1840-100
Comment Letter No. 133

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By email: director@fasb.org

Technical Director
Financial Accounting Standards Board
401 Merritt 7
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Norwalk, CT 06856-5116

Re: File Reference No. 1840-100: Exposure Draft regarding Disclosure of Certain Loss Contingencies (Topic 450)

Dear Sir/Madam:

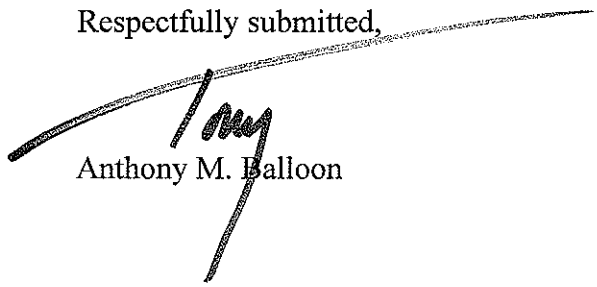
On behalf of the General Counsels of AFC Enterprises, Inc., Albemarle Corporation, Cardinal Health, Inc., CBS Corporation, Comcast Corporation, Eastman Kodak Company, Emerson Electric Co., Ford Motor Company, Goodrich Corporation, Halliburton Company, Hallmark Cards, Incorporated, Hewlett-Packard Company, Intel Corporation, JPMorgan Chase & Co., Johnson Controls, Inc., Kimberly-Clark Corporation, McDonald's Corporation, Monsanto Company, News Corporation, Northrop Grumman Corporation, Owens & Minor, Inc., Pepsico Inc., Raytheon Company, Textron Inc., The Goodyear Tire & Rubber Company, The Lubrizol Corporation, Tyco International Ltd., United Parcel Service, Inc., Verizon Communications Inc., Viacom Inc., and YUM! Brands, Inc., I enclose Comments on the Financial Accounting Standards Board (FASB) exposure draft of the proposed Accounting Standards Update of Topic 450, issued July 20, 2010, as it proposes to amend FASB Accounting Standards Codification Subtopic 450-20, *Accounting for Contingencies*, formerly known as FASB Statement No. 5 (the "Exposure Draft").

As you will see from the enclosed, the above corporations wish to express their collective concern regarding the significant financial and legal detriments to corporations and their investors that would be produced by the Exposure Draft as it proposes to amend FASB Accounting Standards Codification Subtopic 450-20, *Accounting for Contingencies*. While the corporations share FASB's desire to provide investors with meaningful, timely disclosures regarding contingent liabilities, they have significant concerns regarding the Exposure Draft's approach to disclosure of contingent liabilities, especially disclosures regarding pending

litigation. Therefore, the corporations urge FASB not to adopt the proposed amendment to ASC 450-20.

Thank you for considering these views on this critical subject. If you have any questions or need additional information, please do not hesitate to contact me.

Respectfully submitted,



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enclosure

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TYCO INTERNATIONAL LTD.
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VERIZON COMMUNICATIONS INC.
VIACOM INC.
YUM! BRANDS, INC.

REGARDING

"DISCLOSURE OF CERTAIN LOSS CONTINGENCIES (EXPOSURE DRAFT)"

September 15, 2010

I. Introduction & Summary.

Our companies represent a cross-section of industries.[1] We write to share our deep concerns that companies and their shareholders would suffer significant financial and legal injury from the Exposure Draft of the proposed Accounting Standards Update of Topic 450, issued July 20, 2010 (the "Exposure Draft"), as it proposes to amend FASB Accounting Standards Codification Subtopic 450-20, *Accounting for Contingencies*, formerly known as FASB Statement No. 5 ("ASC 450-20"). Specifically, we believe that the updated disclosure requirements relating to remote contingencies, accruals, insurance information and increased qualitative evaluations can be neither implemented (absent potential adverse consequences to companies and potential misleading information provided to investors) nor audited and would provide less meaningful disclosure.

As discussed more fully below, we believe that the proposed disclosure approach required by the Exposure Draft:

- **Unduly prejudices company positions in litigation, particularly given the proposed litigation reserve accrual disclosure requirements, thereby harming shareholder value;**

- **Undermines the protections of the attorney-client privilege and work product doctrine by compelling companies to disclose information prepared in consultation with legal counsel;**

- **Potentially encourages frivolous litigation by giving credence to otherwise meritless claims due to new requirements for "remote" disclosures;**

- **Leads to counterproductive disclosures, as companies protectively "hedge" disclosures to avoid prejudicial impact on litigation and potential exposure for misleading investors; and**

- **Places impractical and costly administrative and resource burdens on in-house accounting and legal teams, as well as outside auditors.[2]**

Companies share with investors the desire to have more certainty and transparency associated with disclosures relating to litigation.[3] However, it is important that investors and the

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[1] Given the cross-section of industries represented, it is important to note that while each company supports the positions articulated in these comments, the practical steps each company takes to implement the requirements of the current ASC 450-20, as well as any changes to ASC 450-20 ultimately adopted by FASB, may vary, including with respect to any specific approach identified herein.

[2] We note that the Exposure Draft is an improvement over the 2008 Proposal, but continues to expand the nature of loss contingencies that must be disclosed and increases the qualitative and quantitative descriptions of those contingencies, the result of which very likely could be misleading and thus harmful to the investor as well as detrimental to the company.

[3] The business community, as well as many other groups, has worked for years on tort reform and eliminating frivolous law suits, but the volatility and lack of transparency in the U.S. system remain strong. *See*, *e.g.*, Lawrence

FASB understand that the current litigation system in the U.S. is an adversarial system which operates very differently from litigation systems outside of the United States.[4] In no small part due to these systemic differences, the U.S. is an exceptionally litigious environment where each side acts out of self-interest and forces the other side to prove its case.[5] Mandating the disclosure of subjective evaluations, accruals or insurance coverage would greatly advantage the adverse party in settlements and provide a roadmap for contingent fee lawyers determining whether it is worth pursuing their case.

The arguments advanced in favor of the new disclosure thresholds in the Exposure Draft appear to be (1) a general predisposition to bring U.S. litigation disclosures closer to the type of disclosure typically encountered outside of the U.S., potentially in preparation for IFRS convergence,[6] and (2) an attempt to avoid "surprise disclosures" to investors when key litigation events occur without advance notice (e.g., settlement or verdict). Concerning the first point, there is no meaningful correlation between the litigation systems outside the United States where IASB standards are applied (e.g., continental Europe) and the U.S. system. With respect to the second point, the goal of avoiding litigation surprises through precise and continually updated disclosure evaluations fails to appreciate (1) that there is no precision until a judge or jury decides (and the appeals process is exhausted or abandoned) or (2) that the present regime of accrual and disclosure works well in providing practical answers as to the status of matters in the U.S. litigation system.[7] Rather than a need for new and additional requirements, greater efforts should be focused on ensuring that the current requirements under existing ASC 450-20 are applied.

II. The Enhanced Disclosures Required by the Exposure Draft Will Harm Companies and their Shareholders.[8]

J. McQuillan, et. al., "*Jackpot Justice: The True Cost of America's Tort System*," Pacific Research Institute 5-9 (2007) (discussing "the lawsuit industry" generally and noting that "in an effort to restore balance and predictability to their tort systems, many states and the federal government have enacted reforms targeted at fixing the problems").

[4] Certain elements of the U.S. litigation system make it unique among methods of dispute resolution. These differentiating elements include punitive damages, contingent fee arrangements, each party bearing its own costs (as opposed to the losing party paying all costs), and jury trials in civil suits.

[5] As Judge Friendly noted in observing the role of lawyers in the U.S. litigation system: "Under [the U.S.] adversary system the role of counsel is not to make sure that the truth is ascertained but to advance his client's cause by any ethical means. Within the limits of professional propriety, causing delay and sowing confusion not only are his right but may be his duty." Henry J. Friendly, "*Some Kind of Hearing*," 123 U. PA. L. REV. 1276, 1288 (1975).

[6] The Exposure Draft is outside the scope of the current Memorandum of Understanding in place between FASB and the IASB regarding GAAP/IFRS convergence. As such, it would appear that the positions taken in the Exposure Draft are unrelated to, if not completely divorced from, IFRS convergence or the proposed IAS 37. Indeed, FASB insomuch as acknowledges this disconnect on page 3 of the Exposure Draft when discussing the differences between the Exposure Draft and IAS 37.

[7] Indeed, as discussed more fully below, under ASC 450-20 today, a loss contingency must be accrued when a loss occurrence is probable and can be reasonably estimated. Even if an accrual is not required, a loss contingency must be disclosed if there is at least a reasonable possibility that a loss may be incurred.

[8] This letter focuses on the impact of the proposed revisions to ASC 450-20 on the civil litigation process. Nevertheless, the principles discussed herein would be equally applicable to proceedings in administrative, regulatory and criminal contexts.

We believe that the disclosure framework under the Exposure Draft will jeopardize shareholder value by: (1) requiring the disclosure of information that prejudices companies in litigation (such as accruals and/or insurance coverage), including through waiver of the attorney-client privilege and protections afforded by the work product doctrine; (2) requiring the costly disclosure of constantly changing and uncertain information that may confuse investors; and (3) exposing the company to the risk of future satellite litigation for allegedly misleading information contained in a premature disclosure that proves to be inaccurate.

A. Understanding the U.S. Litigation System is Critical to Appreciate the Adverse Consequences of the Exposure Draft.

Given the central role that the U.S. litigation system plays in establishing contingent liabilities, we have included an overview of the litigation system attached as Appendix A.[9] As indicated in Appendix A, the adversarial litigation process has an enormous impact on both the availability of reliable information (as opposed to adversarial positioning) to disclose, as well as the nature and scope of an appropriate disclosure. This is due to the inherently subjective nature of the process (e.g., the same fact pattern may be interpreted numerous ways depending on the inclination of a particular party). There also is natural volatility in the process because the system contemplates potential errors in judgment by judges and juries and provides opportunities for correction in the form of motions for reconsideration and appeals.

The U.S. litigation system has certain determinative points when facts relevant to outcomes are determined, often revolving around the rulings of judges and the verdict of juries. Disclosure of these determinative events is meaningful although not necessarily dispositive (e.g., judges set aside verdicts, jury determinations are reversed on appeal). The Exposure Draft, in seeking to force evaluations and quantitative assessments of potential litigation outcomes in a manner divorced from the key determination points in the litigation process, could undermine severely a company's litigation position by forcing premature disclosure that ultimately could prove to be inaccurate. Specifically, the disclosures required in the Exposure Draft facilitate access by adverse parties to otherwise confidential information, and the associated leverage, which they otherwise would not have had, and diminishes the meaningful ability of companies to defend themselves.[10]

With this background in mind, we turn to the specific elements of the Exposure Draft, starting with the proposed quantitative and qualitative disclosures, including the absence of a "prejudice" exemption to disclosure, and then addressing the new "remote" disclosure requirements.

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[9] Although there have been modest improvements in the Exposure Draft when compared with the "Disclosure of Certain Loss Contingencies: An Amendment of FASB Statements 5 and 141(R) Exposure Draft" issued in 2008 (the "2008 Proposal"), based on the experience of all of our companies in major litigation, the Exposure Draft fails to recognize the unique aspects of the adversary litigation system in the United States.

[10] There have been efforts in the past to move our litigation system from adversarial to joint obligations from the parties to stipulate truth. Those efforts have failed as the American culture believes that truth is best found by a third party judge or jury after each adversary presents facts and arguments from its self-interest.

B. The Quantitative and Qualitative Disclosures Required by the Exposure Draft Are Harmful to Companies in Litigation.

The quantitative and qualitative disclosure requirements in the Exposure Draft pose a significant burden for companies in litigation and will undermine protections provided by the attorney-client privilege and the work product doctrine.

1. The Quantitative Disclosure Requirements in the Exposure Draft, Particularly the Tabular Reconciliation of Accruals, Will be Prejudicial to Companies in Litigation.

For "reasonably possible" contingencies,[11] the Exposure Draft would require disclosure of the following "quantitative information:" (1) "publicly available quantitative information" (for example, "the amount claimed by the plaintiff or the amount of damages indicated by the testimony of expert witnesses"); (2) the company's estimate of the "possible loss or range of loss and the amount accrued, if any;" (3) if such an estimate is not possible, a disclosure that "an estimate cannot be made and the reason(s) why;" (4) other information that is not subject to the attorney-privilege and/or work product doctrine and that "would be relevant to statement users to enable them to understand the potential magnitude of the possible loss;" and (5) information about possible insurance recoveries, but only if and to the extent that it has been provided in discovery, is discoverable by either a plaintiff or a regulatory agency, or relates to a booked receivable for such recoveries.[12]

Similar to the 2008 Proposal, a company would be required to provide a reconciliation in tabular form of accruals. The Exposure Draft departs from the 2008 Proposal, however, requiring the reconciliation by class, rather than on an overall aggregate basis. The reconciliation is essentially a "rolling" approach for litigation contingencies, including the presentation of the following information: (1) carrying amounts of the accruals at the beginning and end of the period; (2) amount accrued during the period for new loss contingencies recognized; (3) increases for changes in estimates for loss contingencies recognized in prior periods; (4) decreases for changes in estimates for loss contingencies recognized in prior periods; and (5) decreases for cash payments or other forms of settlements during the period.

The class aggregation method provides limited, if any, protection from disclosure of prejudicial information and waiver of the attorney-client privilege. This protection is further eroded by the Exposure Draft's requirement that the basis for aggregation be disclosed as well as additional information to enable investors to understand the timing, nature and magnitude of the particular class of aggregated accruals. To the extent adjustments in accruals can be traced to a particular dispute or matter (which will be the case for many companies), the tabular reconciliation provides ample opportunity for plaintiffs to confirm a company's own assessment of litigation exposure, undermining the adversarial litigation system, with the disclosure, rather

[11] ASC 450-20 currently only requires that the disclosure regarding "reasonably possible" contingencies include only the "nature of the contingency" and an "estimate of the possible loss or range of loss or a statement that such an estimate cannot be made."

[12] For "remote" contingencies that meet the "severe" disclosure threshold articulated in the Exposure Draft, the same quantitative disclosures — other than the estimated loss or a statement explaining why no estimate can be made — are mandated.

than the merits of the case, potentially driving the ultimate outcome of the dispute. Indeed, because plaintiffs will likely assume that companies are willing to settle the dispute for this amount, the amount disclosed will become a baseline for settlement discussions, with the ongoing disclosures leading to a continuous "ratcheting-up" effect.

Further, in failing to account for the differing litigation environments across industries (e.g., a pharmaceutical company will have different types of litigation from a communications company or an automobile manufacturer), aggregation may not provide sufficient anonymity for an individual claim. Where a company is involved in a single or relatively unique legal dispute, for example, aggregation is both pointless and technically impossible. Even when aggregated with one or more smaller claims, it will often be evident that a particular claim accounts for the bulk of an aggregated provision.

In summary, while the Exposure Draft is an improvement over the 2008 Proposal with respect to quantitative disclosures regarding individual contingencies, there still are significant concerns regarding the proposed quantitative disclosures required in the Exposure Draft.[13] The quantitative disclosure requirements could have two highly prejudicial consequences for reporting entities: (1) they could result in waiver of privilege or work-product protection because the amount of the accrual is typically predicated on the advice of counsel; and (2) they could give litigation adversaries a major tactical advantage in settlement negotiations by telling them the amount the entity has determined it is required to accrue (on an ongoing, periodic basis) which will become the floor for negotiations, a result that is particularly onerous to companies and their shareholders. In particular, it is highly likely that the proposed tabular reconciliation of litigation contingencies will be prejudicial to companies in litigation. The prejudice may be particularly acute in the context of settlement discussions or where a company either has few cases pending, or multiple cases spread out over a number of classes of litigation.

An additional concern is the disclosure of claims made by expert witnesses.[14] A major litigation system reform regularly pursued in litigation is the elimination of often unreliable speculations as to liability offered under the aegis of so-called "expert witnesses." The disclosure requirement in the Exposure Draft fails to recognize the frequent unreliability of experts and the rigors of the *Daubert* doctrine required for "expert" testimony to be admitted as evidence at trial.[15] By mandating such disclosure when the expert's testimony is "publicly available," the new draft would require entities to publicize in their financial statements the damage claims endorsed by the testifying experts retained by their litigation adversaries no

[13] The Exposure Draft does not contain certain of the most criticized quantitative disclosure requirements of the 2008 Proposal, which would have required companies to disclose the amount claimed or assessed or, if none, the company's best estimate of the maximum exposure to loss.

[14] The current version of ASC 450-20 does not require the disclosure regarding the "amount of damages indicated by the testimony of expert witnesses."

[15] *See Daubert v. Merrell Dow Pharmaceuticals,* 509 U.S. 579 (1993) (articulating the standards by which a court should determine whether an expert witness should be permitted to testify at trial) and *Kumho Tire Co. v. Carmichael,* 526 U.S. 137 (1999) (applying the *Daubert* test to non-scientific expert witnesses).

matter how speculative those claims might be and despite the potential for the "experts" making such claims to be disqualified from testifying under the *Daubert* requirements.[16]

2. The Proposed Qualitative Disclosures are Prejudicial to Companies and Will Jeopardize the Attorney-Client Privilege.

The Exposure Draft proposes to require the disclosure of "[q]ualitative information to enable users to understand the loss contingency's nature and risks." During early stages of litigation, the reporting entity must disclose, "at a minimum, the contentions of the parties" (e.g., the basis for the claim, the amount of damages claimed and the basis for the entity's defense or a statement that it has not yet formulated one). In subsequent reporting periods, the disclosure must be "more extensive as additional information about a potential unfavorable outcome becomes available" and must include the "anticipated timing of, or the next steps in, the resolution" of the disclosed contingency. In addition, the entity would have to disclose "sufficiently detailed information to enable financial statement users to obtain additional information from publicly available sources, such as court records."

The Exposure Draft's effort to seek constant short term evaluations and related disclosure would prejudice the litigation posture of companies by unilaterally exposing the company's strategic approach, which undercuts the need for confidentiality that facilitates settlement talks or litigation tactics and strategies. In a similar vein, the Exposure Draft's requirement that a company disclose the "basis for the entity's defense or a statement that the entity has not yet formulated its defense" may lead to premature disclosures where a particular defense has not been pled in court filings or other publicly available documents. As with the other qualitative requirements, premature disclosure of strategy may be prejudicial to a defendant company in litigation.

To comply with the qualitative requirements of the Exposure Draft as proposed, companies would need to consult with counsel and experts about the factors required to be disclosed and how they might impact each matter. This analysis of factors and their impact directly influences, and is part of, the strategy behind the administration of each claim.[17] To then disclose this information would encourage plaintiffs to argue that the attorney-client privilege and work product doctrine have been waived. A key benefit of the attorney-client privilege and work product doctrine is being able to discuss information with counsel to assist the company in developing a strategy to obtain the best possible results, *without that information or strategy being available to the other side to use against the company*. The proposed qualitative disclosure could jeopardize this benefit, causing a company inadvertently to waive these protections. Ironically, the Exposure Draft could create the unwanted effect of a company

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[16] The Exposure Draft does not appear to require such disclosure when the expert's testimony is not publicly available because, for example, a confidentiality order entered in the litigation prohibits the parties from disclosing deposition testimony that has been designated confidential by one of the litigants or a third party.

[17] *See*, *e.g.*, *Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414, 1424 (3rd Cir. 1991) (observing that "voluntary disclosure to a third party of purportedly privileged communications has long been considered inconsistent with an assertion of the privilege."); *SEC v. Brady*, 238 F.R.D. 429, 439 (N.D. Tex. 2006) (concluding that attorney-client privilege is waived where a company makes "significant disclosures of privileged information to third parties who lacked a common legal interest").

choosing not to confide in counsel, impairing counsel's ability to represent the company, and adversely impacting the company and ultimately the shareholders.

Equally troubling, the Exposure Draft would effectively add a requirement for disclosure of information relating to possible insurance recoveries -- a defendant's liability coverage is generally subject to discovery and therefore would almost always have to be disclosed under the new proposed standard -- and thus would prejudice companies by requiring them to broadcast their liability coverage terms to other potential litigation adversaries. Further, despite being generally discoverable, coverage typically is not admissible in a trial. Following disclosure, plaintiffs will claim that companies have waived their ability to object. Juries can be greatly prejudiced against a party if they perceive that there is insurance to pay the damages. Further, given the sophistication of insurers and most commercial insurance policies, the likelihood of contested coverage or reservation of rights by an insurer against the insured may render financial statement disclosures regarding coverage subject to claims that they are misleading or prejudicial.

We also note that the Exposure Draft omits the "prejudicial exemption" that was included in the 2008 Proposal, which permitted companies to avoid disclosure of information that was unduly prejudicial. The SEC and others overseeing public disclosure long have recognized the difficulty in foreseeing unintended consequences that may stem from regulatory changes or prescriptive requirements. Accordingly, a principle of exemption from disclosure for prejudicial disclosures provides an appropriate check against the potential unintended consequences of more robust disclosure requirements. The absence of a catch-all disclosure exemption for prejudicial material could disadvantage the disclosing company in litigation, resulting in harm both to the disclosing company and its investors.

C. Requiring Disclosure of "Remote" Loss Contingencies if they Would Have a "Severe" Impact Will Lead to Misleading Disclosures and Fails to Account for the Dynamic Nature of the Litigation System.

Similar to the 2008 Proposal, the new Exposure Draft seeks to modify the disclosure standard applicable to "remote" litigation contingencies in an attempt to increase the number and types of contingencies requiring disclosures.[18] Under the current version of ASC 450-20, in the event that a contingency is remote, no disclosure is required. When evaluating a claim based on the factors of "magnitude of risk" and "likelihood of occurrence," the current standard recognizes that claims of great magnitude, even frivolous ones, may be made in initial pleadings, and that motions and discovery are necessary to remove speculative, meritless or highly inflated claims from the case or to have frivolous suits dismissed.

In establishing the "potential severe impact" standard, the Exposure Draft notes that a company "will need to exercise judgment" in determining the appropriateness of disclosure. A

[18] The Exposure Draft retains the current requirement that an asserted claim be disclosed in footnotes to financial statements if there is at least a "reasonable possibility . . . that a loss may have been incurred." The disclosure threshold for unasserted claims also remains the same: disclosure is not required if there has been "no manifestation by a potential claimant of an awareness of a possible claim" unless it is "probable that a claim will be asserted" and there is a "reasonable possibility that the outcome will be unfavorable."

"severe impact" is defined as a higher threshold than material, but less than catastrophic, and means a "significant financially disruptive effect on the normal functioning of an entity." Three factors to be considered in making this judgment are identified: the potential impact on operations; the cost of defense; and the amount of effort and resources management may have to devote to resolve the contingency. The present ASC 450-20 approach allows companies to classify such speculative, meritless or highly inflated claims and frivolous suits as "remote" and does not require disclosure until a court ruling establishes otherwise. However, the Exposure Draft's suggested factors for making a judgment on the appropriateness of disclosure for remote claims are not meaningful in the context of these types of claims. A motion to dismiss or for summary judgment may eliminate speculative or meritless claims of great magnitude. Highly inflated claims may be right-sized through the litigation process, and frivolous suits may be dismissed in their entirety. It is impossible, however, to predict with any degree of certainty how much time, resources or expense will be required before these results are achieved. More importantly, these factors are almost entirely irrelevant in determining whether disclosure of claims determined by management to be remote has any value to investors. Indeed, such disclosure is harmful because investors may be, at best, confused, and, at worst, misled, especially given the Exposure Draft's prohibition on consideration of possible insurance or indemnification recoveries in determining the need for disclosure. Of equal concern, this approach gives unwarranted credibility to frivolous claims through disclosure and thereby encourages their continuation and possibly their proliferation.[19]

The Exposure Draft also requires disclosure of probable, but unasserted claims, if a reputable scientific journal (or other credible sources) indicates a potential significant hazard related to a company's products or operations. This requirement will increase the number of disclosures required by companies, but add little value to the investor. The highly speculative nature of unasserted claims, based solely on scientific reports (whether a single report or series of reports), will create more uncertainty and confusion for investors and completely ignores the reality that many of the theories tested in scientific studies are either simultaneously disputed by competing studies or disproved by later studies and will not be admissible in court proceedings. Further, by publicizing theoretical studies suggesting liability, a company will appear to give credence to such theories, thereby inviting law suits.[20]

The Exposure Draft likely will have the unintended result of encouraging frivolous "fishing expeditions" by contingent fee lawyers because the contemplated disclosure suggests credibility for the amount of liability claimed, regardless of its probability of success. The vague nature of the requirement to disclose a loss contingency that is remote, meaning extremely

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[19] Not only could the "severe" threshold result in potentially misleading disclosures to investors, it is also likely to result in substantially increased disclosure of litigation, which could obscure otherwise meaningful disclosure of loss contingencies and related accruals.

[20] Science journals will publish thought-provoking theories that may not be supported by the research protocols that a judge will require in deciding admissibility. The standards for academic publication are quite different from burdens of proof for admissibility in litigation. Moreover, by disclosing probable claims based on scientific reports, the adverse party will claim that a disclosing party already will have determined that such source is credible and relevant. Such disclosure could permit an adverse litigant to more easily meet the relevance and reliability standards set forth in *Daubert v. Merrell Dow Pharmaceuticals* and its progeny. *See Daubert v. Merrell Dow Pharmaceuticals,* 509 U.S. 579 (1993), *General Electric Co. v. Joiner*, 522 U.S. 136 (1997), and *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999).

doubtful or slight, gives rise to meaningless disclosure with harmful effects, and provides minimal benefit other than to potential claimants. The present approach of "remote," "probable" and "reasonably possible" allows for the experienced judgment of lawyers to provide long term evaluations that produce accurate assessments and appropriate levels of disclosure.

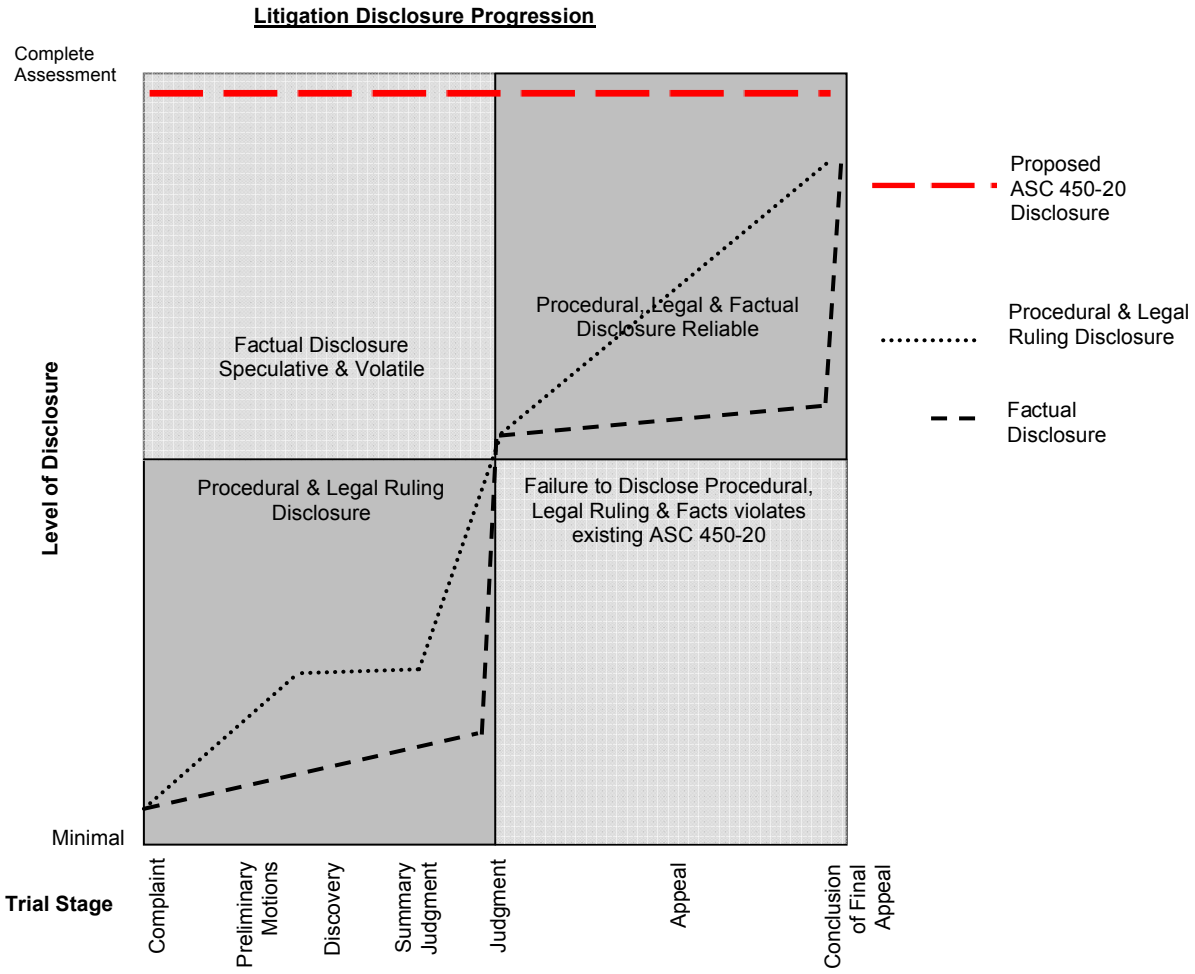
III. The Current Version of ASC 450-20 is Effective and Appropriately Tailored to the U.S. Litigation System.

The accrual and disclosure provisions currently contained in Statement 450-20 and in effect for over thirty years work well to assure the use of accruals and meaningful disclosure tests without interfering with the needed confidential advice and evaluation of legal counsel.[21] As discussed above, moving from the present system under Statement 450-20 to the disclosure requirements contained in the Exposure Draft risks producing significant negative impacts on companies and, in turn, the very investors intended to benefit from the enhanced information for which the Exposure Draft calls. The complaint that the present system is imprecise and allows surprises may be valid, but that is the flaw of the litigation system generally, not the disclosure regime. The proposed additional disclosures required by the Exposure Draft will not remedy these perceived shortcomings, but may serve to overwhelm investors with an excess of information, much of which will not be meaningful and could be misleading while simultaneously disadvantaging corporations in litigation. Adherence to the current disclosure requirements minimizes, if not neutralizes, any challenges that the U.S. adversarial system of justice affords investor knowledge.

In forcing these disclosures, the Exposure Draft, ironically, would create disclosures that are less precise than those presently provided under current ASC 450-20. Because litigation is inherently a fact-finding process, a company would be required to predict the outcome of the investigatory and fact-finding process based on speculation about facts that may not be knowable until later stages of the process. This would lead to extensive boiler plate assumptions and qualifications to attempt to protect against subsequent claims of being misleading and to prevent adversaries from claiming admissions of fault. Such disclosures are ultimately of limited value to investors.

As the following chart shows, the availability of facts and determinations as to the viability of legal positions are not available in the initial stages of litigation and remain uncertain until definitive settlement or final appeal. The existing ASC 450-20 regime guides users in a meaningful progression from the lower left quadrant to the upper right quadrant as the case progresses. The Exposure Draft impatiently seeks to force premature subjective evaluations where the judge and jury have yet to act, which, as indicated above will lead to assumptions and boilerplate protective disclosures that guard against claims of admission in court and claims of misleading information.

[21] As discussed throughout these comments, the U.S. litigation system reflects a carefully constructed balance among competing considerations. The disclosure requirements in the Exposure Draft would upset this balance in fundamental ways, and, accordingly, would undermine the objectives of the courts and the legal system, which so painstakingly have developed the rules and procedures that govern the litigation process. In other words, the Exposure Draft not only undermines companies' interests in litigation, but also undermines the public policy considerations underlying the litigation process.



In contrast to ASC 450-20, the quantitative and qualitative disclosure requirements of the Exposure Draft could expose a company to litigation claims regarding misleading disclosures resulting from the unintended conflict between the disclosure rules and management's fiduciary obligation to manage the company's litigation in a competent manner. These conflicts will arise due to the nature of the litigation system and the unique manner in which information certainty is achieved in the U.S. adversarial system.

The current application of ASC 450-20 strikes a credible balance by reflecting the realities of the litigation system but not requiring quantitative disclosure until such time as the possible loss is estimable. [22] If there is a perception that in some instances companies have held back from disclosing litigation loss contingencies that truly are estimable at an early stage in the

[22] Under ASC 450-20 today, a loss contingency must be accrued in the financial statements when a loss is *probable* of occurrence and can be reasonably estimated. Even if an accrual is not required, a loss contingency must be disclosed if there is at least a *reasonable possibility* that a loss may be incurred. The disclosure must indicate the nature of the contingency and provide an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure of the loss contingency in and of itself puts the reader on notice that the contingency could result in a loss that would be *material* – a substantial piece of information. No disclosure is required for a loss contingency that is deemed to be *remote* or that is not material.

trial process, then, we respectfully submit, the proper response is to ensure better adherence to the current ASC 450-20, but not to substitute a standard that presents a significant risk of distorting the disclosure process.[23]

Further, to the extent that FASB is concerned about the "surprises" that sometimes arise from the volatility inherent in the U.S. litigation system, long term, the litigation system largely is self-correcting. While there will be occasional run-away juries and biased judges, the appellate system is designed to correct these flaws. We submit that despite the occasional systemic flaw in the U.S. litigation system, seeking to curtail that volatility via the requirements of the Exposure Draft is impractical and inappropriate. The Exposure Draft will not only cause significant additional (and adverse) litigation risk to companies, but also will result in less than meaningful disclosure based on decisions that are "more predictive or speculative in nature than factual."[24]

IV. Even in the Absence of Serious Prejudice to Companies, Implementation of the Exposure Draft Places Significant Administrative and Resource Burdens on Companies with Minimal Benefits to Users of Financial Statements.

The Exposure Draft fails to account for the practical impact and potential administrative burden of "operationalizing" the enhanced disclosure requirements. The requirements contained in the Exposure Draft, in particular the quarterly tabular accrual reconciliation, in many instances, will require wholesale re-engineering of the existing financial statement preparation approach companies take in determining appropriate contingent liability disclosures. A public company's current disclosure controls and procedures and system of internal controls, as established in conformity with applicable securities laws (e.g., the Sarbanes-Oxley Act of 2002), will need to be revised -- in some cases extensively, depending on the particular company or industry -- to meet the new requirements of the Exposure Draft.

The enhanced disclosure requirements of the Exposure Draft also risk significant change to the interface among corporate accounting, in-house legal teams and the outside auditor, which not only potentially impacts attorney-client privilege and work product protection, but also will require more documentation and nuanced, sometimes speculative judgment calls. To that end, the audit procedures for these enhanced disclosures also will need to be agreed upon and implemented. Further complicating this interface is the potential conflict between the Exposure Draft and (1) the AICPA/ABA "treaty" regarding disclosures to auditors and attorney-client privilege, and (2) current SEC disclosure requirements under the Securities Exchange Act of 1934, including Regulation S-K.

With respect to the accrual aggregations, the Exposure Draft suggests a complex classification. Establishing the classes of accruals demands a resource-intensive, judgment-

[23] Companies signing this letter have collectively been involved in numerous cases where the outcomes – positive or negative for the company – have changed dramatically by events that occur during the pendency of a case. Documents uncovered in discovery, intervening decisions and credibility determinations by a judge or jury could all be one of the several reasons why a company could not be faulted for failing to know the ultimate outcome of these disputes, not being aware of the significance of documents that it is in the process of reviewing or failing to predict the outcome of intervening judicial precedent.

[24] Exposure Draft at 38.

oriented evaluation without considering the administrative burden of the ongoing periodic accrual adjustments. For multinational companies with multiple types or quantities of litigation or similar proceedings across a number of U.S. and international venues (often involving a wide variety of claims subject to any number of outcome determinative procedural and substantive attacks), the mere act of classification could result in either misleading or uninformative disclosures. We respectfully submit that all of the above additional efforts will be costly and imperfect, with the costs far outweighing any benefits produced.

Lastly, given the required process engineering for implementation of the Exposure Draft, the December 15, 2010 implementation date is neither practical nor achievable. While moving the implementation date to the 2011 reporting year would not solve any of the substantive defects of the Exposure Draft outlined above, any changes of consequence that FASB desires to implement in the area of accounting for contingent liabilities requires a more meaningful initial assessment and implementation timeframe.

V. Conclusion.

As outlined above, despite the efforts to address the concerns raised over the 2008 Proposal in the Exposure Draft, there continues to be a significant disconnect between the proposed disclosure requirements and the realities of the adversarial litigation system in the United States, as well as the critical role that attorney-client privileged evaluations and confidential strategic planning play in successfully resolving disputes. The Exposure Draft's push for enhanced disclosure and quantitative information greatly jeopardizes the ability of public companies to preserve shareholder value in litigation while seeking to give meaningful disclosure. The remote disclosure requirements, the quantitative and qualitative disclosure provisions, particularly with respect to insurance coverage and quarterly "true ups" of litigation accruals contained in the Exposure Draft present the same concerns as to which so many objected in the 2008 Proposal.

We believe that ASC 450-20, as currently drafted, provides appropriate information to assist the users of financial statements in understanding litigation loss contingencies. ASC 450-20 works in tandem with the volatile nature of our litigation system by only requiring the type, scope and timing of information on loss contingencies involving litigation that can be provided in a reasonably accurate manner. We believe that the proposed disclosure required by the Exposure Draft will result in less clear and less meaningful disclosure that will be harmful to company and investor interests. We would urge FASB to reconsider the need for the Exposure Draft and instead seek to apply the current standards in ASC 450-20.

Appendix

U.S. Litigation System Overview

The litigation process has an enormous impact on both the availability of reliable information to disclose publicly, as well as the nature of an appropriate disclosure, particularly in its early stages. There is inherent volatility in the process, particularly with respect to the ultimate resolution of a particular claim. A myriad of factors, many of which relate little if at all to the underlying facts or merits of the legal claims, can significantly impact that resolution. To name but a few:

- The interposition of a neutral third party (judge or jury) to resolve the conflict only at a much later stage;
- The skill, biases and availability of the ultimate decision-maker;
- The relative resources and skills of the parties;
- Dismissal of a case based on legal defenses;
- Vague liability thresholds that exist in both the common law and the statutes of many states;[25]
- The unpredictable nature of dramatically different available remedies, such as restitution, treble or punitive damages, or injunction, that may evolve during a case;
- Access to evidence to support (or defeat) a claim;
- The substitution of amended or restated pleadings; and
- The fact that many, indeed most, cases are resolved before verdict, frequently on a basis that does not directly mirror the theoretical merits of the claims.

While the volatility of a dispute within the litigation system is significant, the litigation system itself, if allowed by the parties to run its full and normal course (i.e., if the parties do not settle a dispute out of court), follows a largely uniform set of procedures that begin with the filing of a complaint setting forth a plaintiff's allegations and end when the final appeal is exhausted. The below chart sets forth the sequence of events in a "typical" litigation:

[25] *See*, *e.g.*, CA Bus and Professions Code §17200 (creating cause of action for "unfair competition" defined as any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising…."). California courts have interpreted this statute as imposing liability where the challenged practice (1) without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the common law, or otherwise – whether, in other words, it is within at least the penumbra of some common law, statutory, or other established concept of unfairness; (2) is immoral, unethical, oppressive, or unscrupulous; or (3) causes substantial injury to consumers (or competitors or other businessmen). Another test espoused by California courts to determine whether a particular business practice is "unfair" involves an "examination of its impact on its alleged victim, balanced against the reasons, justifications and motives of the alleged wrongdoer. In brief, the court must weigh the utility of the defendant's conduct against the gravity of the harm to the alleged victim – a weighing process." Other states have similarly vague statutes with similarly expansive interpretations. The point is not that claims under such statutes result in substantial liabilities. In practice, frequently they do not. But surely, short of resolution by a court or a settlement, it is nearly impossible to predict the ultimate result under such a standard.

Litigation -- An Adversarial Process

Notice Pleadings

•Plaintiff alleges claim(s) based on plaintiff's limited, one-sided facts (the "Complaint").
•Defendant responds to allegations in Complaint based on defendant's limited, one-sided facts.
•May be based on information that is inadmissible at trial and cannot be considered by a fact-finder in rendering judgment.
•Two competing "Truths" exist.

Initial Motions

•Defendant typically files a motion to dismiss asking the Judge to rule in favor of the Defendant.
•Judge may dismiss all or certain claims and rule definitively on certain legal issues.
•Two competing "Truths" exist, but Judge can make favorable presumptions and rule on legal (but not factual) merits of case.

Discovery

•First opportunity for parties to have access to evidence in possession of adversary.
•Parties have ability (through motions, etc.) to limit discoverable and/or admissible information.
•Parties assess relative strength of cases and develop evidence for trial.
•Parties able to refine the two competing "Truths."

Dispositive Motions

•Parties may file motions to end the dispute prior to trial (e.g., summary judgment).
•Judge may dismiss all or certain claims and rule definitively on certain legal issues.
•A trial is needed only in the event of disputes of FACT. Two competing "Truths" exist, but Judge can make favorable presumptions and rule on legal (but not factual) merits of case.

Trial

•Used to resolve questions of FACT.
•Fact-finder may be either Judge or Jury.
•Parties present evidence and arguments advocating for their preferred position.
"Truth" determined by fact-finder, not parties. Application of law to "Truth" determined by Judge.

Verdict & Judgment

•Fact-finder reaches conclusions of fact, arriving at the "Truth."
•Judge has the right to make factual presumptions in one party's favor and then rule on matters of law (directed verdict and judgment notwithstanding the verdict).

Appeal

•Dissatisfied party (either "winner" or "loser") may appeal all or part of the judgment.
•Appeals Court has the ability to overturn trial court findings of fact and judgments of law.
•Appeals Court "Truth" may be different than "Truth" determined at trial.

In reviewing the above diagram, it is important to recognize that particular factual or legal components of a dispute typically are not resolved until a judge or jury renders a decision, and, in a typical litigation context, the first instance in which a defendant will have relative clarity regarding the potential for a realized, quantifiable loss will be the Verdict and Judgment stage. Disclosure of the procedural posture of material litigation under the current ASC 450-20 can provide meaningful, verifiable information concerning litigation. In contrast, the Exposure Draft would create a paradigm shift in the way companies address their quarterly portfolio of litigation by compelling companies to make speculative disclosures during the most volatile stages of the process. Putting aside the tremendous strain on both internal and external resources that will be required to create these disclosures, companies may be forced, in effect, to assume or speculate as to facts before the litigation process generates the information necessary to determine them, creating a significant risk of misleading disclosure and resulting injury to both the disclosing company and investors who rely on the disclosures.