



AMERICAN ARBITRATION ASSOCIATION®

INTERNATIONAL CENTRE
FOR DISPUTE RESOLUTION®

AAA Mediation.org™

2017

ANNUAL REPORT

AND FINANCIAL
STATEMENTS

MAY 22, 2018 | NEW YORK, NY



Cornell University
ILR School
Scheinman Institute on Conflict Resolution

**NEW YORK
LAW SCHOOL**



NEW YORK
LAW SCHOOL



AMERICAN ARBITRATION ASSOCIATION®

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2017 ANNUAL REPORT & FINANCIAL STATEMENTS



OUR SHARED MISSION

The American Arbitration Association is dedicated to effective, efficient and economical methods of dispute resolution through education, technology, and solutions-oriented service.

OUR SHARED VISION

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

OUR SHARED VALUES

INTEGRITY

We develop and practice the highest ethical standards. We communicate openly, honestly and directly. We ensure that the integrity of the ADR process is preserved.

CONFLICT MANAGEMENT

We practice the principles of conflict management and dispute resolution in all aspects of our work. We believe in collaboration and teamwork to accomplish shared goals.

SERVICE

We strive for excellence in all aspects of our work. We take responsibility for our actions, deliver what we promise and lead by example. We take initiative to make things better and are a source of new ideas and innovation.

DIVERSITY AND INCLUSION

We are committed to the recruitment, retention and advancement of a diverse and inclusive Panel, Council and workforce, and seek to advance diversity and inclusion in all aspects of the AAA's work.

PRESIDENT'S LETTER 2017

If I were to choose two words that best describe the state of the Association during the past year, they would be “energized” and “successful.”



And yet, because there are important risks for all organizations in the current global business environment—such as cybersecurity, loss of public confidence, even natural or man-made disasters—at the AAA-ICDR we chose to work as if we had to prove ourselves every hour of every day.

In 2017, we pursued many initiatives in our six strategic directions: Quality, Ease of Use, Options, Knowledge Sharing, Increased Presence and Outreach. The write-ups in the following pages are just a sampling of these initiatives and accomplishments over the last year and are truly the tip of the iceberg when it comes to the entirety of our efforts to impact the ADR field, and those who rely on our services, in a positive way.

The caseloads in all areas reached new highs with the surge in global economic growth. We opened a new office in Buffalo, New York, to assist with our high-growth and high-volume New York State Insurance Caseload, which reached 290,486 cases in 2017. International cases exceeded 1,000 cases in 2017, as they have for the last several years.

Parties and panelists rely on our data and online systems for their cases and, by the same token, we rely on our systems for both case administration and operational purposes. We therefore harnessed considerable AAA-ICDR resources to focus on cybersecurity and data protection, including having the staff engage in security awareness training all year long. Part and parcel of this ongoing effort was regular system and staff testing to gauge its effectiveness.

IN 2017, WE PURSUED

MANY INITIATIVES

IN OUR SIX STRATEGIC

DIRECTIONS: QUALITY,

EASE OF USE, OPTIONS,

KNOWLEDGE SHARING,

INCREASED PRESENCE

AND OUTREACH.

Elevating the AAA's and ICDR's public profile through social media and advertising and on our website, www.adr.org, was a priority in 2017. Since www.adr.org is the most visited ADR website in the world, we developed and launched a faster, more navigation-friendly version of it to make it easier for interested parties to connect with us. Our executives also spoke about the AAA and ADR at dozens of conferences and wrote articles that were published in the U.S. and abroad.

We are all aware that trust is such an important aspect of what we do, so it was gratifying that we were awarded an important program from the U.S. Department of Commerce: the administration of the ADR components of the EU Privacy Shield program. You will read more about it in the ICDR section of this Annual Report, but nothing better underscores how positively the AAA is perceived by many levels of government as well as the judiciary for our professionalism, objectivity and administrative efficiencies.

By the time you turn the last page of this Report, I am confident you will agree that 2017 was an extraordinary year of service and growth for the AAA and the ICDR. We look forward to positive challenges and even greater success in 2018!



India Johnson

President & Chief Executive Officer



AMERICAN ARBITRATION ASSOCIATION® | INTERNATIONAL CENTRE
FOR DISPUTE RESOLUTION®

FOUNDATION®

The American Arbitration Association and its international division, the International Centre for Dispute Resolution, announced the establishment of the AAA-ICDR Foundation® in May 2015.

The Foundation is a 501(c)(3) not-for-profit organization and is able to solicit donations and provide grants to fund a range of worthy causes that promote the Foundation's wide-reaching mission, which is to support the use and improvement of dispute resolution processes in the USA and internationally, including:

- Fostering measures that reduce potential escalation, manage and resolve conflicts.
- Expanding the use of dispute resolution processes tailored to the conflict.
- Supporting research, education and initiatives promoting high quality, efficient and fair dispute resolution.
- Increasing access to justice in and through alternative dispute resolution.
- Encouraging collaborative processes to resolve public conflicts.
- Sharing expertise across diverse groups and cultures.
- Partnering with others dedicated to advancing the Foundation's mission.

In December, the Foundation welcomed four new Directors to its Board: James E. Coleman, Jr., Eric D. Green, Scott S. Partridge and Lawrence Susskind. These new Board members joined the current Board, Edna Sussman (Chair), James R. Jenkins, India Johnson, John J. Kerr, Jr., Carolyn Lamm, Francis McGovern and Bruce Meyerson.

To help raise funds for the Foundation, the AAA-ICDR offered the option for AAA-ICDR panelists to contribute 50 percent of their 2018 Panel Fee to the Foundation. The panel fee donations combined with the generous donations made by the Foundation's other donors raised \$520,543 for the Foundation in 2017.

The Foundation issued a press release in May 2016 announcing its second round of grant solicitations. In May 2017, the Foundation, led by its Grants Committee, after a careful review of the 92 Initial Descriptions received and the presentation of full grant proposals, approved the following 12 grants totaling approximately \$435,000 in funding:

- New York State Unified Court System Online Dispute Resolution Platform - \$125,000 to fund a multi-year pilot for court online dispute resolution (ODR) for consumer debt cases. <http://www.nycourts.gov/>



**THE FOUNDATION IS A 501(C)(3)
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DONATIONS AND PROVIDE
GRANTS TO FUND A RANGE
OF WORTHY CAUSES THAT
PROMOTE THE FOUNDATION'S
WIDE-REACHING MISSION.**

- ABA Fund for Justice and Education: ABA Free Legal Answers - \$25,000 to provide low-income citizens access to brief legal advice via an online interactive website, utilizing pro bono attorneys. <http://abafreelegalanswers.org/>
- University of Maryland Training in Conflict De-Escalation and Management - \$25,040 to fund training for Baltimore City School Police and other school staff. www.cdum.org
- Research Foundation of CUNY on behalf of John Jay College: The Dispute Resolution in Mental Health Initiative - \$24,998 to fund scalable mediation training for certified peer specialists to serve an underserved population of peers living with mental

health issues. www.jjay.cuny.edu/disputeresolution
and <http://mhmediate.com/drmh/>

- New York State Dispute Resolution Association - \$25,000 to create a tool kit to help schools apply for AmeriCorps grants to receive conflict resolution education. <http://www.nysdra.org/>
- Columbia Law School Research of Twilight Issues in International Arbitration - \$25,000 to fund analysis and development of best practices for twilight issues, which are not clearly substantive or procedural, with global presentations and publication. <http://www.law.columbia.edu/center-for-international-arbitration>
- ArbitralWomen Unconscious Bias Toolkit - \$25,000 to fund an educational series and mentorship to promote equality, diversity, access to justice, and leadership opportunities. <http://www.arbitralwomen.org/>
- Minnesota State Office for Collaboration and Dispute Resolution and Dispute Resolution Institute at Mitchell Hamline School of Law 2017 Talk with Purpose: Using Dispute Resolution to Engage Communities and Foster Relationships for Constructive Change - \$45,000 to continue funding a transformative project to produce qualitative change in the type of engagement currently taking place between dominant and non-dominant communities in Minnesota. <https://mn.gov/bms/ocdr/>
- Ohio State University Foundation on behalf of The Ohio State University Moritz College of Law's Divided Community Project - \$40,000 to fund a study that describes local ADR responses and planning initiatives to address controversies that divide communities and development of a Community Preparation Assessment Test tool for community use. <http://moritzlaw.osu.edu/dividedcommunityproject/>
- The Curators of The University of Missouri: Reasoning in International Commercial Arbitration: Comparisons Across the Common Law-Civil Law Divide, the Domestic-International Divide and the Judicial-Arbitral Divide - \$25,396 to fund research on arbitral reasoning in arbitral awards. <http://law.missouri.edu/about/>

\$520,543

FOR THE FOUNDATION IN 2017

\$125,000

To fund a multi-year pilot for court online dispute resolution (ODR) for consumer debt cases.

\$25,000

To provide low-income citizens access to brief legal advice via an online interactive website, utilizing pro bono attorneys.

\$25,000

To fund analysis and development of best practices for twilight issues, which are not clearly substantive or procedural, with global presentations and publication.

\$24,998

To fund scalable mediation training for certified peer specialists to serve an underserved population of peers living with mental health issues.

\$25,000

To create a tool kit to help schools apply for AmeriCorps grants to receive conflict resolution education.

\$25,396

To fund research on arbitral reasoning in arbitral awards.

\$25,040

To fund training for Baltimore City School Police and other school staff.

\$25,000

To fund an educational series and mentorship to promote equality, diversity, access to justice, and leadership opportunities.

\$45,000

To produce qualitative change in the type of engagement currently taking place between dominant and non-dominant communities in Minnesota.

\$40,000

To address controversies that divide communities and development of a Community Preparation Assessment Test tool for community use.

\$25,500

For training scholarships to enable women community leaders to complete four days of advanced mediation and community leadership training.

\$25,000

To support travel and training scholarships for female community leaders from Belarus, Russia, and Ukraine, for advanced mediation and leadership training, focused on promoting peace and interfaith/interethnic tolerance.

- Project Keshet: Training for Women in Belarus, Russia and Ukraine - \$25,000 to support travel and training scholarships for female community leaders from Belarus, Russia, and Ukraine, for advanced mediation and leadership training, focused on promoting peace and interfaith/interethnic tolerance. www.projectkeshet.org
- Mediators Beyond Borders International - Women in Peacebuilding: Promoting Peace Through Leadership and ADR Training for Women in Bolivia, Colombia, Ecuador, Panama, Peru and Venezuela - \$25,500 for training scholarships to enable women community leaders to complete four days of advanced mediation and community leadership training. <http://mediatorsbeyondborders.org/>

In June 2017, the Foundation announced its third funding cycle, and in September 2017 the Foundation announced that, besides continuing to support its broader mission, the third funding cycle would include a special initiative. In response to recent divisive events throughout the country, the Foundation will offer funding to a limited number of organizations with successful experience in providing opportunities for dialogue in situations involving racial, ethnic and religious conflict. In response, the Foundation received 93 Initial Descriptions of Grant Requests and will be deciding on those grants in 2018.

More information about how to contribute to the AAA-ICDR Foundation and the Grants it has funded can be found on the Foundation's website: www.aaaicdrfoundation.org.

The Foundation is not involved in any way in the oversight, administration or decision making of AAA-ICDR cases or in the maintenance of the AAA-ICDR's various rosters of arbitrators and mediators.

THE GOVERNANCE 2026 COMMITTEE

When the AAA Board of Directors voted to amend the AAA's Bylaws and Articles of Incorporation in order to modify the AAA's overall governance structure, what had been an approximately 100-person Board of Directors was reconfigured into a Council of the American Arbitration Association, consisting of between 80 and 100 Council Members, and the creation of a smaller Board of Directors of between 18 and 21 Directors.

The amendments were approved by the Board of Directors during the AAA's May 2016 Annual Meeting and were the outgrowth of a detailed analysis and report conducted by the Governance 2026 Committee.

An important outcome of the restructuring of the AAA's governance is the clear direction and purpose given to the Board of Directors and the Council of the American Arbitration Association. Under the new governance structure, the Council are Members of the AAA under the Association's Bylaws. In this role, Council Members have all of the powers and duties of members of a charitable not-for-profit corporation. The Board of Directors are all Council Members and have fiduciary duties that attach to a Corporation's Board and the authority to act as the AAA's governing body.

The establishment of the Council has also allowed the AAA and ICDR to tap into the vast expertise

of the Council through Council Member participation in subject-matter specific committees such as the Employment Committee, Arbitrator Committee, Mediation Committee, Labor Committee, Health Care Committee, Large Case Committee and International Advisory Committee. Each of these committees is chaired by AAA Council Members and has senior AAA management liaisons from divisions throughout the organization. In the short period of time that this new structure has been in place, the AAA and ICDR have seen significant results with Committees providing valuable input on a wide range of important matters.

The work of the Arbitrator Committee serves as a good example of the significant impact of the AAA's Council Committee structure. The Arbitrator Committee proposed revisions to the *Standards and Responsibilities for Members of the AAA Roster of Arbitrators and Mediators*, which were adopted by the AAA, in order

to address the important issue of arbitrator and mediator fitness to serve in that capacity. Specifically, the revised standards make explicit that arbitrators and mediators are required to be fit to engage in cases for which they are listed or to which they are appointed, and that they must advise the AAA-ICDR of any condition that may impair their ability to fully execute their responsibilities during all phases of a case. This is just one example of the important work that AAA Council Committee members have engaged in throughout the year, and we expect continued value from Committee work going forward.

The Arbitrator Committee proposed revisions to the Standards and Responsibilities for Members of the AAA Roster of Arbitrators and Mediators, which were adopted by the AAA, in order to address the important issue of arbitrator and mediator fitness to serve in that capacity.



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AMERICAN ARBITRATION
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COMMERCIAL DIVISION

In 2017, the Commercial Division launched a number of new service offerings designed to provide parties with additional cost- and time-saving options in connection with their arbitration matters.

In cases where the rules or parties' agreement requires a panel of three arbitrators to decide their case, parties can elect to utilize the *Streamlined Three-Arbitrator Panel Option*, which allows parties to move through the preliminary and exchange of information stages of a case working with a single arbitrator, with the full panel being involved only at the evidentiary hearing stage and to issue an award. The AAA has found that a three-arbitrator panel can actually cost five times as much as a single arbitrator. By maximizing the use of a single arbitrator, parties are able to capitalize on the cost savings while still preserving the parties' right to have the actual merits of the case ultimately decided by a three-arbitrator panel.

Aware that the rise in the use of electronically stored information (ESI) is resulting in a corresponding increase in the number of eDiscovery-related disputes, the AAA rolled out *AAA eDiscovery Special Master Select*, not only for parties in arbitration but also those involved in litigation. Courts and litigants increasingly are seeking knowledgeable individuals to serve as eDiscovery Special Masters. This service provides parties access to a panel of experts in the preservation, collection and production of electronically stored data. The use of a Special Master can reduce the legal costs of resolving eDiscovery disputes in court or arbitration as well as narrow the eDiscovery disputes in contention.



Adding to its list of À La Carte services, which offers parties the option of selecting certain stand-alone services for non-administered cases, the AAA introduced *Case Financial Administrative Services*, which allows parties to utilize the full range of financial administration services provided by the AAA without committing to full case administration. With this service, the AAA acts as an impartial third party managing the financial aspects of the case, thereby supporting the continued neutrality of the arbitrator.

The Commercial Division also continued to promote its newly created Cyber Security/Cyber Breach Panel through a free webinar on preventing and arbitrating business-to-business (B2B) data breach disputes, which was attended by several hundred participants.

As part of the AAA's continuing effort to expand diversity on the Panel of arbitrators and mediators, the Commercial Division collaborated with the Minority Corporate Counsel Association (MCCA) through sponsorship of the MCCA's annual meeting and presentation of an ADR program for its members. The Commercial Division also assisted with the conception of a new organization, the ADR Inclusion Network, which focuses on promoting diversity in the ADR community.

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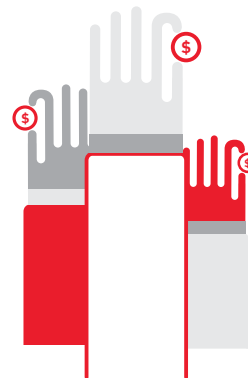
PRESERVING THE PARTIES'

RIGHT TO HAVE THE ACTUAL

MERITS OF THE CASE

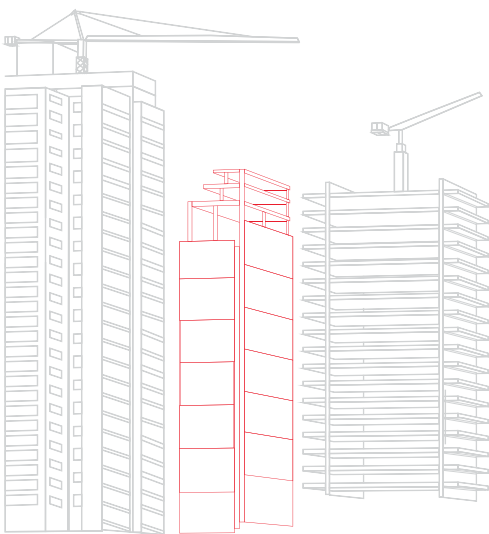
ULTIMATELY DECIDED BY A

THREE-ARBITRATOR PANEL.



CONSTRUCTION DIVISION

There was a continued upward trend in construction case filings during 2017. Overall, construction filings were up 4%; cases with claim amounts of at least \$500,000 increased 12% and cases with claim amounts of at least \$1,000,000 increased 13%.



The 2017 revisions to the American Institute of Architects (AIA) contracts and forms continue to name the AAA as provider of mediation services and, if selected, as arbitration provider for disputes that may issue from AIA projects. The forms, which are reviewed and updated every 10 years, are utilized throughout the design and construction industry for managing transactions and relationships involved in construction projects.

The AAA continued to participate at key industry events in 2017. AAA Construction Division Vice Presidents and Directors presented at, exhibited, attended, and/or sponsored the following: ABA Forum on Construction Law meetings, ABA Fidelity and Surety Law Committee, National Society of Professional Engineers, Construction Owners Association of America, Women in Construction Conference, Construction SuperConference, as well as various regional events, law firm presentations and company presentations.

**2017 AAA®
CONSTRUCTION CONFERENCE**
**NAVIGATING THE UNIQUE ASPECTS OF
CONSTRUCTION ARBITRATION**

Consistent with the AAA's mission of education, the AAA Construction Division hosted its annual construction conference on June 22, 2017 in New York City for a record 200 attendees consisting of construction lawyers, in-house counsel and industry professionals interested in learning about the benefits of ADR. There were 15 firm/company sponsors and 13 cooperating associations.

**THE AAA CONSTRUCTION
DIVISION HOSTED ITS ANNUAL
CONSTRUCTION CONFERENCE FOR**

**A RECORD
200
ATTENDEES.**

Titled "Navigating the Unique Aspects of Construction Arbitration," the Conference featured the following discussion topics:

- How to Effectively Deal with the 300 Change Order Dispute – Who Controls the Process?
- Global Construction Disputes – Don't Get Left Behind
- Changes to the 2017 AIA Documents and Potential Impacts on Dispute Resolution
- The Best Defense is a Good Offense – Keys to Claims Prevention and Mitigation
- How Do We Get the War Stories if We're Never Allowed to Go to Battle?
- Minimizing Risks of Ethical Dilemmas at Arbitration

LABOR, EMPLOYMENT AND ELECTIONS DIVISION

In 2017, the Labor, Employment and Elections Division leveraged its depth of operational expertise and the Association's decades of experience in dealing with and shaping the alternative dispute resolution landscape to adapt its service offerings as the parties' needs dictated.



To make sure that the Division's efforts and initiatives are known to stakeholders, Division teams were dispatched to major national gatherings of employment and labor law experts, such as the 2017 ABA Labor and Employment Section Annual Conference and the Society for Human Resource Management's – SHRM 2017 Conference. Division team members engaged with hundreds of advocates, HR leaders and union representatives who are users of Association case management and elections services or might wish to be at some time in the future.

A new Employment Fee Schedule was implemented in 2017, undertaken in response to changing employment and labor laws aimed at increasing access to alternative dispute resolution modalities and to ensure equity in the resolution of workplace-related disputes. The AAA addressed concerns raised by parties with respect to cost by shifting the responsibility for the advancement of arbitrator compensation to the employer or company. In addition, filing fees were simplified by the crafting of a flat fee for both parties. In 2017, employment cases filed by individuals increased by 8.6%. Employment-related "group" filings grew by 11%.

Labor case filings in 2017 were down by 4% versus a 7% drop in 2016. We note, however, that union membership increased by 262,000 in 2017, a jump of nearly 1.8%. This growth in union membership may result in a modest increase in labor case filings in 2018.

In 2017, the Elections Department issued over one million ballots to union members voting in elections nationwide. In addition to administering three elections where the voting membership exceeded 75,000 eligible voters, the Elections Department was retained to conduct

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an election for official recognition of a graduate student union at a major university. This was the first time a third-party organization was used by a university to bypass the National Labor Relations Board process. The AAA remains the largest administrator of union elections in the United States.

The Division continues to apply innovative techniques, such as in the administration of the mediation caseload for Asbestos Personal Injury Trusts. With over 3,700 asbestos mediation claims filed in 2017, these cases use customized administration, telephonic mediations and a unique billing process to help reduce costs and streamline administration. Innovations such as a scheduling system currently being developed for our web-based case administration platform allow us to continue to optimize the time of the parties as well as the staff and the mediators.

An innovative service offering that the Division initiated in 2017 was Special Master Panels to help parties deal with making determinations about which Rules apply, contract interpretation, rulings on global issues for group filing and/or to approve settlements to meet FLSA requirements for wage and hour cases.

In 12 instances parties took advantage of this unique, highly experienced panel to help them move past thorny issues and expedite the administration of their cases.

During 2017, the Labor, Employment and Elections Division hosted 19 training programs across the country in New York, Pennsylvania, Connecticut, Rhode Island, Ohio, Michigan, Illinois, Massachusetts and California. The training programs covered subjects such as Advocacy Training, Labor Grievance Processing, Brief Writing and Closing Arguments, Off-Duty Misconduct and Ethical Issues for Arbitrators and Advocates. These programs also included two in-house training programs for a large public-sector union in New York.

45% OF THE PANELISTS
ADDED BY THE
DIVISION IN 2017

WERE EITHER WOMEN OR MINORITIES OR BOTH.

The Division continued to make the Association's commitment to diversity a priority. Over 45% of the panelists added by the Division in 2017 were either women or minorities or both. Equally as important, the case management teams were focused on ensuring that lists that were sent to the parties for consideration were as diverse as the parties' requirements would allow. The diversity of the National Labor Roster is approaching 30%, exceeding other panels.

INTERNATIONAL DIVISION

There were 1,026 cases filed with the ICDR in 2017, with total claims of \$6.33 billion and counterclaims of \$648 million.

The largest claims by industry were (in descending order) in technology, commercial insurance, energy, aviation/aerospace/national security, pharmaceuticals, financial services and commercial construction. There was a 21% increase in Canadian parties in ICDR cases, and 55 hearings took place in Canada. The ICDR has administered 76 emergency arbitrations since the inception of the Emergency Rule.

In 2017, the ICDR further strengthened its commitment to panel diversity with 22% of arbitrator appointments being female, a 6% increase from 2016.

The ICDR launched its international arbitrator online search platform in 2017, a resource that enables parties to search the ICDR's Roster of Arbitrators and assists them in selecting party-appointed arbitrators, the Tribunal Chair and other members of the Tribunal.



INTERNATIONAL CENTRE
FOR DISPUTE RESOLUTION®

— IN 2017, THE ICDR FURTHER —
STRENGTHENED ITS COMMITMENT TO

**PANEL
DIVERSITY
WITH 22%
OF ARBITRATOR APPOINTMENTS
BEING FEMALE,
A 6% INCREASE FROM 2016.**

The International Administrative Review Council (I-ARC) was constituted in 2017. Composed of ICDR executives, I-ARC will make determinations on the following: arbitrator challenges, filing requirement disputes/challenges to ICDR administration, hearing locale and the number of arbitrators to be appointed. To provide consistency in decision-making, guidelines, standards and statistics will be published on the issues that have been reviewed.

In 2017, the ICDR was designated by the U.S. Department of Commerce to administer the “Annex I Binding Arbitration Program.” The EU-U.S. Privacy Shield Framework was designed to provide a compliance mechanism for data protection requirements involving personal data transferred from the European Union to the United States. U.S. Privacy Shield organizations are required to participate in arbitrations that will determine if a Privacy Shield organization violated its data protection obligations to EU individuals. Approximately 2,900 companies are participating in the privacy shield program. The ICDR, in consultation with the U.S. Department of Commerce and its EU counterparts, developed an expedited set of international arbitration rules and arbitrator code of conduct for the program.

The ICDR Young & International conducted more than 30 international arbitration programs around the world last year.



APPROXIMATELY

2,900

COMPANIES ARE

PARTICIPATING

IN THE PRIVACY

SHIELD PROGRAM.

NEW YORK STATE INSURANCE CASELOADS

In 2017, the New York No-Fault Insurance program experienced another record year. The AAA staff processed 290,486 new case filings, a 17% increase over the previous record of 248,117 cases in 2016.

In response to the increased case filings in the Northwest New York region of the state, the AAA opened an office in Buffalo, New York, in 2017. The Buffalo center focuses on meeting the needs of these parties while coordinating with the New York City location in managing the statewide caseload.

Despite the increase in filings, there was continued focus on resolving disputes and facilitating the settlement of almost one out of every two cases filed without the need for an arbitration hearing. In 2017, a 45% settlement rate was attained during the conciliation period, demonstrating that conciliation remains a highly-effective opportunity for parties to resolve their no-fault disputes.

The size of the No-Fault Arbitrator Panel also increased to a record number. In 2017, the New York State Department of Financial Services (DFS) made the determination to add an additional 30 arbitrators for downstate New York and three arbitrators for the Northwest region. Currently there are 152 arbitrators serving on the no-fault panel.

The Supplemental Underinsured/Uninsured Motorist (SUM) program also experienced moderate growth in new filings. The SUM Department received 2,550 new filings for arbitration in 2017.

THE AAA OPENED AN
OFFICE IN BUFFALO, NY
IN 2017.

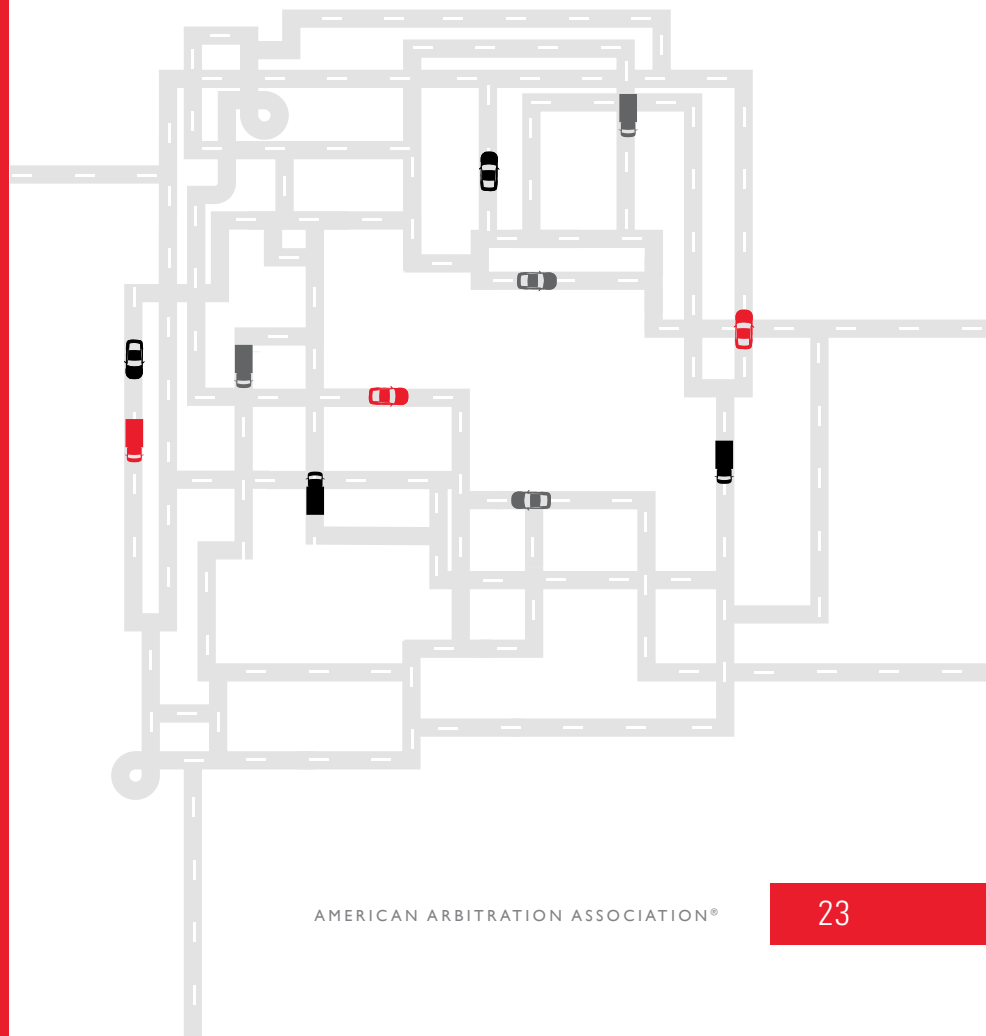


MINNESOTA STATE INSURANCE



**IN 2017, THE AAA
COLLABORATED WITH
THE MINNESOTA
NO-FAULT STANDING
COMMITTEE TO AMEND
THE STANDARDS
OF CONDUCT FOR
MINNESOTA NO-FAULT
ARBITRATORS.**

In 2017, the AAA collaborated with the Minnesota No-Fault Standing Committee to amend the Standards of Conduct for Minnesota No-Fault Arbitrators, which were accepted by the Minnesota Supreme Court and became effective on January 1, 2018. The Minnesota No-Fault office also launched newsletters for the parties and the panelists and developed and facilitated five CLE seminars for Minnesota No-Fault Arbitrators.



CONSUMER ADR

The Consumer Team provided case administration for over 4,000 disputes in 2017, an increase of more than 1,000 cases over 2016 figures.

There was also significant restructuring and growth within the Consumer Team. The Manager of ADR Services model was introduced with the promotion of two administrators to the manager position, each overseeing a team of three case administrators and one case assistant. Staffing was increased to accommodate sustained filings. The Consumer Clause Registry grew to 415 businesses by the end of 2017, continuing the AAA's efforts to increase transparency in consumer arbitrations administered by the AAA. Both consumer and employment arbitrations continue to be reported online at *Consumer and Employment Arbitration Statistics* on www.adr.org pursuant to a California law requiring providers to post case information in these two areas of arbitration.



THE CONSUMER CLAUSE REGISTRY GREW TO

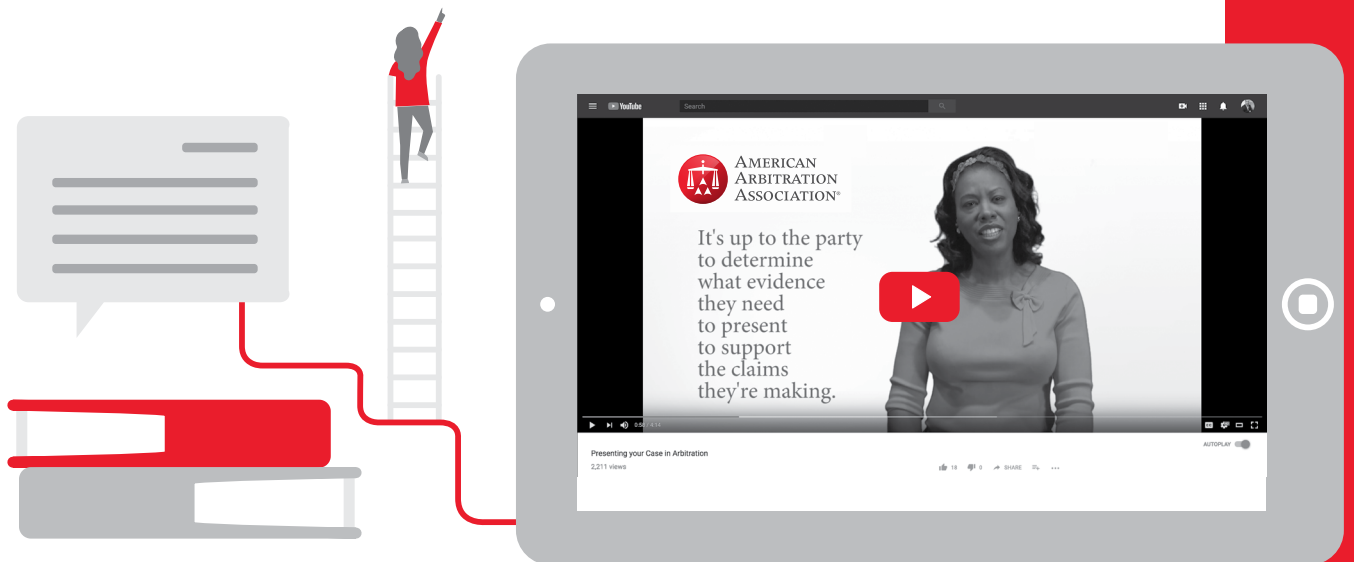
415

**BUSINESSES BY
THE END OF 2017.**

PRO SE CASE ADMINISTRATION

The Pro Se Group provided case administration for 858 cases.

It also expanded its offering of resources for pro se parties, including the addition of a new video to provide information on presenting a case in arbitration, and through cooperation with the American Bar Association provided access to the ABA's Affordable Legal Services resources.





AAA Mediation.orgSM

In 2017, AAA Mediation.org made further progress in expanding its mediation service and product lines and in developing new innovations to roll out in 2018. They included the following:



- Extensive promotion of the automatic “mediation step” now embedded in AAA Commercial and Construction Rules, and continued training of key regional and case management teams in effectively promoting the mediation step to parties with pending AAA arbitration case filings.
- Assignment of Master Mediator Panelists to over 400 large and complex mediations nationally.
- Continued expansion of mediation education/training courses offered by AAA Mediation.org and delivery of widely acclaimed basic, advanced and industry-specific mediation trainings in a new 32-hour format in multiple venues across the country. Last year, there were 129 attendees from four countries at AAA Mediation.org trainings. Since 2012, 758 legal and business professionals from 22 countries have completed the AAA’s introductory mediator training courses. Publishing achievements included a mediation-focused edition of the internationally acclaimed *Dispute Resolution Journal*.
- Continued support of the work of the International Mediation Institute (IMI) through thought leadership for, collaboration in and sponsorship of the Global Pound Conference, a worldwide “ADR Futures” symposium in multiple venues globally. AAA Mediation.org also co-hosted an international mediation symposium in Buenos Aires in collaboration with the ABA’s international cross-cultural exchange program and Argentina’s DiTella University, as well as hosted a similar symposium in Madrid in affiliation with the Madrid Chamber of Commerce.
- Through our diversity outreach we continued to mentor Higginbotham Fellows alumni. We conducted mediation training workshops in conjunction with the National Bar Association’s 2017 Annual Convention in Toronto to prepare diverse candidates for AAA Mediation.org panel consideration.

Assignment of Master Mediator Panelists to over 400 large and complex mediations nationally.

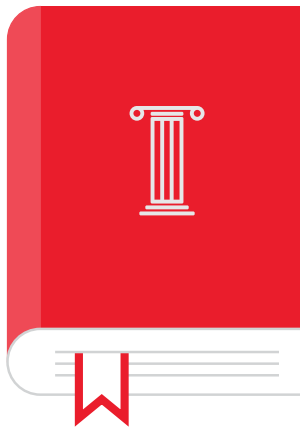
- Conducted staff trainings at regional case-management centers on the Association's mediation mission and current initiatives. Trained New York State Insurance Conciliation program staff in advanced conciliation techniques to equip staff conciliators with the skill sets required to better influence settlement outcomes and overall user satisfaction with the process.
- Nominated, vetted and profiled nine AAA-ICDR mediation panelists in the June 2017 special edition of the National Law Journal's Legal Times supplement. They are: Theo Cheng, Harold Coleman Jr., Hon. Nickolas J. DiBiaso, Nancy Lesser, Jane Michaels, Hon. Harriet O'Neill, Bennett Picker, Edna Sussman, and Richard Ziegler.



**CONDUCTED STAFF
TRAININGS AT REGIONAL
CASE-MANAGEMENT
CENTERS ON THE
ASSOCIATION'S MEDIATION
MISSION AND CURRENT
INITIATIVES.**

AAA PUBLICATIONS / EDUCATION SERVICES / PANEL RELATIONS

The AAA's flagship publication, *Dispute Resolution Journal*, celebrated its 80th birthday in 2017.



Special focus issues on mediation and dispute resolution in Korea were published, as well as an issue that featured articles submitted to the annual AAA/Rory Brady Memorial Prize Essay Competition, sponsored by the AAA and organized by the School of Law at Trinity College Dublin to honor the memory of Rory Brady, former Attorney General of Ireland. Also published were the most recent editions of the AAA's hardcover "Handbook" series – AAA Handbook on International Arbitration & ADR, 3rd Edition, and AAA Handbook on International Arbitration Practice, 2nd Edition, produced in partnership with JurisNet, LLC.

In 2017, there were 1,148 registrations for the AAA's 14 online Arbitrator Continuing Education (ACE) courses and 2,000 registrations for the AAA's extensive library of 110 on-demand recorded webinars, an increase of 53% over 2016 figures for the latter. The new ACE program for 2017 was "Red Flags and Risk Areas: Challenges to Arbitrator Authority." There are 33 complimentary recorded programs available through the AAA's website to educate the public, advocates, arbitrators and mediators on various ADR topics.

AAA Education Services, in conjunction with AAA Mediation.org, conducted six sessions of the 32-hour "Mediator Essentials: Skills for Facilitating Negotiated Agreements" mediator training course. The AAA-ICDR also conducted five conferences attended by more than 500 people.

Topics for the conferences included construction arbitration, international arbitration, international oil and gas arbitration, dispute resolution in the global energy sector, and the future of arbitration.

There were 228 new panelists trained in 2017. New arbitrator training programs took place in Atlanta, Chicago, Dallas, Houston, Las Vegas, Los Angeles, Miami, New York, Santa Fe and Seattle.

228 **NEW PANELISTS**
WERE TRAINED IN 2017.

As part of the AAA's ongoing efforts to better meet the needs of the parties, Panel Relations—in concert with all AAA Divisions—conducted an extensive review and revision of how panelists' expertise is identified so as to provide the best possible arbitrator and mediator candidates for a dispute. The department also conducted an important webinar that provided vital information on the issue of arbitrator fitness, based on recommendations issuing from the work of the AAA Arbitrator Council Committee.

As part of the AAA's ongoing efforts to better meet the needs of the parties, Panel Relations—in concert with all AAA Divisions—conducted an extensive review and revision of how panelists' expertise is identified so as to provide the best possible arbitrator and mediator candidates for a dispute.

DIVERSITY

Diversity and Inclusion are core values for the American Arbitration Association.

We are committed to the recruitment, retention and advancement of a diverse and inclusive Panel, Council and workforce, and seek to advance diversity and inclusion in all aspects of the AAA's work. In 2017, the AAA launched an important company-wide staff training curriculum to advance a greater level of comprehension on diversity and inclusion. The curriculum includes 12 hours of training and provides staff with an opportunity to examine implicit bias, learn how to resolve diversity-related conflicts and understand the organizational benefits of promoting a diverse and inclusive workplace that fosters innovation and collaboration. Approximately 50% of our staff have signed up to engage in this voluntary diversity and inclusion training and have completed 680 hours of diversity and inclusion-related training to date. In 2018, the curriculum becomes required for all staff and executives.

The AAA also continued to emphasize diversity in its recruitment of arbitrators and mediators. Executives across every division of the organization actively recruited women and minority candidates who met the criteria established for the AAA's panels. As a result, in 2017, the AAA added 78 new women and minority candidates to its Roster. As part of its recruitment efforts, the AAA continues to build coalitions and participate in events with national, minority, and local bar associations and law schools around the country in order to provide training and create opportunities for diverse

practitioners. Among the initiatives launched in 2017 is a joint recruitment initiative with the National Association of Minority & Women Owned Law Firms (NAMWOLF) to recruit their members for inclusion on the AAA's Roster. The AAA also successfully partnered with the National Bar Association (NBA) to provide training and recruitment opportunities to its members, which resulted in several of its members being invited to apply to the AAA's Roster.

Another area of focus was on providing diverse lists of proposed arbitrators to parties on cases and prioritizing diversity in the selection of speakers for the AAA's educational programs. This includes a nationwide organizational goal of making sure that at least 20% of the names included on lists of arbitrators proposed on a case are women and minority panelists where party qualifications are met. For arbitrator and mediator lists finalized in 2017, overall 87% of lists sent to parties during this period met that goal.

IN 2017, THE AAA ADDED **78** NEW WOMEN & MINORITY CANDIDATES TO ITS ROSTER.

The AAA also saw continued success with the advancement of AAA Higginbotham Fellows in the ADR field. The AAA Higginbotham Fellows Program is a highly visible, extremely successful program created in 2009 to provide training, networking, and mentorship for up-and-coming diverse ADR practitioners. In 2017, three Fellows were accepted to the AAA's Roster, increasing to 27 the total number of Fellows who are currently on the Roster. The AAA will host its next AAA Higginbotham Fellows Program class in May 2018.

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AMERICAN ARBITRATION ASSOCIATION®

AMERICAN ARBITRATION ASSOCIATION, INC. AND SUBSIDIARIES

REPORT ON CONSOLIDATED FINANCIAL STATEMENTS
AND INDEPENDENT AUDITOR'S REPORT

DECEMBER 31, 2017 AND 2016

AMERICAN ARBITRATION ASSOCIATION, INC. AND SUBSIDIARIES

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Independent Auditor's Report

To the Board of Directors
American Arbitration Association, Inc.

We have audited the accompanying consolidated financial statements of American Arbitration Association, Inc. and Subsidiaries (the "Association"), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Association as of December 31, 2017 and 2016, and the results of its operations and changes in net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



New York, New York
April 30, 2018

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2017 AND 2016

	2017	2016
ASSETS		
CASH AND CASH EQUIVALENTS	\$ 10,727,000	\$ 12,814,000
RESTRICTED CASH	1,752,000	-
INVESTMENTS - At Fair Value	140,823,000	120,858,000
ADMINISTRATION FEES RECEIVABLE, Less allowances for cancellations and uncollectible accounts of \$776,000 in 2017 and \$621,000 in 2016	19,857,000	19,490,000
OTHER RECEIVABLES, Less allowances for uncollectible accounts of \$35,000 in 2017 and \$52,000 in 2016	460,000	561,000
PREPAID EXPENSES	3,086,000	2,873,000
INTERNAL-USE SOFTWARE DEVELOPMENT AND CONSTRUCTION IN PROGRESS	302,000	396,000
FURNISHINGS, EQUIPMENT, IT SYSTEMS AND LEASEHOLD IMPROVEMENTS - Net	20,465,000	19,931,000
TOTAL ASSETS	<u>\$ 197,472,000</u>	<u>\$ 176,923,000</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable and accrued expenses	\$ 84,301,000	\$ 77,198,000
Agency Fund	1,752,000	-
Accrued postretirement medical costs	10,499,000	9,573,000
Accrued pension liability	1,839,000	7,464,000
Deferred rent	5,169,000	4,512,000
Deferred revenue	9,224,000	8,000,000
Total Liabilities	<u>\$ 112,784,000</u>	<u>\$ 106,747,000</u>
Commitments and Contingencies	-	-
UNRESTRICTED NET ASSETS:		
Undesignated net assets	16,422,000	9,375,000
Board Designated net assets	68,266,000	60,801,000
Total Unrestricted Net Assets	<u>84,688,000</u>	<u>70,176,000</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 197,472,000</u>	<u>\$ 176,923,000</u>

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS
AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
OPERATING REVENUES		
Administration fees earned:		
Commercial	\$ 54,671,000	\$ 53,057,000
State insurance	27,362,000	23,750,000
Labor	4,333,000	4,753,000
Elections	3,549,000	5,544,000
Totals	<u>89,915,000</u>	<u>87,104,000</u>
Publications and education	1,925,000	2,535,000
Other operating income	1,180,000	1,053,000
Totals	<u>93,020,000</u>	<u>90,692,000</u>
OPERATING EXPENSES		
Administration of tribunals	76,584,000	70,858,000
Elections	3,564,000	4,941,000
Publications and education	935,000	1,627,000
General and administration	4,830,000	4,623,000
Totals	<u>85,913,000</u>	<u>82,049,000</u>
Net Operating Income	7,107,000	8,643,000
NON OPERATING INCOME AND EXPENSES		
Interest and dividends on investments - net of fees	2,760,000	1,672,000
Net realized and unrealized gains on investments	4,750,000	3,174,000
Loss on disposal of assets	(10,000)	(1,000)
CHANGE IN UNRESTRICTED NET ASSETS BEFORE CHANGES IN NET ASSETS	<u>14,607,000</u>	<u>13,488,000</u>
Pension liability adjustment	721,000	806,000
Postretirement medical obligation adjustment	(816,000)	(336,000)
CHANGE IN UNRESTRICTED NET ASSETS	14,512,000	13,958,000
UNRESTRICTED NET ASSETS, BEGINNING OF YEAR	<u>70,176,000</u>	<u>56,218,000</u>
UNRESTRICTED NET ASSETS, END OF YEAR	<u>\$ 84,688,000</u>	<u>\$ 70,176,000</u>

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 14,512,000	\$ 13,958,000
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	3,945,000	3,617,000
Bad debt and change in provisions for uncollectible accounts	568,000	407,000
Deferred rent	657,000	156,000
Net realized and unrealized gains on investments	(4,750,000)	(3,174,000)
Loss on disposal of assets	10,000	1,000
Changes in operating assets and liabilities:		
Increase in administration fees receivable	(935,000)	(3,674,000)
Decrease/(Increase) in other receivables	101,000	(372,000)
Increase in prepaid expenses	(213,000)	(117,000)
Increase in accounts payable and accrued expenses	7,103,000	9,148,000
Increase in Agency Fund	1,752,000	-
Increase in accrued postretirement medical costs	926,000	376,000
Decrease in accrued pension liability	(5,625,000)	(197,000)
Increase in deferred revenue	1,224,000	1,755,000
Net cash provided by operating activities	19,275,000	21,884,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furnishings, equipment, technology and leasehold improvements	(4,093,000)	(2,579,000)
Proceeds from sale of investments	17,010,000	46,179,000
Purchase of investments	(32,225,000)	(59,203,000)
Internal use software development and construction in progress	(302,000)	(396,000)
Net cash used in investing activities	(19,610,000)	(15,999,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments to restricted cash	(1,926,000)	-
Proceeds from restricted cash	174,000	-
Net cash used in financing activities	(1,752,000)	-
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	(2,087,000)	5,885,000
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	12,814,000	6,929,000
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 10,727,000	\$ 12,814,000

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 1 - BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Business and principles of consolidation:

The accompanying consolidated financial statements include the financial position and operating activities of American Arbitration Association, Inc. ("AAA"), and the Subsidiaries it controls (collectively the "Association"). All inter-company accounts and transactions have been eliminated in consolidation.

AAA is a not-for-profit organization that provides administrative, educational and development services for the widespread use of dispute resolution procedures both domestically and internationally.

Administration fees and deferred revenue:

The initial filing fee for commercial cases, which are 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 limited circumstances, the 60-day time period for refund eligibility is extended for arbitration cases that utilize AAA's mediation services. Based on analysis of current trends, the Association recorded a provision for deferred revenue in 2017 and 2016 of \$158,000 and \$226,000, 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 \$7,405,000 and \$5,816,000 as of December 31, 2017 and 2016, respectively, is included in deferred revenue in the accompanying consolidated balance sheets.

Registration fees and other payments for educational programs and other services may be payable in advance prior to an education program event or delivery of services. Deferred education and services revenue of \$164,000 and \$236,000 as of December 31, 2017 and 2016, respectively, is included in deferred revenue in the accompanying consolidated balance sheets.

A panel fee is collected from individuals serving on the Association's panel of arbitrators and mediators. The fee is assessed annually on a calendar-year basis. Payments received in advance of the start of the assessment year totaling \$703,000 and \$1,042,000 as of December 31, 2017 and 2016, respectively, are included in deferred revenue in the accompanying consolidated balance sheets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Filing parties in certain high-volume programs may deposit funds with the Association to be drawn down and applied to invoices as filing fees are invoiced. Such deposits received in advance of demands for arbitration being filed totaling \$794,000 and \$680,000 as of December 31, 2017 and 2016, respectively, are included in deferred revenue in the accompanying consolidated balance sheets.

Cash and cash equivalents:

The Association considers all highly liquid investments with original maturities of three months or less on the date of purchase to be cash equivalents. Unrestricted cash and cash equivalents were \$10,727,000 and 12,814,000 as of December 31, 2017 and 2016, respectively.

Restricted Cash:

Restricted cash represent funds designated for the EU-US Privacy Shield Annex I Binding Arbitration Mechanism, which the Association's international division, the International Centre for Dispute Resolution, manages for the U.S. Department of Commerce. This program requires participating organizations of the EU-US Privacy Shield program to pay a periodic contribution to the Fund to be used for the costs associated with the arbitrations arising out of the Privacy Shield program. The Association records restricted cash and a corresponding liability for amounts received from these participating organizations. The restricted cash and corresponding liability balances as of December 31, 2017 and 2016 were \$1,752,000 and \$0, respectively.

Concentrations of credit risk:

Financial instruments, which potentially subject the Association to concentrations of credit risk, include cash and cash equivalents, administration fees receivable, other receivables, and investments (see Note 2). The Association maintains cash and cash equivalents in bank deposit and other accounts, the balances of which exceeded Federally insured limits by \$21,533,000 and \$22,797,000 as of December 31, 2017 and 2016, respectively. The Association places its cash and cash equivalents with creditworthy, high-quality financial institutions. Credit risk with respect to administration 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 administration fees receivable and establishes an allowance for doubtful accounts, based on a history of past write-offs and collections and current credit considerations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Investments:

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

Furnishings, equipment, IT Systems and leasehold improvements:

Furnishings, equipment, IT Systems and leasehold improvements are stated at cost less accumulated depreciation and amortization. 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 developed for internal use:

The Association capitalizes costs incurred for the development of software for internal use. The cost of development is amortized over the useful lives of the underlying applications, varying from three to ten 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.

Income taxes:

The AAA is exempt from Federal income tax under the provisions of Section 501(c)(3) of the Internal Revenue Code; therefore, no provision for income taxes is included in the Association's consolidated financial statements. The Association has no unrecognized tax benefits at December 31, 2017 and 2016. The Association's Federal and state income tax returns prior to fiscal year 2014 are closed and management continually evaluates expiring statutes of limitations, audits, proposed settlements, changes in tax law and new authoritative rulings.

Deferred rent:

Certain of the Association's lease agreements provide for scheduled rent increases during the lease term or for rental payments commencing at a date other than initial occupancy. Provision has been made for the excess of operating lease rental expense, computed on a straight-line basis over the lease term, over cash rentals paid.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

Classification of net assets:

Categories of net assets are classified as unrestricted, temporarily restricted, and permanently restricted depending upon donor restriction. An operating reserve fund designated by the Board totaled \$68,266,000 and \$60,801,000 as of December 31, 2017 and 2016, respectively. Board designated net assets are unrestricted net assets which the board has set aside to mitigate risks that may impact the Association's financial sustainability and to serve as a long term capital fund. There were no expenditures from the operating reserve fund in 2017. The Association had no permanently restricted net assets as of December 31, 2017 and 2016.

Subsequent events:

The Association has evaluated subsequent events through April 30, 2018, which is the date the consolidated financial statements were available to be issued.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 2 - INVESTMENTS:

Investments at December 31, 2017 and 2016 consist of the following:

	2017		2016	
	Cost	Fair Value	Cost	Fair Value
Short Term Bond funds	\$ 45,668,000	\$ 44,948,000	\$ 48,551,000	\$ 47,834,000
Intermediate Term Bond funds	24,014,000	23,738,000	20,205,000	19,579,000
Inflation-Protected Bond funds	3,073,000	3,184,000	2,740,000	2,811,000
Long Term Bond Funds	2,848,000	2,867,000	-	-
High Yield Bond funds	13,434,000	13,379,000	5,900,000	5,755,000
Emerging Markets Bond funds	6,491,000	6,699,000	5,882,000	5,772,000
International Equities funds	5,743,000	7,819,000	6,121,000	6,818,000
U.S. Equities funds	26,772,000	31,318,000	25,377,000	28,125,000
Emerging Markets Equities funds	1,421,000	2,010,000	1,464,000	1,525,000
Real Estate Investment Trust funds	1,534,000	1,527,000	1,458,000	1,377,000
Cash/Money Market funds	3,334,000	3,334,000	1,262,000	1,262,000
Totals	<u>\$ 134,332,000</u>	<u>\$ 140,823,000</u>	<u>\$ 118,960,000</u>	<u>\$ 120,858,000</u>

Interest and dividends on investments are reported net of investment management fees and bank charges of \$1,706,000 and \$1,352,000 in 2017 and 2016, respectively.

The Association values its financial assets and liabilities based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, a fair value hierarchy that prioritizes observable and unobservable inputs is used to measure fair value into three broad levels, which are described below:

- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.
- Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in inactive markets; or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data.
- Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Association utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. There have been no changes in the methodologies used at December 31, 2017 and 2016.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Financial assets carried at fair value at December 31, 2017 and 2016 are classified as Level 1.

Investments in exchange traded funds and mutual funds, which account for all of the Association's investment holdings at December 31, 2017 and 2016, are valued using market prices on active markets (Level 1). Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets.

The Association recognizes transfers between levels in the fair value hierarchy at the end of each year. There were no such transfers during the years ended December 31, 2017 and 2016.

Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheets.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Association believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 3 - FURNISHINGS, EQUIPMENT, IT SYSTEMS AND LEASEHOLD IMPROVEMENTS:

Furnishings, equipment, IT Systems and leasehold improvements consist of the following:

	Estimated Life	2017	2016
Furnishings and equipment	7 to 10 years	\$ 10,345,000	\$ 13,498,000
Software developed for internal use	3 to 10 Years	16,952,000	16,466,000
Leasehold improvements	Term of Lease	11,581,000	12,924,000
		38,878,000	42,888,000
Less accumulated depreciation and amortization		(18,413,000)	(22,957,000)
Totals		\$ 20,465,000	\$ 19,931,000

In 2017 and 2016, the Association recognized a net loss of approximately \$10,000 and \$1,000 relating to the disposal of certain assets with original costs totaling \$8,499,000 and \$5,101,000, respectively.

Included in fixed assets are capitalized costs associated with the development of software for internal use of \$16,952,000 and \$16,466,000 as of December 31, 2017 and 2016, respectively. Related accumulated amortization as of December 31, 2017 and 2016 was \$8,012,000 and \$6,281,000, respectively.

Software development costs in progress, for various case management applications, websites, and web applications, totaling \$92,000 were placed into service in 2017 and are being amortized over a period of three to six years. Additionally, the Association had software development costs in progress, inclusive of related software licenses, totaling \$298,000 as of December 31, 2017. When placed in service these costs will be included in capital assets and amortized over a period of three to six years.

The Association had construction-in-progress totaling approximately \$4,000 as of December 31, 2017. These costs are primarily associated with leasehold improvements for office leases which will be placed in service in 2018. When placed in service, these costs will be included in capital assets and amortized over the lives of the underlying leases. Construction-in-progress costs totaling \$304,000 in 2016 were placed in service in 2017.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 4 - PENSION AND OTHER POSTRETIREMENT BENEFIT 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, 2017 and 2016 the projected benefit obligation and accumulated benefit obligation are equal.

The Association makes contributions to the plan based on actuarial calculations. Total employer contributions required for the fiscal year beginning January 1, 2018 are zero; therefore, the Association expects to make no contributions to the plan during 2018. The Association intends to terminate the plan and settle all liabilities via lump sum distributions in 2018 and annuity contract purchases in 2019.

The Association also provides certain healthcare 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. Prior to a plan amendment in December 2008, active employees hired on or before June 30, 2003 were eligible for retiree healthcare coverage upon retirement with at least 10 years of service after age 45. Effective December 31, 2008, eligibility for retiree medical was changed to require 15 years of service after the age of 45. However, exceptions were made for employees who would be eligible for retiree healthcare coverage as of December 31, 2008 under the previous eligibility rules of having at least 10 years of service after age 45, for employees who have at least 15 years of service as of December 31, 2008 and who were within 2 years of eligibility under the previous rules, and for a small group of senior executives. Employees who qualify under those exceptions will maintain the previous eligibility provision. The change in this benefit also limits the Association's annual net subsidy for retiree healthcare coverage to twice the 2008 net subsidy provided for all participants.

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, 2017 and in the aggregate for the years beginning in 2023 are as follows:

January 1,	Pension Benefits	Healthcare Benefits
2018	\$ 2,875,000	\$ 472,000
2019	2,658,000	513,000
2020	2,841,000	551,000
2021	2,587,000	580,000
2022	2,725,000	573,000
Years 2023 to 2027	12,447,000	2,938,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

For the defined benefit 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, 2017 and 2016:

	Pension Benefits		Healthcare Benefits	
	2017	2016	2017	2016
Benefit obligation at December 31	\$ 42,304,000	\$ 41,515,000	\$ 10,499,000	\$ 9,573,000
Fair value of plan assets at December 31	40,465,000	34,051,000	-	-
Net unfunded status of the plan	<u>\$ (1,839,000)</u>	<u>\$ (7,464,000)</u>	<u>\$ (10,499,000)</u>	<u>\$ (9,573,000)</u>
Amounts recognized in the consolidated balance sheets consists of the following:				
Current liabilities	\$ -	\$ -	\$ 472,000	\$ 412,000
Noncurrent liabilities	1,839,000	7,464,000	10,027,000	9,161,000
Totals	<u>\$ 1,839,000</u>	<u>\$ 7,464,000</u>	<u>\$ 10,499,000</u>	<u>\$ 9,573,000</u>
Components of net periodic benefit cost and other amounts recognized in other changes in net assets				
Net periodic benefit cost:				
Service Cost	\$ -	\$ -	\$ 145,000	\$ 157,000
Interest Cost	1,587,000	1,697,000	375,000	383,000
Expected return on plan assets	(2,455,000)	(2,492,000)	-	-
Amortization of prior service cost	(2,000)	-	-	(115,000)
Amortization of net actuarial loss	1,366,000	1,404,000	42,000	25,000
Net Periodic benefit cost at December 31	<u>\$ 496,000</u>	<u>\$ 609,000</u>	<u>\$ 562,000</u>	<u>\$ 450,000</u>
Unrecognized net loss included in net assets	\$ 16,685,000	\$ 17,406,000	\$ 2,256,000	\$ 1,439,000
Employer's contribution	5,400,000	-	453,000	410,000
Plan participants' contributions	-	-	53,000	49,000
Net periodic benefit costs	496,000	609,000	562,000	450,000
Benefit payments	(3,066,000)	(2,809,000)	(505,000)	(459,000)
Amounts recognized in other changes in net assets in the statement of operations and changes in net assets consist of:				
Net actuarial (gain)/loss	\$ (721,000)	\$ (806,000)	\$ 816,000	\$ 336,000
Weighted-average assumptions to determine the benefit obligation as of December 31:				
Discount rate	3.46%	3.95%	3.52%	4.00%
Rate of compensation increase	N/A	N/A	N/A	N/A
Pre- and Post-Mortality	RP-2014 Employee and Healthy Annuitant Tables adjusted back to 2006 and projected forward with Scale MP-2017 for all years		RP-2014 Employee and Healthy Annuitant Tables adjusted back to 2006 and projected forward with Scale MP-2017 for all years	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

	Pension Benefits		Healthcare Benefits	
	2017	2016	2017	2016
Weighted-average assumptions to determine the net benefit cost for the year ended December 31:				
Discount rate	3.95%	4.15%	4.00%	4.25%
Expected return on plan assets	7.50%	7.50%	N/A	N/A
Unrecognized actuarial loss:				
Beginning of year	\$ 17,406,000	\$ 18,212,000	\$ 1,439,000	\$ 1,103,000
Actual return on plan assets	(4,080,000)	(2,432,000)	-	-
Expected return on plan assets	2,455,000	2,492,000	-	-
Actuarial loss	2,268,000	558,000	859,000	246,000
Amortization of net loss	(1,366,000)	(1,404,000)	(42,000)	(25,000)
Amortization of prior service cost	2,000	(20,000)	-	115,000
End of year	<u>\$ 16,685,000</u>	<u>\$ 17,406,000</u>	<u>\$ 2,256,000</u>	<u>\$ 1,439,000</u>

The estimated net loss for the defined benefit pension plan that will be amortized from unrestricted net assets into net periodic benefit cost for the next fiscal year is \$1,313,000. The estimated prior service cost for the defined benefit pension plan that will be amortized from unrestricted net assets into net periodic benefit cost for the next fiscal year is \$2,000. The estimated net loss 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 \$113,000.

For measurement purposes, a 7.00% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2017. The rate was assumed to decrease gradually to 5.00% until 2022 and remain at that level thereafter.

The target allocations of pension assets are outlined below:

Plan assets:	Target Allocation	Percentage of Plan Assets at December 31,	
		2017	2016
Equity securities	0%	0%	56%
Fixed income	100%	100%	44%
Totals		<u>100%</u>	<u>100%</u>

The overall objective of these allocations is to have plan asset returns match plan liabilities, and reduce the volatility of the Plan's unrecognized loss. The expected long-term rate of return on assets is 4.5%. 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 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

The fair values of the Association's pension plan assets at December 31, by asset category are as follows:

2017 Asset Category	Quoted Prices in Active Markets (Level 1)	Significant Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total
Bond Mutual Funds	\$ 40,465,000	–	–	\$ 40,465,000
Totals	\$ 40,465,000	–	–	\$ 40,465,000

2016 Asset Category	Quoted Prices in Active Markets (Level 1)	Significant Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total
Bond Mutual Funds	\$ 14,969,000	–	–	\$ 14,969,000
U.S. Equities Mutual Funds	12,535,000	–	–	12,535,000
International Equities Mutual Funds	6,547,000	–	–	6,547,000
Totals	\$ 34,051,000	–	–	\$ 34,051,000

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in methodologies used at December 31, 2017 and 2016.

Mutual funds are valued at the net value of shares held by the plan at year-end (Level 1). Level 1 instrument valuations are obtained from real-time quotes for transactions in active markets involving identical assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

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 2018 and 2030. Most of the leases provide for future escalation charges relating to real estate taxes and other building operating expenses. Rental expenses charged to operations amounted to \$8,998,000 and \$8,635,000, for the years ended December 31, 2017 and 2016, respectively. In addition, the Association leases certain furniture, computer equipment, and office equipment under various operating leases, all of which expire over the next one to four years.

Minimum non-cancelable 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, 2017 and thereafter are as follows:

Year Ending December 31,	Amount
2018	\$ 7,843,000
2019	8,088,000
2020	7,903,000
2021	7,562,000
2022	7,653,000
Thereafter	31,994,000
Total	<u>\$ 71,043,000</u>

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, 2017 and 2016, advance deposits collected totaled \$73,611,000 and \$68,422,000, respectively. These amounts are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

As of both December 31, 2017 and 2016, pursuant to various office space leases, the Association has letter of credit agreements totaling \$2,632,000. These agreements guarantee operating lease rental obligations and are secured by a portion of the investment portfolio. There were no payments drawn against these letters of credit by any of the beneficiaries during 2017 and 2016.



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