

SULLIVAN & CROMWELL LLP

TELEPHONE: 1-212-558-4000
FACSIMILE: 1-212-558-3588
WWW.SULLCROM.COM

*125 Broad Street
New York, NY 10004-2498*

LOS ANGELES • PALO ALTO • WASHINGTON, D.C.

FRANKFURT • LONDON • PARIS

BEIJING • HONG KONG • TOKYO

MELBOURNE • SYDNEY

August 8, 2008

Via E-mail

Technical Director,
Financial Accounting Standards Board,
401 Merritt 7,
P.O. Box 5116,
Norwalk, CT 06856-5116.



LETTER OF COMMENT NO. 119

Re: File Reference No. 1600-100

Ladies and Gentlemen:

This letter is in response to the Exposure Draft of the proposed Statement of Financial Accounting Standards issued by the Financial Accounting Standards Board (the "Board") relating to the disclosure of certain loss contingencies (the "Proposal").

We appreciate the opportunity to submit these comments for the Board's consideration. As lawyers, we have serious concerns with the Proposal because we believe it would require disclosures that would be potentially confusing and prejudicial to entities' litigation positions, and would involve inappropriate speculation as to potential loss contingencies.

We understand that the Proposal reflects, to some significant extent, users' dissatisfaction with the general level and quality of disclosure of loss contingencies. We believe, however, that current disclosure practices largely reflect the challenges of making such disclosures. In our experience, projecting the outcome of a loss contingency, especially a matter subject to litigation, is inherently difficult and quite often speculative. Lawyers routinely decline to express any view on the outcome of litigation matters due, in large part, to the unpredictable nature of litigation. In our view, imposing a duty on issuers to project the outcome of litigation when counsel is unable meaningfully to assist in the analysis is not appropriate and will not lead to useful disclosures.

I. Disclosure of Loss Contingencies Regardless of Likelihood of Loss

Paragraph 5 of the Proposal excludes from the SFAS Statement 5 disclosure requirements any loss contingency as to which the likelihood of loss is determined to be remote, or that involves an unasserted claim meeting specified criteria. But paragraph 6 of the Proposal would require an entity to disclose a loss contingency excluded from disclosure by paragraph 5 if the contingency is expected to be resolved within one year of the date of the financial statements and the contingency could have a “severe impact” on the entity’s financial position, cash flows, or results of operations. For the reasons that follow, we do not believe that disclosure of loss contingencies excluded by paragraph 5 is appropriate.

We do not understand why it would be in the interests of users of financial statements to disclose remote loss contingencies. The fact that a loss contingency is remote makes it inherently immaterial, and disclosure of such loss contingencies is likely to generate confusion. The markets have generally been conditioned to attach significance to any disclosure that issuers make; requiring immaterial disclosures and inviting issuers to “explain them away” is therefore fundamentally inconsistent with current market practices and expectations.

Moreover, we believe that the “severe impact” threshold, which the Board indicates includes loss contingencies that are something more than material but not necessarily “catastrophic,” does not provide a meaningful standard by which an entity can determine whether a particular loss contingency must be disclosed. The imposition of such a nebulous standard, in our view, would likely result in confusion and inconsistency in application.

II. Best Estimate of Exposure to Loss

As noted by the Board, paragraph 10 of current SFAS Statement 5 requires an entity to “give an estimate of the possible loss or range of loss or state that such an estimate cannot be made.” The Board indicates that some users of financial statements believe that entities are improperly relying on the latter part of this instruction, stating that estimates cannot be made where perhaps they could be, and that the failure to disclose this information diminishes the usefulness of financial statements. In response, the Board proposes in paragraph 7 to require an entity to disclose the amount of a claim or assessment or, where no amount is specified, the entity’s best estimate of the maximum exposure to loss.

We agree with the Board that where the amount of a claim or assessment is specified, that amount should be disclosed. We do not believe, however, that it is appropriate to require an entity to estimate its maximum possible exposure where no claim or assessment amount has been specified. To the extent that an entity is able to

estimate the amount of a possible loss or a range of losses, whether because of the status of the proceeding, the entity's experience with similar matters or the advice of counsel, the disclosure of that amount is required under the existing paragraph 10 standard. If an entity is unable to estimate the magnitude of a possible exposure, however, paragraph 7 of the Proposal would require the entity to speculate as to its maximum loss possibility, and the entity may be forced to determine this amount by reference to unreliable sources or by mere guess work. More important, any such disclosure of the entity's estimate of its maximum exposure will provide the other side an insight into the entity's view of the matter, which may confer a significant practical advantage over the entity in litigating or settling the matter. The same is true of the permissive disclosure of the entity's "best estimate of the possible loss or range of loss."

The Board states that it decided that the disclosure of settlement offers should not be required because "those offers expire quickly and may not reflect the status of negotiations only a short time later." We find it doubtful that the proposed maximum loss disclosure is more valuable to financial statement users than outdated or unrealistic settlement offers, as neither of these amounts is likely to reflect accurately the true value of the loss contingency. In practice, a maximum loss determination may in fact be based on the same settlement offers that the Board decided were unhelpful.

Although the Board states its view that financial statement users would prefer to have a "highly uncertain estimate supplemented with a qualitative description than no quantification of a potential loss," for the reasons discussed above, we do not believe that speculative disclosures called for by paragraph 7 will in fact provide relevant or useful information for users of financial statements.

III. Tabular Reconciliation of Recognized Loss Contingencies

Paragraph 8 of the Proposal requires an entity to provide a reconciliation, in tabular format, of the total amount recognized in the aggregate for disclosed loss contingencies, accompanied by a qualitative description of significant activity in the reconciliation and disclosure of the line items in the statement of financial position in which recognized loss contingencies are included.

In our view, the quantitative disclosures required by paragraph 8 would frequently result in the disclosure of prejudicial information regardless of the level at which the loss contingencies are aggregated. The amounts by which reserves increase or decrease as a result of the recognition of loss contingencies or changes in estimates of the amounts of loss contingencies during the period will be easily identifiable and, we believe, often traceable to particular loss contingencies. This concern is especially acute in the current litigation environment where a major settlement by one defendant may require a reassessment by all defendants of the likelihood of loss. And the more significant a particular litigation, the more likely that changes relating to it will be

identifiable from the reconciliation. We therefore expect that these disclosures will often provide the reporting entity's adversaries with insights into the entity's view of particular litigation matters, which will confer on those adversaries an advantage in litigating or settling the matters.

Because of the risk of prejudice and the concerns we have with the limited exemption from disclosing prejudicial information described below, we do not believe the tabular reconciliation contemplated by paragraph 8 should be required.

IV. Exemption from Disclosing Prejudicial Information

As discussed above, we are concerned that some of the new disclosures contemplated by the Proposal raise a significant risk that an entity may be required to disclose prejudicial information. The Board acknowledges this fact and has attempted to address it in paragraph 11 of the Proposal, which allows an entity to aggregate loss contingencies at a higher level than by nature of the contingency and, in certain "rare" instances when aggregation at a higher level will not cure the prejudice, to forego disclosing the prejudicial information, including the tabular reconciliation required by paragraph 8. The Board indicates that the term "rare" is not intended to mean "never," and that "the determination of when it is appropriate to exercise this exemption is a matter of significant judgment that depends on the facts and circumstances."

While we welcome the Board's effort in paragraph 11 to mitigate the damage that may otherwise result from the Proposal, we believe that the instances in which the Proposal will require the disclosure of prejudicial information, regardless of the level at which the contingencies are aggregated, will be far from "rare" and may occur frequently depending on the entity in question. We certainly agree with the Board that the "extremely rare" standard adopted by the IASB is inappropriate.

* * *

We appreciate this opportunity to comment on the Proposal. You may direct any questions with respect to this letter to Robert E. Buckholz at (212) 558-3876, Robert W. Reeder at (212) 558-3755, Robert W. Downes at (212) 558-4312 or Kenneth T. Taylor at (212) 558-3271.

Very truly yours,

SULLIVAN & CROMWELL LLP