1840-100
Comment Letter No. 125
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EATON
Powering Business Worldwide

September 10, 2010

Alexander M. Cutler
Chairman and Chief Executive Officer

Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: *File Reference No. 1840-100*

Ladies and Gentlemen:

Eaton Corporation ("Eaton") appreciates the opportunity to comment on the Financial Accounting Standard Board's ("FASB") Exposure Draft: *Disclosure of Certain Loss Contingencies* (the "ED").

Eaton Corporation is a diversified power management company with 2009 sales of $11.9 billion. Eaton is a global technology leader in electrical components and systems for power quality, distribution and control; hydraulics components, systems and services for industrial and mobile equipment; aerospace fuel, hydraulics and pneumatic systems for commercial and military use; and truck and automotive drivetrain and powertrain systems for performance, fuel economy and safety. Eaton has approximately 70,000 employees and sells products to customers in more than 150 countries.

We appreciate this opportunity to express our concerns in response to the ED. We believe that the existing standard (formerly FAS No. 5, recodified as ASC Section 450.20) works well and is not in need of change. The below numbered points outline our major concerns with the ED:

1. <u>The requirement to disclose certain remote contingencies</u>. The proposed requirement to disclose contingencies could involve a severe impact on the preparer of financial statements (Section 450-20-50-1D) even if such a result is deemed remote. Such a change could also have broad ramifications for other types of disclosures not included in the financial statements (e.g., those in securities filings).

Further, the proposed standard would be burdensome and costly, especially for large companies. As a large company, Eaton Corporation occasionally is named in lawsuits that are frivolous, but contain large damages demands, including punitive damages. While the risk of a material loss from such claims is very remote, the proposed standard will require us to analyze each such lawsuit individually. This analysis would be overly burdensome and costly. Moreover, the proposed standard will prompt plaintiffs' lawyers to increase their damages claims, hoping that our concerns about disclosing the matter, even if the likelihood of severe loss is believed to be remote, may prompt early settlement.

The speculative nature of these disclosures also casts doubt on their usefulness. Users of the financial statements may well be confused rather than enlightened by disclosures of outcomes that are not only remote but also uncertain. If the goal of the proposed standard is to improve the transparency and usefulness of contingent loss disclosures, this part of the proposal works against that objective.

In addition, the proposed standard can create potential liability for preparers if disclosures are wrong. Disclosures in financial statements are specifically excluded from the safe harbor for forward looking statements contained in the Private Securities Litigation Reform Act of 1995 ("PSLRA"). If the financial statement preparer does disclose the remote contingency, the protection for forward looking statements in the PSLRA will not be available to protect the preparer. If the preparer does not disclose a remote contingency, plaintiffs' attorneys may claim that the preparer was reckless in failing to disclose the contingency. Eaton urges the FASB to eliminate the requirement that remote contingencies be disclosed from any final standard.

2. The requirement to assess the materiality of contingencies without regard to possible recoveries. The ED requires preparers (Section 450-20-50-1F) to assess the materiality of loss contingencies to determine whether disclosure is required without regard to insurance or other indemnification arrangements. Currently, preparers take expected insurance or other recoveries into account when assessing materiality of claims. Large industries such as the health insurance and consumer product industries face large numbers of claims from beneficiaries or consumers as a routine part of their business. These claims are often covered by extensive third party or self insurance arrangements, the costs of which are disclosed in the financial statements. Under the proposed standard a preparer may be obligated to disclose the portion of the uninsured loss even though it has sufficient insurance to cover all or enough of the claim to render the loss immaterial. We urge the FASB to eliminate the requirement that materially be assessed without regard to possible recoveries from any final standard.

3. The requirement to disclose individual loss accruals. The ED requires preparers to provide the possible loss or range of loss and the amount accrued, if any if such amounts are estimable. For such items where an amount has been accrued for a possible loss, for example, in connection with an individual lawsuit, this means that the individual accrual will have to be disclosed in the discussion of that contingency.

The proposal involves a significant departure from the current standard in which disclosure of specific accruals is only required where "necessary for the financial statements not to be misleading." Most preparers do not disclose individual accruals even when they have accrued such amounts with respect to a material contingency that is disclosed in the financial statements. The amount of the loss deemed probable by the preparer may be much smaller and immaterial to the financial statements. Such amounts have not usually been disclosed, but under the proposed standard such amounts would now have to be disclosed.

Disclosure of specific accruals is usually not done because it gives plaintiffs in litigation a window into the preparer's thought processes about the probable outcome of pending litigation. Requiring disclosure of such amounts may cause preparers serious harm by requiring the disclosure of confidential assessments of probable outcomes. We urge the FASB to eliminate the requirement to disclose individual loss accruals.

4. The requirement for tabular disclosure in each annual and interim reporting period by class of recognized (accrued) loss contingencies. The proposed standard requires tabular disclosure in each reporting period of loss accruals by class and changes in those accruals during the preceding period. We are uncertain what "by class" means under the proposed standard. If individually material items must be disclosed separately or if a single large case dominates a "class," disclosure of the changes in the accruals during the period will give plaintiffs' attorneys another view into the preparer's thinking about the case. We urge the FASB to eliminate the requirements for tabular disclosure in each annual and interim reporting period by class or recognized loss contingencies.

5. The requirement for quantitative disclosure of possible recoveries, if "discoverable." The ED requires preparers to disclose information about insurance and other possible sources of recovery if information has been provided to a plaintiff or if it is "discoverable." Courts, not companies, often make the determination as to whether particular information is discoverable. When a court has not yet made a determination about discoverability, the preparer must speculate about determination which further subjects preparers to the risk of liability for false and misleading statements if such determination is later proved wrong by the court. When information is discoverable, it is often produced under seal or pursuant to a confidentiality agreement or court order and is not available to third parties. The ED would make such information available to other plaintiffs' attorneys who may bring claims under a disclosed insurance policy in the hope of getting a quick settlement from the insurer. We urge the FASB to eliminate this requirement or at the very least limit any disclosure of potential insurance recoveries to lawsuits where such information has been provided to the adverse party in a manner that is not confidential.

6. The absence of an exemption for potentially prejudicial disclosures. The ED does not contain an exemption for potentially prejudicial disclosures. We believe such an exemption is needed and should be included in any final standard.

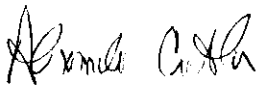
The ED requires the disclosure of other non-privileged information that would be relevant to financial statement users to enable them to understand the potential magnitude of the loss. This requirement will apply to all disclosed contingencies, including remote ones. Such information can involve highly confidential, previously undisclosed analyses and assessments of the contingency by management or its agents. Actual individual accruals, potential recoveries, and changes to accruals may be prejudicial to preparers, particularly in pending litigation. We urge the FASB to retain an exemption for potentially prejudicial disclosures.

7. The impact of the proposed standard on the attorney/client privilege and audit ability of the standard. The analysis of individual accruals and whether potential sources of recovery are "discoverable" will rely on the analysis of the attorneys involved in the lawsuits. To the extent such determinations reflect legal advice given by those attorneys to the preparer, their disclosure risks waiving the attorney/client privilege. Auditors will also seek information from such attorneys since it may represent the best audit evidence for evaluating the disclosures. We are concerned that the protocol for communications between lawyers and auditors agreed to by the American Bar Association and the American Institute of Certified Public Accountants in 1976 (the "Treaty") will no longer prove adequate in light of the new disclosure requirements because auditors will require more detailed disclosures from attorneys than is permitted under the Treaty.

Finally, we note that the proposed effective date of the new standard for fiscal year ending after December 15, 2010, is less than four months after the end of the comment period. Even if the FASB acts to adopt the standard promptly following the close of the comment period, preparers with December 31 fiscal year ends are likely to find complying by the effective date to be extremely burdensome and expensive. Coincidentally, this timeline coincides with the recent financial reform legislation and regulations. We urge the FASB to extend the effective date of any final standard so that it will not be effective until fiscal years ending at the earliest after June 30, 2011.

Thank you for considering Eaton Corporation's concerns. If you have questions or concerns, or if we can provide you with additional information that would be useful to you, please contact Barry Doggett at (216) 523 4664.

Respectfully submitted,



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