



American Arbitration Association

Dispute Resolution Services Worldwide

2007

*President's Letter &
Financial Statements*

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 and a diverse Roster of Neutrals, a diverse Board and we commit to respect and increase diversity in all our endeavors.

MEETING 21ST CENTURY NEEDS WITH 21ST CENTURY SOLUTIONS

Vibrant organizations today are those that respond well to the ever-evolving customer landscape. Customer needs and demands are growing, and companies that respond quickly and appropriately to clients' numerous and varied expectations are often in the best position to retain existing customers and to gain new ones.

When organizations respond to client demands, they frequently do so by *engaging in internally driven solution-seeking and thoughtfully examining the external environment for clues*—events and trends that could have a profound impact on the organization or the industry in which it operates.

In 2007, the American Arbitration Association (AAA) continued to heed the Voice of the Customer, as in prior years, by looking internally to identify processes and services that could benefit from reexamination, as well as looking externally at the “shifts in the wind” that seemed to be aiming toward new opportunities to meet customers' needs.

The AAA's internal and external assessments identified two important drivers for change. Internally, it was clear, based on ongoing Voice of the Customer information, that clients have a great desire for *choice*. The desire for more choice relates to the AAA's methods of service delivery, fees and the modes by which the organization interacts with customers. Externally, changes in the legal industry—such as the consolidations of law firms and a greater emphasis on cost management driven by firms' clients—seemed to be pointing to the industry's increased focus on *efficiency*. And one of the greatest generators of efficiency is *technology*. Naturally, because of the demands on them, firms want those organizations with which they do business to join in lockstep with their *use of technology to provide more cost-effective, efficient and convenient services*.

Vibrant organizations also look for opportunities to grow. In 2007, the AAA undertook a significant and important number of initiatives to respond to the marketplace's need for efficiency and cost-effective service delivery and to continue to grow its business.

GIVING CUSTOMERS MORE CHOICES

Choice became a key element of service delivery at the AAA in 2007. Initiatives to provide customers with increased options as well as to solidify relationships with parties included the piloting of two alternative commercial fee schedules and the creation of a task force to begin addressing the prevalence of discovery in international arbitrations.

Alternative Commercial Fee Schedules

Users of AAA arbitration services know that each arbitration case is different. Factors that can play a role in how different each case is are the size of the claim, the industry in which the dispute arises, the matter at hand and even the parties themselves. These differences can have an impact on how quickly a case may be resolved and by what means. Regardless, many customers have a desire to expedite the dispute resolution process in order to return to managing their affairs. *One-sized arbitrations do not always fit all*, and AAA clients have made that clear. In 2007, the AAA offered two alternative commercial fee schedules to provide choice and meet users' needs based on the case at hand.

The first pilot fee schedule was developed for clients who, after filing their arbitration case, were able to determine that the parties might wish early settlement of their dispute. The benefit to users of this alternative commercial schedule was that, because of lower upfront filing fees, parties could save up to 30% on the AAA's standard commercial fees if settlement occurred prior to neutral selection. If the matter did not settle and proceeded to hearing and award, however, other fees would be charged similar to those reflected in the AAA's current fee schedule. Despite this, many users saw a place for and had interest in this new fee schedule.

The intent of the second pilot was to provide alternatives for yet another set of user needs. AAA users have said that the AAA's presence in the arbitration process provides value due to the AAA's role in overseeing matters, ensuring that

the case does not “go off the rails” or that if it does, it does not remain off track for long. However, some clients also have said that in certain instances, full-service arbitration case administration may not be necessary. While access to the AAA’s superior panel of neutrals is desirable, parties in less contentious disputes may need a “lighter” version of the AAA’s involvement in the process. This pricing pilot, Arbitrator Selection Services, enables parties to select arbitrators with decreased levels of AAA administration.

Client feedback captured as part of the pilot tests indicated that the response to these offerings was overwhelmingly positive. Both pilots will run through 2008 and, depending on results, may become permanent service offerings available to users, meeting the strong desire for greater flexibility and choice with regard to AAA filing and administrative fees.

Task Force on Exchange of Documentary and Electronic Materials

In addition to offering multiple pricing options and to positioning services to deliver greater value—deepening the relationships with our clients—2007 found the AAA looking more closely at an issue that concerned many in the field of alternative dispute resolution (ADR). The AAA’s commitment is to ADR that is fast and effective. So the fact that some have complained that litigation-related practices such as discovery have been pervading ADR meant that investigation was needed. In 2007, the AAA established the Task Force on Exchange of Documentary and Electronic Materials for the purpose of assessing document-disclosure practices in international arbitrations. One of the key goals of the Task Force was to produce recommendations for preferred practices and/or new or amended Rules related to documents exchange. The final standards derived from the process could apply to all international arbitrations administered by the International Centre for Dispute Resolution® (ICDR).

With this effort, the AAA, in its role as ADR leader, hopes to establish a framework for other Rules and to address a matter of great importance that ultimately affects users’ preferences for arbitration over other available dispute resolution options.

TECHNOLOGICAL AND OPERATIONAL IMPROVEMENTS TO ENHANCE SERVICE DELIVERY

Suffice it to say that today, *regardless of the industry*, it is imperative to incorporate technology into the development or provision of services in order to expedite delivery and lower costs.

Operational Efficiencies

In 2006, the AAA identified opportunities for service enhancements. Several projects were undertaken in 2007, as a result.

One such project involved improving service delivery at the stage at which clients initiate a case. Intake Teams in the AAA’s Case Management Centers are clients’ first point of contact with the AAA. To increase the group’s efficiency, minimize the time required for training and foster expertise about certain case types, the Intake Teams were reorganized based on industry or Rules. Intake Team members now can develop a level of knowledge and sophistication that will benefit AAA filers and expedite the case initiation stage of the arbitration process at the AAA.

Additional improvements extended to the AAA’s regional offices. The AAA now is poised to offer users the ability to “connect” parties to a case and the neutral in a more cost-effective manner. Through the AAA’s 23 regional offices, parties and neutrals may now hold pre-hearing meetings, hearings and conferences using the latest in video conferencing technology that saves the time and cost of in-person meetings and increases the quality of meetings as compared with telephone conference calls.

With video conferencing through the regional offices, the AAA can offer high-quality, high-definition video and sound, at a cost that is far lower than the national average for video conferencing. The service was set up in 2007 and is being rolled out in 2008.

And, in a move to more closely tie the operations of AAA regional offices and Case Management Centers together, case managers now can schedule case-related events more efficiently through an online, organization-wide scheduling system. AAA regional office resources, such as video conferencing, Internet access and meeting rooms, now can be reserved by the Case Manager. This new service is indispensable in avoiding facility scheduling conflicts and expediting case-related events.

These and other enhancements have helped reduce the median time frame in, for example, construction arbitration cases from 328 days in 2006 to 315 days in 2007.

Mediation Services Delivery

In addition to various operationally driven projects, the AAA continued its move toward modern methods of service delivery in order to provide greater choice. In 2006, the AAA heard customers say that in addition to their expectations regarding arbitration pricing and efficiencies, they had similar expectations regarding mediation services.

Because of this, the AAA introduced online mediation for filers under the AAA's Claims Programs. With online mediation, the mediation process can be conducted largely online by a trained, experienced AAA Staff Mediator, with no telephone sessions and no face-to-face meetings. This service is designed for mediation cases where the dispute involves two parties with a claim amount under \$10,000, and the entire fee, including filing and mediator services, is a mere \$50. What enables the AAA to provide this unique service at a more-than-competitive price is the fact that case-related discussions and the mediation conference itself all take place in an online chat-room environment using "real-time" communications technology.

The AAA expects this service to be quite successful in the Claims Program arena where high-volume activity requires faster and more efficient solutions. Currently, *AAWebFile*[®] is being used in a similar fashion for filers of arbitration cases under the Claims Programs umbrella.

In fact, the total value of claims on *AAWebFile* reached \$1.1 billion in 2007. While this represents a total increase of 2% from 2006, in several caseloads there were much more significant increases: international filings (a 39% increase in 2007 over 2006), mediation (20%), commercial (16%) and construction (11%).

No-Fault Enhancements

The New York No-Fault automobile caseload also implemented several operational and technological enhancements, which have made a difference to that group's users. The AAA revised the Supplementary Underinsured Motorist (SUM) arbitration procedures in order to provide greater convenience for the parties. In 2007, a new, uniform set of procedures for hearings of SUM cases was unveiled. A pre-hearing conference call of the parties with the arbitrator is now the first step on a new case. In the call, parties are able to discuss with the arbitrator the exchange of documents, the witness lists, the scheduling of the hearing and other preparations. Now, with the direct involvement of the parties in the initial planning of the hearing, the number of adjournments has been reduced. This change is contributing to a quicker resolution process.

Further contributing to efficiencies in New York State No-Fault arbitrations, the AAA began allowing parties and attorneys to participate in No-Fault hearings by telephone if the arbitrator agrees that telephone participation will meet his or her requirements to make a decision in the case. Telephone participation can be particularly useful

for cases in which there are no witnesses and cases can be decided based on documents. Telephone participation by at least one of the parties existed in 12.2% of the hearings for which an arbitrator issued an award in the last quarter of 2007. The figure was only 7.4% of hearings in the last quarter of 2005.

With these and other operational and technological improvements in delivery of ADR services, the AAA is truly on the forefront of enhancements to ADR worldwide.

GROWTH THROUGH SERVICE EXPANSION

While many of AAA's 2007 initiatives were aimed squarely at increasing choice and making service improvements through operational and technological enhancements, the AAA also responded to the larger "voice" heard in the marketplace in order to grow its business.

Mediation

The AAA is and will continue to be the largest provider of ADR services. This includes mediation. In response to the fact that the AAA administers far fewer mediations annually than arbitrations and that there is a national trend emphasizing the use of mediation, the AAA overhauled its mediation offerings.

Now, parties may start the mediation process by selecting a mediator using the recently revamped online mediator search tool through the AAA's website. After mediator selection, mediations can be commenced without any up-front filing fee. The AAA removed the filing fee after marketplace assessments indicated that it was a barrier to usage. In addition to improved mediator selection services and the elimination of filing fees, the Mediation Procedures associated with many of the AAA's Rules were modified to state that members of the AAA's Panel of Mediators must abide by the Model Standards of Conduct for Mediators. Additionally, the new Mediation Procedures better define the mediators' and parties' duties and responsibilities in order to help ensure successful mediations.

Strides were also made with regard to increasing the acceptance and use of mediation internationally, as the AAA/ICDR partnered with the Netherlands Mediation Institute and the Singapore Mediation Centre/Singapore International Arbitration Centre to form the International Mediation Institute (IMI). The IMI, located in The Hague, Netherlands, plans to provide certification for mediators worldwide. In 2007, the IMI proposed to draft International Competency Standards to further promote mediation.

Rules Updates

The AAA's Mediation Procedures were not the only Rules updates in 2007. Last year, the AAA introduced a new set of Rules to address the large number of arbitrations arising out of the construction of new homes—certainly a booming area in the years prior to 2007. The new Home Construction Arbitration Rules and Mediation Procedures were developed to address disputes between builders and homeowners and are designed to be more approachable, given that these disputes are more likely to involve a homeowner and less likely to involve business-to-business disputes, as with the Construction Rules. The new Home Construction Rules replaced the Residential Construction Disputes Supplementary Procedures and incorporate the principles of the Consumer Due Process Protocol. With the Home Construction Rules, clients have options regarding filing fees (based on the size of the claim) and with regard to the hearing process (documents-only hearings, telephone- or in-person hearings). To date, 24 claims have been filed under these new rules, a testament to their success given the mid-year launch in 2007.

ICDR

The ICDR was also quite busy in 2007, promoting its services globally to further grow its business; in fact, its caseload grew to 622 new case filings, representing a 6% increase over 2006. Plans included the opening of its Singapore office in order to better serve that region of the world. The ICDR and Singapore International Arbitration Centre (SIAC), one of the leading arbitral institutions in Asia, officially opened the doors of the ICDR's Singapore office on October 17, 2007. There is indeed demand for arbitration in Asia: the ICDR saw filings from Asia increase by 34% from 2005 to 2006.

Four international areas showed especial growth in 2007. Entertainment case filings increased by 180%; insurance filings increased by 45%; filings via *AAAWebfile*[®], 39% and construction by 20%.

And to further increase awareness of the ICDR and to promote the use of ADR in certain sectors and regions of the world, the ICDR conducted several conferences in 2007 with the aims of outreach and education. Highlights included the ICDR North America Dispute Resolution Series: *ADR after NAFTA*, which discussed the completion of the fifteen-year implementation of the North American Free Trade Agreement in the context of the field of ADR. Two sessions of this three-part series took place in Mexico City and Toronto in 2007 (the third session will be held in Chicago in 2008). The ICDR International ADR Reporting Programs held conferences in New York City and Washington, D.C. focusing on Latin America, the European Union, the Middle East and North Africa as well as the latest technology provided and utilized by the ICDR to benefit users and clients. In 2007, the ICDR held its International Arbitration Practice conference in Brazil on Arbitrating in Brazil under the ICDR Rules and Administrative System and included an International Arbitration Energy Roundtable. Lastly, among others, the ICDR participated in several European conferences on international oil and gas disputes.

Labor

There was considerable activity in support of the AAA's Labor caseload in 2007. Specifically, the organization participated in several regional meetings of the National Academy of Arbitrators (NAA) as well as its annual meeting in San Francisco. Related activities included regular meetings with the Chair of the Academy's Designating Agency Liaison Committee, where issues of concern to both the NAA and the AAA, as well as the AAA's labor and management clients, were addressed. In addition, the AAA's labor awards, residing in an online, searchable database managed by LexisNexis, grew to 5,000 in number in 2007. These redacted, full-text awards are an invaluable resource for arbitrators, advocates and parties. Finally, in the area of labor education, the AAA hosted a series of 13 programs held in 7 cities, covering introductory to advanced topics in labor advocacy for union and management representatives, as well as those simply interested in the topic. The programs were so successful that they will be offered again in 2008 in locations around the country.

Claims and Government Programs

In 2007, service expansion was also experienced in the AAA's Claims and Government Program areas. Last year, three new caseloads came in under the banner of Claims Programs, including disaster-related dispute resolution. The AAA was chosen to administer the Combustion Engineering 524(g) Asbestos PITrust Distribution Procedures (TDP) and the Procedures for Reviewing and Liquidating TDP Claims. The AAA was also selected to administer the Connecticut Insurance Department's auto physical and property damage liability insurance claims disputes involving private passenger motor vehicles. And, the AAA will now resolve disputes in connection with Chapter 11 Bankruptcy proceedings for the Dana Corporation—the nation's largest auto parts supplier.

Since being selected by the states of Mississippi and Louisiana to administer mediation programs to help bring quick resolutions to insurance claim disputes for those affected by Hurricanes Katrina and Rita in 2005, the AAA has administered *over 17,000 claims* in the state departments of insurance programs and *256 cases* in the federal program. In 2007, a similar disaster claims program was instituted in the Louisiana Federal Court.

The AAA has also worked with states to provide elections services for state employee unions. Since 2004, the Elections Department has provided various states with services for representation card checks and elections involving daycare workers, adult care workers and state employees. After issuing Executive Orders calling for collective bargaining by thousands of employees, the states of Illinois, Massachusetts, Ohio, Maryland, Colorado and Pennsylvania, along with various unions, selected the AAA to oversee representation elections in 2007—a sure sign of continued demand for the AAA’s Elections Services.

In addition to programs for and services to state governments, the AAA provides and hopes to expand services offered in the federal sector. In 2005, the federal Centers for Medicare & Medicaid Services (CMS) established a demonstration project with the states of Connecticut, Massachusetts and New York, under existing statutory authority, to resolve certain disputes related to home-health services through arbitration. The AAA, the CMS and the states developed the AAA Medicare Demonstration Project Rules and established a select panel of neutrals to hear these cases. The multi-year program was launched in August, 2007.

Online Dispute Resolution (ODR) Solutions

In 2007, the AAA partnered with Cybersettle to launch ODR Solutions, a comprehensive suite of online ADR services. This strategic alliance between the world’s most recognized conflict-management companies further enables the AAA to deliver ADR services efficiently and effectively to customers in ways that they choose.

PUBLIC SERVICE AND EDUCATION

The AAA’s mission is one of service. The Association is a neutral organization interested in educating the public about the benefits of ADR, ensuring, through its position as a neutral third party, that ADR remain a party-driven process, and that all persons, regardless of ethnicity, gender or other characteristics have access to systems connected with alternative dispute resolution.

Amicus Brief Filing

The AAA filed an *amicus* brief in *Hall Street Associates v. Mattel*, which was recently decided by the Supreme Court of the United States. In *Hall Street*, the question presented to the Supreme Court was whether parties may expand the standards of judicial review of arbitration awards beyond those specifically provided for in the Federal Arbitration Act. The AAA viewed the case as one that was important with respect to the development of arbitration law in the United States and also believed that the AAA’s views would be of interest to the Court. The AAA’s *amicus* brief was filed in support of the prevailing view that the text of the Federal Arbitration Act itself did not permit parties’ agreements for expanded judicial review, and that if such agreements were permissible they would detract from the finality normally afforded to arbitration awards. In addition, the AAA emphasized that expanding judicial review of arbitration awards would result in the diminishment of the benefits of the arbitration process by transforming arbitration into litigation. The Supreme Court’s decision in *Hall Street* essentially embraced the positions advanced by the AAA.

AAA Publications

The final installment of the AAA's six-book hardcover Handbook series, a cooperative effort of the AAA and JurisNet, LLC, was completed in 2007 with the publication of the *Handbook on Construction Arbitration and ADR*. This series brings together qualitative articles addressing key areas of interest to ADR professionals, culled from the *Dispute Resolution Journal* and other sources. The authors are recognized specialists in the field who provide world-class assessments of contemporary issues in commercial, construction, labor, employment and international arbitration and ADR and mediation.

Fairness in Consumer Disputes

One aspect of the AAA's role as a neutral organization is to ensure the adequate and fair provision of ADR services to all individuals involved in the disputes that it administers. The AAA distinguishes itself from other ADR providers administering consumer disputes by ensuring that the process remains one where all voices are heard equally. The *Consumer Due Process Protocol*, which the AAA was instrumental in designing, clearly outlines certain immutable characteristics related to the provision of arbitration services, one of which is neutrality. The AAA's approach to these cases is deliberate, inclusive and thoughtful. Currently, contending parties are engaged in legislation in the U.S. regarding how ADR should be delivered. The AAA, as a neutral organization, believes that ADR can be delivered fairly to all parties in the process, consumer and non-consumer alike. And, because of the AAA's structure, history and processes, all of which point to the organization's neutrality, the AAA is able to provide that value-added element that can ensure the fairness that is required in alternative dispute resolution. This is an important message which the AAA is working to communicate to state and federal legislative bodies.

Diversity Initiatives

The AAA also seeks to ensure that all parties have access to diverse neutrals, and so the AAA established the Advisory Committee on Diversity, chaired by AAA Board Member Hon. Timothy K. Lewis. The Committee met several times in 2007 to discuss plans to increase the level of inclusiveness in ADR, particularly with respect to participation by those who have been historically excluded from meaningful participation in the ADR process. The Diversity Committee's efforts included the creation of an AAA Fellows program that will award 15 fellowships to women and persons of color in the field of ADR. Through the AAA Fellows program, participants will receive comprehensive ADR training to broaden their experience and will be presented with opportunities to network with leaders in the field.

Promotion of AAA and ADR

In 2007, the AAA's presence in the media was substantial and further assisted in educating the public about the benefits of ADR. In 2007, the AAA's more proactive approach to media relations helped to increase the organization's profile as well as to increase awareness of AAA services in particular and ADR in general.

Media opportunities included a feature article in *Inside Counsel* magazine; several articles in entertainment-industry publications on the use of ADR in the entertainment field, generated as a result of the increased use of ADR in California; several article placements with Singapore's largest business newspapers and broadcast networks in connection with the opening of the ICDR's Singapore office; a feature article on the launch of the IMI in the *ABA Journal* and a feature article, also in the *ABA Journal*, on Online Dispute Resolution, based on the AAA's partnership with Cybersettle. The AAA was also successful in securing meetings with various newspapers and other publications with national distribution to discuss greater coverage of alternative dispute resolution in their pages.

AAA Foundation and Research Center

The need for a research capacity for the field of conflict management is more critical today than ever—both domestically and internationally. This has been punctuated by the absence of data as to time, costs, award enforcements and multiple other risk-management analyses in international cases. On the domestic front, arguments made to legislative bodies based upon exceptions to typical practices remain unanswered where case facts and data are unavailable to support the norm.

Initiating this much-needed component requires focused efforts and significant dedicated resources. This area was only lightly addressed in 2007 but must be advanced—and could be launched with the help and generosity of those who support arbitration and mediation.

Regional Office Anniversary

The Minnesota office celebrated 40 years of service in 2007. This significant occasion also marked 22+ years serving the state of Minnesota's No-Fault automobile caseload.

President's Award for Living the Values

This prestigious award is presented each year to that individual who, in the judgment of a committee of peers, epitomizes the AAA's core values—integrity, conflict management and service, standards intrinsic to the AAA as it sets forth to accomplish its vision for the future. The 2007 recipient was Becky Bays, Online Panels Coordinator, AAA Neutrals Services Department in Dallas, Texas.

Conclusion

In 2007, the AAA continued to respond to the Voice of the Customer in providing more choices and services: administrative options, operational enhancements, expansions in online service delivery and mediation services, as well as online awards and advocacy programs for labor and management system users. The AAA's international caseload once again grew and is the largest of any institutional provider worldwide, more elections were administered by the AAA than in any other year in its history and there was expansion in services to state and federal governments. The AAA continued to advance its long-term commitment to expanding opportunities for persons historically precluded from meaningful involvement in the field of ADR. Finally, the AAA's financial results in 2007 bespeak a solid foundation appropriate for a service-oriented, not-for profit entity.

All that has been referenced, as well as other achievements in 2007, were possible because of the dedicated staff of the AAA, an engaged Board of Directors who continuously add value and the leadership of the senior managers on the AAA Policy and Strategy Group.

Heartfelt and abiding appreciation is herein expressed to all.

A handwritten signature in black ink that reads "William K. Slate II". The signature is written in a cursive style with a stylized arrow pointing to the right at the end of the name.

William K. Slate II

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AMERICAN ARBITRATION ASSOCIATION, INC. AND SUBSIDIARIES

**REPORT ON CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2007 AND 2006**

AMERICAN ARBITRATION ASSOCIATION, INC. AND SUBSIDIARIES

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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 sheets of American Arbitration Association, Inc. and Subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations and changes in net assets and cash flows for the years 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 audits.

We conducted our audits 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 audits provide 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, 2007 and 2006, and the changes in their net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the American Arbitration Association, Inc. and Subsidiaries changed its method of accounting for employee benefit plans upon adoption of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans".

Handwritten signature of J.H. Cohen LLP in cursive script.

New York, New York

April 24, 2008

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
ASSETS		
Cash and cash equivalents	\$ 8,323,000	\$ 12,822,000
Investments, at fair value (Note 2)	88,694,000	80,382,000
Administration fees receivable, net of allowances for cancellations and uncollectable accounts of \$941,000 in 2007 and \$923,000 in 2006	22,947,000	20,606,000
Other receivables	208,000	189,000
Prepaid expenses	2,872,000	2,431,000
Construction in progress (Note 4)	37,000	2,451,000
Furnishings, equipment and leasehold improvements, net (Note 4)	<u>8,810,000</u>	<u>8,041,000</u>
Total Assets	<u>\$ 131,891,000</u>	<u>\$ 126,922,000</u>
 LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses (Notes 3 and 5)	\$ 63,073,000	\$ 65,654,000
Accrued postretirement medical costs (Note 3)	8,400,000	9,970,000
Accrued pension liability (Note 3)	4,986,000	8,191,000
Deferred rent	3,955,000	3,643,000
Deferred revenue	<u>2,451,000</u>	<u>2,340,000</u>
Total Liabilities	82,865,000	89,798,000
Commitments and contingencies (Note 5)	—	—
Unrestricted net assets	<u>49,026,000</u>	<u>37,124,000</u>
Total Liabilities and Net Assets	<u>\$ 131,891,000</u>	<u>\$ 126,922,000</u>

See Notes to Consolidated Financial Statements.

**CONSOLIDATED STATEMENTS OF OPERATIONS AND
CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
OPERATING REVENUES		
Administration fees earned:		
Commercial	\$ 45,559,000	\$ 44,533,000
State insurance	15,753,000	17,729,000
Labor	4,937,000	4,832,000
Elections	<u>5,281,000</u>	<u>3,468,000</u>
Total	71,530,000	70,562,000
Publications and education	<u>1,118,000</u>	<u>1,763,000</u>
Total	<u>72,648,000</u>	<u>72,325,000</u>
OPERATING EXPENSES		
Administration of tribunals	59,801,000	61,918,000
Elections	5,042,000	3,135,000
Publications and education	1,855,000	2,256,000
General and administration	<u>3,091,000</u>	<u>2,847,000</u>
Total	<u>69,789,000</u>	<u>70,156,000</u>
Net Operating Income	2,859,000	2,169,000
NON OPERATING INCOME AND EXPENSES		
Interest and dividends on investments, net of fees (Note 2)	3,341,000	2,296,000
Net realized and unrealized gains on investments	2,574,000	7,297,000
Loss on disposal of assets (Note 4)	<u>—</u>	<u>(1,048,000)</u>
CHANGE IN UNRESTRICTED NET ASSETS BEFORE CHANGES IN NET ASSETS		
	8,774,000	10,714,000
Minimum pension liability adjustment (Note 3)	1,262,000	2,507,000
Effect of adoption of recognition provision of SFAS 158 (Note 3)	<u>1,866,000</u>	<u>—</u>
CHANGE IN UNRESTRICTED NET ASSETS	11,902,000	13,221,000
UNRESTRICTED NET ASSETS, BEGINNING OF YEAR	<u>37,124,000</u>	<u>23,903,000</u>
UNRESTRICTED NET ASSETS, END OF YEAR	<u>\$ 49,026,000</u>	<u>\$ 37,124,000</u>

See Notes to Consolidated Financial Statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 11,902,000	\$ 13,221,000
Adjustments to reconcile the change in net assets to net cash provided by operating activities:		
Depreciation and amortization	2,340,000	2,887,000
Net realized and unrealized gain on investments	(2,574,000)	(7,297,000)
Loss on disposal of assets	—	1,048,000
Changes in operating assets and liabilities:		
Increase in administration fees receivable	(2,341,000)	(805,000)
(Increase)/Decrease in other receivables	(19,000)	174,000
(Increase)/Decrease in prepaid expenses	(441,000)	146,000
(Decrease)/Increase in accounts payable and accrued expenses	(2,581,000)	7,119,000
(Decrease)/Increase in accrued postretirement medical costs	(1,570,000)	302,000
Decrease in accrued pension liability	(3,205,000)	(1,233,000)
Increase/(Decrease) in deferred rent	312,000	(510,000)
Increase in deferred revenue	<u>111,000</u>	<u>230,000</u>
Net cash provided by operating activities	<u>1,934,000</u>	<u>15,282,000</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furnishings, equipment and leasehold improvements	(658,000)	(873,000)
Proceeds from sales of investments	30,850,000	40,126,000
Purchase of investments	(36,588,000)	(39,860,000)
Construction in progress	<u>(37,000)</u>	<u>(2,451,000)</u>
Net cash used in investing activities	<u>(6,433,000)</u>	<u>(3,058,000)</u>
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	(4,499,000)	12,224,000
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>12,822,000</u>	<u>598,000</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 8,323,000</u></u>	<u><u>\$ 12,822,000</u></u>

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.

Accounting change

The Association adopted the provisions of Statement of Financial Accounting Standards No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)” (“SFAS 158”), which became effective for fiscal years ending after June 15, 2007. SFAS 158 requires an employer that sponsors a defined benefit pension or postretirement plan to report the funded status of each plan in its statement of financial position and to include enhanced disclosures about each plan in its notes to the financial statements. In addition, SFAS 158 requires the measurement of plan assets and benefit obligations as of the date of the employer’s fiscal year-end statement of financial position.

The following presents the effects of applying SFAS 158 on the individual line items in AAA’s balance sheet as of December 31, 2007 (see note 3):

	Under SFAS 87	Adjustments	After Application of SFAS 158
Accrued postretirement medical costs	\$ 10,266,000	\$ (1,866,000)	\$ 8,400,000
Change in unrestricted net assets	10,036,000	1,866,000	11,902,000
Unrestricted net assets	47,160,000	1,866,000	49,026,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)*****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 2007 and 2006 of \$250,000 and \$126,000, respectively, which is included in the accompanying consolidated balance sheets 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 \$2,157,000 and \$2,151,000 as of December 31, 2007 and 2006, respectively, are included in deferred revenue in the accompanying consolidated balance sheets.

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.

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 exceeded federally insured limits by \$15,658,000 and \$16,600,000 as of December 31, 2007 and 2006, respectively. 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 statements of operations and changes in net assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)

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 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use". The costs associated with the development of software were 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.

ICDR, LLC is a taxable entity in Ireland. There are no provisions for income taxes for 2007 and 2006 due to losses incurred. As of December 31, 2007 and 2006, ICDR, LLC has offset the deferred tax asset related to its loss carryforwards of approximately \$2,500,000 and \$2,000,000, respectively, by a valuation allowance of an equivalent amount as such deferred tax asset is not expected to be realized. Accordingly, there are no credits for income taxes reflected in the accompanying consolidated statements of operations and changes in net assets to offset ICDR, LLC's pretax losses.

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.

Reclassifications

Certain prior year balances have been reclassified to conform with the current year financial statement presentation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**NOTE 2 - INVESTMENTS**

Investments at December 31, 2007 and 2006 consist of the following:

	2007		2006	
	Cost	Fair Value	Cost	Fair Value
Fixed income/Money market funds	\$ 37,350,000	\$ 37,326,000	\$ 35,672,000	\$ 35,371,000
Domestic equity mutual funds	21,316,000	23,829,000	16,738,000	19,568,000
International equity mutual funds	22,000,000	23,209,000	11,809,000	14,448,000
Real estate mutual funds	4,230,000	4,330,000	9,116,000	10,995,000
Totals	<u>\$ 84,896,000</u>	<u>\$ 88,694,000</u>	<u>\$ 73,335,000</u>	<u>\$ 80,382,000</u>

Interest and dividends on investments are reported net of fees of \$668,000 and \$679,000 in 2007 and 2006, respectively.

NOTE 3 - PENSION AND OTHER POSTRETIREMENT BENEFITS PLANS

The Association maintains a noncontributory, qualified defined benefit pension plan covering all eligible employees. Effective December 31, 2006 the defined benefit pension plan was frozen and no additional benefits will be accrued by employees for future years of service. Accordingly, at December 31, 2007 and 2006 the projected benefit obligation and accumulated benefit obligation are equal. The curtailment of the Plan was accounted for in 2006 in accordance with Statement of Financial Accounting Standards No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits." The Association recognized in operating expenses a curtailment loss of \$434,000 in 2006 and a reduction in benefit obligation of \$3,131,000 in 2006.

The Association makes contributions to the Plan based on actuarial calculations. Total employer contributions required for the fiscal year beginning January 1, 2008 are zero. The Association expects to make a discretionary contribution of up to \$1,500,000 to the Plan during 2008.

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 10 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. For 2007 and 2006, the expense associated with this unfunded plan, which is included in general and administrative expenses, was \$146,000 and \$10,000, respectively. For 2007 and 2006, the accrued benefit obligation, which is actuarially determined and included in accounts payable and accrued expenses, was \$565,000 and \$419,000, respectively. The discount rate used to determine the benefit obligation was 6.50% and 6.00% in 2007 and 2006, respectively.

For the defined benefit plan and the healthcare benefit plan, the following tables set forth each plan's funded status and amounts recognized in the Association's financial statements at December 31, 2007 and 2006:

	Pension Benefits		Healthcare Benefits	
	2007	2006	2007	2006
Benefit obligation at December 31	\$ 33,118,000	\$ 35,052,000	\$ 8,400,000	\$ 7,921,000
Fair value of plan assets at December 31	28,132,000	26,861,000	—	—
Net unfunded status of the plan	(4,986,000)	(8,191,000)	(8,400,000)	(7,921,000)
Unrecognized net (gain)/loss included in net assets	5,149,000	—	(1,866,000)	—
Employer's contribution	2,500,000	2,000,000	324,000	270,000
Plan participants' contributions	—	—	42,000	38,000
Net periodic benefit costs	557,000	3,274,000	620,000	573,000
Benefit payments	(2,705,000)	(3,202,000)	(366,000)	(309,000)
Amounts recognized in other changes in net assets in the statement of operations and changes in net assets consist of:				
Prior service credit	—	—	(888,000)	—
Net actuarial gain	—	—	(978,000)	—
Weighted-average assumptions to determine the benefit obligation as of December 31:				
Discount rate	6.50%	6.00%	6.50%	6.00%
Expected return on plan assets	7.50%	7.50%	N/A	N/A
Weighted-average assumptions to determine the net benefit cost for the year ended December 31:				
Discount rate	6.50%	6.00%	6.50%	6.00%
Expected return on plan assets	7.50%	7.50%	N/A	N/A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The estimated net loss for the defined benefit pension plan that will be amortized from changes in unrestricted net assets into net periodic benefit cost for the next fiscal year is \$166,000. The estimated prior service cost credit and net gain for the postretirement plan that will be amortized from changes in unrestricted net assets into net periodic benefit cost over the next fiscal year is \$312,000.

For measurement purposes, a 9.75% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2007. The rate was assumed to decrease gradually to 4.50% until 2014 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 and through December 31, 2006, 1.75% of earnings in effect on January 1 of such year.

Estimated future benefit payments in each of the five years subsequent to December 31, 2007 and in the aggregate for the five years beginning in 2013 are as follows:

<u>January 1,</u>	<u>Pension Benefits</u>	<u>Healthcare Benefits</u>
2008	\$ 2,237,000	\$ 438,000
2009	2,276,000	453,000
2010	2,280,000	495,000
2011	2,283,000	539,000
2012	2,323,000	533,000
Thereafter	11,919,000	3,049,000

The target allocations of pension assets are outlined below:

	<u>Target Allocation</u>	<u>Percentage of Plan Assets at December 31,</u>	
		<u>2007</u>	<u>2006</u>
Plan assets:			
Equity securities	40 - 70%	<u>57%</u>	56%
Fixed income/Group annuity contract	30 - 60%	<u>43</u>	44
Total		<u><u>100%</u></u>	<u><u>100%</u></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 objectives of the Association's Pension Investment Objectives and Policies Statement.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 ("DIMA") introduced 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. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003", the Association elected to recognize the effects of DIMA on its retiree medical benefits expense in 2005. Due to the inclusion of DIMA, the Plan's benefit obligation was reduced by \$1,568,000 in 2007 and by \$1,924,000 in 2006.

NOTE 4 - FURNISHINGS, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Furnishings, equipment and leasehold improvements consist of the following:

	<u>2007</u>	<u>2006</u>
Furnishings and equipment	\$ 14,750,000	\$ 17,749,000
Leasehold improvements	<u>13,393,000</u>	<u>12,871,000</u>
	28,143,000	30,620,000
Less accumulated depreciation and amortization	<u>(19,333,000)</u>	<u>(22,579,000)</u>
Total	<u>\$ 8,810,000</u>	<u>\$ 8,041,000</u>

In 2007 and 2006, the Association recognized a net loss of approximately \$0 and \$1,048,000 relating to the disposal of certain assets with original costs totaling \$6,754,000 and \$2,559,000, respectively. Included in these amounts and recorded as part of operations in 2006 was \$755,000 in losses related to the disposal of certain assets due to office consolidations that had original costs of \$2,146,000.

Furnishings and equipment as of December 31, 2007 and 2006 includes costs associated with the development of software for internal use of \$4,907,000. Related accumulated amortization for both periods was \$4,907,000.

In-progress construction costs for leased facilities totaled \$37,000 in 2007 and \$2,451,000 in 2006. When placed into service, these in-progress construction costs will be included in capital assets and amortized over the lives of the underlying leases. In-progress construction amounting to \$2,451,000 and \$31,000 was completed and placed into service during 2007 and 2006, respectively.

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 2008 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 operations for the years ended December 31, 2007 and 2006 amounted to \$10,343,000 and \$12,142,000, respectively. In addition, the Association leases certain computer and office equipment under various operating leases, all of which expire over the next one to five years.

Due to the consolidation of certain offices during 2006, the Association recorded liabilities for future lease obligations of \$142,000 and \$227,000 for 2007 and 2006, respectively. These liabilities are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

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, 2007 and thereafter are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2008	\$ 11,115,000
2009	10,980,000
2010	10,399,000
2011	9,876,000
2012	9,842,000
Thereafter	<u>12,141,000</u>
Total	<u>\$ 64,353,000</u>

The Association is the sublessor for certain leased office facilities under sublease contracts that expire between 2007 and 2013. The minimum rentals to be received under noncancelable subleases in each of the five years subsequent to December 31, 2007 and thereafter are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2008	\$ 2,110,000
2009	2,110,000
2010	2,264,000
2011	2,264,000
2012	2,264,000
Thereafter	<u>189,000</u>
Total	<u>\$ 11,201,000</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - COMMITMENTS AND CONTINGENCIES (CONCLUDED)

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 consolidated financial position.

The Association bills and collects amounts in advance for unearned arbitrators' compensation. At December 31, 2007 and 2006, advance deposits collected totaled \$57,158,000 and \$56,224,000, respectively. These amounts are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

The Association has a letter of credit agreement totaling \$355,000 at December 31, 2007. This agreement guarantees an operating lease rental obligation and is secured by the investment portfolio.



American Arbitration Association
Dispute Resolution Services Worldwide

American Arbitration Association

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