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August 6, 2008

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LETTER OF COMMENT NO. 37

Request for Comments on a Proposed Statement, Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R) (File Reference No. 1025-300)

Dear Sirs:

We are pleased to comment on the Proposed Statement, "*Disclosure of Certain Loss Contingencies*" (the "Exposure Draft" or "proposed statement"). We support the FASB's efforts to improve the information available to users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies.

However, we believe the proposed statement defies certain fundamental principles and purposes of financial reporting:

- 1) It presumes that losses on all contingencies, including litigation, can be reliably quantified. The factors that can affect the outcome of litigation in our capitalistic markets and judicial system are innumerable. To presume that for each and every matter, regardless of its stage of development, an estimate of the loss or maximum exposure to loss can be quantified, is incongruous.
- 2) The qualitative disclosures will benefit plaintiffs and plaintiffs' lawyers that are adversaries of the reporting entity. So, while purporting to benefit financial statement users, it ignores the apparent harmful impact on users who are shareholders of the reporting entity.
- 3) It forces management to assign an estimate to contingent losses that cannot be estimated with any reliability, thus providing no meaningful information to investors.

- 4) We fail to see the need to modify the existing Standard, which has a logical framework and requires the use of judgment in preparing disclosures about loss contingencies, and that if applied (and enforced) appropriately, results in the disclosure of useful information.

Expanding on the remarks above, this comment letter does not support the adoption of the proposed statement as a final Statement based on concerns specifically in the following areas:

- 1) The requirement to disclose an estimate of maximum exposure to loss if there is no claim or assessment amount, and
- 2) The requirement to disclose certain qualitative information, in particular disclosures about the factors that are likely to affect the ultimate outcome of a contingency, the entity's qualitative assessment of the most likely outcome of a contingency and significant assumptions made by the entity in estimating the amounts required to be disclosed.

The FASB states that the reason for issuing this proposed standard is that users of financial information have expressed concerns that disclosures about loss contingencies under the existing guidance in FASB Statement No. 5, *Accounting for Contingencies*, do not provide adequate information to assist users of financial statements in assessing the *likelihood, timing, and amount* of future cash flows associated with loss contingencies. The proposed standard goes on to state that the enhanced disclosure requirements will significantly improve the overall *quality* of disclosures about loss contingencies by providing financial statement users with *important information*.

For information to be *important*, it must be useful for decision making, for that underlies the objectives of financial reporting. Relevance and reliability are the two primary qualities that make accounting information useful for decision making.¹

Requirement to Disclose a Maximum Exposure to Loss

The proposed standard would require disclosure of an amount related to each contingency (or group of contingencies), other than those determined to be remote, and would eliminate the existing standard's "reasonable estimate" threshold for disclosing an amount related to a loss contingency. This would presumably address, at least in part, the concern that users of financial statements are not provided with adequate information to assess the amount of future cash flows associated with loss contingencies.

We believe that a requirement to disclose amounts related to a loss contingency that is either probable or reasonably possible and material to the financial statements does provide financial statement users with useful information, provided that the amounts required to be disclosed are reasonably estimable. If the amount of a claim or

¹ Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information* (SFAC No. 2)

assessment is known, we believe that providing disclosure of such an amount and allowing an entity to assert whether the amount is representative of the entity's actual exposure improves transparency. However, if a maximum exposure to loss cannot be reasonably estimated, we do not believe that requiring an entity to disclose it if there is no claim or assessment amount improves the *quality* of disclosures or a financial statement user's ability to assess the *amount* of future cash flows. An option to disclose an amount of loss or range of loss in the event the maximum exposure is not representative of an entity's actual exposure to loss does not remove the problem of disclosing a maximum exposure to loss that cannot be reasonably estimated.

Contingent matters, and in particular litigation, are often complex and evolve over time. Determining the possible outcome of litigation, which the current standard requires (whether remote, reasonably possible or probable), often involves extremely complex judgments and any conclusion is inherently uncertain. Attempting to assign a dollar amount equal to the maximum exposure and then also determining whether the maximum exposure (or claim amount) is representative of an enterprise's actual exposure would involve weighing those complex judgments, quantifying their impacts, and in many cases, would ultimately produce extremely unreliable and unverifiable amounts. This is especially true for litigation that is in its early stages. Consider the numerous factors that may influence the outcome of litigation: the venue; the practices of the judge and lawyers involved; case law and common law precedents; the judgmental evaluation by the judge and jurors of facts, opinions and evidence presented; the media atmosphere; past settlements of similar cases; legal defense costs; resolution of factual disputes; the political environment; the entity's decision as to how to respond to the litigation (i.e. defend at trial, seek settlement or mediation).

We do not believe that a maximum exposure or an estimate of the possible loss or range of loss can be reliably measured in certain cases, and in such cases, would not improve the quality of information related to disclosures about the amount of future cash flows associated with loss contingencies. For example, if an entity is named in a product liability lawsuit with no asserted claim amount, and at the time the entity files its financial statements no discovery or exchange of information with the plaintiffs has taken place, the entity may have no basis to determine what the alleged damages are. With limited information, the entity would most likely not be able to conclude that the likelihood of a loss is remote, and the proposed standard would preclude the entity from disclosing that a reliable estimate could not be made at the time of filing. Instead, the entity would have to derive an estimate of the maximum exposure to loss and disclose that amount. Taking into account the factors listed above, a conclusion on and disclosure of the maximum exposure to loss would arguably be considered unreliable, and therefore would not meet one of the fundamental characteristics (relevance and reliability) that makes information useful (or *important*). The determination of maximum exposure becomes even more complicated in litigation matters where multiple defendants are named.

Also, eliminating the option for an entity to disclose that a reasonable estimate of a loss or range of loss cannot be made, and requiring an entity to estimate and disclose the

“maximum exposure” (in the absence of a claim or assessment amount) and an option to disclose a “possible loss or range of loss” threatens to become a source of securities litigation if an entity’s estimate of the maximum or “most likely” loss proves to be inaccurate.

Furthermore, we believe that initially determining and then updating on a quarterly basis a quantitative analysis for loss contingencies related to litigation in order to verify disclosures about maximum exposure to loss (and other estimates of loss if the maximum is not representative of actual exposure) would require an extensive amount of time and would be costly. We do not believe that providing disclosure of an amount that is arguably not verifiable² outweighs the cost of determining such amount.

In conclusion on the matter of requiring disclosure of the maximum exposure, and the requirement in all cases to disclose an amount, we recommend the Board eliminate the requirement to disclose a maximum exposure amount and carry forward the current provision that allows an entity to conclude and disclose that an amount is not reasonably estimable.

Requirement to Disclose Certain Qualitative Information

We believe the requirement to disclose the factors that are likely to affect the ultimate outcome of a contingency would expose sensitive litigation information to adversaries, and could reveal legal thinking and defense strategy for resolving a matter. The qualitative disclosures required by this proposed statement could be argued to be admissible in evidence against an entity in the very litigations that are the subject of the disclosure. The qualitative disclosure regarding an entity’s assessment of the most likely outcome of a contingency could be purported by an adversary as an admission of guilt. Disclosure of the maximum amount of exposure, or another measure that is considered more representative of actual exposure, may also provide an adversary with a floor for settlement negotiations. Publicly-traded companies will be at a disadvantage in litigation with plaintiffs that are not required to publicly disclose the same quantitative and qualitative information. In a litigation matter, if a defendant were to unilaterally disclose to the plaintiff their assessment of the most likely outcome, significant assumptions they used in estimating a maximum amount of exposure, and factors that will most likely affect the ultimate outcome, such disclosure would undoubtedly be prejudicial.

Moreover, once an entity publicly discloses information about a lawsuit, such as factors that could affect the outcome and assumptions that support the required disclosures, there is an argument to be made that the entity has waived its attorney-client privilege and attorney work product immunity, which would otherwise protect such information from discovery or from use against an entity in litigation. A similar argument could be made that once an entity has disclosed to its independent auditors all of the information used to support the amounts and qualitative assessments required to be disclosed in the

² Verifiability is defined in SFAC No. 2 as “a quality that may be demonstrated by securing a *high degree of consensus* among independent measurers using the same measurement methods.”

entity's financial statements, and we can assume that auditors will have a responsibility to review this information, such information would become discoverable.

Despite the prejudicial exemption (which instances are expected to be "rare") that would allow an entity to aggregate disclosures at a level higher than the nature of the contingency, the requirement to disclose factors that are likely to affect the outcome of a contingency could result in disclosures that pertain to an individual matter. We believe that depending on the nature of the litigation, such disclosure may permit an entity's litigation adversaries to link the disclosure to a particular case or subset of cases. If the standard is passed as proposed, we encourage the Board to add additional implementation guidance and illustrative examples that would clarify how the prejudicial exemption would be applied in practice.

The proposed standard also requires a description of the terms of relevant insurance or indemnification arrangements, including any caps, limitations or deductibles. This information could be difficult for entities to ascertain, especially during the early stages of litigation. Coverage is often subject to negotiation with the carrier and such a description could be prejudicial to an entity's position and could lead to greater volatility in coverage and rates. Further, it is likely to result in disclosure of an entity's analysis and strategy relating to specific contingencies that could negatively impact the entity's ability to recover. Moreover, entities are usually ill-advised to make disclosure about insurance given the uncertainty of claims coverage. The required disclosure would almost certainly trigger risk factor disclosure as to the various ways in which claims may be denied or delayed, which would also be prejudicial to the entity's position. We are unclear as to the benefits of creating an expectation of coverage which in itself would trigger the need for further disclosure to dispel that expectation.

In conclusion on the matter of certain required qualitative disclosures, we believe that requiring the disclosure of a description of the contingency, how it arose, its legal or contractual basis and its current status would improve current disclosure standards, and agree with the Board that these disclosures are generally included under the existing Statement 5 requirements. We also believe disclosures about the anticipated timing of a contingency's resolution should be required if determinable. However, based on the comments above, we do not believe it appropriate to require an entity to disclose the factors that are likely to affect the ultimate outcome of a contingency, a qualitative assessment of the most likely outcome of a contingency, significant assumptions made by the entity in estimating the amounts required to be disclosed, or specific information about insurance arrangements.

Other Considerations

Notwithstanding the concerns that we have with the proposed standard as described above, we believe that the Exposure Draft needs clarification in the following areas before issuance as a final Statement:

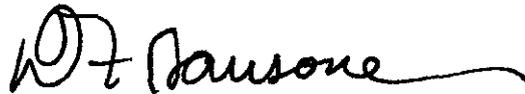
Paragraph 8 - Clarify whether the qualitative description of significant activity in the reconciliation is subject to the expanded qualitative disclosure requirements of this proposed statement or the FASB Statement No. 5 requirement to disclose the nature of the contingency. If subject to the expanded disclosure requirements of this proposed statement, we recommend that the Board limit disclosure to a description of the contingency, how it arose, its legal or contractual basis, its current basis, and the anticipated timing of its resolution, if determinable.

Paragraph 6.b. - The proposed statement should clarify the measurement criteria to be used when evaluating whether a remote loss contingency "could" have a severe impact to an entity's financial position, cash flow, or results of operations. It is not clear whether "could" should be defined as management's best estimate of the loss, some point in a range of possible losses or the maximum exposure of the claim.

Paragraph A11 - The proposed statement should further clarify that the disclosure requirements be considered in the context of providing useful information to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. We recommend the proposed statement provide guidance in applying this concept from a quantitative standpoint when there is no claim or assessment amount. Should the quantitative threshold for disclosure requirements be judged based on a loss contingency's claim amount, the estimated maximum disclosure or the best estimate of the loss or range of loss?

We appreciate the opportunity to provide our views on this Exposure Draft.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. F. Sansone", with a long horizontal flourish extending to the right.

D. F. Sansone, Senior Vice President and
Chief Financial Officer