficient reason exists for the discovery and issue an Order.
- F. Consequences. An Arbitrator may draw an unfavorable, adverse inference or presumption from the failure of a Party to provide discovery. An Arbitrator may impose Sanctions and

The JAMS rules oblige the parties to exchange documents and witness lists and give all parties the right to discovery by deposition. The arbitrator is given broad discretion to order discovery and resolve disputes and in certain circumstances can appoint a special master to supervise discovery.¹¹

The NAF rules are the most elaborate. Parties have the right to demand answers to no more than 25 written questions *or* to a deposition.¹² Parties have the right to demand Requests of Admission and physical and mental examinations. Disputes about discovery are to be resolved by the arbitrator and the arbitrator is permitted to draw a negative inference from the failure of a party to cooperate with the discovery process and further, the arbitrator has the authority to impose sanctions, costs and fees.¹³

But all of the facilitators will accommodate contractual terms providing for discovery rules that modify, supplement and replace the published rules. As was noted above, because of the variations in the rules of these four facilitators it is important for the draftsman of any ADR agreement to familiarize himself or herself with all the applicable rules. The full right to discovery can easily be provided for when necessary. This would appear to be especially important if the parties agree to arbitration administered by either the AAA or CPR.

B. Appeals

Appellate procedure in arbitration is misunderstood. There is a misconception that an arbitrator's award must be final and subject to review only through the statutory mechanism of *vacatur*. In reality a number of mechanisms exist to insure an appeal if one is desired. Contractual provisions can be structured to provide an "internal" appeal and in some jurisdictions the courts respond favorably to contractual designations of jurisdiction for the review of issues of law raised during an arbitration proceeding.

1. Internal Appeals

The rules of three of the four major facilitators provide in some manner for an "internal" appeal, i.e., an appeal to a panel of one or more arbitrators. Parties wishing an appellate review can simply include reference in the ADR agreement to the rules of these facilitators. CRP¹⁴ and JAMS¹⁵ have formal rules detailing virtually all aspects of the

costs and fees related to seeking or resisting discovery under Rule 29, including reasonable attorney fees, Arbitrator fees, and administrative fees against the non-prevailing Party.

¹¹ *Supra* note 9

¹² Rule 29 B 1, *supra* note 10

¹³ Rule 29 B 3 and F, *supra* note 10

¹⁴ CPR Arbitration Appeal Procedure available at http://www.cpradr.org/arb_appeal_procedure.

¹⁵ JAMS Optional Arbitration Appeal Procedure available at <http://www.jamsadr.com/rules/optional>.

appeals process. NAF has no rule specifying the details for an appeal but the concept of an “internal” appeal is recognized.¹⁶ While the commercial rules and the special rules applicable to disputes involving accountants of the AAA are silent as to “internal” appeals, the current policy of the AAA is to recognize and administer ADR agreements that call for an “internal” appeal provided that the clause sets out in detail what the parties want in the way of procedures for the appeal.

Within the context of an “internal” appeal there is an issue of major significance that should be addressed by the draftsman of any ADR clause calling for an “internal” appeal. It is important to that parties agree in advance as to scope of the appeal, i.e., will to appeal be limited to issues of law or will the appeal be *de novo*? If the appeal is limited to issues of law the parties must require that the arbitrator hearing the claim must issue a reasoned decision. If the appeal is to be *de novo*, the parties will require a record of the proceedings as well as a reasoned decision by the arbitrator. This issue has significant implications concerning the overall cost of the arbitration process.

2. Appeals to the judiciary

Recently there have been attempts to contractually grant jurisdiction to the courts for the review of issues of law addressed during the arbitration process itself. These efforts have not been well received by either the federal courts¹⁷ or those state courts¹⁸ that have considered the question. Still, there have been some favorable decisions.¹⁹ The US Supreme Court has yet to resolve the issue at the federal level. For the moment it seems that pursuing this approach is chancy and unpredictable. However, in those jurisdictions where it has been approved, it is an option available to the draftsman of any ADR agreement.

Conclusion

ADR is neither an unsafe nor an unsound practice. No court has ever held that ADR is unsafe or unsound. Indeed, all courts from the US Supreme Court down recognize ADR as a useful and important tool for the resolution of disputes. The rights of any of the

¹⁶ Rule 1 (D): “Parties may modify or supplement these rules as permitted by law. Provisions of this Code govern arbitrations involving an appeal de novo of an arbitration by other Arbitrators.”

¹⁷ The Seventh, Eighth and Tenth Circuits have refused. Chicago Typographical Union No. 16 v. Chicago Sun-Times, Incorporated, 935 F.2d 1501,1505 (7th Cir 1991); UHC Management Company, Inc. v. Computer Sciences Corporation et al, 148 F. 3d 992 (8th Cir 1998); Bowen v. Amoco Pipeline Company, 54 F. 3d 925 (10th Cir 2001)

¹⁸ *compare* Crowell v. Downey Community Hospital Foundation, 95 Cal. App. 4th 730 (2nd Dist. 2002) (interpreting the California Arbitration Act); Dick v. Dick, 534 N.W. 2d 185 (Mich. Ct App. 1994) (interpreting Michigan arbitration statute); Chicago, Southshore and South Bend Railroad v. Northern Indiana Commuter Transportation Dept., 682 N.E. 2d 156 (Ill App 3d 1997) *rev'd other grounds* 184 Ill 151 (1998) (interpreting Illinois Arbitration Act) with Primerica Financial Services, Inc. v. Wise, 217 Ga. App. 36 (1995) (interpreting the F.A.A.)

¹⁹ The Fourth, Fifth and Ninth Circuits are prepared to recognize such contracts. Syncor Int'l Corp. v. McLeland, 120 F 3d 262 (4th Cir 1997); Gateway Technologies, Inc. v. MCI Telecommunications Corp., 64 F. 3d 993 (5th Cir 1995); Lapine Technology Corporation v. Kyocera Corporation et al, 130 F. 3d 884 (9th Cir 1997); New England Utilities v. Hydro-Quebec, 10 F. Supp 2d 53 (D. Mass 1998).

members of this Council can be easily and appropriately preserved as a part of any agreement providing for ADR. In addition to preserving rights such as discovery and appeal, any agency accepting ADR will enjoy the benefits normally associated with non-judicial resolution of a dispute such as reduced cost, a speedy determination and confidentiality. Any and all concerns about the rules governing arbitration can easily be resolved through a carefully drafted ADR agreement.

For the reasons above stated, I submit that it is not an unsafe or unsound practice to include an ADR provision in an external audit engagement letter.

Respectfully submitted,

Paul Bennett Marrow

June 8, 2005

Ladies and Gentlemen:

On June 6, 2005 I filed comments pertaining to the FFIEC Intgeragency request for comment. I have subsequently discovered a mistake and I would like to correct the record. Footnote 19 should read:

"19 The Fourth and Fifth Circuits are prepared to recognize such contracts. Syncor Int'l Corp v. McLeland, 120 F 3d 262 (4th Cir 1997); Gateway Technologies, Inc. v. MCI Telecommunications Corp., 64 F 3d 993 (5th Cir 1995); New England Utilities v. Hydro-Quebec, 10 F Supp 2d 53 (D.Mass 1998)."

The substance of my comments remains the same.

Please attach this email to my original submission.

Thank you.

Respectfully submitted,

Paul Bennett Marrow

