



August 8, 2008

LETTER OF COMMENT NO. 189

Mr. Robert H. Herz
Chairman
Financial Accounting Standards Board
Norwalk, CT 06856-5116

Re: File Reference No. 1600-100

Dear Mr. Herz:

The U.S. Chamber of Commerce is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. Our members are both users and preparers of financial information. We support the objectives of the Financial Accounting Standards Board ("FASB" or "Board") to enhance the usefulness of financial disclosure to the benefit of users, preparers, and the U.S. capital markets. However, we must add our voice to the growing chorus of concern with the proposed amendments to the Statements of Financial Accounting Standards No. 5 ("FAS 5") and 141(R) expressed from every quarter of FASB's constituencies.

The proposed amendments will not have the effect desired by the Board. Instead of benefiting users, adopting these proposed changes would add uncertainty, complexity, new liability, and a great deal of cost while compelling companies to provide potentially unreliable, and often immaterial, information about pending litigation. Existing Securities and Exchange Commission ("SEC" or "Commission") rules for public companies provide much of what the proposed standard hopes to accomplish. This proposal will also endanger the integrity of the attorney-client and work product privileges. Further, the proposed amendments will obstruct FASB's stated goals of converging U.S. accounting standards with international standards and severely inhibit the competitiveness of the U.S. capital markets. In light of these critical considerations, we urge FASB to abandon these proposed amendments.

I. Existing Disclosure Requirements Already Achieve the Objectives of the Proposed Amendments

As an initial matter, we question the need for such amendments. The Exposure Draft asserts that investors and other users of financial information have urged FASB to adopt standards requiring more detail on the likely outcomes of loss contingencies. We are not aware of any notable crises, SEC focus, or heightened media attention to this issue, nor of any concerns expressed by users of private company financial statements. In short, this may be a proposed solution in search of a problem.

For the most part, FAS 5 has worked. Although companies sometimes struggle with whether a loss is probable or estimable, the process has generally proved workable in supplying information and providing a more dynamic income statement. FAS 5 is not the primary source for disclosure of loss contingencies. For public companies, Regulation S-K Item 103 is the primary source for disclosure of material pending or threatened litigation. It requires companies to:

[d]escribe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. Include similar information as to any such proceedings known to be contemplated by governmental authorities.¹

In addition, Item 303 (“MD&A”) requires disclosure of material loss contingencies. Item 303(a)(3)(ii) states:

[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material

¹ 17 C.F.R. § 229.103 (2008).

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favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed.²

Between Items 103, 303, and the traditional contingency footnote to the financial statements, investors are provided with substantial disclosure of the material aspects of loss contingencies.

Should there be a demonstrated need for disclosure enhancements, the SEC is the appropriate body to address this issue. In fact, in 2000, the SEC proposed amendments to Item 302(c) of Regulation S-K to seek more disclosure of loss contingencies (with some parallels to your proposed action).³ It was widely criticized and the SEC declined to adopt it. This proposal should meet a similar fate.

II. The Proposal Will Increase Financial Reporting Complexity and Confuse Investors

The underlying premise of the Board's proposal is that more information about future loss contingencies is better disclosure. However, it is not the quantity of information that is critical to this analysis – it is the quality and reliability of information that matters most. Users of financial statements need information that will assist them in assessing disclosures, including the likelihood, timing, and amount of future cash flows associated with loss contingencies.

In this regard, the additional proposed disclosures require companies to release an excess of immaterial information to investors and, in many instances, information that is unreliable, leading to confusion. Language in regulations, contracts, and even accounting standards are often subject to multiple interpretations. Moreover, each

² 17 C.F.R. § 229.303 (2008).

³ SEC Release Nos. 33-7793; 34-42354; File No. S7-03-00, *Supplementary Financial Information* (Jan. 21, 2000), available at <http://sec.gov/rules/proposed/34-42354.htm>.

case has unique facts and circumstances. Coupled together, you can appreciate the challenge. Depending upon the type of suit involved, outcomes can vary widely from court to court and state to state. No one can predict what judge may be assigned to a case or how he or she will view the facts and the law. Also, juries are bodies that defy prediction. They are capable of awarding \$2.9 million for a spilled cup of coffee.

Unlike areas that lend themselves to actuarial analysis or other financial modeling, legal outcomes are inherently difficult, if not impossible to predict. Thus, compelling companies to guess what the maximum liability might be, or the likely outcome, will undoubtedly lead to the disclosure of some arbitrary, unreliable amounts and outcomes. Reliability is a cornerstone of financial reporting. Without it, investors might receive more information, but of less utility.

III. The Proposal Will Lead to Excessive Lawsuits Against Public Companies Generated by Plaintiffs' Lawyers and Impose a Variety of Unjustified Costs on U.S. Registrants

Even if the benefits to investors were measurable, the costs and burdens imposed by the proposed changes would overwhelm them. Any standard setter should be mindful of the costs and benefits of a proposed rule change. This proposal will significantly increase litigation risk and exposure, damaging public companies.

The cost of excessive litigation to public companies is significant. In short, notwithstanding the efforts of Congress to reign in abusive litigation, a multibillion dollar plaintiffs' lawyer industry is eroding the competitiveness of the U.S. capital markets at a time when they face perhaps the greatest threat from foreign competition.

Overzealous plaintiffs' lawyers work to extract settlements against corporate defendants whom they believe to possess deep pockets, often irrespective of the merits of the claim. In particular, the costs of securities class action litigation are well documented in the recent white paper issued by the U.S. Chamber Institute for Legal Reform.⁴ The number of suits and the dollar amounts involved are mushrooming.

⁴ See, U.S. Chamber Institute for Legal Reform, *Securities Class Action Litigation – The Problem, Its Impact and the Path to Reform*, 3-14 (2008)[hereinafter *ILR White Paper*], available at

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The total settlement value of securities class actions alone over the past decade is \$51.8 billion.⁵ In addition, plaintiffs' lawyers have earned nearly \$17 billion in these cases in the last decade.⁶ FASB should not adopt new amendments that exacerbate an already troubling situation.

Indeed, the Board's proposal would make these matters far worse. Besides providing unreliable and immaterial information to investors, the proposed changes would offer unwarranted insights into a company's assessment of litigation and its trial strategies, thereby encouraging plaintiffs' lawyers to file suits with exorbitant damages claims.

The Exposure Draft requires the disclosure of loss contingencies that are not reasonably possible to occur or estimate. The greatest danger of this proposal is not necessarily the immaterial and unreliable information that it would elicit, but in the fundamental way that the proposal would change the motivations and strategies underlying abusive lawsuits. It would provide new avenues to vex companies into settlements in abusive lawsuits.

For example, paragraph A13 of the Exposure Draft proposes a standard that a company must disclose all loss contingencies, expected to be resolved in the near term, if they "could" have a severe impact on an entity, regardless of the likelihood of loss. If "could" was interpreted to mean any possibility, no matter how remote, it would force companies to disclose meritless claims that risk misinforming shareholders while providing plaintiffs' lawyers with a new avenue for publicizing their case and pressuring for a settlement. Therefore, if the woman who spilled coffee on herself had sued for \$10 billion, although there would be almost no chance that she could recover that amount, there would need to be disclosure analyzing the case

<http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1213>. See also, John C. Coffee, Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation, 106 Colum. L. Rev. 1534, 1540 (Nov. 2006); and Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan.L.Rev. 497, 528-34 (1991).

⁵ *ILR White Paper*, *supra* note 4, at 8 (citing Laura E. Simmons & Ellen M. Ryan, Cornerstone Research, Securities Class Action Settlements: 2007 Review and Analysis 5 (2008)).

⁶ It is estimated that plaintiffs' attorneys obtain 32% of the value of a settlement in fees, and in the past decade securities class action defendants settled for a total of nearly \$52 billion. Coffee, *supra* note 4, at 1546 & n.38.

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and its likely outcome, even though the case was truly immaterial to investors of that public company. A \$10 billion judgment would be “severe” for most companies, and it would encourage plaintiffs’ lawyers to allege exorbitant damages so as to force disclosure and gain an insight into the company’s case.

FASB should understand that, under its proposed standard, all disclosures, including the possible maximum amount of liability, would likely be introduced into evidence as admissions of liability. In addition, any dollar amount identified as to a likely settlement would be viewed by plaintiffs’ counsel as the opening bid for settlement, meaning greater costs imposed on public companies to settle lawsuits identified as a result of these proposed changes. Likewise, cases would be filed just prior to an SEC filing requirement to increase the pressure to settle litigation swiftly before it must be reported.

Any action by Government or private standard setters that has the effect of encouraging abusive litigation should be scrutinized carefully. It is not far-fetched to imagine plaintiffs’ attorneys making an industry of filing cases without merit, alleging damages of sufficient size to trigger disclosure under this proposed standard, and forcing settlements that only increase litigation costs for U.S. companies.

The proposed prejudicial exemption (to allow the withholding of “prejudicial” information and the aggregation of reserves) would do little to ameliorate the harm and costs. The Board, by providing the ability to aggregate information, does not assist companies that have only a few material cases. The ability to withhold prejudicial information is helpful, but only to the extent that it would permit withholding of information relating to likely outcomes and amounts of maximum liability.

Lastly, the proposed changes are costly in that they are largely redundant with Item 103 of Regulation S-K if you allow prejudicial information to be withheld. There are already too many redundancies in the periodic report disclosures without further overlap.

IV. The Proposal Will Force Companies to Disclose Information Covered by the Attorney-Client and Work Product Privileges

The proposal requires disclosure of a company's confidential strategy regarding pending litigation and therefore the proposal presents a very serious challenge to maintenance of an attorney-client privilege. This privilege is an essential component of our judicial system. Attempts by the government to abrogate it have been met with concern from the U.S. Congress, as we have seen recently. A cornerstone of our legal system should not be sacrificed readily for dubious benefit. The privilege is lost by public disclosure, and it is jeopardized by disclosure to a company's independent auditor (who would be required to audit compliance with this standard).

Not only is some of the information to be disclosed protected under the attorney-client privilege, but some of it is commercially sensitive information of the nature protected by the Freedom of Information Act, 5 U.S.C. § 552b. Thus, the proposed disclosures would give rise to a flurry of requests for confidential treatment resulting in added burden and costs for both corporations and the SEC.

V. The Proposal Will Obstruct Progress towards International Convergence of Accounting Standards

In a global economy, the U.S. should strive for consistency with international accounting standards. This proposal is inconsistent with international accounting standards. Thus, FASB should look at harmonizing its standards with IAS 37 - governing contingent liabilities and contingent assets. For example, IAS 37 states that it aims to ensure that only genuine obligations are dealt with in the financial statements. The proposed changes to FAS 5 move the U.S. even further from this principle and some of the other principles and factors in IAS 37. Further, this proposal represents a step back from the progress made towards adopting principles-based standards, utilized by the IASB, and adds restrictive requirements that cloud reliable financial data for both preparers and investors.

VI. The Proposal Will Undermine the Competitiveness of the U.S. Capital Markets

The proposal would encourage the same abusive litigation that is threatening the integrity and efficiency of our legal system. The litigious nature of the U.S. markets have put us at a competitive disadvantage vis-à-vis other markets. In fact, all four recent reports on the competitiveness of the U.S. capital markets have cited excessive litigation generally or securities class actions specifically as a significant threat to the competitiveness of our capital markets.⁷ As we have discussed, this proposal will have the effect of increasing litigation against public companies in the U.S.

Further, a recent survey conducted by the Financial Services Forum, polling 334 senior executives of companies based in the U.S., U.K., France, Germany, India, China, and Japan, found that “[o]ne of three companies in the survey that considered going public in the United States rated litigation as an ‘extremely important’ factor in their decision” and “nine out of 10 companies who de-listed from a U.S. exchange in the last four years said that the litigation environment played some role in that decision.”⁸

⁷ Committee on Capital Markets Regulation, Interim Report, 74-80(Nov. 2006), available at http://www.capmktreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf; Commission on the Regulation of the U.S. Capital Markets in the 21st Century, Independent Bipartisan Commission Established by the U.S. Chamber of Commerce, Report and Recommendations, 30 (Mar. 2007), available at <http://www.uschamber.com/publications/reports/0703capmarketscomm.htm>; 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, 73-78(2007), available at http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPO_RT%20_FINAL.pdf; The Financial Services Roundtable also prepared a comprehensive report that addresses this issue. Richard M. Kovacevich et al., The Financial Services Roundtable, The Blueprint For U.S. Financial Competitiveness (Nov. 2007), available at <http://www.fsround.org/cec/pdfs/FINALCompetitivenessReport.pdf>.

⁸ The Financial Services Forum, *2007 Capital Markets Survey*, 6-8 (2007), available at <http://www.financialservicesforum.org/atf/cf/%7B95f7c378-e3f0-4073-ab67-ed043f25dbb7%7D/FINAL%202007%20FORUM%20IPO%20STUDY.PDF>.

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It is easy to see that the flawed legal system and standards that encourage excessive litigation would make the U.S. capital markets less attractive to foreign companies.

Conclusion

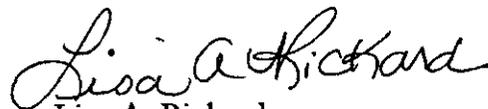
We recommend that the proposed changes to FAS 5 be abandoned. The need for amending the rule is not apparent. Its intended consequences will hinder rather than help effective disclosure of litigation contingencies. The unintended consequences will foster additional abuse of our liability system, and hand plaintiffs' attorneys a tool to compel misleading disclosure. The difficulties created by the proposal are too fundamental to be cured by drafting changes.

Thank you for your consideration.

Sincerely,



David T. Hirschmann
President
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce



Lisa A. Rickard
President
Institute for Legal Reform
U.S. Chamber of Commerce

cc: George J. Batavick, Financial Accounting Standards Board
Thomas J. Linsmeier, Financial Accounting Standards Board
Leslie F. Seidman, Financial Accounting Standards Board
Lawrence W. Smith, Financial Accounting Standards Board
The Honorable Christopher Cox, Chairman, Securities and Exchange
Commission
The Honorable Luis A. Aguilar, Securities and Exchange Commission
The Honorable Kathleen L. Casey, Securities and Exchange Commission
The Honorable Troy A. Paredes, Securities and Exchange Commission
The Honorable Elisse B. Walter, Securities and Exchange Commission