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Mr. Robert H. Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

LETTER OF COMMENT NO. 33

Re: Proposed Revisions to FASB 5
File Reference No. 1600-100

Dear Mr. Herz:

Please accept this response to your request for comment on the Exposure Draft, Disclosure of Loss Contingencies (an amendment of FASB Statements No. 5 and 141(R)). Our office routinely gives audit response letters for a New York Stock Exchange public company. We also serve as that company's General Counsel, therefore deal directly with outside defense counsel and with the company's auditors. Thus, we are significantly concerned over the proposed changes to the disclosure requirements for "pending and threatened litigation." In short, the proposed amendments will dramatically alter the disclosure requirements of lawsuit-related loss contingencies, with unintended, and potentially unpreventable consequences resulting.

Lawyer Relationships

To act responsibly, the quantitative disclosures called for by the proposed revisions will inevitably require companies to turn to their lawyers for information. However, engaging in the kind of speculation and estimation contemplated by the draft is to ask lawyers to go beyond what they can do in a professionally responsible way. As a result, companies will be left to engage in their own speculation and estimating. This estimation process will generate friction and conflicts between the corporation and their lawyers. In addition, because the expanded disclosures will have to be derived by companies from their lawyers, companies will be exposed to the risk that the disclosures themselves will be found to constitute a waiver of the attorney-client privilege.

The proposed amendments require the disclosure of several categories of information that are troubling: a description of the contingency, how it arose, its legal or contractual basis, its current status, the "anticipated timing of its resolution," a "description of the factors likely to affect the ultimate outcome," a "qualitative assessment of the most likely outcome for the contingency," and "significant assumptions made by the entity in estimating the amounts disclosed." These disclosures can only practically be based on confidential information provided in material part by the company's own lawyers and/or defense counsel. Yet once a company discloses, even to an independent auditor, the company faces the real risk that a court will deem these disclosures to have waived the attorney-client privilege or work-product immunity.

Under the current rules, we already have periodic issues with disclaimers and limitations from outside litigation counsel in "pending legal" audit response letters. We usually work through these, yet the proposal will only worsen those situations. Having recently talked to one of our better outside defense counsel about the new draft, he responded rather bluntly, "I'm only going to do and say what the Bar Association says; what FASB or the accountants say will be your problem." Thus, the proposal will all the more put the onus on GCs and CFOs to "interpret" or be forced to add to or take away from the responses, at the behest of and likely pushing from the accounting auditors.

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 has been the standard for the foregoing but also was designed to ensure preservation of the attorney-client privilege and work product protections. To the extent that the disclosing entity's judgments and estimates are based on privileged communications between a disclosing entity and its counsel, under the new rules, auditors may feel obliged to seek privileged information from counsel in order to test the disclosures. Thus, another area of risk of waiver of the attorney-client privilege looms, with open-ended consequences.

Less Meaningful Disclosures May Result; Not Better

Because underestimating a large loss may result in legal malpractice liability for counsel providing the estimate (or even just professional embarrassment), the resulting tendency may be to err on the side of caution, resulting in "safe" (that is, "shoot high") estimates of loss and resultant inflated reserves by the company. The estimate may also become a self-fulfilling prophecy: the company will be prone to settle for that figure rather than risk a greater loss at trial, even if the true odds of an unfavorable verdict or judgment are lower than the estimate. Alternatively, the disclosures will serve as a settlement floor because the corporation itself valued the claim at that amount, and a plaintiff will refuse to accept anything less.

Even baseless claims will "have legs" under the proposal. If a plaintiff asserts a large but weak claim, it still may be months before defense counsel can gather the necessary information to defeat the claim. Until that happens, the defending entity may still be required to include this "large claim" in a footnote of its financials and in possibly other reports. Thus, the simple threat of a claim could be sufficient for a plaintiff to extract unwarranted settlement dollars by merely threatening a large claim, then offering to "settle it quickly." More sophisticated plaintiffs' counsel will be able to use effectively, to the disadvantage of a disclosing defendant, any information contained in the expanded disclosures.

The Proposed Exception is Inadequate

While it appears the proposal contemplates an acknowledgment for and how to address when disclosure of certain information may be prejudicial to the company's litigation position, it still has serious flaws. Indeed, the proposed rules allow a company to disclose an estimate or range of possible loss or in "rare instances," to omit the disclosures altogether. However, the practicalities of litigation are that the "rare instance" exception is anything but "rare" in the real litigation world.

The extortion type approach noted above aside, reporting the plaintiff's claim amount may not be an insurmountable hurdle if it merely involves repeating the demand. Yet requiring a defendant to report either its maximum potential loss or a range of possible losses where the plaintiff has been unwilling, unable, or not required to make a specific demand raises problems. As a result, the disclosure itself may supply evidence that will be used in the case as an "admission against interest" by the defendant. The disclosure, and what underlies it, certainly looms to be sought by plaintiffs as "within the scope of discovery."

Additional Points of Concern

- When suits are filed toward the end of accounting periods or shortly before financial statements are issued, the proposal may affect the ability of companies to timely complete and issue their financial statements.

- The strength of legal theories, factual discovery, litigation costs and many other factors must be weighed when a lawsuit is assessed. Having counsel, then the company, measure these subjective and non-economic factors will be more costly.

- When a disclosure that attempts to quantify fundamentally unpredictable outcomes inevitably proves inaccurate, new lawsuits will be filed that will seize upon the "mistaken" disclosures as a basis for liability.

- The proposal may increase pressure to create reserves at a time when the case is not far enough advanced to permit accurate estimation.

Nothing Has Drastically Changed on the Litigation Front

Litigation has been and is fraught with any number of subjective and non-economic factors (many of which may not even be known), yet they still can affect the outcome. A single juror or a single evidentiary ruling can have a dramatic impact on a lawsuit's outcome.

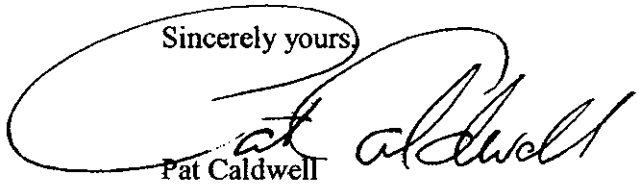
Indeed, it is highly doubtful that any company or lawyer who ever lost a large-dollar case ***expected*** that result. Some results are simply unanticipated, and unexpected results will continue to occur. That is because litigation has been and remains unpredictable by nature.

Experienced trial lawyers may dramatically differ as to the expected or likely result of a particular case. If everyone was in agreement on the value of a claim, there would be nothing to try. The case has therefore not been made for change.

Conclusion

The present approach for disclosing legal contingencies is well understood. It protects important interests under our legal system. It acknowledges that litigation is inherently unpredictable. The proposal's approach would therefore not only be a backward step toward achieving more transparent financial reports, but also have additional loss effects and risks raised.

Sincerely yours,



Pat Caldwell

JPC/btw