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January 16, 2009

Via email to: director@fasb.org

Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06586-5116

File Reference: Proposed FSP FAS 141(R)-a.



LETTER OF COMMENT NO.

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Law and Accounting (the "Committee" or "We") of the Section of Business Law of the American Bar Association in response to the request for comments by the Financial Accounting Standards Board (the "Board") on proposed FASB Staff Position FAS 141(R)-a (the "Proposed FSP"), as posted on December 15, 2008.

The comments expressed in this letter represent the views of the Committee only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the American Bar Association (the "ABA"). In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committee.

The Proposed FSP would amend FASB Statement No. 141 (revised 2007), Business Combinations ("FAS 141R"), as it applies to contingent assets acquired and contingent liabilities assumed in a business acquisition. In particular, the Proposed FSP would modify the standards for recognizing loss contingencies, including contingencies arising from pending or threatened litigation. Basically, the modified standard would provide that, if the fair value of a loss contingency cannot be reasonably determined at the acquisition date, the liability will be recognized and measured in accordance with FASB Statement No. 5, Accounting for Contingencies ("FAS 5"), and FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss ("FIN 14"). Importantly, the Proposed FSP recognizes that the fair value of litigation contingencies often will not be reasonably determinable.

The Committee strongly supports the Proposed FSP as it relates to contingent liabilities. Our comments focus on litigation contingencies in particular, and we do not address in this letter contingent liabilities more generally or the provisions of the Proposed FSP relating to contingent assets. The Proposed FSP largely addresses the concerns raised by H. Thomas Wells, Jr., President of the American Bar Association, in his September 18, 2008 letter to Robert H. Herz, Chairman of the Financial Accounting Standards Board, about application of FAS 141R's current rules for recognition and disclosure of loss contingencies arising from litigation. As indicated in that letter, implementation of the current rules would raise issues similar to those raised by the Board's proposed Exposure Draft, *Disclosure of Certain Loss Contingencies: An Amendment of FASB Statements 5 and 141(R)*, (issued June 30, 2008) ("Disclosure Exposure Draft"). We appreciate the Board's willingness to revisit and modify the loss contingency provisions of FAS 141R in light of its decision to redeliberate the Disclosure Exposure Draft.

It is unnecessary here to restate the serious concerns that underlie the ABA's position with respect to the Disclosure Exposure Draft and the request that the Board not implement the loss contingency provisions of FAS 141R in light of those concerns. We generally agree with and endorse the reasons for modifying FAS 141R set forth in Paragraphs C6-C8 of the Proposed FSP.

As described in the Proposed FSP, the amendments to FAS 141R are modeled on the requirements in FASB Statement No. 141, *Business Combinations* ("FAS 141"), the standard that applied to business combinations before January 1, 2009. After giving effect to the amendments, the basic structure for recognizing and measuring contingent liabilities under FAS 141R would operate as follows:

- Contingent liabilities assumed in the business combination will be recognized at fair value, in accordance with FASB Statement 157, Fair Value Measurements, if the acquisition-date fair value can be reasonably determined.
- If the acquisition-date fair value of the contingent liability cannot be reasonably determined, the liability would be measured at the amount that would be recognized for liabilities in accordance with FAS 5 and FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss ("FIN 14") (referred to in the Proposed FSP as "future settlement amounts)." That is, if the contingency falls into the category where acquisition-date fair value cannot be reasonably determined, a liability would be recognized and measured at its future settlement amount if (1) it is probable that a liability had been incurred at the acquisition date and (2) the future settlement amount of the liability can be reasonably estimated.

The Committee believes that use of FAS 141 as a model for accounting for litigation contingencies in the context of acquisitions is appropriate and generally achieves the objectives identified in the Proposed FSP. It largely returns accounting for litigation contingencies assumed in a business combination to the well-established standards of FAS 5 and FIN 14. Financial statement preparers, their attorneys and their auditors are familiar with and used to applying

The ABA's views on the Disclosure Exposure Draft, as set forth in its August 5, 2008 letter and comments, are available at http://www.abanet.org/polady/priorities/privilegewaiver/2008aug5\_privwaiv\_fasb\_l.pdf.

these standards. This framework should protect the legitimate interests of preparers and their attorneys in preserving the attorney client privilege and in avoiding prejudicial disclosures of information about litigation that could benefit litigation adversaries. This framework should also reduce the costs of accounting for contingencies as compared to the current rules in FAS 141R. At the same time, it will continue to provide users with necessary and reliable information.

FAS 141R in its present form, by contrast, would require expensive and time consuming evaluations of litigation matters and other potential legal liabilities in order to determine whether the "more likely than not" standard would be satisfied. It would also lead to costs to develop valuations of litigation that would satisfy a fair value standard (even if that were possible given the vagaries of litigation described in the Proposed FSP), plus the costs of audits of such determinations.

Having said that, we recommend that the Board clarify certain aspects of the Proposed FSP. We discuss these issues and provide suggested alternatives below:

## Application of "Reasonably Determinable" Standard

As noted above, the Proposed FSP requires recognition of a contingent liability assumed in a business combination if the acquisition-date fair value can be "reasonably determined." The Proposed FSP provides guidance regarding when a liability is "reasonably determinable." Put generally, the Proposed FSP indicates in Paragraph 10 that fair value of a contingency is reasonably determinable (1) if prices for identical or similar liabilities can be observed in the marketplace or (2) if observable market prices are not available, "sufficient information exists to apply a valuation technique." The proposal elaborates on these standards in subsequent paragraphs. Importantly, Paragraph 13 of the Proposed FSP specifically discusses the application of this standard to litigation contingencies:

13. Because of the number of variables and assumptions involved in assessing the possible outcomes of a legal dispute, sufficient information may not exist to reasonably estimate the date the contingency will be resolved or a range of potential resolution dates or the probabilities associated with a range of potential settlement amounts related to a legal dispute, particularly in the early stages of the case. Therefore, entities often will not be able to reasonably determine the acquisition-date fair value of a liability arising from a legal contingency, particularly in its early stages. However, it is expected that sufficient information will be available to measure the acquisition-date fair value of other assets and liabilities arising from contingencies in a business combination, including some legal contingencies in the later stages of the case.

We believe that inclusion of a specific reference to the application of the Proposed FSP to litigation contingencies is desirable. However, we believe that the references in the paragraph to "early stages" and "later stages" of a case may be confusing and may suggest that the stage of the proceeding is the most important consideration in assessing legal contingencies. While we agree

that, in the early stages of a case, it may be impossible for a company to value a legal dispute, we think that the stage of the litigation is one of various appropriate considerations in determining whether a legal contingency can be valued. Accordingly, we recommend revising Paragraph 13 to provide as follows:

13. Because of the number of variables and assumptions involved in assessing the possible outcomes of a legal dispute, sufficient information may not exist to reasonably estimate the date the contingency will be resolved or a range of potential resolution dates or the probabilities associated with a range of potential settlement amounts related to a legal dispute. The stage of the legal dispute as well as the nature of the legal dispute, including experience with similar legal disputes in the past, are among the factors that will affect an entity's ability to value a legal dispute. Therefore, entities often will not be able to reasonably determine the acquisition-date fair value of a liability arising from a legal contingency. However, it is expected that sufficient information will be available to measure the acquisition-date fair value of assets and liabilities arising from contingencies other than legal disputes assumed in a business combination.

## Disclosure

The Proposed FSP contains revised rules in Paragraphs 26-27 for disclosure of contingent liabilities recognized in a business combination. Paragraph 26 requires certain disclosures in the reporting period in which a business combination occurs about contingencies recognized at the acquisition date. This includes contingencies recognized both at fair value and under the FAS 5 and FIN 14 prong of the modified standard. Paragraph 27 requires certain disclosures in subsequent periods.

We are concerned that the new disclosure rules will require disclosures about litigation contingencies that go beyond those currently required by FAS 5 and FIN 14. This does not appear to be the Board's intent. Paragraph C23 of the Proposed FSP articulates the concerns that were raised about the current disclosure standards in FAS 141R, concerns with which we entirely agree. Paragraph C24 comments on the adequacy of disclosure in practice under FAS 5 and asserts that the proposed requirement to disclose an amount recognized at the acquisition date is consistent with FAS 5. The Board also states that as to unrecognized contingencies it decided not to require any disclosures beyond those required in FAS 5.

Notwithstanding the Board's comments, we believe that at least the following types of disclosures required by the Proposed FSP, as they apply to litigation contingencies, are not contemplated by FAS 5 and raise the concerns identified in Paragraph C23:

- Estimate of the range of outcomes (undiscounted) (¶ 26.a)
- Reasons why the fair value of the liability cannot be reasonably determined (¶ 27.d)

• Changes in range of outcomes (undiscounted) for both recognized and unrecognized liabilities and the reasons for those changes (¶ 27.a)

We respectfully suggest that this FSP is not the right forum to debate the adequacy of disclosure practice under the current standards. Moreover, in light of the Board's comments, we think it is unnecessary to attempt to elaborate on existing standards in this FSP. In our view, a better path would be to incorporate existing standards by reference insofar as they apply to litigation contingencies which are not recognized at fair value on the acquisition date.

We recommend that the following paragraph be included to address contingent liabilities not recognized at fair value:

For each liability that is not recognized at acquisition-date fair value (including unrecognized liabilities), the acquirer shall provide the disclosure required by Statement 5 and Interpretation 14.

Paragraphs 26 and 27 should be appropriately modified to exclude contingencies covered by the foregoing paragraph. Conforming changes should be made elsewhere in the document.<sup>2</sup>

We note that there appear to be inconsistencies in Paragraphs 26 and 27 regarding unrecognized contingencies. Paragraph 26 applies only to recognized contingencies. Paragraph 27 refers in its introductory language to periods "until the asset or liability arising from a contingency is derecognized in full." This implies that only recognized contingencies are covered. The first sentence of Paragraph 27.a, however, talks about "both recognized and unrecognized contingencies." Our recommended language would cover disclosures as to both recognized and unrecognized contingent liabilities.

The Committee appreciates the opportunity to comment on the Proposed FSP and respectfully request that the Board consider the recommendations and comments set forth above. Members of the Committees are available to discuss them should the Board or the staff so desire.

Respectfully submitted,

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Thomas W. White, Chair of the Committee on Law and Accounting

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