## *PROGRESSIVE*

CHARLES E. JARRETT Chief Legal Officer 6300 Wilson Mills Road - N72 Mayfield Village, Ohio 44143 (440) 395-3696 chuck\_jarrett@progressive.com

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



LETTER OF COMMENT NO.

File Reference No. 1600-100

## Ladies/Gentlemen:

This letter is submitted on behalf of The Progressive Corporation to provide comments on the Exposure Draft of the proposed Statement of Financial Accounting Standards that is intended to replace and enhance the disclosure requirements in FASB Statement No. 5, Accounting For Contingencies, for loss contingencies that are recognized as liabilities in a statement of financial position and for unrecognized loss contingencies that would be recognized as liabilities if certain criteria for recognition were met. We concur in the Board's observation that investors and other users of financial information may benefit from additional disclosures relating to truly material loss contingencies, and appreciate this opportunity to respond to the Board's request for comments. Specifically, we would like to express the following comments, and offer the following suggestions, regarding the proposed Statement:

- 1. Impracticability of Providing Meaningful Estimates of the Timing of, and of Quantifying, Certain Loss Contingencies. This point cannot be emphasized enough. Litigation, by its very nature, is highly unpredictable and susceptible to a succession of unanticipated twists, turns and developments. There are many factors that can influence the outcome of a given lawsuit, including (without limitation):
  - the relative financial resources of the respective parties;
  - changes in the financial situation or management of a party during the course of the litigation;
  - the relative skill levels and resources of legal counsel for the respective parties;
  - the factual context giving rise to the litigation;
  - the ability of the parties to ascertain and to document or otherwise prove those facts;
  - uncertainties regarding applicable legal principles;
  - the reconciliation of potentially conflicting legal principles;
  - the perceived credibility of witnesses;
  - the availability and integrity of the evidence;

- the venue of the lawsuit:
- the composition of the jury, as well as the attitude and perceptions of individual jury members:
- developments in the law or public attitudes; and
- the availability of witnesses and the ability and willingness of those witnesses to recall and recount accurately that which transpired and to withstand vigorous cross-examination.

In a given case, the ability to calculate with any degree of accuracy the interrelationship between these many factors and predict the ultimate outcome, or range of potential outcomes, of the litigation may be highly subjective and problematical. Unlike high frequency property/casualty claims, there is no body of prior settlements, verdicts or other precedents for most class actions and other non-routine commercial cases from which one can estimate the entity's exposure, since cases of this nature and magnitude are normally highly unique, placing the parties and the court in "unchartered waters." Similarly, determining the time at which the litigation will be concluded, and a loss contingency will be recognized, may prove to be illusive in many instances.

While we appreciate, and sympathize with, the desire of investors to obtain more complete and reliable information regarding the likelihood, timing and amount of future cash flows, that expectation must be tempered by what is realistically achievable. In the context of litigation, point-in-time estimates of the timing and ultimate outcome of a given case are inherently speculative and likely to prove inaccurate and unreliable, even if developed in good faith and with careful analysis and diligence. In many instances, management simply is unable to predict the ultimate outcome of a contingency with a significant degree of confidence. In those instances, any "number" representing management's "best estimate" of the ultimate outcome of the loss contingency may prove to be wildly inaccurate. Any reliance that a reader might place on that "number" could well be misplaced.

We believe that the conclusion reached by management that the amount and timing of a particular loss is "unestimable" should be respected as an appropriate and good faith assessment, absent evidence to the contrary. There should be no requirement that an entity report "an estimate of the maximum exposure to loss" or its "best estimate of the possible loss or range of loss", if management believes that it is unable to provide such an estimate.

2. Prejudicial Effect of Certain Disclosures. Public disclosure by an entity of the anticipated loss, or range of anticipated loss, in a given lawsuit to which it is a party can be highly prejudicial to the entity's position in the lawsuit. Providing a definitive number, or range of numbers, that the reporting entity expects to pay in the suit will embolden the plaintiff's lawyer, give him or her a roadmap to a substantial, and perhaps unjustified, recovery and establish a "floor" for settlement negotiations, often at the high end of the estimated range. Certain qualitative statements concerning the merits of the claim, and management's assessment thereof, could imperil or compromise the company's litigation strategy and negotiating posture, as well as create an invitation and roadmap for future claimants. Moreover, such disclosures will likely contain information that is subject to the attorney-client privilege; thus, the making of such disclosures could waive that privilege. Such waiver could destroy a company's ability to defend the litigation, and possibly other cases as well. These consequences would be highly

detrimental to the interests of shareholders, as the public reporting of such information would likely drive, or at a minimum significantly influence, the result in the litigation and inherently increase the cost of litigation.

These circumstances are recognized by the Board in Paragraph 11 of the Statement, which provides that if the disclosure of certain information about the contingency may be prejudicial to an entity's position, the entity may aggregate the required disclosure at a higher level, such that the disclosure is no longer prejudicial. We appreciate the Board's recognition of the potential prejudice and damage that an entity may incur by reason of such disclosure. However, we are quite troubled by certain aspects of Paragraph 11, for two reasons. First, although aggregation may limit the prejudicial effect of quantitative disclosures, it is not clear how the aggregation of qualitative factors required by Paragraph 7 could be accomplished. Second, the last sentence of Paragraph 11 effectively negates the relief provided by requiring a substantial amount of case-specific information, including an estimate of the entity's maximum exposure to loss. We do not believe that a party who is aggregating and reporting at a higher level should be required to provide any such prejudicial case-specific information.

Instead, we recommend that a reporting entity should be permitted to exclude information about a particular lawsuit that it reasonably believes would be prejudicial to its interests in that lawsuit, whether or not it elects to aggregate the exposure at a higher level. However, in order to provide investors and other users of financial statements with useful information regarding outstanding loss contingencies, the reporting entity should be required to describe in reasonable detail the nature of the contingency; the principal legal or contractual bases therefor, as alleged; its current status; a description (but not an evaluation) of major factors that are likely to affect the outcome of the contingency; and a summary of any substantive defenses that are available to the entity (if and to extent that such defenses have been asserted and are a matter of public record or the disclosure otherwise would not be prejudicial).

In a private (i.e., non-governmental) action, the reporting entity should not be required to state the amount claimed, since in many instances the plaintiff or plaintiff class is seeking a level of damages that is intended to intimidate or represents "wishful thinking", but bears no relationship to any realistic potential recovery. In addition, no disclosure of "likely outcomes" or the "estimated loss or range of loss" should be required, if, in management's judgment, that information either cannot be reasonably estimated or would be prejudicial to the interests of the entity in the lawsuit or other proceeding. Once the reported litigation has been concluded, the entity should make a prompt public disclosure, via a news release or Form 10-Q or 8-K, setting forth the material terms of the resolution.

In summary, we agree that the Statement should include the proposed exemption from disclosing prejudicial information at a case-specific level, but oppose the second step in the proposed two-step approach. Our opposition is based upon the fact that the information required in the second step, itself, may be prejudicial, and in many instances would negate both the benefits and effectiveness of the prejudicial exemption.

We believe that the Statements' proposed definition of "prejudicial information" (i.e., information that, if disclosed, could affect, to the entity's detriment, the outcome of the contingency itself) is an appropriate and workable definition.

3. Proposed Requirement to Report on Certain Contingencies Expected to be Resolved in the Near Term. Paragraph 6 of the Statement requires that, notwithstanding the guidance provided in Paragraph 5, an entity must disclose a loss contingency if (a) the contingency is expected to be resolved in the near term (i.e., less than one year from the date of the financial statement), and (b) the contingency could have a severe impact on the entity's financial position, cash flows or results of operations, regardless of the likelihood of loss. This proposed requirement is problematical for a number of reasons.

Initially, it is often difficult to anticipate the time at which a given contingency will be resolved. Resolution may require agreement among multiple parties, the conclusion of a seemingly unending series of motions, completion of an extended discovery process and/or a decision or other action by a court or regulatory authority, most of which is well beyond the control of the reporting entity. In addition, there are typically many delays and postponements in the litigation process, itself, as well as in the process for resolving litigation, not to mention the possibility of a lengthy appeal process. As a result, timing projections will be unreliable more often than not, and, even if not misleading, will be of little or no use to investors.

Moreover, such a projection would likely be prejudicial to the reporting entity's interests. By indicating that a given lawsuit is expected to be resolved in the near term, the reporting entity could be inadvertently signaling to opposing counsel that its management is pressuring its lawyers to bring the litigation to a speedy conclusion or that a recent settlement offer is, or is close to being, a number that is acceptable to the reporting entity. This could undermine the entity's negotiating posture and provide opposing counsel with increased leverage in any settlement discussions. Further, if an entity has publicly disclosed its expectation that a particular loss contingency will be resolved in the near future, opposing counsel may use threats of delay to exact a more favorable settlement, given the reporting entity's desire to avoid allegations that it has misrepresented the time at which the resulting loss is expected to occur.

The proposed requirement relates to any contingency that <u>could</u> have a severe impact on the entity's financial position, cash flows or results of operations, regardless of the likelihood of loss. Such disclosure might unduly alarm investors, if the likelihood that a loss will be realized is remote or highly unlikely. Again, the disclosure could embolden a plaintiff's lawyer to demand a large settlement even if liability is only a remote possibility, given the issuer's public admission that it could have a significant exposure in the case. Such disclosure could be extremely damaging to the reporting entity and its shareholders and may not only significantly overestimate the actual risk of a loss, but could make that estimated "loss" more likely to come to fruition.

We believe that <u>any</u> litigation or other loss contingency that could have a "severe impact" on the entity should be disclosed, without regard to when management expects the matter to be resolved, if there is reasonable possibility of loss. Please note that this may be a

higher threshold than "remote". In our view, if there is less than a "reasonable possibility" that a loss has been incurred, disclosure should not be mandated.

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In summary, the disclosure obligation should be driven by the likelihood that a loss has been incurred and the magnitude of the potential loss, rather than by the timing of the loss. Accordingly, we believe that Paragraph 6 should be deleted from the Statement in its entirety.

4. Incorporation of a Materiality Threshold. Paragraph 5 of the proposed Statement would require that a reporting entity must disclose all loss contingencies, other than those determined by management to be remote. Many public companies are exposed to a large number of loss contingencies of varying degrees of significance and magnitude. Such contingencies also vary in the degree of likelihood that a loss ultimately will be incurred. For many, if not most, of those contingencies, even if the "worst case" scenario is realized, the resulting loss may not be material to the entity's financial statements or otherwise of significant interest to investors. The requirement that all loss contingencies, regardless of materiality, must be reported would expand the footnotes to financial statements to include a volume of information that is not material to investors, increase the cost of compliance and obfuscate information that is truly important to investors.

The Statement, as currently proposed, provides some relief from this disclosure requirement by including the notation, which appears in all FASB statements, that "the provisions of this Statement need not be applied to <u>immaterial</u> items." (emphasis added) We believe that it is generally recognized that only those loss contingencies that are "material" need be reported, and that the exclusion of "immaterial" items is intended to achieve that result. However, we are concerned that the term "immaterial", without clarification, may be interpreted to mean something other than "not material," potentially resulting in the required disclosure of numerous contingencies which fall far short of the applicable "material" standard that is prescribed under the federal securities law (i.e., that which a reasonable investor would consider important in making an investment decision).

Specifically, we note that The American Heritage Dictionary of the English Language: Fourth Edition 2000 defines "immaterial" as "of no importance or relevance; inconsequential or irrelevant". Other general English language dictionaries define the term in a similar manner, and we were unable to find a definition of "immaterial" in any dictionary of financial terms. Thus, the term "immaterial", if not further clarified, could be interpreted to be quite limited in scope and to include only a small subset of that which is "not material". In such a scenario, a matter may well be of some significance or relevance, but yet fall far short of being "material". If an entity were required to provide the expanded disclosures with respect to all matters of this nature, users of financial statements could be subjected to voluminous footnotes containing page after page of detail on a variety of cases of only minor significance. At the same time, information that may be truly important to investors, rather than being highlighted, would be buried by the sheer volume of disclosures and quite possibly overlooked by the reader. For that reason, we recommend that the reporting obligations set forth in the Statement be expressly limited to material loss contingencies. As an alternative, we propose that the Statement (or related commentary) confirm that, for purposes thereof, "immaterial" is deemed to include all that is not "material".

5. Disclosure of Settlement Offers. We support the Board's decision not to require the disclosure of settlement offers made between parties to a dispute. As recognized by the Exposure Draft, the settlement offer may expire quickly and may not reflect the status of negotiations a short time later. Moreover, numerous offers may be exchanged over a brief period, as a part of ongoing settlement discussions between the parties. A flurry of meaningless filings would result from a requirement to disclose interim settlement offers. It also should be recognized that, in many instances, a settlement offer is made subject to an agreement of confidentiality, particularly when an offer is made by or to only one of multiple defendants. A requirement that settlement offers must be disclosed would impede the settlement process and the resolution of litigation, and may require parties to violate commitments to maintain the confidentiality of such offers.

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Again, we appreciate the opportunity to comment on the Exposure Draft, and respectfully request that our views be considered as the Statement is further developed and finalized. Please call me at (440) 395-3696 if you have any questions regarding this letter.

Very truly yours,

Charles E. Jarrett Chief Legal Officer

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