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August 8, 2008

LETTER OF COMMENT NO. 168

Technical Director -File Reference No. 1600-100
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Exposure Draft - Proposed Statement of Financial Accounting Standards - Disclosure of Certain Loss Contingencies - an Amendment of FASB Statements No. 5 and 141(R) - File Reference No. 1600-100

Director:

The amendments to FASB Statement No. 5 that the Board has proposed in the above-captioned exposure draft (the "Proposal") would, if adopted, lead to the most significant changes in the relationship among lawyers, their clients, and the accounting profession since the adoption of "the Treaty"[1] in 1975-1976. As a law firm that responds, within the bounds of the Treaty, to many hundreds of auditor's requests for information every year, we have more than thirty years of experience in dealing with the legal and practical concerns that such requests raise for clients and their attorneys.

We recognize that users of financial information reflected in audited financial statements have a legitimate need for adequate information relating to the assessment of the likelihood, timing and amount of future cash flows associated with loss contingencies. This need, however, is not the only relevant consideration and must be appropriately balanced against the interests of other constituents in the process, including entities and their counsel. We believe that the Proposal does not adequately balance these interests and will not meet the Board's stated objective of providing enhanced disclosures about loss contingencies so that the benefits of the disclosures justify the incremental costs. The existing implementation of FASB Statement No. 5 as codified in the Treaty does appropriately balance these interests, and we urge the Board to retain FASB Statement No. 5 in its existing form.

The Proposal will not meet the project's objective of providing enhanced disclosures about loss contingencies so that the benefits of those disclosures justify the incremental costs.

No matter how much information users of financial information may have concerning an entity, they will always want more. The determination of how much information is "enough" consequently necessitates a pragmatic evaluation of the costs of providing incremental information in relation to the benefits to users of providing it. We believe that the Proposal significantly understates the costs of providing the proposed enhanced disclosure and at the same time overstates the benefits to users that would follow from the provision of such information.

[1] The colloquial description of the related American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors Requests for Information (December 8, 1975) (the "ABA Statement of Policy") and the American Institute of Certified Public Accountants Statement on Auditing Standards No. 12 – Inquiry of a Client's Lawyer Concerning Litigation, Claims and Assessments (January 12, 1976).

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The ABA Statement of Policy recognizes that, in most cases, "it should not be anticipated that meaningful quantifications of 'probability' of outcome or amount of damages can be given by lawyers in assessing litigation."[2] Historically, the only exceptions to this general statement have been situations in which an unfavorable outcome would be either "probable" or "remote."[3] The Proposal, on the other hand, would require disclosure *unless* the entity determines that the likelihood of a loss is "remote," in which case both the quantitative and qualitative disclosures contemplated by paragraph 7 would ordinarily be required.

The judgments involved in both the quantitative and qualitative assessments contemplated by paragraph 7 are in the first instance assessments that can only be made on the basis of counsel's experience and judgment. Most entities will not be able to provide the qualitative and quantitative information required by paragraph 7 of the Proposal without reverting to their counsel. The Proposal does not address how, in practice, counsel are supposed to meet their clients' needs for the enhanced information in situations where an unfavorable outcome is neither probable nor remote, with the result that counsel's quantitative assessment, at least in the context of the traditional standards of the legal profession, is unlikely to be meaningful.

This conundrum has several likely outcomes, none of which are desirable. First, the universe of loss contingencies for which counsel must attempt the required quantitative and qualitative assessment will be significantly broadened, leading to increased expenditure of time and resources and increased costs to the client. Second, the quality of the information provided by counsel (in the sense of the correspondence of counsel's evaluation of the potential outcome of a loss contingency to the actual eventual outcome) will likely decrease, because counsel will be more often forced to estimate outcome and loss in situations in which both will be by definition less predictable. Third, the tension between the client's need for information meeting the requirements of paragraph 7 and counsel's ability to provide that information will damage the attorney-client relationship.

These concerns are exacerbated in the case of public companies. Financial statements included in or incorporated into filings with the Securities and Exchange Commission are subject to all the sanctions of the securities laws in cases of material misstatement or omission. Paragraph 7 of the Proposal would require the entity to disclose either the amount of the claim (including damages, such as treble or punitive damages) or, if the entity believes that the amount of the claim is not representative of the entity's actual exposure, its "best estimate" of the loss or range of loss. It will be the rare case in which the amount of the claim, based on the plaintiff's rosiest hopes unmitigated by the realities of litigation, will be representative of the entity's actual exposure. On the other hand, the entity's only permissible alternative disclosure, its "best estimate," will inevitably be founded upon counsel's estimate of the probability of outcome or loss, which is itself subject to inherent limitations. As noted above, the ABA Statement of Policy, in its current form, recognizes that in most cases counsel's estimate of the probability of outcome or the amount of damages cannot be "meaningful." As a result, paragraph 7 will, almost by definition, push the public company in the direction of including in its financial statements quantitative and qualitative information about litigation-related loss contingencies that may be inherently unreliable, not

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[2] ABA Statement of Policy, Commentary Section 5.2
[3] *Ibid.*

because of any ill will or lack of diligence on the part of the company or its counsel, but because of the fundamental and irreducible uncertainties of litigation.

We note the Board's belief, stated in paragraph A36 of the Proposal, that "many entities already have the information necessary to fulfill these disclosure requirements and that including the information should not require substantial additional cost or effort." We are skeptical that this is in fact the case, but, even if it were, this is only the beginning of the inquiry, not the end. The fact that information exists does not mean that it is material to investors and should be disclosed.

We share, with many other previous commentators, the concern that paragraph 7's requirement for disclosure of a "description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome" will, at best, significantly and negatively affect an entity's ability to plan and implement its litigation strategy and, at worst, seriously undermine traditional notions of attorney-client privilege and attorney work-product protection. These are serious concerns, all the more so when the disclosures that will create them are likely to be expensive, time consuming and ultimately of little value to the users of financial information.

The Board should not adopt the requirement in paragraph 6 of the Proposal that an entity provide disclosures about loss contingencies, *regardless of the likelihood of loss, if the resolution of the* contingencies is expected to incur within one year of the date of the financial statements and the loss contingencies could have a severe impact upon the operations of the entity.

The proposed requirements of paragraph 6 of the Proposal also are, in our view, unlikely to lead to the disclosure of information that would be meaningful to users of financial statements. We recognize the intent of the Proposal to provide a heightened disclosure threshold by use of the "severe impact" standard rather than a standard of mere materiality.

We are concerned, however, that paragraph 6 will nonetheless tend to result in the disclosure of immaterial, potentially confusing and unnecessarily alarming information. Paragraph 6 expressly forbids an assessment of the likelihood of loss; only the period of time in which the entity anticipates resolution of the loss contingency is relevant. The entity would be required to disclose any loss contingency that "*could have a severe impact*" *on the entity.* "*Could have*" *is not defined; in the absence of a specific* definition, we would take it that mere possibility would be enough to require disclosure.

We believe the Board is seriously underestimating the frequency with which entities, particularly large public companies, confront litigation-related loss contingencies that "could have a severe impact." Loss contingencies that actually have, or are even reasonably likely to have, a severe impact are of course much rarer.

Looking at paragraphs 6 and 7 in tandem suggests further problems with the Proposal's approach. It appears to us that in most cases the entity would have to base its determination of whether a loss contingency could have a severe impact, for purposes of paragraph 6, on the amount of the claim or assessment (under paragraph 7(a)(1)), that is, on the pleadings, notwithstanding that the entity's "best estimate" of the loss contingency (under paragraph 7(a)(2)) might be such that there is less than a remote possibility that the loss contingency will, in fact, have a severe impact. In many cases, even a relatively short period of time prior to the expected resolution of a case, it will not be possible to say, as a matter of law, that it is impossible that the plaintiff will recover an amount that could have a severe impact. Paragraph 6 as proposed will lead to the useless disclosure of worst-case scenarios, completely divorced from the probability of their occurrence.

Conclusion

We believe that FASB Statement No. 5, as it presently exists, and the more than thirty years of cooperation between the accounting and legal professions under the terms of the Treaty have resulted in a disclosure system for litigation-related loss contingencies that adequately and reasonably protects and balances the interests of entities and the users of financial information. We believe this system should be maintained. If the Board determines nonetheless that it must continue on the course it has charted, we believe that the Proposal requires significantly more study prior to enactment, and entities and their counsel will require significantly more time to design implementation, than the Proposal's current December 15, 2008 effective date would afford. In addition, it appears to us that it would be appropriate to involve the Securities and Exchange Commission in designing appropriate regulatory relief to ensure that entities will not be subjected to an unwarranted increase in liability under the securities laws based on compliance with the requirements of the Proposal.

We appreciate this opportunity to comment on these important issues.

Very truly yours,

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