



American Arbitration Association  
*Dispute Resolution Services Worldwide*

*President's*

*President's Letter*

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#### OUR SHARED MISSION

The American Arbitration Association is dedicated to the development and widespread use of prompt, effective, and economical methods of dispute resolution. As a not-for-profit organization, our mission is one of service and education.

We are committed to providing exceptional neutrals, proficient case management, dedicated personnel, advanced education and training, and innovative process knowledge to meet the conflict management and dispute resolution needs of the public now and in the future.

#### OUR SHARED VISION

The American Arbitration Association will be the global leader in conflict management – built on integrity, committed to innovation, and embracing the highest standards of client service achievable in every undertaking.

#### OUR SHARED COMMITMENT TO DIVERSITY

The American Arbitration Association is the global leader in conflict management with core values of integrity and service. Our integrity demands impartial and fair treatment of all people with whom we come in contact, regardless of gender, race, ethnicity, age, religion, sexual orientation, or other characterization. Our conflict management services put into practice our goal for the resolution of disputes between parties with different perspectives, experiences, and backgrounds.

Because of the breadth of the Association's work and the global reach of its services, we recognize the importance and contribution of a diverse work force, a diverse Roster of Neutrals, a diverse Board, and commit to respect and increase diversity in all our endeavors.



American Arbitration Association  
*Dispute Resolution Services Worldwide*

## 2004 PRESIDENT'S LETTER

In the last quarter of 2004, the American Arbitration Association (AAA) began an extended celebration of a milestone event, the 80th anniversary of the Federal Arbitration Act – groundbreaking legislation that shaped modern arbitration and dramatically affected how international and domestic commerce is conducted.

It is fitting that we play a principal role in marking the passage of the Federal Arbitration Act (FAA). For eight decades we have been instrumental in helping chart the development of conflict management and the responsible use of arbitration for courts, attorneys, arbitral institutions, and business organizations and unions – an influence that has extended far beyond the borders of this country.

And that work continues. The past year was marked by important developments in both our domestic and international service platform, as we continued a broad program of service enhancement and expansion. Specifically, we point to heightened activity in five areas: the implementation of our strategic plan, the continued expansion of the AAA's international operations, our rapidly growing election administration services, the continued enhancement of online services, and areas in which specific growth initiatives have been undertaken.

### THE FAA 80TH ANNIVERSARY TRIBUTE AND CELEBRATION

The FAA, enacted in 1925 and signed into law by President Coolidge, is landmark legislation that became the cornerstone of modern arbitration, ensuring the validity and enforceability of arbitration agreements. Because of the FAA's enduring importance to the field of conflict resolution, more than two years ago we made a commitment to play a leadership role in the 80th anniversary commemoration of the act's passage.

The planning committee for the event included the Hon. Janet Reno and the Hon. William H. Webster as Co-Chairpersons, and the other members were James H. Carter, Esq., Edward V. Lahey Jr., Esq., John M. Townsend, Esq., and myself. The committee unanimously decided that the tribute should take the form of an anniversary lecture series that would examine the value and impact of the FAA from a number of different perspectives.

The first of the four lectures – “Why a Federal Arbitration Act? Modern Arbitration at Its Core” – was given in October 2004 by John D. Feerick, Professor at and former Dean of Fordham Law School, with opening remarks by New York State Chief Judge Judith Kaye.

The second – an address by Judge Webster, former Director of both the Central Intelligence Agency and the Federal Bureau of Investigation, examining the legislative durability of the act – was given in February 2005 at the historic National Archives building in Washington, D.C., where the original document is held.

In greetings sent to those gathered for the Washington celebration, President George W. Bush wrote, “One of our Nation's greatest strengths is its commitment to a just, fair legal system and the protection it affords to the rights and freedoms we cherish. Since 1925, the FAA has played a key role in dispute resolution within the U.S. legal system and has limited the need and cost of courtroom litigation. I commend members of the American Arbitration Association for promoting excellence in your profession. Your efforts strengthen our Nation and help ensure fair and equitable justice for all Americans.”

The final two 2005 events will be held in Dublin, Ireland in May and Chicago in October. In Dublin, Gabrielle Kaufmann-Kohler Esq., Professor at the University of Geneva, Partner at Schellenberg Wiltmer, and President of the Swiss Arbitration Association, will discuss the global implications of the FAA, focusing on the role of legislation in international arbitration. William B. Gould IV, Professor at Stanford Law School and former Chairman of the National Labor Relations Board, will examine the interrelationship between the FAA and modern labor arbitration in the October lecture.

A CRITICAL STEP FORWARD:  
IMPLEMENTING THE STRATEGIC BUSINESS ACTION PLAN

As we reported last year, in 2002 and 2003 the AAA – in keeping with its commitment to service improvement – took a reflective step back and conducted an intensive, in-depth research effort that examined what we do and how well we do it in the context of parties' current and future needs.

In 2003, working with the results gathered through detailed "day-in-the-life" interviews with selected users, the insights obtained through our initial Dispute-Wise<sup>SM</sup> Business Management study, and the results of broad-based mail surveys to more than 48,000 users of our services, we developed a comprehensive action plan for strengthening our services and their delivery. That plan, which stresses service quality, providing added value, and improving the customer's overall experience, is grounded in the principles of this organization's mission, vision, and values – a pledge to continue to be the leader in our field through a commitment to integrity and innovation, setting a service standard that exceeds user expectations.

In keeping with that plan, in late 2004 we began to introduce an enhanced and expanded level of services – AAA adr+ and AAA adr+ for Large Complex Cases (LCCs) – designed to help assist parties resolve disputes more efficiently and effectively across a wide range of industries. These value-rich services, which draw upon our extensive alternative dispute resolution (ADR) knowledge base and experience, offer parties the customized attention to detail they need, based on the size and scope of their cases.

During 2004 several enhanced service components were put in place or piloted, and others will be launched in 2005. Overall, we have adopted a "team concept" approach to case management. While a case manager acts as the primary point person, the ultimate responsibility for a case rests with the entire team, giving the parties confidence that their cases are being managed in the most effective way possible by a knowledgeable team of experts.

The AAA adr+ enhanced service package is extended to all users and, when completely rolled out, will have elements that establish a consistent case data input structure, simplify the case filing process, and provide assistance in scheduling the use of AAA facilities. In 2005, we will introduce two additional modules to the package – AAA Arbitration Roadmap<sup>SM</sup> and AAA ADR KnowledgeBank.

AAA Arbitration Roadmap will help guide parties from the pre-ADR stage forward, educating them about the options available to them and how best to manage the arbitration process and the costs involved, giving users a yardstick by which to measure expected time and costs. AAA ADR KnowledgeBank is an online, protected database system that captures leading ADR practices from parties to disputes, neutrals, attorneys, and leading "dispute-savvy" organizations. It offers parties historical information, actual case examples, and data analysis from AAA-administered cases – all of which may be used to help parties shape decisions about their own particular situations.

AAA adr+ for Large Complex Cases is a direct outgrowth of the AAA's years of experience with sizeable cases. In addition to offering parties all of the services just discussed, the AAA adr+ package also provides three highly innovative offerings tailored primarily for LCCs. The first is **AAA Enhanced Neutral Selection Process for LCCs**, introduced in 2004. A custom-tailored approach to choosing neutrals, it affords parties in LCCs more control over the arbitrator selection process. Expanded arbitrator resumes with in-depth information about qualifications and experience are available online, and, using enhanced screening options based on client-selected criteria, arbitrators can be pre-screened for availability and information about potential conflicts.

**Solutions Manager**<sup>SM</sup>, piloted in the fall of 2004, has been enthusiastically received. A supplement to the traditional case management function, a Solutions Manager serves to guide parties through a broad range of alternative – and often customized – options, helping them structure dispute resolution solutions that can be faster and less expensive than traditional choices. Lastly, in 2005, we are introducing **AAA Resolution Services**<sup>SM</sup>, a tool kit for the Solutions Managers consisting of a portfolio of non-binding processes – such as early neutral evaluation and mini-trials – that promote early dispute resolution.

#### “DISPUTE-WISE” RESEARCH: A FOLLOW-ON STUDY

You will recall that in 2003, we sponsored a study that examined the business conflict management practices of a diverse group of 254 companies in various industries. The study, entitled *Dispute-Wise<sup>SM</sup> Business Management: Improving Economic and Non-Economic Outcomes in Managing Business Conflicts*, found that companies exhibiting certain approaches to conflict management tended as a group to have stronger relationships with valued customers, suppliers, business partners and employees, lower legal department costs, and better utilization of legal resources.

This study aroused a great deal of interest in the legal community here and in Europe, and the AAA made more than 50 presentations of its findings to corporate counsel, law firms, and other interested parties during 2004. Because of continued strong interest in the clear positive correlation between “dispute-savvy” behavior and the measurable benefits accruing to its practitioners, we decided to conduct a follow-on study in 2004 that would take a more in-depth look at the practices of companies that fell within the “most dispute-savvy” category in the initial study.

The new research involved detailed interviews with in-house counsel representing a fairly broad spectrum of business, both by industry area and size. The objective was simply to learn more from these companies – what they do, how they do it, and why. We found that being dispute-savvy does not imply simplistic reliance on any single set of techniques, nor does it imply always avoiding litigation. It is not about being pushovers in disputes or simply pressing for lower outside law firm fees.

The cultural and attitudinal commonalities among the companies surveyed were striking. Their focus is on maximizing business performance, preserving relationships with customers, employees and suppliers, and preventing – or, at least, minimizing – disputes and their impact. They share important characteristics in their attitudes toward disputes and the processes they put in place to help prevent and handle disputes. Most importantly, specific patterns emerged as we analyzed the interview results. In all, nearly 400 distinct practices or approaches to the prevention and management of disputes were catalogued.

With this research as our starting point, we are in the process of developing an intensive hands-on workshop program designed for senior level in-house and outside counsel. The program will provide the tools and insights needed to introduce and implement Dispute-Wise Business Management practices into their organizations.

#### INTERNATIONAL: A VERY ACTIVE YEAR

There was increased activity across the board in the AAA's international operations in 2004. In its eighth year, the International Centre for Dispute Resolution® (ICDR), the international division of the AAA, once again administered more than 600 cases and remains the largest international provider of dispute resolution services.

Our Dublin office, opened in 2001 and the site of the AAA's 2005 annual meeting, continues to be the hub of our expansion and growth in Europe. The good news is that after four years on the ground there, it appears that we are no longer viewed as just another American tourist. There is a recognition that we are there to stay, and that recognition is coupled with a steadily increasing willingness among European businesses and within the European legal community to use ICDR services.

The increased use of our services is primarily the result of three factors. First, for the last four years, we have been reaching out aggressively to build brand awareness through educational programs targeted at the international business and ADR communities, primarily in Europe, the Middle East, and Latin America. In the past year, for example, we either sponsored or participated in educational programs in France, Spain, Ireland, Belgium, Italy, the Netherlands, and Germany. We also co-sponsored a major conference in Brazil, participated in a symposium in Egypt, were represented at a trade conference in the People's Republic of China, and hosted an important ICDR conference in New York on the investment outlook for Latin America and the use of cross-border arbitration and other ADR practices in that part of the world. These programs have helped make international ADR users and practitioners aware of our resources – which include a 500-member worldwide panel of neutrals – and of our reach.

Second, the fact that ICDR rules mirror the standards and enforceability established by the rules of the United Nations Commission on International Trade Law (UNCITRAL) has proved to be a very compelling reason for European businesses to write the ICDR into contracts involving business with companies in other nations around the world. In these situations, there is mutual comfort that, should a dispute arise, the rules and processes will be both familiar and enforceable and that the case management services will be of the highest quality.

Third, we are recognized as an authority on and a leader in the development of cross-border ADR practices. For the last four years, for example, we have served as a non-governmental organization (NGO) member of UNCITRAL, which is continuously examining issues surrounding ADR in the context of international trade law. In the past year, we were instrumental in helping forge an important compromise with respect to interim measures of relief when an *ex parte* hearing is sought.

At issue was whether relief similar to court-ordered injunctions could be made available in the arbitral process. The situation in which such relief is needed typically arises when one party to a dispute seeks, essentially, to freeze a situation to avoid damage – a ship arrest, for example, or a freezing of assets. Our three-nation NGO delegation proposed a 48-hour stay order – which has the same force of law as a court injunction – that would maintain the status quo until a hearing before an arbitrator could be held. This is an instance where arbitral practice is evolving, and we are proudly at the center of it.

In a similar vein, we are the only organization to both foster and require the ongoing training of neutrals. We do so on a domestic basis, and we do it internationally. In March and October, we sponsored major two-day neutrals conferences in San Antonio and Atlanta, featuring pre-conference training programs and a series of workshops that serve, in part, to fulfill the AAA's annual mandatory training requirements for neutrals. We also conducted offshore training sessions in Auckland, Brussels, and Dublin.

At the highly successful New Zealand symposium – held in connection with the International Bar Association's annual meeting – leading international ADR practitioners shared techniques and best practices with colleagues from around the world.

In another undertaking aimed at expanding the understanding and appreciation of cross-border arbitration and other forms of ADR, the international division in 2004 launched ICDR Young & International (Y&I), a networking group for ADR practitioners under the age of 40. At this writing, the group has more than 350 associates from 34 countries, and enthusiasm is running high. The goal of ICDR Y&I, which has already had two formal meetings in New York and one in Paris, is to provide educational resources to its members and to offer a forum where they can meet other young international ADR professionals, exchange ideas, and learn from both peers and more senior experts in the field.

In a very active year on the international front, two other topics merit discussion – our involvement in bilateral investment treaties and our expanding relationships in Latin America.

Bilateral investment treaties, in which private investors enter into a treaty with a nation state, are a relatively new area for us. Five years ago there were about 30 such agreements in the world, and today there are more than 3,000, involving mainly countries in Latin America and the Middle East. Somewhat controversial, bilateral treaties are not contracts, but they enjoy the legal force of a treaty. We will administer disputes that arise from these treaties through the ICDR and are in the process of developing supplemental rules with the assistance of our international advisory committee chaired by Board member Carolyn Lamm, along with an expert panel of neutrals.

Lastly, the agreements we entered into last year with the Inter-American Commercial Arbitration Commission (IACAC) and the Inter-American Bar Association (IABA) are providing an excellent bridge to Latin America and the development of relationships there. The cooperative agreement with the Inter-American Bar Association has a goal of promoting international commercial arbitration across the Western Hemisphere through educational conferences and other means. The IACAC agreement, in addition to promoting ADR in the Americas, calls for all IACAC cases to be administered at the ICDR's administrative offices in New York.

#### ELECTION SERVICES: AN AREA OF STRONG GROWTH

The AAA's election services – widely recognized for its use of state-of-the-art systems – continues its pattern of steady growth. In 2004, the AAA administered 241 elections for unions, associations, colleges, and corporations compared to 227 in 2003. These assignments involved the counting and verification of more than one million ballots, and revenues from election administration increased by 23% year-to-year.

In the past year, the AAA's vast experience in administering private elections has been tapped by a number of groups interested in improving the public election process. We testified in June before a subcommittee of the House of Representatives' Committee on Government Reform. The hearing topic was "The Science of Electronic Voting Machine Technology: Accuracy, Reliability and Security." In prepared remarks we stressed our conviction about the importance and value of a voter-verified paper trail when using "paperless" direct recording electronic voting systems, as well as the necessity for on-site machine testing and intensive poll worker training.

This past year we also began to make strides toward expanding our involvement in international elections. We interpreted for the media the United Nation's fact-finding report on holding elections in Iraq, and AAA experts briefed a number of other reporters and editorial boards nationwide prior to the Iraqi election on the mechanics of setting up and overseeing complicated international elections. In addition to discussions with the media, our representatives met with officials from the UN's Electoral Assistance Division to discuss the administration of international elections. We are also exploring involvement with the UN's Volunteer Division in Bonn, Germany, which coordinates and staffs international election field missions.

#### INNOVATION IN ADR: THE GROWING IMPACT OF TECHNOLOGY

Virtually every time we set out to develop a service enhancement, we ask ourselves whether emerging technology will play a role. More often than not, the answer is a resounding "yes." Our willingness to experiment with and invest in new technology over the last decade has literally changed the way in which we do business. To name just a few areas, we see its impact on the way we administer cases large and small, communicate with parties and neutrals, conduct training programs of every stripe, oversee elections, operate our New York Insurance Case Management Center, access our vast library of ADR information, and send billing statements to our clients.

The volume of cases filed online using AAA WebFile<sup>SM</sup>, our online framework for communications and case management, continued to grow in 2004. It increased about 37% over 2003 levels, and for the first time we are seeing international cases filed online – a total of 38 in 2004, some of them very large. Also in 2004, we began to make employment case awards available online for the first time.

The feedback we receive from AAA WebFile users continues to be very positive. They cite ease of use, the ability to track case progress online even when a case is filed offline, and the enhanced communications aspects of AAA WebFile. To date, more than 2,500 cases have been filed online. Similarly, neutrals are enthusiastic about both AAA WebFile and the newly introduced Neutrals' eCenter<sup>SM</sup>, which permits them to track, schedule, and communicate with parties online.

The online version of the Arbitrator Ethics and Disclosure training program continues to get good reviews. Those who have taken the online version like the flexibility, convenience, and cost-effectiveness of the web-based course, which takes about two and one-half hours to complete. All neutral training programs are available online to case managers, and more than 40 hours of online training programs are available to AAA staff.

We are also using online services to manage and check the status of Claims Programs. Typically, these cases involve large numbers of claims arising out of bankruptcies, manufacturers' warranty programs, and disputes between brokerage houses and insurance companies and their customers.

#### NEW GROWTH INITIATIVES IN A STILL DIFFICULT ECONOMIC ENVIRONMENT

Because significant segments of our business lag the economy, we have not yet felt the full impact of the economic recovery that is under way. Caseload year-to-year was down in 2004, with much of the decrease attributable to the loss of a large no-fault insurance client. On the good news side of the ledger, we were selected in a competitive bid process by the state of Minnesota through its Supreme Court to continue its no-fault arbitration administration, a role we have been fulfilling for more than 30 years.

Despite the decline in caseload, there was an increase in the average size of claims filed, strong revenues in our elections, banking, and international caseloads, as well as in our educational programs, and solid dividend and interest revenues and substantial market-to-market gains in our investment portfolio. It is important to note that we were able to build our surplus in a year when we continued to make sizeable investments in our infrastructure and technology-based services along with a substantial pro bono commitment.

What is especially heartening – in addition to solid performances from traditional businesses – is that we are seeing new sources of business across a fairly broad spectrum of interests. In addition to online filings of international cases discussed earlier, and 28 labor cases filed online – another first – the list of fresh opportunities includes:

- Administering disputes under New York's marine statute, the 317<sup>th</sup> such state statute into which we are written by law – we are the only not-for-profit organization referenced in this way in both state and federal law.
- Administering more than 60 class action arbitrations – an entirely new area of service. In its 2003 decision in *Green Tree Financial Corp. v. Bazzle*, the Supreme Court held that it was for an arbitrator, and not a court, to decide whether an arbitration agreement permits or precludes class actions where the arbitration agreement itself is silent on the issue. Implicit in the decision is that class action proceedings could take place in an arbitration setting. In response, we created Supplementary Rules for Class Arbitrations, which we are currently using to administer these often complex and difficult cases. Transparency is assured in these cases by posting the class action docket on our website.
- Once again administering in an Olympic year right-to-compete issues, code-of-conduct disputes, and anti-doping arbitrations under the United States Anti-Doping Agency (USADA). In all we handled more than 30 cases, most of which were put on a fast track because of the time pressures involved in an Olympic Games setting.
- A growing intellectual property caseload, which rose 6% in a year when we helped form the Patent Advisory Council – an outside advisory group seeking to develop rule improvements. We also helped create rules for the International Patent Board and sponsored a series of four intellectual property lectures across the country.

During the year we initiated a two-pronged labor arbitration program for minority ADR professionals. In collaboration with the Capital University Law School in Columbus, Ohio, we created an intensive, five-day, 40-hour training program for minority professionals interested in becoming labor arbitrators. As a follow-on to the training, we helped establish an innovative mentoring program designed to develop skills further, offer career guidance, and provide opportunities for networking. Each member of the class of 26 students from 11 states who successfully completed the course is being assigned to work with an experienced labor arbitrator in a 12-month mentorship.

We also conducted Labor Advocacy Arbitration Training classes in five states. In these courses, union representatives have an opportunity to increase their skills for representing clients in arbitrations. As a result of this training, a growing number of unions are electing to use their own personnel to represent grievants in arbitration proceedings.

Mandatory labor arbitrator training – initiated in 2001 – was completed in 2004. More than 900 active panelists took part in this training. Once again, we worked on rule revisions with the National Labor Management Advisory Council, a committee of labor and management users of AAA rules and procedures, as well as neutrals. While most of the work was completed in 2004, the revisions

will not go into effect until July, 2005. Each of the 11 AAA offices handling labor case management administration was involved in the work with the National Labor Management Advisory Council and the labor advocacy programs.

The construction industry – which represents 30% of the AAA's commercial case filings – is traditionally an area of major focus for us. The caseload remained even this year but a number of important activities were pursued.

Late in 2004, using a very careful and rigorous selection process, we created an exclusive, high-profile 90-member Construction Master Arbitration Panel. Construction industry representatives and attorneys drew up the stringent qualifying criteria, which included requirements as to the number of arbitrations recently conducted, leadership in industry organizations, and AAA training faculty participation. Intended for large cases involving claims of \$5 million or more, the panel is available to users at no extra charge. The full panel list is proprietary, and parties that have filed a case and choose to use the panel receive a sample list of arbitrators exceptionally well qualified to administer the dispute in question.

For the second successive year, the AAA and the National Construction Dispute Resolution Committee jointly sponsored a National Forum on Conflict Management in the Construction Industry. Held in Orlando, the gathering attracted more than 120 attendees from 16 states and Puerto Rico, as well as from South America and Europe.

Finally, we introduced a comprehensive Construction Industry Guide to Dispute Avoidance and Resolution. The booklet defines ADR techniques used to avoid and resolve disputes, explicitly describing how they may be implemented, and discusses in detail the menu of support services offered by the AAA.

#### CORPORATE GOVERNANCE: NEW STANDARDS OF CONDUCT

When the Sarbanes-Oxley legislation was enacted in 2002, we recognized it as a treatise on corporate governance, recommitting ourselves to organizational integrity and enhanced transparency in all our activities. Overall, the spirit of the new standards of conduct we have put in place are less rules-based and more values-based.

We initiated an organization-wide corporate records-management and retention program and took steps to determine independence standards for our directors generally. Only independent directors serve on our Audit Committee.

Two new principal officers of the AAA's Board of Directors were elected at the AAA's last annual meeting. James H. Carter, a partner in Sullivan & Cromwell's litigation group and coordinator of the firm's international arbitration practice, succeeded Edward V. Lahey, Jr. as Chairman of the Board. John M. Townsend, partner and chairman of the Alternative Dispute Resolution Group at Hughes Hubbard & Reed in Washington, D.C., succeeds Mr. Carter as Chairman of the AAA Board's Executive Committee.



*Officers of the American Arbitration Association: John C. Emmert, Jr., Jennifer J. Coffman, James H. Carter, William K. Slate II, Francesco Rossi, John M. Townsend, and Eric P. Tuchmann.*

#### THE PRESIDENT'S AWARD AND THE MICHAEL HOELLERING FELLOWSHIP

Inaugurated in 2001, the President's Award for Living the Values is bestowed upon the person who best exemplifies the core values that will help the AAA best achieve its vision for the future. The 2004 award was won by Lisa Romeo, a 15-year employee and a Regional Liaison Officer in our East Hartford office. In addition to the \$10,000 award Lisa received, five other awards of \$3,000 each were awarded to: Bernice Begay, a labor Case Manager in Cleveland; Peggy Imbesi, an Assistant Vice President in the New York Insurance Case Management Center; Michael G. Manning, a Senior Case Manager in the Central Case Management Center; Charles Natho, a Case Manager in the Southeast Case Management Center; and Mary Ann Somerville, an Office Manager/Elections Manager in Cleveland.

In recognition of Michael Hoellering's long and distinguished service as General Counsel of the AAA and his championship of international alternative dispute resolution, the Association established the Hoellering Fellowship. Michael, a distinguished internationalist, passed away in 2003, and his memory was honored this past year in a moving tribute at the Cairo Arbitration Center. It is entirely fitting that this fellowship is awarded to outstanding individuals committed to advancing international dispute resolution. This year there were two Hoellering Fellows – the first Alexandra Alvarado Bowen, an attorney from Ecuador, and the second Juliana Barbosa Pechincha, a Brazilian attorney and law professor.

All in all, this was an exciting and demanding year for the Association – far-reaching change and innovation, significant progress in our strategic program of service enhancement, and substantial strides taken in the international arena. All of this called for hard work on the part of the entire organization, and my personal and abiding thanks go out to each of my committed and focused colleagues, and our dedicated and involved Board members.

William K. Slate II  
*President and Chief Executive Officer*

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- Hon. Gabrielle Kirk  
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*Reelection to the 2005-2009 term*
- \*\* *Proposed Member*  
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- \* *Past Chairman of the Board*
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AMERICAN ARBITRATION ASSOCIATION, INC.  
AND SUBSIDIARIES

REPORT ON CONSOLIDATED FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2004

AMERICAN ARBITRATION ASSOCIATION, INC.  
AND SUBSIDIARIES

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Consolidated Statement of Operations and Changes in Net Assets Year Ended December 31, 2004	4
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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors  
American Arbitration Association, Inc.

We have audited the accompanying consolidated balance sheet of American Arbitration Association, Inc. and Subsidiaries as of December 31, 2004, and the related consolidated statements of operations and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Arbitration Association, Inc. and Subsidiaries as of December 31, 2004, and the changes in their net assets and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

*J.H. Cohn LLP*

New York, New York  
March 22, 2005

CONSOLIDATED BALANCE SHEET  
DECEMBER 31, 2004

ASSETS

Cash and cash equivalents	\$ 6,122,000
Investments, at fair value (Note 2)	68,180,000
Administration fees receivable, net of allowances for cancellations and uncollectible accounts of \$1,240,000	25,097,000
Other receivables	225,000
Prepaid expenses and other assets (Note 4)	3,348,000
Deferred pension costs (Note 3)	646,000
Furnishings, equipment and leasehold improvements, net (Note 4)	<u>13,639,000</u>
<b>Total</b>	<b><u>\$117,257,000</u></b>

LIABILITIES AND NET ASSETS

Liabilities:

Accounts payable and accrued expenses (Notes 3 and 5)	\$ 64,802,000
Accrued postretirement medical costs (Note 3)	9,227,000
Accrued pension liability (Note 3)	9,134,000
Deferred rent (Note 8)	4,762,000
Deferred revenue	<u>2,202,000</u>
Total liabilities	90,127,000
Commitments and contingencies (Note 5)	<u>-</u>
Unrestricted net assets	<u>27,130,000</u>
<b>Total</b>	<b><u>\$117,257,000</u></b>

*See Notes to Consolidated Financial Statements*

CONSOLIDATED STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS  
YEAR ENDED DECEMBER 31, 2004

OPERATING REVENUE

Administration fees earned:	
Commercial	\$44,989,000
No-fault and uninsured motorist	18,162,000
Labor	4,970,000
Elections	<u>4,346,000</u>
Total	72,467,000
Publications and education	<u>1,935,000</u>
Total	<u><b>74,402,000</b></u>

EXPENSES

Administration of tribunals	65,981,000
Elections	3,678,000
Publications and education	3,387,000
General and administration	<u>3,197,000</u>
Total	<u><b>76,243,000</b></u>

**Net operating loss** (1,841,000)

NON OPERATING INCOME AND EXPENSES

Interest and dividends on investments, net of fees (Note 2)	1,809,000
Unrealized gain on investments	4,202,000
Contribution expense (Note 6)	(799,000)
Loss on disposal of assets	<u>(3,000)</u>
Change in unrestricted net assets before minimum pension liability and discontinued operations	3,368,000
Minimum pension liability adjustment (Note 3)	<u>4,000</u>
Change in unrestricted net assets before discontinued operations	3,372,000
Discontinued operations (Notes 4 and 7)	<u>(156,000)</u>
Change in unrestricted net assets	3,216,000
Unrestricted net assets, beginning of year (Note 8)	<u>23,914,000</u>
<b>Unrestricted net assets, end of year</b>	<u><b>\$27,130,000</b></u>

*See Notes to Consolidated Financial Statements*

CONSOLIDATED STATEMENT OF CASH FLOWS  
YEAR ENDED DECEMBER 31, 2004

OPERATING ACTIVITIES

Change in net assets	\$ 3,216,000
Adjustments to reconcile net change in net assets to net cash provided by operating activities:	
Depreciation and amortization	3,690,000
Postretirement benefits other than pensions	612,000
Unrealized gain on investments	(4,202,000)
Loss on disposal of assets	327,000
Changes in operating assets and liabilities:	
Administration fees receivable	(1,822,000)
Other receivables	(33,000)
Prepaid expenses and other assets	295,000
Accounts payable and accrued expenses	7,355,000
Accrued pension liability	(242,000)
Deferred rent	(638,000)
Deferred revenue	<u>623,000</u>
Net cash provided by operating activities	<u>9,181,000</u>

INVESTING ACTIVITIES

Purchase of furnishings, equipment and leasehold improvements	(1,729,000)
Proceeds from sales of investments	6,000
Purchase of investments	(6,168,000)
In-progress construction	<u>(530,000)</u>
Net cash used in investing activities	<u>(8,421,000)</u>

Net increase in cash and cash equivalents	760,000
Cash and cash equivalents, beginning of year	<u>5,362,000</u>
<b>Cash and cash equivalents, end of year</b>	<b><u>\$ 6,122,000</u></b>

*See Notes to Consolidated Financial Statements*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### BUSINESS AND PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the financial position and operating activities of the American Arbitration Association, Inc. and the subsidiaries it controls, ADRWorld.com and the International Centre for Dispute Resolution, LLC. All intercompany accounts and transactions have been eliminated in consolidation. As used herein, the "Association" includes the American Arbitration Association, Inc. and subsidiaries.

The American Arbitration Association, Inc. ("AAA") is a not-for-profit organization that provides administrative, educational and development services for the widespread use of dispute resolution procedures.

ADRWorld.com ("ADRW"), a Delaware limited liability company, delivers via the internet alternative dispute resolution news research and industry information.

The International Centre for Dispute Resolution, LLC ("ICDR, LLC"), an Irish subsidiary of the Association, promotes, facilitates and provides dispute management services.

#### ADMINISTRATION FEES

The initial filing fee for commercial cases, which is subject to a minimum fee, is billed at the commencement of the dispute resolution process. Over the next 60 days, which is the time period for refund eligibility, a portion of the refundable initial filing is recognized as revenue as services are performed. Under certain circumstances the 60-day time period for refund eligibility is extended indefinitely for arbitration cases that utilize the AAA's mediation services. Based on analysis of current trends, the Association recorded a provision for deferred revenue in 2004 of \$78,000, which is included in the accompanying consolidated balance sheet and represents the estimated amount of future refunds.

A case service fee is payable in advance prior to the first scheduled hearing. The case service fee is refundable at the conclusion of the case if no hearings have occurred. Case service fee revenue is recognized, net of estimated refunds, as case administration services are provided.

Deferred case service fee revenue of \$1,949,000 as of December 31, 2004 is included in deferred revenue in the accompanying consolidated balance sheet.

#### CONTRIBUTIONS

The Association contributes money to fund expenses incurred by the Global Center for Dispute Resolution Research ("GCDRR"). On an annual basis, the Association also contributes money to the ICDR, LLC.

#### CASH AND CASH EQUIVALENTS

The Association considers all highly liquid investments with maturities of three months or less on date of purchase to be cash equivalents.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### CONCENTRATIONS OF CREDIT RISK

Financial instruments, which potentially subject the Association to concentrations of credit risk, include cash and cash equivalents and administration fees receivable. The Association maintains cash and cash equivalents in bank deposit and other accounts, the balances of which, at times, may exceed federally insured limits. The Association places its cash and cash equivalents with creditworthy, high-quality financial institutions. Credit risk with respect to fees receivable is also limited because the Association deals with a large number of customers in a wide geographic area. The Association closely monitors the extension of credit to its customers while maintaining allowances for potential credit losses. On a periodic basis, the Association evaluates its fees receivable and establishes an allowance for doubtful accounts, based on a history of past write-offs and collections and current credit considerations.

#### INVESTMENTS

Investments are reported at fair value. Cash equivalents included in investments are held for investment purposes. Changes in unrealized investment gains or losses are reported in the statement of operations and changes in net assets.

#### FURNISHINGS, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Furnishings, equipment and leasehold improvements are stated at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the individual asset or the lease term, if shorter than the useful life. The cost of maintenance and repairs is charged to expense as incurred.

#### CAPITALIZATION OF SOFTWARE

The Association capitalized expenses incurred for the development of software for internal use in accordance with Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." The costs associated with the development of software are amortized over five years.

#### USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

#### TAX STATUS

The AAA is exempt from federal income tax under the provisions of Section 501(c)(3) of the Internal Revenue Code; therefore, no provision for income taxes is included in the Association's consolidated financial statements.

The ICDR, LLC is a taxable entity in Ireland. There is no provision for income taxes for 2004 due to losses incurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)

As a single member LLC, any taxable income or loss of ADRW is passed on to the member and taxable in accordance with the member's tax status.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of cash and cash equivalents, administration fees receivable, accounts payable and accrued expenses approximate fair value because of the short-term nature of the items. The fair value of investments is determined by quoted market prices.

NOTE 2 - INVESTMENTS

Investments at December 31, 2004 consist of the following:

	<u>Cost</u>	<u>Fair Value</u>
Intermediate Bond Fund	\$ 31,492,000	\$ 32,185,000
Total U.S. Equities Index Fund	14,491,000	19,857,000
International Equities Index Fund	5,258,000	7,524,000
REIT Admiral Index Fund	4,213,000	4,997,000
Mid-Cap Equities Index Fund	<u>2,569,000</u>	<u>3,617,000</u>
<b>Totals</b>	<b><u>\$ 58,023,000</u></b>	<b><u>\$ 68,180,000</u></b>

Interest and dividends on investments are reported net of fees of \$404,000 for the year ended December 31, 2004.

NOTE 3 - PENSION AND OTHER POSTRETIREMENT BENEFITS PLANS

The Association maintains a noncontributory, qualified defined benefit pension plan covering all eligible employees. The Association makes contributions to the plan based on actuarial calculations. Total employer contributions required for the fiscal year beginning January 1, 2005 are zero. The Association expects to make a discretionary contribution of \$3,000,000 to the plan during 2005.

The Association also provides certain health care benefits for substantially all of its retirees. The Association is required to accrue the estimated cost of these retiree benefit payments during the employees' active service period. The Association pays the cost of the postretirement benefits as incurred.

Employees hired on or after July 1, 2003 are not eligible for retiree healthcare coverage. Active employees hired on or before June 30, 2003 are eligible for retiree healthcare coverage upon retirement with at least ten years of service after age 45.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - PENSION AND OTHER POSTRETIREMENT BENEFITS PLANS (CONTINUED)

The Association also maintains a nonqualified, Supplemental Retirement Plan. The Association pays the cost of benefits as incurred. For 2004, the accrued benefit obligation, which is included in accounts payable and accrued expenses, was \$342,000.

The following tables set forth each plan's funded status and amounts recognized in the Association's financial statements at December 31, 2004:

	<u>Pension Benefits</u>	<u>Other Benefits</u>
Benefit obligation at December 31	\$ 37,699,000	\$ 8,150,000
Fair value of plan assets at December 31	<u>24,888,000</u>	<u>-</u>
Funded status	<u>\$(12,811,000)</u>	<u>\$(8,150,000)</u>
Accrued benefit costs recognized in the balance sheet	<u>\$ (9,134,000)</u>	<u>\$(9,227,000)</u>
Benefit costs	\$ 2,762,000	\$ 966,000
Employer's contribution	3,000,000	354,000
Plan participants' contributions	-	14,000
Benefits paid	2,396,000	368,000

Weighted-average assumptions as of December 31:

Discount rate	5.75%	5.75%
Expected return on plan assets	7.50%	N/A
Rate of compensation increase	5.30%	N/A

The accumulated benefit obligation related to the defined benefit pension plan as of December 31, 2004 was \$34,022,000.

For measurement purposes, a 9% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2004. The rate was assumed to decrease gradually to 4.50% until 2010 and remain at that level thereafter.

The pension plan provides a benefit equal to the sum of (a) for each year of benefit accrual service (or any fractional part thereof) credited on or before January 1, 1997, 1.75% of earnings in effect on January 1, 1997, and (b) for each year of benefit accrual service credited after January 1, 1997, 1.75% of earnings in effect on January 1 of such year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - PENSION AND OTHER POSTRETIREMENT BENEFITS PLANS (CONTINUED)

The provisions of SFAS No. 87, "Employers' Accounting for Pensions," require the Association to recognize a minimum pension liability relating to certain unfunded obligations, establish an intangible asset relating thereto and adjust net assets. At year-end, this minimum pension liability is remeasured as required by the statement. As a result, at December 31, 2004, the Association's additional minimum liability was \$9,911,000 and the related intangible asset was \$646,000. Net assets increased by \$4,000 in 2004 to reflect the net change in the additional minimum liability offset by the net change in the related intangible asset. The Association recognized an accrued pension liability in 2004 of \$9,134,000, which is related to the prepaid benefit cost of \$777,000 and an additional minimum liability of \$9,911,000.

Estimated future benefit payments attributable to estimated future employee service in each of the five years subsequent to December 31, 2004 and in the aggregate for the five years beginning in 2010 are as follows:

<u>January 1,</u>	<u>Pension Benefits</u>	<u>Other Benefits</u>
2005	\$ 2,245,000	\$ 408,000
2006	2,205,000	384,000
2007	2,220,000	411,000
2008	2,302,000	432,000
2009	2,375,000	440,000
Thereafter	13,158,000	2,660,000

The target allocations of pension assets are outlined below:

	<u>Target Allocation</u>	<u>Percentage of Plan Assets at January 1, 2004</u>
Plan assets:		
Equity securities	40 - 70%	56%
Fixed income/Group annuity contract	30 - 60%	<u>44%</u>
<b>Total</b>		<u><b>100%</b></u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - PENSION AND OTHER POSTRETIREMENT BENEFITS PLANS (CONCLUDED)

The overall objective of these allocations is to provide for long-term growth while maintaining an acceptable level of risk. The expected long-term rate of return on assets is 7.5%. The assumption is based on future rates of return for the investment portfolio, with consideration given to the distribution of investments by asset class and historical rates of return for each individual asset class. All investments are chosen with prudence and due diligence by investment managers to ensure that results over time meet the goals and objectives of the Association's Pension Investment Objectives and Policies Statement.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 ("DIMA") introduces a prescription drug benefit under Medicare, as well as a federal subsidy to sponsors of retiree medical benefit plans that provide a benefit that is similar to Medicare. In accordance with Financial Accounting Standards Board Staff Position ("FSP") No. 106-1, "Accounting and Disclosure Requirements related to Medicare Prescription Drug, Improvement and Modernization Act of 2003," the Association has elected to defer recognizing the effects of DIMA on its retiree medical benefits expense until 2005. However, the benefit obligation shown as of December 31, 2004 does reflect the impact of DIMA.

NOTE 4 - FURNISHINGS, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Furnishings, equipment and leasehold improvements consist of the following:

Furnishings and equipment	\$18,591,000
Leasehold improvements	<u>14,576,000</u>
	33,167,000
Less accumulated depreciation and amortization	<u>19,528,000</u>
<b>Total</b>	<b><u>\$13,639,000</u></b>

In 2004, the Association recognized a loss of approximately \$327,000 relating to the disposal of certain assets with original costs totaling \$1,115,000. Included in these amounts and recorded as part of discontinued operations were \$324,000 in losses related to the disposal of certain assets with original costs of \$790,000.

Also included in furnishings and equipment are costs associated with the development of software for internal use of \$4,907,000 and \$3,444,000 of related accumulated amortization.

Included in prepaid expense are in-progress construction costs for leased facilities of \$530,000. When placed into service, these in-progress construction costs will be included in capital assets and amortized over the lives of the underlying leases.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - COMMITMENTS AND CONTINGENCIES

LEASE COMMITMENTS

The Association conducts all of its activities from leased office space and is currently a party to various leases that expire between 2005 and 2017. Most of the leases provide for future escalation charges relating to real estate taxes and other building operating expenses. Rental expenses charged to continuing operations for the year ended December 31, 2004 amounted to \$12,034,000. In addition, the Association leases certain computer equipment under various operating leases, all of which expire over the next one to five years.

Minimum noncancelable lease commitments for office facilities, equipment and software, exclusive of any future escalation charges, due in each of the five years subsequent to December 31, 2004 and thereafter are as follows:

<u>Year Ending</u> <u>December 31,</u>	<u>Amount</u>
2005	\$10,961,000
2006	9,397,000
2007	8,921,000
2008	7,519,000
2009	6,776,000
Thereafter	<u>27,027,000</u>
<b>Total</b>	<b><u>\$70,601,000</u></b>

CONTINGENCIES

The Association is a defendant in certain lawsuits arising in the ordinary course of business. While the outcome of lawsuits or other proceedings against the Association cannot be predicted with certainty, the Association does not expect that those matters will have a material adverse effect on its financial position.

The Association discovered a pattern of external check fraud that occurred in 2003 totaling \$743,000, of which \$202,000 was recovered immediately from its bank. Additionally, in 2004, the Association was reimbursed by its insurance carrier in the amount of \$516,000.

The Association bills and collects amounts in advance for unearned arbitrators' compensation. At December 31, 2004, unearned arbitrators' compensation for which amounts had been collected totaled \$52,988,000. This amount is included in accounts payable and accrued expenses in the accompanying consolidated balance sheet.

The Association has a letter of credit agreement totaling \$1,065,000 at December 31, 2004. This agreement guarantees an operating lease rental obligation and is secured by the investment portfolio.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 6 - GLOBAL CENTER FOR DISPUTE RESOLUTION RESEARCH

In the ordinary course of business, the Association has made contributions to GCDRR, a research organization dedicated to exploring the effectiveness and enhancing the utility of business dispute resolution methods throughout the world. These contributions, which are used to fund expenses incurred by GCDRR, reflect an economic interest by the Association. Since the Association maintains only a minority voting interest on GCDRR's Board of Directors, the Association does not have direct control over how GCDRR operates or derives other contributions. In accordance with Statement of Position 94-3, "Reporting of Related Entities by Not-for-Profit Organizations," the Association does not consolidate the operating results of GCDRR and, accordingly, reports these contributions on the statement of operations and changes in net assets.

Contributions made to GCDRR are not guaranteed by the Association and are approved on an annual basis. For the year ended December 31, 2004, amounts contributed to GCDRR totaled \$799,000. Contributions from outside sources in 2004 totaled \$6,000. GCDRR had revenues in the amount of \$82,000 in 2004 relating to an international conference. Contributions to GCDRR, net of revenues earned by GCDRR, have aggregated \$3,164,000 through December 31, 2004.

### NOTE 7- DISCONTINUED OPERATIONS

As of April 15, 2004, the Association no longer administers the New Jersey Personal Injury Protection ("no-fault") Program. Included in the statement of operations and changes in net assets are net no-fault revenues of \$3,460,000 and direct expenses, excluding corporate shared services costs, of \$3,616,000. Included in the direct expenses are one-time charges related to the disposal of assets as well as an accrued liability for future arbitrator compensation, direct payroll costs and operating costs totaling \$821,000. These accrued costs represent the estimated cost of completing the administration of cases pending at December 31, 2004.

### NOTE 8- RESTATEMENT OF NET ASSETS

In accordance with SFAS No. 13, "Accounting for Leases" the Association is required to charge the total amount of base rent payments to expense using the straight-line method over the respective lease term. This method should have been adopted at the inception of the leases. Accordingly, unrestricted net assets as of December 31, 2003 were restated to reflect the effect of the deferred rent that would have been recognized as a liability had the leases been accounted for pursuant to SFAS 13 from the inception of the leases.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 - RESTATEMENT OF NET ASSETS (CONCLUDED)

The adjustment to unrestricted net assets as of December 31, 2003 is as follows:

Unrestricted net assets, as originally reported	\$28,664,000
Adjustment to deferred rent liability	<u>(4,750,000)</u>
<b>Unrestricted net assets, as restated</b>	<b><u>\$23,914,000</u></b>

This adjustment resulted in a deferred rent liability as of December 31, 2003 of \$5,400,000 and a \$32,000 reduction in operating expenses (\$24,000 in administration and tribunals and \$8,000 in general and administration) due to the reduction in rent expense for the year ended December 31, 2003.



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