



LETTER OF COMMENT NO. 154

August 8, 2008

**VIA EMAIL**

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

Re: Comment to Proposed Statement of Financial Accounting Standards—  
Disclosure of Certain Loss Contingencies Amending FAS 5 and 141(R); File  
Reference No. 1600-100

Dear Technical Director:

Thank you for the opportunity to submit these comments on the proposed amendments to Statement of Financial Accounting Standards No. 5 (“FAS 5”), “Accounting for Contingencies” (the “Exposure Draft”). The undersigned law firms represent public and private companies subject to the Financial Accounting Standards Board’s (the “Board”) guidance and offer these comments from our experience as outside corporate and litigation counsel. In this capacity, we are familiar with the complexities and uncertainties surrounding the recognition and measurement of potential liabilities and losses arising from litigation, including the often heated and justifiable disagreements over those potential liabilities and losses inherent in our adversarial legal system. Although the undersigned law firms do not necessarily adopt or share each of the specific views articulated in this comment letter, they do all share a common view that the Exposure Draft’s proposed treatment of litigation contingencies raises numerous serious problems.

We believe that the proposed changes to FAS 5 contained in the Exposure Draft will not improve meaningfully the quality of financial disclosures. At the same time these changes will require real time, speculative public discussion of contingencies that are extremely difficult and costly to evaluate and almost always impossible to quantify with any precision. Such public discussion, in light of the adversarial nature of our judicial system, will almost certainly be prejudicial to the company making the disclosure, which is not in the best interests of its shareholders. If the approach proposed in the Exposure Draft were to be adopted, it would have the unintended and undesirable consequences of increasing the risk of adverse outcomes in lawsuits, prolonging litigation, driving higher settlement costs, resulting in additional litigation by shareholders over litigation evaluations that turn out to be incorrect

and substantially adding to the costs of doing business by public companies already under considerable pressure in a global economy to contain costs.

Fundamentally, the Exposure Draft's approach to litigation contingencies misses the mark because it fails to appreciate the unique nature of litigation contingencies. Unlike other contingencies, litigation contingencies are normally not subject to meaningful quantification and are always subject to judgment, which resists the kind of precision the Board hopes to achieve with the new disclosures. Perhaps more importantly, the Exposure Draft fundamentally misapprehends the adversarial nature of the American judicial system, and forces preparers to put at risk their ability to communicate confidentially with counsel and make fluid judgments about litigation strategy without revealing that strategy to their adversaries.

In short, the Exposure Draft will require entities and their outside legal counsel to fit highly uncertain judgments into a disclosure scheme that operates as if litigation contingencies are just like any other objective operational contingency. Rather than provide better disclosure, this scheme will lead to investor confusion and misunderstanding, along with increased business and litigation risk for preparers.

The Board requested that constituents provide comments on certain questions concerning the Exposure Draft; so we have organized our comments around certain of those questions, as detailed below:

**A. The Exposure Draft will not meet the Board's objective of providing enhanced disclosures about loss contingencies. (Question 1)**

Put simply, we do not believe the Exposure Draft will result in better disclosures. The current standard for accounting for contingencies has been in place for over 30 years, is understood by preparers and users, and is capable of ready application. In an area not subject to mathematical precision, the current disclosure system works. Some financial statement users believe that "a highly uncertain estimate supplemented with a qualitative description" is better than "no quantification of a potential loss as commonly occurs under existing practice." But this view reflects a misunderstanding of the nature of litigation contingencies.

Unlike other loss contingencies, which tend to be operational and thus quantifiable and estimable, litigation is unpredictable and almost always a matter of judgment. Other contingencies are subject to a limited number of valuation factors such as contract terms, interest rates, and other identifiable factors that are known or knowable. Litigation

contingencies are different. A lawsuit is fluid; for instance, it may appear to have merit one day but not the next, after a critical deposition is taken. Or it may appear harmless until a “smoking gun” email appears in discovery. In making assessments about potential liabilities and losses, entities and their legal counsel must consider an almost infinite number of non-economic factors, such as the type of claims, the facts of the case, the venue of the dispute, the judge presiding over the case, the quality and experience of opposing counsel, the state of the controlling law, and other factors relating to human relationships, memories, and conduct that are rarely subject to precision and always dependent on subjective—and constantly evolving—judgments. Should the matter be triable before a jury, the ability to predict the potential outcome becomes even more precarious.

These quantitative and qualitative assessments in litigation frequently change over the life of a lawsuit. The proposed disclosure requirements, however, do not account for this evolutionary process. For example, the Exposure Draft fails to consider the degree of investigation and discovery that may or may not have been conducted at the time of the disclosures. In securities class actions, discovery is generally not allowed until the parties have fully briefed and the court has decided the defendant’s motion to dismiss.<sup>1</sup> This process can take years, given the time for briefing, the court’s time to consider and rule upon the motion, and opportunities to replead. Assuming the plaintiff makes it past the motion to dismiss stage, then, and only then, will the plaintiff be entitled to any discovery. At that stage, moreover, the court will be called upon to certify the class of potential claimants. The amount of any stock price decline attributable to the defendant’s conduct will only begin to be known at this stage, when the plaintiff will present expert witness testimony to support the claims. Yet, the Exposure Draft would have the defendant disclose a range of potential outcomes, derived from guesswork about a plaintiff’s claims, potentially years before discovery even begins.

These issues are particularly acute because one event can change the course of a lawsuit and prove a disclosure grossly incorrect—whether too high or too low. A lawsuit progresses through several stages before it concludes. Some lawyers and businesses will use a decision tree analysis in an attempt to assign mathematical probabilities and evaluate the implications of certain potential outcomes in a lawsuit. Where used, this can be one, very rough, means of attempting to evaluate litigation exposure. The mathematical probability of successfully reaching the desired end is the product of the probabilities of being successful at each stage. Identifying the “branches on the tree”, the range of potential outcomes for each branch, and assigning the “mathematical probabilities” is a highly subjective and judgmental

---

<sup>1</sup> See 15 U.S.C. § 78u-4(b)(3)(B) (Private Securities Litigation Reform Act).

process; but it can create the illusion of mathematical precision. While not used by every lawyer or in every lawsuit, a hypothetical example of this analysis demonstrates both the mercurial nature of predicting potential litigation outcomes and the dangers of assigning mathematical precision to those predictions.

To demonstrate, assume a gambler makes a bet that wins \$1 million dollars if he tosses a coin heads four times in a row. The present value of that bet is \$62,500 ( $.5 \times .5 \times .5 \times .5 = 0.0625$ ) before the first toss. If it were a lawsuit, at the very early stages, the settlement value would be \$62,500. If the gambler puts up \$100,000 to play, he is foolish to do so. But if he tosses heads on the first throw, the chances of doing so three more times ( $.5 \times .5 \times .5 = 0.125$ ) makes the bet worth \$125,000 at that stage. If the second throw is also successful, the bet is worth \$250,000, and, before the last throw, when the gambler has a 50% chance of winning the \$1 million, the “value” of the wager equals \$500,000.

Applying this type of analysis to a lawsuit demonstrates how wildly estimates can and do range. At the most simplistic level, a plaintiff must establish a duty, a breach of duty, injury-in-fact, causation, and damages before he can win a lawsuit. If the damages would be either \$100,000 or \$1 million, depending on a novel theory of damages, and the lawyers and client evaluate the odds of the plaintiff prevailing at each step at 50%, then the lawsuit is worth either \$6,250 or \$62,500 at inception, depending on which damage theory applies. Of course, the odds on any particular issue are rarely 50/50. Rather, the evaluator may see “duty” as a 75/25 issue, but “breach” at 60/40, “causation” at 10/90, etc. The monetary outcome, and the present value of the claimed damages, will fluctuate dramatically depending on which path of potential outcomes the evaluator chooses to reach his or her predicted final outcome and “value” of the case.

Furthermore, this complex evaluation changes with every meaningful event in the lawsuit. Win a summary judgment on an issue and the case goes away or is halved. Lose the summary judgment motion on an issue previously evaluated as 75% likely to be resolved in the company’s favor, and the value on the claim jumps upward. Produce a damaging email in discovery and revise the likelihood of the company prevailing on the causation element down from 70% to 30%. The process becomes even more complicated when more than two results are possible for any issue on the decision tree, or as the possible/probable damages change.

These concepts illustrate the uncertainty of litigation evaluations for financial statement purposes. At the very core level, the fact that a litigant is probably going to win does not mean that litigant will not lose. Nor does the converse hold true. The assessment of litigation risks and rewards requires specialized knowledge and judgment that is almost

always disputed and simply not subject to mathematical precision. The Exposure Draft ignores this reality and creates a false sense of precision that could have real consequences in the marketplace, where investors make their decisions based on these disclosures. Imagine the worse than ironic result when investors sell their shares of a company after it discloses a \$500 million contingent liability, only to see the stock price move up when the suit is dismissed on summary judgment. The Exposure Draft does not result in better disclosures. To the contrary, it creates new investor risk.

**B. Entities should not be required to provide disclosures about remote loss contingencies without regard to the likelihood of the loss simply because the resolution of the contingencies is expected to occur in the near term and could potentially have a severe impact upon the entity's operations. (Question 3)**

In a significant expansion of a preparer's disclosure obligations, the Exposure Draft requires disclosure of loss contingencies if the contingencies are expected to be resolved in the near term and if the contingencies could have a "severe impact" on the entity, *without regard to the likelihood of loss*. The Board "initially considered requiring disclosure of all loss contingencies that could have a severe impact on the entity, without regard to the expected timing of resolution," but "narrow[ed] this requirement because it believe[d] that disclosure of all contingencies that could severely affect the entity would result in disclosure of a significant amount of information that would not be cost-beneficial." Exp. Draft at A13.

The requirement that entities disclose litigation contingencies that are deemed "remote" will waste time and expense on matters that are unlikely to have any ultimate relevance. If management and its counsel are convinced that the likelihood of loss is remote, then regardless of the severity of the outcome, the loss is unlikely to be realized and therefore any disclosure is unnecessary and potentially inflammatory and prejudicial to the preparer. Nothing prevents a plaintiff from filing a lawsuit alleging astronomical damages even though the suit has no legal or factual basis to support it. Under the proposed rule, if the preparer and its counsel believe that in the near term a court will rule in the entity's favor on a motion to dismiss, the Exposure Draft appears to require disclosure of the amount claimed even though it is arguably frivolous. Furthermore, the disclosure would likely need to contain a statement evaluating the likelihood of success on the dispositive motion—an evaluation that could prejudice settlement efforts, influence a court evaluating the matter in real time, and in and of itself create new liabilities if the evaluation misses the mark. This result would confuse financial statement users, potentially embolden the plaintiff to continue the meritless litigation, and result in extra work and effort on the part of the preparer and its counsel.

Finally, requiring any disclosure of remote contingencies may conflict with existing definitions of materiality.<sup>2</sup> The Exposure Draft indicates that the term “severe impact” “is a higher threshold than material.” Exp. Draft at n.2. Each Statement of Financial Accounting Standards adopted by the Board states, “The provisions of this Statement need not be applied to immaterial items.”<sup>3</sup> It is typically understood that a loss contingency that has only a remote possibility of occurring is not material. The change proposed in the Exposure Draft makes even a highly remote contingent loss material if the magnitude of the potential loss is great enough. This change is inconsistent with existing standards.

The Board has itself noted that “magnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment.”<sup>4</sup> Relevant here, “[a]mong the considerations that may well render material a quantitatively small misstatement of a financial statement item are whether the misstatement arises from an item capable of precise measurement or whether it arises from an estimate and, if so, the degree of imprecision inherent in the estimate.”<sup>5</sup> For items subject to more precise estimates, the amount of deviation “considered immaterial may increase as the attainable degree of precision decreases.”<sup>6</sup> The Board specifically notes that “accounts payable usually can be estimated more accurately than can contingent liabilities arising from litigation or threats of it, and a deviation considered to be material in the first case may be quite trivial in the second.”<sup>7</sup> By now requiring that preparers disclose litigation contingencies that are remote or even highly remote, the Board is expanding the scope of what is material and removing the judgment about the likelihood of a litigation result from the hands of management, its counsel, and the independent auditors.

---

<sup>2</sup> The Supreme Court has defined material fact as one where there is a “substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

<sup>3</sup> See Staff Accounting Bulletin (“SAB”) No. 99, Materiality.

<sup>4</sup> FASB, Statement of Financial Accounting Concepts No. 2, Qualitative Characteristics of Accounting Information, 125 (1980).

<sup>5</sup> SAB 99, n.14.

<sup>6</sup> Concepts Statement No. 2, 130.

<sup>7</sup> *Id.*

**C. The Exposure Draft's quantitative disclosures requirements will not improve the usefulness of the financial statements. (Question 4)**

The Exposure Draft requires an entity to disclose the “[q]uantitative information about the entity’s exposure to loss from the contingency (including any amounts already recognized in the financial statements but excluding potential recoveries disclosed under paragraph 7(c)), as follows: (1) The amount of the claim or assessment against the entity (including damages, such as treble or punitive damages), if applicable [or] (2) If there is no claim or assessment amount, the entity’s best estimate of the maximum exposure to loss.” The Exposure Draft further provides: “An entity also may disclose its best estimate of the possible loss or range of loss if it believes that the amount of the claim or assessment or the maximum exposure to loss is not representative of the entity’s actual exposure.”

Disclosing the amount of the plaintiff’s claim may not be problematic if the plaintiff’s publicly filed pleadings have clearly articulated the amount claimed. After all, that disclosure simply discloses what is already publicly available. By contrast, the new requirement that an entity disclose either its maximum potential loss or a range of possible losses where the plaintiff has been unwilling or unable to do so is highly problematic. As an initial matter, the amount disclosed is likely to bear little resemblance to what is ultimately at stake. Reasonable estimates of possible losses or damages in complex litigation matters are often impossible to make and again are highly subjective, particularly before meaningful discovery has taken place, and depend on information not readily available. In fact, an accurate assessment of damages may not be available in many cases until well after discovery is complete and experts have offered their opinions, particularly, in large complex cases, like class actions or antitrust disputes. In such matters, determining the true amount in controversy often requires the help of an expert, who is not typically hired at the beginning of the case. In antitrust matters, the calculation of damages usually involves complex market studies, which are costly and time consuming to produce. In securities class actions, a corporate defendant will need to hire a trained expert in economics or finance, but is unlikely to do so until the plaintiff survives a motion to dismiss and successfully moves for class certification, which could take years. In fact, in a wide range of lawsuits, under federal and state laws, it is common for plaintiffs not to state an amount of damages at the outset of the case. Yet the Exposure Draft would require an entity to marshal its forces to arrive at a damages assessment that may never be relevant (for instance, if the plaintiff does not survive a motion to dismiss or get the class certified), or worse, may be grossly incorrect.

Fundamentally, the requirement to state potential exposure when a plaintiff has not pleaded a specific amount of damage upsets the balance of the U.S. adversarial system. The estimate itself will reveal to the plaintiff and other potential plaintiffs how the defendant

values the case, which is typically not disclosed in litigation. Requiring that entities provide their own estimate of maximum possible loss or an estimate of a likely range of losses could thus seriously disadvantage defendants in the litigation, both in any negotiations or in front of a jury, where it will be very hard for defendant's damages expert to opine there are no damages, when the defendant's own financial disclosures estimate those damages. Right or wrong, and regardless of caveats, there is a risk that the jury will choose the defendant's "own words." In this regard, we do not believe that the possible loss or range of loss should be a required disclosure if an entity believes the amount of the claim or assessment or its best estimate of the maximum possible exposure to loss is not representative of the entity's *actual exposure*. (see Question 4b.) How the defendant values a case can have real impact on the positions the plaintiff takes in the litigation, the filing of additional lawsuits, and the perception of investors regarding the merits of the litigation.

The Board asks in the Exposure Draft what quantitative disclosures would best fulfill financial statement users' needs for quantitative information and at the same time not reveal significant information that may be prejudicial to an entity's position in a dispute. (see Question 4c.) We believe the current standard, which requires disclosure when the "amount of loss can be reasonably estimated," is the most workable and meaningful disclosure. FAS No. 5 ¶¶ 8b, 33. That standard recognizes that the "filing of a suit or formal assertion of a claim or assessment does not automatically indicate that accrual of a loss may be appropriate." *Id.* ¶ 37. The standard also does not require the preparer or its legal counsel to engage in speculation about a question that in many instances is simply unanswerable with any degree of reliability. The current rule is workable and well-recognized, and given the concerns raised by the Exposure Draft, there is little reason to jettison the current approach.

**D. The nominal benefits of requiring that entities provide a reliable estimate of the maximum loss exposure when the contingency does not have a specific claim amount are substantially outweighed by the potential harm to disclosing parties. (Question 5)**

As discussed throughout these comments, making an estimate in instances where the litigation contingency does not have a specific claim amount is guesswork; requiring that estimate to be "reliable" will be impossible in most instances.

The Exposure Draft fails to appreciate the consequences of making this nominally useful additional disclosure available to a preparer's litigation adversaries. Placing a purportedly reliable estimate of litigation exposure in the hands of current adversaries will not only reveal the preparer's assessment of the case, but could also lead to litigation by other claimants emboldened by the company's assessment of the contingency. This kind of data

will serve as an invitation for strike suits, which have little or no merit but are designed to extort a quick settlement, or tag-along actions, where multiple suits are filed for the same conduct. The risk of these types of suits is already present, but the Exposure Draft raises the risk to a higher level.

A potentially bigger problem, however, is that there is a substantial chance that any estimate made during the fluid process of litigation will turn out to be wrong, in one direction or another. The Exposure Draft injects a substantial new risk of additional litigation alleging reliance on what time may prove to be an inaccurate estimate. Given the unpredictable nature of litigation and the substantial uncertainties involved in assessing risks and possible outcomes, it seems inevitable that these estimates more often than not may, at least in the eyes of some readers, be wrong in one way or another. Consequently, preparers will be exposed to potential lawsuits alleging claims that disclosures were relied on for some purpose to the alleged detriment of the plaintiffs. The preparer (or possibly the plaintiffs in such a lawsuit) may also seek to assert claims against outside professionals, such as outside counsel, auditors, liability and damages consulting firms, expert witnesses, or others. Whatever the merits of these kinds of allegations, since litigation assessments are inherently uncertain, the proposed amendment itself promises to become a source of litigation when a preparer's estimates purportedly turn out to be inaccurate. The cost of this proliferation of litigation will ultimately be borne by the public companies required to make these disclosures, in turn rendering them less competitive in a highly competitive global marketplace.

**E. A requirement that entities disclose the amount of settlement offers would be highly prejudicial and would not result in meaningful disclosures. (Question 6)**

The Board correctly declined in the Exposure Draft to require the disclosure of settlement offers. Settlement offers are typically not accurate indications of possible exposure. Rather, settlement offers sometimes represent posturing during negotiations. In almost all cases, settlement offers represent attempts to minimize future legal costs and time by compromise. Requiring the disclosure of settlement offers would discourage parties from engaging in settlement discussions in good faith because the threat of public disclosure of an offer could result in the other side using the offer to discredit the opponent's case if the suit does not settle. Accordingly, the Federal Rules of Evidence and most state rules of procedure prohibit the parties from using settlement discussions in the litigation itself.<sup>8</sup>

---

<sup>8</sup> *E.g.*, FED. R. EVID. 408 (prohibiting the use of settlement offers "when offered to prove liability for, invalidity of, or amount of a claim that was disputed as to validity or amount, or to impeach through a prior inconsistent statement or contradiction."); TEX. R. EVID. 408 (same).

Furthermore, the disclosure of settlement offers could allow financial statement users to second guess management, for rejecting an offer that, in hindsight, would have been a good settlement, or for offering too much for claims that lack merit. Finally, settlement discussions are very fluid in nature. As with other concerns about the Exposure Draft, a requirement to disclose settlement offers would raise the specter of myriad supplemental disclosures. The Board's decision not to require the disclosure of settlement offers was the right decision.

**F. The requirement that entities make a tabular reconciliation of recognized loss contingencies, even on an aggregated basis, will not result in meaningful disclosures. (Question 7)**

In general, the recognition and measurement of contingencies are inherently difficult due to the uniqueness and uncertainty of any particular contingency. As other commentators have recognized, the possibility of providing quantitative disclosures, at the lowest level of detail, is alluring and conceptually appealing. Unfortunately, the output is only as good as the input and when it comes to quantifying litigation risks and possible losses, the inputs are highly subjective and speculative in the typical situation. In most instances, the preparer of the financial statements, even with help from counsel, will only be guessing at the outcome. Such guesses are not required in other areas of the accounting standards, nor should they be required here. *Aggregating these liabilities will not necessarily provide discernible patterns* that would be useful to users of financial statements, in large measure because the disclosures would lack consistency and comparability. Moreover, the tabular representation of the contingencies creates a false sense of precision that is confusing and volatile, at best, and potentially misleading, at worst. The course of litigation is rarely linear; instead litigation is almost always subject to significant ups and downs as facts develop, rulings are made, and positions refined. The Exposure Draft would require the disclosure of only a snapshot in time that is likely to be meaningless in terms of the final outcome.

---

**G. The Exposure Draft dramatically increases the risk that prejudicial information will not be protected. (Question 8)**

One of the more likely and ironic outcomes of the expanded disclosure requirements is that they will negatively affect communications between attorneys and clients. The Exposure Draft will require that information about litigation be disclosed earlier and more expansively than has been required under the current standards. Both the company issuing the financial statements and its counsel will consider the effect of the new disclosure requirements on the extent and nature of their conversations. Counsel will understand that the legal advice he or she gives to the client may be disclosed in the financial statements. This will necessarily affect the advice that is given.

The proposed standard has the potential to erode the protections of the attorney-client privilege and work product doctrine in other ways, as well. The communications between the auditor and client and auditor and counsel will necessarily be more detailed to comply with the Exposure Draft. Auditors will almost certainly feel compelled to review privileged information from the company's legal counsel in order to audit the disclosures. Of course, the Exposure Draft also threatens to undermine the "Treaty" between the American Bar Association and the American Institute of Certified Public Accountants that has governed lawyers' responses to auditors' inquiries for over 30 years.<sup>9</sup> All of these issues point to potentially dangerous waiver of privileged information.

Although the question of whether privilege is waived when information relating to litigation assessments is disclosed to outside auditors is not clearly answered in the case law, it is clear that the attorney-client privilege can be waived when privileged information is shared with a third party for purposes unrelated to the rendering of legal advice.<sup>10</sup> The courts are split on whether the disclosure of work product to auditors and other third parties constitutes a waiver, but there are cases holding that such disclosure *does* waive the privilege.<sup>11</sup> We do not believe these cases represent the correct result, but they do highlight the risk that no matter what precautions the preparer and its counsel take, there can be no guarantees that the privileges will be maintained once the information is disclosed to the

---

<sup>9</sup> The "Treaty" is comprised of two documents: the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Request for Information, adopted by the ABA Board of Governors in 1975, and the AICPA Statement on Auditing Standards No. 12, adopted in 1976 and supplemented up to 1998.

<sup>10</sup> See, e.g., *United States v. Kovel*, 296 F.2d 918, 922 (2d Cir. 1961).

<sup>11</sup> See, e.g., *In re Pfizer, Inc. Sec. Litig.*, No. 90 Civ. 1260, 1993 WL 561125, at \*6 (S.D.N.Y. Dec. 23, 1993); *United States v. MIT*, 129 F.3d 681, 687 (1st Cir. 1997).

auditors. The Exposure Draft substantially increases that risk. If the most core attorney work product—an evaluation of the merit of and exposure in a lawsuit—is subject to discovery because it was shared with auditors evaluating FAS 5 disclosures, the American adversary system as we know it will simply not function.

**H. The two-step approach to protecting prejudicial information is inadequate and unworkable. (Question 9)**

We believe that any future statement on loss contingencies should not require the disclosure of prejudicial information that would compromise an entity's position in ongoing or threatened litigation.<sup>12</sup> The Board "considered concerns about prejudicial information and decided to include an exemption from the disclosure requirements that would strike a balance between the interest of both users and preparers." Exp. Draft at A27. Unfortunately, the Exposure Draft does not adequately strike that balance.<sup>13</sup>

First, the aggregation of data results in less meaningful information. This problem is not unique to the aggregation problem at issue here. Aggregation will do nothing to minimize the inherent problems in assessing litigation contingencies, but will simply compound the potential errors, resulting in disclosures that are less meaningful.

Second, the ability to aggregate information about loss contingencies at a higher level will not address the problem faced by companies with only a few large outstanding litigation matters. Aggregation only works to mask the details of a specific lawsuit when there is a large enough group of cases, such as a company's overall asbestos exposure, to make individual matters indiscernible. For many entities, however, a single piece of litigation or a group of claims will constitute a disproportionate part of the total exposure. This problem is not unique to the disclosures here. In statistical analysis of sensitive health-related or census data, for instance, small population sets are of great concern because disclosure of the information might lead to violation of individuals' right to anonymity and privacy. Sophisticated users of the entity's financial statements will almost certainly be able to decode

---

<sup>12</sup> The Exposure Draft defines the term "prejudicial information" as information whose "disclosure . . . could affect, to the entity's detriment, the outcome of the contingency itself" (*see* Question 11). We do not object to that definition.

<sup>13</sup> The Exposure Draft provides a two-step approach for entities to follow. In the first step, entities would be allowed to aggregate information about loss contingencies at a higher level than by the nature of the contingency. In the second step, if disclosure of the information would still be prejudicial even when aggregated at this higher level, an entity would be allowed to forgo disclosing only the information that would be prejudicial. Exp. Draft at A25.

the disclosures and uncover particular cases from the aggregated quantitative and qualitative disclosures.

Finally, aggregating similar kinds of cases will require significant time, effort, and expense. The preparer, its legal counsel, and its independent auditor, will spend many hours formulating the estimates on an individual level and aggregating them in a way that prevents the disclosure of prejudicial information. It is difficult to see how this increased cost and effort is merited by a disclosure that is likely to be meaningless outside the context of the litigation.

In step two, the Exposure Draft seeks to deal with those “rare instances” in which aggregation would still be prejudicial by allowing the preparer to “forgo disclosing only the information that would be prejudicial to the entity’s position” and “disclose the fact that, and the reason why, the information has not been disclosed.” Exp. Draft at 11. But in “no circumstance may an entity forgo disclosing the amount of the claim or assessment against the entity (or, if there is no claim amount, an estimate of the entity’s maximum exposure to loss); providing a description of the loss contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution; and providing a description of the factors that are likely to affect the ultimate outcome of the contingency along with the potential impact on the outcome.” *Id.*

The mandatory disclosures eliminate the “limited” exception entirely. If entities are required to disclose the amount of the claim or assessment against the entity or an estimate of the entity’s maximum exposure to loss, that disclosure alone will permit the opposing party to determine how the company assesses the claims and may be discoverable if shared with the company’s auditor. Moreover, the requirement that the preparer provide a description of the loss contingency, including how it arose, its legal or contractual basis, its current status, the anticipated timing of its resolution, 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 will provide as much information as a future or current plaintiff could ever hope to receive. In the end, the two-step process is inadequate because it fails to shield—but rather requires the disclosure of—information that will be prejudicial to the company in the hands of its adversary or before the trier of fact.

## Conclusion

In summary, we believe the Exposure Draft cannot be reconciled with the unique nature of litigation contingencies. In contrast to disclosures of other contingencies, which are often quantifiable and less subject to specialized judgment, the disclosures of litigation contingencies would be based on extremely fluid matters of specialized judgment that are highly subjective and, in most instances, speculative. Moreover, those disclosures may constitute admissible evidence or affect the course of the action in the very proceeding that triggers the disclosure. In our view, these potential harms far outweigh the benefit of guesswork disclosures under the new regime.

Once again, we thank you for the opportunity to comment on the Exposure Draft. If you have any questions or wish to discuss any of our comments, please do not hesitate to contact John Wander at Vinson & Elkins LLP, 214.220.7878 or [jwander@velaw.com](mailto:jwander@velaw.com).

Sincerely,

VINSON & ELKINS L.L.P.

CARLTON FIELDS, P.A.

GOODSILL ANDERSON QUINN & STIFEL LLP

KNOBBE MARTENS OLSON & BEAR LLP

TAFT STETTINIUS & HOLLISTER LLP