

August 8, 2008

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Financial Accounting Standards Board
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LETTER OF COMMENT NO. 175

Re: Proposed Amendment of FASB Statements No. 5
and 141(R), File Reference No. 1600-100

Dear Mr. Golden:

Mayer Brown LLP appreciates the opportunity to present its views regarding the proposed amendments to Statement of Financial Accounting Standards No. 5 and No. 141(R) (“FAS 5 and 141(R)”) released for comment on June 5, 2008. As applied to litigation-related contingencies, the very substantial costs that would result from implementation of this proposal – for corporations and, therefore, for investors, as well as for our entire economy – do not come close to being outweighed by corresponding benefits.

Mayer Brown is one of the world’s leading global law firms, with 1800 lawyers located in the United States, Europe, South America, and Asia. The firm provides legal services to many of the world’s largest companies, including a significant proportion of the Fortune 100, FTSE 100 and DAX companies and more than half of the world’s largest investment banks. We frequently represent parties in litigation, as well as provide advice with respect to disclosures required by securities laws, and our comments focus on the amendments’ dramatic impact with respect to litigation-related contingencies.

Summary

The proposed amendments would expand the disclosure obligation for litigation-related contingencies, as a practical matter requiring disclosure with respect to virtually all non-frivolous litigation. Moreover, the required disclosures would provide no benefit to investors. The disclosures either would reveal information about how the company assesses the risk of a case in a manner that would be prejudicial to the company’s position in the lawsuits, eviscerate the attorney-client privilege, and end up forcing the company (and, as a result, the investors who are the company’s owners) to incur an expense much greater than what it otherwise would bear with respect to the litigations that are the subject of the disclosures; or – to avoid that harm – the company would have to resort to disclosures that convey little or no useful information. Neither result furthers investors’ interests. The proposal’s provisions permitting aggregate disclosures,

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and an exemption from the disclosure requirement in “rare” cases, do not solve the problem. Rather, they increase the likelihood of meaningless disclosure, essentially boilerplate discussions of litigation strengths and weaknesses, without reducing the likelihood of litigation prejudice. For these reasons, the Board should not adopt the amendments with respect to litigation-related contingencies.

Background

Currently, FAS 5 requires disclosure with respect to a litigation-related contingency only when there is “at least a reasonable possibility” that a loss may have been incurred. The rule defines “reasonable possibility” as a chance that is “more than remote, but less than likely.” If disclosure is required, “[t]he disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made.”

The proposed amendments would expand both the circumstances in which disclosure is required as well as the nature of the disclosure that must be made. With respect to asserted claims, disclosure would be required *unless* “the entity has made an assessment and determined that the likelihood of loss is remote,” with “remote” defined as the chance of occurrence “being slight.” Every case in which it is not possible to determine affirmatively that the chance of occurrence is only “slight” would become subject to the disclosure obligation as a result of the amendments. See Background Information, ¶ A12.¹

When disclosure is required, the registrant would be obliged to provide (a) the amount of the claim (including trebling or punitive damages) or its “best estimate of the maximum exposure to loss” if no specific amount is claimed; and (b) “qualitative information” including “a description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome,” the registrant’s “qualitative assessment of the most likely outcome,” and the “significant assumptions” made in estimating the amount of the claim and “the most likely outcome.”

The proposed amendments will have very substantial adverse effects upon investors.

- 1. The amendments will expand the disclosure requirement for litigation-related contingencies, likely attaching the new disclosure obligations to virtually every non-frivolous litigation claim.**

The scope of the proposed disclosure obligation is quite broad. Given the uncertainties of the litigation process, it is difficult to make an affirmative determination that the chances of incurring a loss are “slight” as to *any* claim that is not frivolous. Courts’ rulings with respect to

¹ The proposed amendments also would require disclosures regarding even “remote” contingencies if the matter is likely to be resolved in the next year and could have a severe impact on the registrant. They also would require disclosures regarding unasserted claims in specified circumstances.

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legal issues cannot be predicted with certainty, and jury determinations are notoriously hard to assess in advance. The only case in which a registrant is likely to be able to rule out a payment therefore could well be one that is frivolous – a standard that leaves all but a very small percentage of litigation claims subject to the disclosure obligation.

It is true that the proposed new standard would not apply to non-material items. But materiality itself is a concept that does not produce clear lines. And here the uncertainty of the materiality standard would be combined with uncertainty regarding the “maximum exposure to loss” – especially when possible punitive and multiple-damages exposure is considered – to require disclosure in virtually every case. Certainly a registrant that failed to make disclosures with respect to a non-frivolous claim would be risking a private class action for damages if the non-disclosed lawsuit produced a wholly unexpected but significant loss.

2. The amendments will lead to one of two results: litigation-related disclosures that inflict very substantial harm on investors, or boilerplate disclosures that provide no useful information while continuing to carry a significant risk of litigation prejudice.

As a threshold matter, even if it were possible to eliminate entirely the risk that the disclosures required by the amendments would be used against the registrant in litigation, so that the disclosures could be crafted without regard to their litigation impact – and, of course, it is not possible to do so – the disclosures required by the amendments almost certainly would not provide information useful to investors. That is because of the inherent difficulty in assigning a value to litigation and the volatility that any valuation would have over the life of the lawsuit.

Litigation claims are not traded on a market; there accordingly is no readily-available mechanism for valuing particular claims. And there is no other generally-accepted means of establishing a claim’s “maximum exposure.” Few plaintiffs identify the maximum amount sought in their complaints – today’s generous pleading rules rarely require them to do so. That principle applies especially with respect to punitive damages: a plaintiff need only assert entitlement to punitive damages without specifying an amount. And even if the complaint contains an amount for compensatory or punitive damages, many courts will “conform the pleadings to the proof” and allow recovery of whatever amount the jury awards if it is supported by the evidence adduced at trial.

Moreover, the “maximum exposure” associated with a particular claim may vary greatly depending on the point in the litigation cycle at which the assessment is made. When the complaint is first filed, and both the facts and legal standards are not clear, a registrant would be hard-pressed to conclude that the plaintiff’s chance of prevailing is “slight.” It therefore would likely be required to make a disclosure with respect to the claim unless it could be categorized as non-material.

If the court’s ruling on the registrant’s motion to dismiss adopted a favorable view of the law – but permitted the parties to develop relevant facts through discovery – the registrant might

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believe, based on its initial investigation, that the plaintiff would not be able to develop facts necessary to prevail on its claim. It therefore might decide against a disclosure with respect to the matter.

But subsequent discovery might reveal factual material previously unknown to the registrant that made the plaintiff's chance of prevailing at trial more than "slight." Under the proposed amendments, that would require a disclosure with respect to the litigation contingency.

Thus, the same claim might produce drastically different disclosures depending upon where the case is in the litigation cycle on the registrant's reporting date. That is likely to create substantial confusion in year-to-year comparisons rather than providing information useful to investors.

The claim-specific disclosures required by the proposed amendments would always be prejudicial to the registrant's litigation position. It is impossible to imagine any situation in which severe prejudice would not result from a claim-specific disclosure of the information required by the proposed amendments.

The "quantitative disclosure" required by the proposal – the "best estimate" of the maximum loss – is highly sensitive information for the vast majority of cases, in which the claimant has not specified a maximum amount. The defendant's assessment of the plaintiff's maximum recovery obviously would be extremely useful information to the plaintiff. The plaintiff would gain a significant advantage in settlement negotiations: knowledge of its adversary's assessment of the possible value of the case would make that assessment the "floor" in any negotiation. And the valuation also would be useful to the plaintiff in setting litigation strategy. Finally, the valuation could well be admissible in the litigation itself as evidence of the registrant's assessment of its potential.

The "qualitative" disclosures would be even more prejudicial. The proposed amendments require an assessment by the registrant of the strengths and weaknesses of its litigation position, including a description of all of the relevant factors and an assessment of the likely outcome. This discussion would provide the plaintiff with a complete guide to the registrant's defense, the relevant legal and factual considerations, and how the registrant believes they are likely to play out in the resolution of the claim. Considerations supporting the claimant's position would be revealed whether or not they are known to the claimant, making the registrant the architect of its opponent's case. This information, routinely provided by outside litigation counsel on a confidential basis to inside counsel and high-ranking corporate executives, lies at the core of what is protected by the attorney-client and work product privileges. The disclosures could even be used against the registrant in court to the extent the registrant attempted to take positions in the litigation inconsistent with its assessment of the relevant considerations.

Aggregation of information would produce information useless to investors. Recognizing the possibility that disclosure of litigation-specific information would be prejudicial, the proposed amendments allow the registrant to aggregate its disclosures "by the nature of the loss

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contingency” or to “aggregate the disclosures . . . at a higher level than by the nature of the contingency such that disclosure of the information is not prejudicial.” But these aggregations are likely to produce information that is at best useless to investors and at worst misleading.

Any sort of aggregation –whether within a particular litigation category or at a higher level – eliminates the connection between the quantitative amount and the qualitative assessment. This inevitably will produce an odd set of mismatched disclosures. For example, assume that the registrant faces three patent cases as to which disclosures are required: case A in which the maximum loss is \$500 million but the registrant has strong defenses; case B in which the maximum loss is \$50 million but the registrant has weak defenses; and case C in which the maximum loss is \$400 million but the outcome is uncertain.

The aggregated disclosure approach is easy to apply to the quantitative disclosures. Simply adding the three amounts would produce an aggregated disclosure of \$950 million.

But how would the qualitative disclosures be aggregated? One option would be to retain all of the specific discussion of the relevant factors of each of the individual cases and simply disguise the identity of the case (*e.g.*, substitute “Case A” for “Smith v. Jones”). However, the detailed discussion required by the proposal likely would make it easy for plaintiffs’ lawyers to identify the actual case being discussed (because of the discussion of the key factors present in a particular case), producing the very prejudice that aggregation is intended to prevent. Registrants accordingly would have no choice but to “aggregate” the qualitative disclosures into one discussion applicable to all of the litigation contingencies. In the example above, that would mean combining the observations regarding the three cases into a single discussion at a high level of generality, which would be likely as a practical matter to devolve into a boilerplate disclosure of the generic strengths and weaknesses of the particular type of litigation claim.

How would such an aggregated disclosure help investors? One investor might assume (wrongly) that the lion’s share of the aggregated exposure related to the case in which the defenses were weak; another might assume (wrongly) that most of the aggregated exposure involved the case in which the defenses were strong. The very same confusion will occur when information regarding different type of litigation contingencies is aggregated. The plain fact is that aggregated information carries a very significant likelihood of confusing investors rather than informing them.

Even the aggregation and non-disclosure options would produce litigation prejudice. The aggregation option is not flawed only because it will result in information that confuses rather than informs investors; it is flawed for the additional reason that it does not cure the risk of prejudice associated with disclosure of claim-specific information.

The Board undoubtedly is aware of the substantial controversy that now exists among registrants and their tax counsel, on the one hand, and auditors, on the other hand, with respect to disclosure to auditors of opinions of counsel assessing a registrant’s tax positions; the disagreement extends

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to disclosure to auditors of other types of privileged information. See, e.g., American Bar Ass'n Task Force on Attorney-Client Privilege, *Report to the House of Delegates* (June 2006), available at http://www.abanet.org/buslaw/attorneyclient/materials/hod/0806_report.pdf. Registrants are concerned about judicial decisions holding that disclosure to auditors of material protected by the attorney-client and/or attorney work product privileges constitutes a waiver of those privileges (see, e.g., *id.* at 12 & n.21) and many have resisted auditors' efforts to obtain access to those materials.

The proposed amendments would put auditors in the position of requesting access to litigation counsels' assessments of all of the registrant's litigation contingencies. If access were granted, at least some courts would hold the privilege waived, and the parties opposing the registrant in the various litigation matters would be able to obtain these confidential assessments of the litigation. If access were not granted, the auditor might not be able to complete its work. The proposal thus sets the stage for a very significant conflict between registrants and their auditors that will create uncertainty at best, and harm investors by subjecting registrants to worse litigation outcomes because of the release of privileged information to their litigation adversaries.

The proposal includes a final attempt to address the prejudice issue through an "exemption," but that provision does not eliminate these very substantial harmful consequences. The "exemption" states that in "rare" instances in which aggregation at a higher level would not prevent prejudice, the registrant "may forgo disclosing only the information that would be prejudicial" to its position, but it may never forgo disclosing the estimate of maximum loss and "a description of the factors that are likely to affect the ultimate outcome of the contingency along with the potential impact on the outcome." This "exemption" thus requires disclosure of the very information most likely to prejudice the registrant – the registrant's assessment of the strengths and weaknesses of the key factors bearing on the outcome of the case. It accordingly does nothing to alleviate the risk of very significant prejudice.²

3. The proposed amendments will open the door to a new species of securities class actions based on allegations of insufficient disclosure regarding litigation contingencies.

The burden imposed upon investors and our capital markets by abusive securities class actions is well-recognized.³ The disclosure obligation that would be imposed by the proposed amendments

² In addition, the "exemption" does nothing to address auditors' inevitable requests for access to the privileged material that provide the basis for the registrant's disclosure decisions, and the privilege waiver that could well result from providing such access.

³ McKinsey & Company, Report Commissioned by Mayor Michael R. Bloomberg and Senator Charles E. Schumer, *Sustaining New York's and the U.S.' Global Financial Services Leadership* (2007), available at http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf; Committee on Capital Markets Regulation, *Interim Report* 74 (Nov. 2006), available at http://www.capmksreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf.

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would open the door to an entirely new species of class actions: claims filed after a litigation is resolved asserting that the disclosures with respect to the litigation were either too optimistic or too pessimistic, depending on the litigation's outcome.

This threat is not merely theoretical; such claims have already begun to be asserted in related contexts. Thus, a company recently paid \$13.5 million to settle a class action asserting that it had failed to disclose weaknesses in its patent claims that resulted in a patent litigation loss. See *Patents: The New Class Action Frontier*, *The Recorder* (July 21, 2008), available at <http://www.law.com/jsp/article.jsp?id=1202423125673>. These claims will proliferate if the proposed amendments are adopted.

For all of these reasons, we urge the Board to reject the proposed amendments, or at the minimum to maintain current standards with respect to litigation-related contingencies. Please contact Andrew Pincus at 202-263-3220 or apincus@mayerbrown.com with any inquiries relating to this submission.

Sincerely,


Mayer Brown LLP