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American Institute of Certified Public Accountants. Task Force on Accountants' Legal Liability

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Alternative Dispute Resolution

American Institute of CPAs

Task Force on Accountants' Legal Liability

June 17, 1988

To: The State Societies, Institutes and Associations of Certified Public Accountants

From: The AICPA Task Force on Accountants' Legal Liability

Re: Alternative Dispute Resolution

Litigation has become increasingly burdensome for accountants. The number of cases filed against accountants continues to accelerate, and an aggressive defense requires expensive legal services. Litigation diverts the time and attention of professional people from productive activity; business relationships are often disrupted; and embarrassing publicity accompanies many cases. Perhaps the greatest burden is the uncertainty, because of the inability of judges and juries to grasp accounting and auditing concepts, that a fair result will eventually be achieved.

In reaction to dissatisfaction with traditional litigation, an Alternative Dispute Resolution (ADR) movement has developed. In general, ADR offers flexible approaches to resolving litigation by transforming the typical confrontational posture into one of cooperation to reach a mutually advantageous solution.

Categories of ADR Techniques

1. Arbitration

Arbitration is the most formal alternative dispute resolution technique. In its most common form, two parties agree to submit any disputes between them with respect to a certain subject matter, such as a contract, to a neutral third party and agree to be bound by the result. Arbitration is authorized by statute. Lawsuits filed in contravention of an arbitration clause can be enjoined, and an award by an arbitrator is enforceable in court with limited judicial review. Arbitration is the only ADR technique that produces a resolution that binds the parties.

Generally, no discovery is available in arbitration. Thus, witnesses cannot be forced to provide testimony and documents in advance of "trial," and legal challenges to the procedure are limited. As a result, the expense of litigation is greatly reduced, but full development of the facts is sacrificed. As the parties select the arbitrator, someone with expertise can be designated.

2. **Court-Annexed Arbitration**

This procedure is being adopted in many state and federal courts. Court-annexed arbitration is nonbinding arbitration required by the court. As it is done in connection with a pending case, discovery is allowed. Studies have shown that between 50% and 75% of the litigants accept the recommendation of the arbitrator.

In some states, if the recommendation by the arbitrator is rejected, a party may be liable for its opponents' attorneys' fees if the ultimate resolution is adverse to that party.

3. **Mediation**

Mediation is a process in which the parties to a dispute select a third party to help resolve it. The mediator does not make a decision but attempts to narrow the issues, and encourages both sides to reach their own resolution.

4. **Mini-trial**

The first use of a mini-trial was in a patent infringement action between two large corporations. After three years of litigation, the two parties held a nonbinding trial before executives of both corporations and a retired judge. Thirty minutes after the hearing, the parties settled the matter.

At a mini-trial, senior executives of the parties hear abbreviated presentations of each side's best case by each side's attorneys, in the presence of a neutral observer. After the presentation, the executives meet to try to reach a resolution.

Mini-trials have reportedly been tremendously successful in settling complicated disputes between sophisticated parties quickly. Their success is attributed to the virtue of forcing litigants to confront the weaknesses in their case by providing a neutral, penetrating and analytical assessment.

5. **Application to the Profession**

Unlike litigation, ADR techniques are not compulsory. In other words, an accountant who is sued in normal litigation

has no choice but to defend against the lawsuit, but has no right to avail himself of ADR techniques absent some special arrangement, such as a specific agreement. Consequently, in most cases, the use of ADR techniques will be restricted to disputes with clients, as opposed to third parties.

One approach to using ADR is for an accountant and his client to agree at the beginning of a client relationship that any disputes between them will be determined by ADR procedures. Such an agreement could be included as one element of an engagement letter. Alternatively, it could be the subject of a separate arrangement with the client. "Disputes clauses" and arbitration provisions are frequently found in many professional service contracts, such as brokerage agreements, engineering contracts, etc. Attached to this memorandum are two model ADR paragraphs for an engagement letter, one specifically for arbitration and the other for more general procedures.

Another approach reflects the concern that it may be neither good business nor good psychology to suggest at the beginning of a client relationship that there may be serious disputes. Accordingly, it is possible to suggest the use of ADR procedures after a dispute has arisen. In these circumstances, it is also more likely that mediation or mini-trial procedures may be usefully employed.

Although less easy to invoke when clients are not involved, the possibility of applying ADR procedures to disputes between accountants and third parties should not be ignored. As it is very difficult to arrange in advance for third-party disputes to be dealt with through ADR procedures, there has to be an incentive after the dispute has arisen for third parties, as well as accountants, to use ADR procedures. These incentives are in many respects the same ones that motivate accountants and their clients in similar circumstances - prompt, less costly, and frequently better informed adjudication.

6. ADR Resources

There are several organizations offering ADR services, training, seminars and educational programs. These include the Center for Public Resources, the American Arbitration Association and the American Bar Association Special Committee on Dispute Resolution.

More than 200 corporations have signed a pledge proposed by the Center for Public Resources that commits the signatories to explore the possibility of resolving disputes with other signatories through negotiation or ADR techniques

before pursuing litigation. Companies that have signed include American Express, Bank America, Chase Manhattan, Prudential and at least two large accounting firms. Subscribers retain their right to proceed with litigation if ADR fails.

ADR techniques will not be appropriate in every instance. This is a decision for each accounting firm to consider in the context of its own circumstances. But in those instances when the opponent is reputable, the issues complex, and the stakes high, these flexible approaches may provide a better way to reach a fair result with less cost, less time wasted and less embarrassment.

Model Arbitration Paragraph

Any controversy or claim arising out of or relating to our engagement to [describe service, e.g., audit the Company's financial statements] shall be resolved by arbitration in accordance with the Commercial Arbitration Rules of The American Arbitration Association, and judgment on the award rendered by the Arbitrator(s) may be entered in any Court having proper jurisdiction.

Model General ADR Paragraph

In the event of any dispute between us relating to our engagement to [describe engagement, e.g., audit the Company's financial statements; prepare the Company's tax returns], we mutually agree to try in good faith to resolve the dispute through negotiation or alternative dispute resolution techniques before pursuing full-scale litigation.