

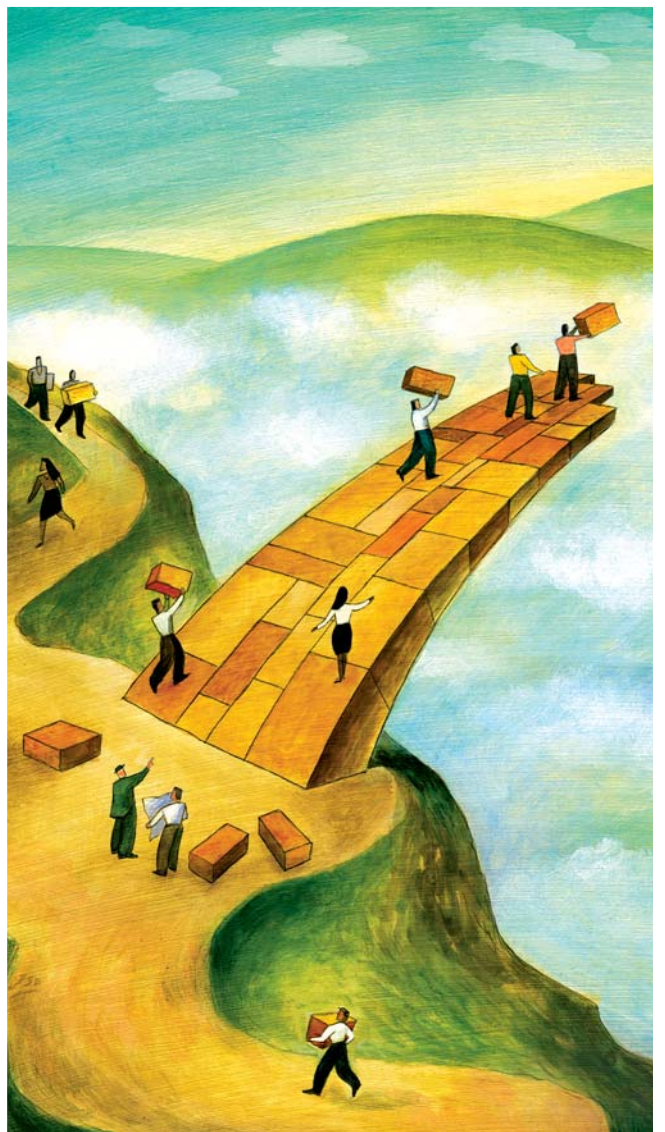


American Arbitration Association

Dispute Resolution Services Worldwide

2003
2003

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.



American Arbitration Association
Dispute Resolution Services Worldwide

2003 PRESIDENT'S LETTER AND FINANCIAL STATEMENTS

In 2003, the American Arbitration Association (AAA) moved into a new phase of its long-term development program – one in which significant resources were devoted to service enhancements and the sponsorship of a broad range of initiatives aimed at improving the process, practice, and benefits of our conflict management services.

The opening of the fifth and last commercial case management center in East Providence in mid-2002 marked the completion of a seven-year program during the course of which we restructured our case management system. Beginning in 1996, we had opened case management centers in Dallas, Atlanta, and Fresno, and an international case management center in New York. The principal objectives of this extensive conversion were to centralize case handling and improve the case management process by taking advantage of innovative case-handling technology and a highly trained group of professional case managers.

With that infrastructure in place, our focus shifts to two other aspects of our long-term development plan:

- > maintaining the AAA's ability to offer, as the global leader in conflict management, flexible services that are of the highest quality and that are directly responsive to user needs, and
- > sponsoring undertakings that strengthen and give recognition to the underpinnings, utility, ease of use, and rewards of conflict management services.

There are five themes that distinguish this latest phase of our strategic development, while maintaining our "center," including fidelity to our mission, vision, and core values:

- > intensifying efforts to improve the AAA's service delivery model to meet client needs and expectations in a rapidly changing conflict management environment,
- > sponsoring research and educational programs that deepen the understanding and appreciation of how ADR is used and the ways in which "dispute-wise" organizations – a concept that arose from our research – benefit in important ways from broadly applied conflict management techniques,
- > supporting and defending the process – promoting the use of conflict management and, when necessary, defending through intensive education efforts the interests of ADR users,
- > fine-tuning the process – the continuation of a long-term commitment to work hand-in-hand with committed parties in specialized areas of conflict management to strengthen rules and procedures and to provide educational outreach programs that both foster interest in specialized ADR and enhance user skill sets, and
- > expanding our service offerings in such areas as international dispute resolution, eCommerce, mass claims, and elections.

GOOD RESULTS IN A CHALLENGING ECONOMIC ENVIRONMENT

The backdrop, as we set out on this path, was a challenging year in which we continued to feel the effects of a soft economy. While our overall caseload was down, primarily as a result of a drop-off in No-Fault automobile insurance cases, revenues increased 5.3% year-to-year, due in part to the

increasing dollar value of claims filed. Overall, despite sharp increases in pension costs, medical insurance, and directors and officers liability insurance, the AAA – with prudent cost control measures in place – showed a healthy bottom line increase over year end 2002.

The drop in No-Fault cases is due primarily to the fact that in 2002 we finished cleaning up the largest part of a previous backlog of No-Fault cases. In a slow economy, our commercial caseload was down about 8%, while labor cases rose slightly. A total of 646 international cases were filed representing more than \$3 billion in claims and involving parties in 88 countries. Once again, those figures reflect the largest number of new international filings of any arbitral institution in the world.

AN ASSOCIATION-WIDE COMMITMENT TO SERVICE IMPROVEMENT

With the completion of the last of the five commercial case management centers, we began to see some of the service delivery improvements that we had sought, and the initial feedback was quite positive from users of our services and neutrals alike. But we knew that the centralization of case management services was only part of the equation.

For some time we had recognized that we were working in a changing and more demanding environment, and we decided to take an in-depth look at what we do and how well we do it as the next phase of our strategic planning process. The impetus for this was in large part anecdotal. Many who had been long-term supporters of arbitration as an important and efficient alternative to litigation had become critical, saying that two of its primary values – speed and cost savings – were being eroded, and that some neutrals and lawyers, through increasingly extensive use of discovery, were diminishing both its effectiveness and value. In addition, there appeared to be significant misperceptions in the marketplace about arbitration among those who were inexperienced in its application.

In mid-2002, we began to formally gather information, undertaking research that would help us review and assess our strengths and our challenges and help determine our future course. We conducted detailed and intensive "day-in-the-life" interviews with a cross section of users of our commercial case management services so that we could better understand how the process was perceived at the point of delivery and how well it functioned. As a counterpoint, we met internally with staff at our case management centers to capture insights they had gained through interaction with parties and their counsel.

At the same time, we conducted broad-based market research across a wider spectrum of ADR users, and we embarked on the largest feedback program we have ever undertaken, one in which a third-party research firm evaluated the responses to surveys mailed to more than 48,000 parties in cases that had recently been completed.

The results of this extensive fact-finding process were a list of strengths and shortcomings and a clear call to action – an imperative, as the world leader in conflict management, to continue to refine and improve the services we offer and the very means by which we offer them. Over the course of 2003, we developed a comprehensive plan for fine-tuning our services and their delivery in a way that embodies the principles and precepts of the AAA's mission, vision, and values – our commitment to maintaining a leadership position in our field built on integrity, committed to innovation, and embracing the highest standards of client service achievable in every undertaking.

To deliver on these values, we have set our sights on creating a Service Delivery Model that will assist parties in averting disputes all together, and that, when they do occur, will provide a quicker, more efficient process for their resolution. The AAA has examined, for example, new ways of organizing

case management staffing to create more efficient working teams, the development of counseling capabilities in the case management centers to offer clients advice on dispute resolution options throughout the life of a case, the creation of processes for better handling of general inquiry calls, the improvement of case intake procedures, and the gathering and cataloging of "leading practices" across all aspects of our service to clients.

As this report goes to press, we have over 70 people working in 13 separate projects aimed at improving service delivery. We have specialized groups handling specific kinds of cases within the case management centers, and we are already getting favorable feedback from clients with respect to service improvement.

And this is just the beginning. This phase of the AAA's development, which is being undertaken on an organization-wide basis, represents a commitment that will drive our collective efforts in the coming years. There is no question about the value of ADR procedures when they are done right – efficiently, quickly, and at a reasonable cost in a way that helps preserve rather than undercut relationships. That is the value we have added in the past and the value we are committed to adding in the future.

GROUNDBREAKING RESEARCH: A LOOK AT "DISPUTE-WISESM BUSINESS MANAGEMENT"

In an extension of our efforts to improve our service offerings and delivery, we commissioned a major research study in 2003 that examined the attitudes and experiences associated with the use of non-judicial dispute resolution.

The first important empirical research in the field since a 1998 Cornell study, *Dispute-Wise ManagementSM: Improving Economic and Non-Economic Outcomes in Managing Business Conflicts*, took a fresh look at the usage trends for arbitration and mediation covered in the earlier study, but also broke new ground by going an important step further. It posed two critical questions – whether companies might be identified as "dispute-wise," and, if so, whether there is any relationship between dispute-wise management practices and favorable outcomes of both an economic and non-economic nature.

The study found that there are, indeed, traits that characterize the legal departments of companies that can be termed "dispute-wise." Moreover, it was also found that companies embracing a dispute-wise approach to managing business and workplace conflicts enjoy lower legal costs and are more successful at preserving business relationships than companies that favor litigation as a matter of policy.

Conducted by an independent firm, the research involved interviews with senior legal department members of 254 companies, including 101 *Fortune* 1000 companies. In what we believe was the first attempt to present a conceptual framework for measuring how companies manage disputes, the AAA-sponsored study found a number of characteristics that describe dispute-wise legal departments. Typically, they are highly integrated into business planning, understand the broader issues facing their company and industry, spend a good deal of time on highly complex and technical issues, are often involved in cross-border international disputes, and work in an environment where senior management is focused on preserving relationships and settling disputes rather than just winning cases whatever the cost.

The most significant finding of the study is that dispute-wise management practices appear to be associated with positive business outcomes. In addition to enjoying stronger relationships with customers, suppliers, and employees and having significantly lower legal department expenses than those companies that were found to be "least dispute-wise" in the survey, they tend to manage their legal resources well and they share an appreciation of the fairness and speed of ADR processes in resolving disputes.

The study is important in two respects. First, it confirms something that we have long accepted on anecdotal evidence – that there are specific business benefits associated with the acceptance and use of ADR processes, which are capable of providing a rapid, comparatively inexpensive, and easily accessed alternative to the judicial system in a time of steadily increasing litigation costs.

Second, it demonstrates that companies willing to adopt a “portfolio approach” to dispute management by taking a more global view of the full spectrum of disputes they face fare better than those with a single-minded focus on litigation. Typically, these companies address each situation in relation to other disputes in the portfolio with an overall view toward minimizing risk, cost, time spent, and resources expended, all within a context of seeking to preserve business relationships. This highly pragmatic and effective behavior falls under the heading “dispute-wise business management” and is indicative of a continuing evolution in attitudes toward conflict management, one that puts a high value on ADR techniques and processes.

As noted earlier, this undertaking is an extension of our efforts to improve our services, as well as their delivery. The reception to the study has been very positive, causing a number of corporate executives to reappraise their companies’ conflict management agendas.

SUPPORTING AND DEFENDING THE PROCESS

Two aspects of the current environment elicit concern. First, as our market research indicated, there is a good deal of misinformation in the marketplace about the uses, effectiveness, and fairness of ADR. Second, ADR is coming under increasingly persistent attack by those whose goal it is to have access to ADR processes – primarily arbitration – curtailed. It is ironic that, as we make plans to celebrate the 80th anniversary of the Federal Arbitration Act in 2005, its defense is a battle we are once again waging.

In last year’s report, we described how we decided to meet head-on an attack on arbitration in California. In that situation, we felt strongly that the commitment of funding and other resources to an education effort was an appropriate course of action, and it led to the rethinking and, in some instances, the removal of some of the most restrictive and potentially damaging provisions of legislation that had been proposed.

This kind of effort on our part continued in 2003 as an element of an aggressive and determined educational outreach program aimed at addressing misinformation and countering outright attacks. This is not a new posture – we have participated in numerous *amicus* briefs over the years in defense of ADR and testified before many legislative bodies, and education is a basic element of our mission as a not-for-profit ADR provider.

Simply put, we intend to elevate our visibility in a variety of forums addressing a broad spectrum of issues, forming partnerships and alliances, and taking whatever steps we can to foster the understanding and fair use of ADR. We spent time in 2003 taking a pro-active stance in policy discussions with legislators and their staffs at both the state and federal levels. We also appeared before editorial boards and spoke with interested organizations on both sides of the argument.

We continue to support a very active educational outreach program through which we co-sponsor events with other organizations and host at least one educational seminar or workshop virtually every working day of the year. In 2003, for example, we co-sponsored our 20th joint symposium with the World Bank, and the AAA’s international division – the International Centre for Dispute ResolutionSM (ICDR) – co-sponsored with the Permanent Court of Arbitration at The Hague a one-day conference on the administration of mass claims and issues surrounding the United Nations Commission for International Trade Law (UNCITRAL) model law.

In April, the AAA signed a cooperative agreement with the Inter-American Bar Association with the goal of promoting, through educational conferences and other means, international commercial arbitration throughout the Western Hemisphere. A similar accord was entered into with the Inter-American Commercial Arbitration Commission (IACAC). In addition to promoting ADR in the Americas, the agreement calls for all IACAC international cases, regardless of where filed, to be administered at the ICDR's case management center in New York.

In 2005, marking the 80th anniversary of the passage of the Federal Arbitration Act will be an important event for us. The celebratory plans, which will be unveiled in the course of the coming year, promise to be ambitious. In keeping with our desire to be out front on policy issues, we plan to sponsor a lecture series and commemorative events in several cities across the country.

FINE TUNING THE PROCESS

Once again this year, we continued to work with interested stakeholders on refinements to existing rules and procedures that govern conflict resolution processes in a number of specialized areas.

An important step was taken in September when the Executive Committee of the AAA's Board of Directors approved a revised *Code of Ethics for Arbitrators in Commercial Disputes*. The revised code, which was jointly sponsored by the AAA and the American Bar Association, in most respects resembles the original which was first adopted in 1977. The key changes are the formal presumption of independence and neutrality for all arbitrators – including party-appointed arbitrators – and the strengthening of disclosure requirements along with a bolstering of protections against bias.

This change in the code of ethics triggered a fresh review of the *Commercial Arbitration Rules and Mediation Procedures (including Procedures for Large, Complex Commercial Disputes)* and the *Construction Industry Arbitration Rules and Mediation Procedures*. A number of changes were made in both sets of procedures, including changes that make the rules conform to the revised code of ethics.

In November, the AAA's National Construction Dispute Resolution Committee (NCDRC) held a two-day forum – the National Construction Forum on Conflict Resolution in the Construction Industry – in Chicago. The forum's primary focus was on ways to resolve disputes in the construction industry through partnering, dispute review boards, mediation, and arbitration. About 120 people, including both construction industry professionals and attorneys, attended the conference.

Co-sponsors of the forum, which attracted attendees from Canada to Brazil, were the American Bar Association Section of Public Contracts, American College of Construction Lawyers, American Consulting Engineers Council, American Institute of Architects, Associated Builders & Contractors, Associated General Builders of America, Associated Specialty Contractors, Dispute Resolution Board Foundation, Engineers Joint Contract Documents Committee, National Association of Home Builders, National Society of Professional Engineers, National Utility Contractors Association, Victor O. Schinnerer & Co., Inc., and Women Construction Owners & Executives.

This year marked the tenth anniversary of the inauguration of the AAA's Large Complex Case (LCC) program and panel of neutrals in what has largely been a successful venture. The LCC program was designed to provide top tier services in complicated business disputes involving claims of at least \$1 million. Since 1993, the thousands of LCC cases we have administered have ranged from breach of fiduciary duty to patent infringement and have involved dollar amounts up to \$10 billion.

We marked the anniversary by taking steps to re-invigorate the program. In response to feedback from the marketplace, we lowered the minimum claim size from \$1 million to \$500,000. In addition, we made four major LCC rule revisions that affect the timing of administrative conferences, enable the use of a single arbitrator, and make changes in procedures for preliminary hearings, subpoenas, and discovery. These changes, supported by a strong panel of experienced LCC neutrals and pro-active management by designated LCC case managers, have been well received by the market.

One of the most interesting changes in arbitration law within the past year has been in the area of class actions. In a plurality opinion, the United States Supreme Court in *Green Tree Financial Corp. v. Bazzle*, 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 was silent on the issue. Implicit in the *Bazzle* decision was a determination that class action proceedings could take place in the arbitration forum.

In response to *Bazzle*, the AAA created *Supplementary Rules for Class Arbitrations* that apply to any dispute "...arising out of an agreement that provides for arbitration pursuant to any of the rules of the AAA where a party submits a dispute to arbitration on behalf of or against a purported class." The supplementary rules will also apply whenever a court refers a matter pleaded as a class action to the AAA for administration, or when new claims in a pending AAA arbitration are asserted on behalf of or against a class.

In issuing our new class arbitration rules, the AAA kept two important priorities in mind. First, we felt that entering any order or award that might bind persons not personally represented in our proceeding was a grave responsibility and had to be undertaken with a scrupulous concern for fairness and due process. Second, we felt that the challenge of taking on a process that could bind absent class members and the need to provide a fair process for those defending the class action, required the AAA to build some unique "safety valves" into our procedures. Our new rules permit any interested party to turn to a court at specified stages in the process if they feel that their rights are not being properly protected.

In addition, the presumption of confidentiality in arbitrations has been reversed for class arbitrations. Consequently, we have created a class action docket on our website where information about class arbitrations can be viewed. Clearly, this is an area of the law that remains in flux and one in which the AAA treads cautiously.

In the labor arena, the AAA's National Labor/Management Advisory Council, a high-powered group with members from across the country, worked to update case management procedures, improve training of neutrals, and fine tune service delivery in the AAA's ten regional offices where labor services are provided. It also worked with the National Academy of Arbitrators to provide training for its members.

Lastly, we revised our commercial fee schedule to reflect a new refund policy under which all of the filing fee – above the minimum \$300 or \$500 fee, depending on case size – will be refunded if a case is settled or withdrawn within five calendar days of filing. Similarly, half of the filing fee will be refunded if the case is settled or withdrawn within 30 calendar days, and 25% will be refunded within 60 days of filing, prior to the appointment of an arbitrator.

EXPANDING OUR SERVICE OFFERINGS

Our commitment to innovation, a core element of our mission statement, is one of our principal organizational strengths and a reflection of the leadership role we play in the dispute resolution field. In the last few years, many of our advances were technologically driven, and much of the expansion of our sphere of influence was in the field of global dispute resolution.

In its seventh year of operation, the ICDR continued to provide a solid foundation for the AAA's participation in the global advancement of ADR principles and practices. During 2003, Slovenia became the 60th country with which we have a cooperative agreement, and we once again participated as co-sponsor in a number of prominent international conferences.

We continued to expand our network of strategic relationships in Latin America, Europe, and Asia. The agreements with the Inter-American Commercial Arbitration Commission and the Inter-American Bar Association mentioned earlier are critical elements in gaining a stronger foothold in South America. That we will be administering IACAC cases is particularly significant. Every Latin American country has an IACAC chapter, and our case administration will be instrumental in helping attract additional European investors into South American countries.

Also in the Latin American arena, we were invited by the World Bank to meet with government and judicial officials in Argentina to help address the stream of lawsuits arising from the devaluation of the Argentine peso. After a series of meetings in Argentina, we submitted a number of recommendations for claim valuation and processing.

We announced in July that our *International Dispute Resolution Procedures* would be revised to add a new section for international mediation. The ICDR is one of the few international arbitral organizations that consistently administers mediations on a global basis.

The "Safe Harbor" program, instituted last year for U.S. companies seeking a framework for avoiding violations of European Union privacy laws in the cross-border transfer of sensitive personal employee data between Europe and the United States, has proven to be a success. More than 25 companies have chosen the AAA as their dispute resolution provider under this program.

In December, the Federal Communications Commission (FCC) named the AAA to handle disputes arising from the purchase by News Corporation of a controlling interest in Hughes Electronics Corporation, which owns direct satellite broadcaster DirecTV. The Commission ordered that disputes arising between News Corporation and local programming distributors be resolved using the AAA's expedited commercial procedures, with some modifications. These cases will be heard by a single AAA arbitrator from a special panel developed jointly by the AAA and the FCC, utilizing final-offer "baseball style" arbitration. Michael Powell, FCC chairman, noted in his statement on the merger approval that use of arbitration was an important part of addressing and alleviating certain concerns about the merger.

We also began in 2003 to administer a unique set of cases in West Virginia that were part of an arbitration program created by the West Virginia legislature to resolve damage disputes between blasting/coal companies and property owners. The program came about as part of surface mining blasting rules established by legislation in 1999, which calls for a two-step process to deal with blasting claims. Under the program, a dispute will first be submitted to the West Virginia Office of Explosives & Blasting, a division of the West Virginia Department of Environmental Protection, for investigation, evidence gathering, and determination by an impartial claims administrator. If the parties are not satisfied with the decision, they can move to the second step – arbitration under the auspices of the AAA.

The impact of technology on the services we provide and how we provide them seems to increase each year. The number of cases filed using our Online Dispute Resolution (ODR) technology framework, AAA WebFileSM, grew about 38% last year. AAA WebFile provides parties participating in either traditional or eCommerce transactions a fast, cost-effective means of handling all or part of the dispute resolution process online. We continued to improve WebFile's platform in 2003, including an upgrade of the tutorial section, and further improvements will be made in 2004.

There is growing interest in AAA WebFile, and we are currently working with a number of national industry associations interested in making online dispute resolution available to businesses and consumers in their industry sectors. Similar interest is also being expressed by several large corporations.

The AAA's No-Fault arbitration team is developing an online electronic case folder (ECF) for New York No-Fault cases. Undertaken in partnership with the New York State Insurance Department, the ECF is essentially a paperless process in which any paper documents that the parties submit are scanned into an electronic record, which the arbitrator and the parties can view online, vastly simplifying document retrieval procedures for all parties in a case.

Similarly, the AAA elections group relies to a greater degree each year on technology-related improvements in the complex task of administering multi-city elections. Last year it introduced a text telephone system for the hearing-impaired and a caller identification system that enables ballots to be cast from the voter's home. Last year, the AAA administered over 300 elections – including three major ratifications for American Airlines and its unions – involving the counting and verification of the ballots of more than 750,000 individuals.

THE PRESIDENT'S AWARD FOR LIVING THE VALUES

First awarded in 2001 as part of our 75th anniversary celebration, the President's Award for Living the Values is bestowed upon the person who best exemplifies the core values that help the Association achieve its vision for the future. In a year when we re-dedicated ourselves to those values, this award has particular meaning, and I was honored to be able to give the award to Nicolle Wright, a supervisor of commercial case management in the Central Case Management Center in Dallas. In addition to the \$10,000 award Nicolle received, five other awards of \$3,000 each were given to Margo Bates, Chris Fracassa, Sandy Marshall, Susan Pfeiff, and PJ Walter.

In the past year, the Association articulated a new statement as part of its core ideology – "Our Shared Commitment to Diversity." This statement is a final addition to our mission of education and public service. The AAA's vision and mission is to be the global leader in conflict management with core values of integrity and service. 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 to fairly resolve disputes between parties with different perspectives, experiences, and backgrounds. Because of the nature of our work and the global reach of our services, we recognize the importance and contributions of a diverse workforce, a diverse roster of neutrals, and a diverse board of directors, and we have made a commitment to foster diversity in all of our endeavors.

MICHAEL HOELLERING

On a somber note, we were all deeply saddened by the passing in September of Michael Hoellering, longtime General Counsel of the Association and a recognized international leader in the fields of arbitration and mediation. Mike was both a friend and a marvelous colleague. His more than 40 years of exceptional service to the AAA were marked by his wisdom, grace, and high personal standards.

He brought distinction to the AAA through his work assisting individuals and arbitral institutions worldwide. His peers elected him to the presidency of the International Federation of Commercial Arbitration Institutions and the vice presidency of the International Council for Commercial Arbitration.

He leaves the Association a stronger place by virtue of his significant, lasting contributions to its principles. Some years ago, in recognition of his distinguished service as counsel and champion of alternative dispute resolution, the Association established the Hoellering Fellowship in his honor. It is entirely fitting that this fellowship is awarded to an outstanding individual committed to advancing international dispute resolution.

At the end of what was not an easy economic period for us, my thanks go out to our board members, staff, and senior management – and particularly to those of you who have devoted long hours to the terribly important task of redefining our services and processes.

Special thanks go to Florence Peterson, who concluded 11 years of outstanding service, including four as the Association's General Counsel, at year end. We offer Eric Tuchmann, who succeeds Florence, congratulations on his new assignment.

Our collective goal for the coming year and beyond can be summed up in a closing anecdote. A federal judge in the Southern District of New York ruled that a dispute before the court should proceed to arbitration rather than be placed in litigation. Why? Because, as he explained in his opinion, "One may expect that once the AAA sets its deservedly renowned machinery in motion an award will be reached sooner than litigating a claim." That kind of praise, my friends, is our grail.

A handwritten signature in black ink that reads "William K. Slate II". The signature is written in a cursive style with a large, stylized "W" and "S". The "II" is written as a simple vertical line with a horizontal bar at the top.

William K. Slate II

President and Chief Executive Officer

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INDEPENDENT AUDITORS' REPORT

TO THE BOARD OF DIRECTORS
OF AMERICAN ARBITRATION ASSOCIATION, INC.

We have audited the accompanying consolidated balance sheets of American Arbitration Association, Inc. and subsidiaries (the "Association") as of December 31, 2003 and 2002, and the related consolidated statements of operations and changes in net assets and of 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 consolidated financial position of the Association as of December 31, 2003 and 2002, and the changes in their consolidated net assets and their consolidated cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The image shows a handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is written in a cursive, flowing style.

March 16, 2004

BALANCE SHEETS
DECEMBER 31, 2003 AND 2002

	2003	2002
ASSETS		
Cash and cash equivalents	\$ 5,362,000	\$ 1,098,000
Investments – At fair value (Note 2)	57,816,000	48,729,000
Administration fees receivable Less allowances for cancellations and uncollectible accounts of \$1,091,000 in 2003 and \$1,538,000 in 2002	23,275,000	27,940,000
Other receivables (Note 5)	192,000	988,000
Prepaid expenses and other assets (Note 5)	3,113,000	3,563,000
Deferred pension costs (Note 4)	862,000	1,081,000
Furnishings, equipment and leasehold improvements – Net (Note 5)	15,927,000	17,613,000
TOTAL ASSETS	<u>\$ 106,547,000</u>	<u>\$ 101,012,000</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses (Note 3)	\$ 58,097,000	\$ 58,032,000
Accrued postretirement medical costs (Note 4)	8,615,000	8,026,000
Accrued pension liability (Note 4)	9,592,000	11,659,000
Deferred revenue (Note 1)	1,579,000	3,069,000
Total Liabilities	77,883,000	80,786,000
COMMITMENTS AND CONTINGENCIES (NOTE 3)	–	–
UNRESTRICTED NET ASSETS	28,664,000	20,226,000
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 106,547,000</u>	<u>\$ 101,012,000</u>

See notes to consolidated financial statements.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2003 AND 2002

	2003	2002
OPERATING REVENUES		
Administration Fees Earned:		
Commercial	\$ 46,283,000	\$ 45,657,000
Accident:		
Uninsured motorist	1,837,000	2,033,000
No-Fault	29,371,000	24,718,000
Labor	5,480,000	5,135,000
Elections	3,543,000	2,554,000
Total Administration Fees Earned	86,514,000	80,097,000
Publications and education	1,872,000	2,632,000
Membership dues (Note 1)	–	1,209,000
Total Operating Revenue	88,386,000	83,938,000
EXPENSES		
Administration of tribunals	74,820,000	72,525,000
Elections	3,098,000	2,337,000
Publications and education	4,314,000	4,908,000
Contribution expense (Note 7)	523,000	827,000
General and administration	4,044,000	4,197,000
Total Operating Expenses	86,799,000	84,794,000
OPERATING INCOME/(LOSS)	1,587,000	(856,000)
NON OPERATING REVENUES AND EXPENSES		
Interest and dividends on investments – Net of fees (Note 2)	1,699,000	1,223,000
Net gain/(loss) on sales of investments	41,000	(9,603,000)
Unrealized investment gain	5,007,000	1,928,000
Loss on disposal of assets (Note 5)	(104,000)	(15,000)
CHANGE IN NET ASSETS	8,230,000	(7,323,000)
UNRESTRICTED NET ASSETS – BEGINNING OF PERIOD	20,226,000	33,781,000
MINIMUM PENSION LIABILITY ADJUSTMENT (NOTE 4)	208,000	(6,232,000)
UNRESTRICTED NET ASSETS – END OF PERIOD	\$ 28,664,000	\$ 20,226,000

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2003 AND 2002

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 8,230,000	\$ (7,323,000)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization – Net	3,686,000	3,478,000
Loss on impairment of goodwill	165,000	–
Net (gain)/loss on sales of investments	(41,000)	9,603,000
Postretirement benefits other than pensions	589,000	546,000
Unrealized gain on investments	(5,007,000)	(1,928,000)
Loss on the disposal of assets	104,000	15,000
Changes in operating assets and liabilities:		
Decrease/(Increase) in administration fees receivable	4,665,000	(9,762,000)
Decrease/(Increase) in other receivables	796,000	(413,000)
Decrease in prepaid expenses and other assets	698,000	374,000
Increase in accounts payable and accrued expenses	65,000	6,716,000
Decrease in pension liability	(1,640,000)	(737,000)
(Decrease)/Increase in deferred revenue	(1,490,000)	233,000
Net Cash Provided by Operating Activities	10,820,000	802,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furnishings, equipment and leasehold improvements	(2,018,000)	(3,857,000)
Proceeds from sales of investments	10,013,000	142,217,000
Purchase of investments	(14,052,000)	(141,406,000)
In-progress construction	(499,000)	(446,000)
Net Cash Used in Investing Activities	(6,556,000)	(3,492,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on capital lease	–	(18,000)
Net Cash Used in Financing Activities	–	(18,000)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	4,264,000	(2,708,000)
CASH AND CASH EQUIVALENTS – BEGINNING OF PERIOD	1,098,000	3,806,000
CASH AND CASH EQUIVALENTS – END OF PERIOD	\$ 5,362,000	\$ 1,098,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2003 and 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

ADRWorld.com, a Delaware limited liability company ("ADRW") and subsidiary of the Association, delivers via the internet, ADR news research and industry information. Operating results of ADRW are included in the financial statements.

The International Centre for Dispute Resolution, LLC ("ICDR, LLC"), an Irish subsidiary of the Association, promotes, facilitates and provides dispute management services. Operating results of ICDR, LLC are included in the financial statements.

The Global Center for Dispute Resolution Research ("GCDRR"), a research organization dedicated to exploring the effectiveness and enhancing the utility of business dispute resolution methods throughout the world, is affiliated with the American Arbitration Association. GCDRR has its own Board of Directors and receives nearly all of its funding from the Association.

Administration Fees On July 1, 2003, the Association modified its commercial fee schedule to include a provision for refunding initial filing fees if certain requirements are met. The initial filing fee, which is subject to a minimum fee, is billed at the commencement of the dispute resolution process. Over the next 60 days, a portion of the refundable initial filing fee is recognized as revenue. If a case is settled or withdrawn before the 60-day period has elapsed, a refund is issued based on the number of days that have elapsed since the case filing requirements were met. The 60-day time period for refund eligibility is extended indefinitely for arbitration cases that utilize the Association's mediation services. Based on analysis of current trends, the Association recorded a provision for deferred revenue of \$131,000 in 2003, which represents the estimated amount of future refunds. Prior to July 1, 2003, the initial filing fee was nonrefundable.

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.

Membership On December 20, 2002, the Association's Board of Directors amended the by-laws to eliminate the reference to members in its governing documents. As such, the Association is no longer an open-enrollment membership organization. Prior to the change, membership dues were recognized upon receipt.

Contributions The Association contributes money on a daily basis to fund expenses incurred by GCDRR.

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.

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.

Goodwill Goodwill, recorded on the purchase of ADRW, and included in Prepaid Expenses and Other Assets in 2002, was reported net of accumulated amortization. The amount amortized on a monthly basis was determined by the estimated useful life of the asset on a straight-line basis, in accordance

with Accounting Principles Board Opinion No. 17, *Intangible Assets*. In accordance with Statement of Financial Accounting Standards (SFAS) No. 142 *Goodwill and Other Intangible Assets*, goodwill is subject to impairment tests at least annually. The Association performed an impairment test on the goodwill for ADRW, which takes into account, among other things, the future cash flows of the entity. As a result, in 2003, the Association recorded a goodwill impairment loss of \$165,000. After recording the impairment loss for the goodwill, the net book value is zero.

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

Capitalization of Software The Association capitalizes 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.

Impairment of Long-Lived Assets In accordance with Statement of Financial Accounting Standards (SFAS) No. 121 *Accounting for the Impairment of Long-Lived Assets*, management reviews long-lived assets and certain identifiable intangible assets whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. In the event that impairment occurs, the fair value of the related asset is estimated, and the Association records a charge to the change in net assets calculated by comparing the asset's carrying value to the estimated fair value. SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*, defines impairment as the condition that exists when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. This statement is applicable to furnishings, equipment and leasehold improvements but not to goodwill, which is accounted for in accordance with SFAS No. 142. Included in Prepaid Expenses and Other Assets in 2002 are legal costs related to patent applications. In applying the future cash flows impairment test on the still pending patent applications in 2003, it was determined that the Association would record an impairment loss of \$303,000. After recording the impairment loss for the still pending patent applications, the net book value is zero.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Change in Estimate During 2003, the Association adjusted the provision for deferred revenue related to the case service fee. Historically, the Association deferred 100% of case service fee revenues until a hearing occurred. Based on actual experience, this estimate was adjusted to defer 42% of case service fee revenues. In 2003 and 2002, the total provision for deferred case service fee revenue was \$1,270,000 and \$2,725,000, respectively.

Tax Status The Association 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 financial statements.

ICDR, LLC is a taxable entity in Ireland. There is no provision for income taxes for 2003 and 2002, due to losses incurred in those years.

2. INVESTMENTS

Investments at December 31, 2003 and 2002 consist of the following:

	2003		2002	
	Cost	Fair Value	Cost	Fair Value
Intermediate Bond Fund	\$ 30,055,000	\$ 30,951,000	\$ 35,722,000	\$ 36,849,000
Total U.S. Equities				
Index Fund	14,167,000	17,635,000	12,058,000	11,880,000
International Equities				
Index Fund	5,109,000	6,226,000	–	–
Mid-Cap Equities				
Index Fund	2,530,000	3,004,000	–	–
	<u>\$ 51,861,000</u>	<u>\$ 57,816,000</u>	<u>\$ 47,780,000</u>	<u>\$ 48,729,000</u>

Interest and dividends on investments are reported net of fees of \$383,000 and \$610,000 for the years-ended December 31, 2003 and 2002, respectively.

3. COMMITMENTS AND CONTINGENCIES

The Association conducts all of its activities from leased office space and is currently a party to various leases that expire between 2004 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, 2003 and 2002 amounted to \$13,146,000 and \$12,336,000, respectively. In addition, the Association leases certain computer equipment under various operating leases, all of which expire over the next one to five years.

Net minimum noncancelable lease commitments for office facilities, equipment and software, exclusive of any future escalation charges, are summarized below:

YEARS ENDING DECEMBER 31,	
2004	\$ 11,536,000
2005	10,459,000
2006	9,647,000
2007	8,823,000
2008	7,289,000
Thereafter	33,195,000
	<u>\$ 80,949,000</u>

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 has been recovered. Reimbursement of the remaining \$541,000 has been denied by the Association's bank, therefore, an insurance claim will be filed.

The Association bills and collects amounts in advance for unearned arbitrators' compensation. At December 31, 2003 and 2002, unearned arbitrators' compensation totaled \$46,676,000 and \$46,549,000, respectively. The amounts are included in accounts payable.

The Association has a letter of credit agreement totaling \$1,065,000 in 2003 and 2002. This agreement guarantees an operating lease rental obligation and is secured by the investment portfolio.

4. 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.

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.

The Association also maintains a nonqualified, Supplemental Retirement Plan ("SERP"). The Association pays the cost of benefits as incurred. For 2003 and 2002, the accrued benefit obligation was \$290,000 and \$142,000, respectively.

In 2003, the Association modified the eligibility requirements for retiree healthcare benefits. 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.

The following tables set forth each plan's funded status and amounts recognized in the Association's financial statements at December 31, 2003 and 2002:

	PENSION BENEFITS		OTHER BENEFITS	
	2003	2002	2003	2002
Benefit obligation at December 31	\$ 34,631,000	\$ 31,177,000	\$ 9,196,000	\$ 8,326,000
Fair value of plan assets at December 31	22,155,000	17,105,000	–	–
Funded status	\$ (12,476,000)	\$ (14,072,000)	\$ (9,196,000)	\$ (8,326,000)
Accrued benefit cost recognized in the balance sheets	\$ (9,592,000)	\$ (11,659,000)	\$ (8,615,000)	\$ (8,026,000)
Weighted-average assumptions as of December 31				
Discount rate	6.00%	6.50%	6.00%	6.50%
Expected return on plan assets	7.50%	7.50%	n/a	n/a
Rate of compensation increase	5.30%	5.80%	n/a	n/a

For measurement purposes, a 9.75% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2003. The rate was assumed to decrease gradually to 4.50% until 2010 and remain at that level thereafter.

	PENSION BENEFITS		OTHER BENEFITS	
	2003	2002	2003	2002
Benefit cost	\$ 2,448,000	\$ 1,833,000	\$ 978,000	\$ 914,000
Employer's contribution	4,088,000	2,570,000	389,000	368,000
Plan participants' contributions	–	–	10,000	12,000
Benefits paid	2,219,000	2,415,000	399,000	380,000

The pension plan provides benefits 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 on January 1, 1997, and (b) for each year of benefit accrual service credited after January 1, 1997, 1.75% of earnings as in effect on January 1 of such year.

The provisions of Financial Accounting Standards Board Statement 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, 2003 and 2002, the Association's additional minimum liability was \$10,131,000 and \$10,559,000, respectively. The related intangible asset was \$862,000 and \$1,081,000, respectively. Net assets increased by \$208,000 in 2003 and decreased by \$6,232,000 in 2002, 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 2003 and 2002 of \$9,592,000 and \$11,659,000, respectively, which in 2003 is related to the prepaid benefit cost of \$539,000 and an additional minimum liability of \$10,131,000.

In December 2003, the FASB issued Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*. The provisions of this Statement do not change the measurement and recognition provisions of FASB Statements No. 87, *Employers' Accounting for Pensions*, No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. Statement No. 132(R) replaces FASB Statement No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*, and adds additional disclosures.

Under the revised Statement, the Association will be required to disclose additional information regarding the plan assets. Required disclosures will include the percentage of total assets for each major category of plan assets, a description of investment strategies and policies employed, and a description of the basis used to determine the overall expected long-term rate of return on plan assets. Disclosures on the benefit obligation will be expanded to include the accumulated benefit obligation, the expected future benefit payment for five years and for the next 6-10 years in the aggregate, and the employer's estimate of expected contributions for the next fiscal year. The Association will be required to disclose key assumptions and the measurement date(s) used in calculating the amounts that make up at least a majority of plan assets and benefit obligations. The Association will adopt FASB Statement No. 132(R) in 2004.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 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 *Medicare Prescription Drug, Improvement and Modernization Act of 2003*, the Association has elected to defer recognizing the effects of the Act on its accounting of retiree medical benefits until such time that specific authoritative guidance is issued. When authoritative guidance is issued, the Association may be required to change previously recorded information.

5. FURNISHINGS, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Furnishings, equipment and leasehold improvements as of December 31, 2003 and 2002 were as follows:

	2003	2002
Furnishings and equipment	\$ 18,612,000	\$ 18,207,000
Leasehold improvements	13,474,000	12,362,000
	32,086,000	30,569,000
Less accumulated depreciation and amortization	16,159,000	12,956,000
	<u>\$ 15,927,000</u>	<u>\$ 17,613,000</u>

In 2003 and 2002, the cost of leasehold improvements has been reduced by \$11,000 and \$670,000, respectively, due from landlords for reimbursement of construction costs. The amounts due are included in other receivables.

In 2003 and 2002, the Association recognized losses of approximately \$104,000 and \$15,000 relating to the disposal of certain assets with original costs totaling \$501,000 and \$244,000, respectively.

Also included in furnishings and equipment are costs associated with the development of software for internal use of \$4,906,000 for both years and \$2,473,000 and \$1,483,000 of related accumulated amortization for 2003 and 2002, respectively.

Included in prepaid expense are in-progress construction costs for leased facilities of \$499,000 and \$446,000 for 2003 and 2002, respectively. When placed into service, these in-progress construction costs will be included in capital assets and amortized over the lives of the underlying leases.

6. SUBSEQUENT EVENTS

As of April 15, 2004, the Association will no longer administer the New Jersey Personal Injury Protection (“PIP” or “No-Fault”) Program. Gross revenues from this program were \$10,491,000 and \$7,081,000 for 2003 and 2002, respectively. For 2004, the Association expected this program to generate approximately \$6 million in gross revenues and \$514,000 in net income. Currently, the Association does not expect to incur losses as a result of discontinuing this program.

7. GLOBAL CENTER FOR DISPUTE RESOLUTION RESEARCH

In the ordinary course of business, the Association has made contributions to the Global Center for Dispute Resolution Research (“GCDRR”). 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 reports these contributions on the Statement of Operations and Changes in Net Assets.

In 1998, the Association’s Board of Directors approved the funding of up to \$6,250,000 over a period of five years. These contributions are not guaranteed by the Association, but are approved on an annual basis. For the years ended December 31, 2003 and 2002, amounts contributed to GCDRR totaled \$523,000 and \$827,000, respectively. Contributions from outside sources in 2003 and 2002 totaled \$19,000 and \$3,000, respectively. Net contributions to GCDRR have aggregated \$2,365,000 to December 31, 2003.



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