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September 16, 2010

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

Re: Proposed Accounting Standards Update, *Disclosure of Certain Loss Contingencies*, File Reference No. 1840-100

Dear Mr. Golden:

We are partners in the King & Spalding LLP law firm and appreciate the opportunity to comment on the Exposure Draft: *Disclosure of Certain Loss Contingencies.* We commend the Board for its efforts to revise the June 2008 Exposure Draft. But we and a number of our clients are troubled by several proposed disclosure requirements in the current Exposure Draft.

In particular, we urge the Board to reconsider the proposed rules concerning the disclosure of (a) "remote" loss contingencies (Point 1), (b) accruals made for litigation contingencies (Point 2), and (c) certain aspects of the contemplated qualitative disclosure about litigation contingencies (Points 3 and 4). For the reasons stated below, we believe that, if adopted, those requirements would prejudice reporting entities facing remote claims and litigation contingencies without providing a benefit to financial statement users.

The views expressed in this comment letter do not necessarily represent the views of King & Spalding LLP as a firm or of our clients. We do believe, however, that our views accurately reflect those of many attorneys, reporting entities, and their investors, creditors, and insurers.

1. The Proposed Requirements for Disclosure of "Remote" Loss Contingencies Raise Serious Concerns.

FASB proposes to reject the current bright-line standard of ASC 450-20, under which "remote" loss contingencies need not be disclosed. Proposed Paragraph 450-20-50-1D would substitute the inherently vague, imprecise, and specultative standard counseling disclosure of

"remote" loss contingencies as "may be necessary" to inform financial statement users of "a potential severe impact." This largely undefined new standard is unworkable. It threatens protections afforded to clients by the attorney/client privilege and work product doctrine,[1] therefore creating a significant risk of prejudice to reporting entities. It also threatens to upset the now well-recognized guidance in the American Bar Association's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (the "ABA Statement of Policy") and the working relationship between reporting entities' auditors and attorneys.

At present, ASC 450-20 makes a lawyer's role and the client's concomitant disclosure obligation with respect to remote loss contingencies quite clear. If the lawyer and client conclude that a litigation contingency is remote, the ABA Statement of Policy permits the lawyer to communicate that conclusion to the client's auditor with the client's consent. Once the lawyer has reached and communicated that conclusion and the client agrees with it, no further communications between the lawyer and auditor are necessary because disclosure of the remote loss contingency is not required.

If FASB adopts Paragraph 450-20-50-1D, however, a determination that a contingency is "remote" will no longer mark the end the decision-making process. It will instead become the launching point for a far-reaching and vaguely-defined inquiry into whether the remote contingency also exposes the reporting entity to a "potential" "severe" "impact." FASB has not set forth clear guidance concerning when a "remote" contingency exposes a company to a "potential" "severe" "impact." Furthermore, Paragraph 450-20-50-1D only mentions three factors the reporting entity "should consider," including "the *potential* impact on the entity's operations" and the "amount of effort and resources management *may have to* devote to resolve the contingency." (Emphasis added.)

Estimating the "potential impact" of a claim on an entity's business operations is inherently speculative, even after a claim has been asserted in litigation and is not "remote." Determining the "potential impact" of a "remote" claim raises the exercise to the level of guesswork having little probative value. The proposed focus of Paragraph 450-20-50-1D requires the lawyer and client to make guesses about (at a minimum) which officers and managers could possibly be required to participate if the "remote" contingency were to arise (*e.g.*, to be interviewed, testify, review documents, provide trial support), their possible level of involvement, the costs that "may be" incurred, the "possible" outcome of the matter, and the potential effect of all this on the company, as well as to guess about whether that effect could be "severe" or not. Guesswork does not improve the quality of disclosures in financial statement reporting or help the reader understand the financial statements. Yet, the cost and effort of such

[1] The attorney/client privilege reflects a strong, well recognized public policy expressly endorsed by the Supreme Court to protect confidential communications between a lawyer and client pertaining to requests for, and giving, legal advice. The policy underlyng the privilege encourages full disclosure and discussion between clients and attorneys. The work product doctrine protects from disclosure to adverse parties "documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative." The work product doctrine implements a well established public policy, also endorsed by the Supreme Court, to assure the effectiveness of our adversarial system of dispute resolution.

an exercise impose a real and present impact, even if the remote contingency never comes to pass (*e.g.,* the Y2K exercise).

Further, if auditors press for information bearing on an entity's "potential" "severe" "impact" determinations, the Exposure Draft will attack the relationship between attorneys and their counsel and unsettle the relationship between lawyers and auditors, and may reduce the likelihood that clients will seek attorneys' input on issues that, under the current rules, are subjects about which clients can freely and confidently solicit legal input. That development would threaten the carefully constructed and balanced ABA Statement of Policy, which instructs lawyers to limit their communications with auditors precisely because "the mere disclosure by the lawyer to the outside auditor . . . on the substance of communications between the lawyer and client may significantly impair the client's ability in other contexts to maintain the confidentiality of such communications." Nothing in the ABA Statement of Policy advises lawyers to communicate with auditors about the necessity and extent of management participation in a lawsuit or the impact of a remote contingency on a client's business operations. Should the lawyer do so, there is a serious risk that the attorney/client relationship will be disrupted and the privilege and work product protection will be lost.

We seriously question whether the kinds of speculative evaluations called for by the proposed revision can provide any information that actually enhances the quality of financial statement disclosure and understanding. On the other hand, we anticipate that adoption of the proposal will impose real costs and cause real harm to reporting entities and their investors and creditors, outweighing any imagined benefits that Paragraph 450-20-50-1D could provide. We urge the Board to reject proposed Paragraph 450-20-50-1D in favor of the current version of ASC 450-20.

2. Requiring Disclosure of Litigation Accruals Risks Waiver of the Attorney/Client Privilege, Work Product Protection, and Prejudice to Corporate Defendants' Ability to Resolve Claims and Litigation.

At present, ASC 450-20 does not require entities to disclose the amount of accruals for litigation contingencies except in "some circumstances" when "necessary for the financial statements not to be misleading." Even in those limited circumstances, ASC 450-20 does not require disclosure of the amounts of accruals for specific litigation matters. Entities currently describe the nature of the accrual, "such as estimated liability" or "liability of an estimated amount." This disclosure standard gives reporting entities sufficient flexibility to achieve fair presentation by including litigation accruals on their financial statements while maintaining the protections now afforded to internal estimates of potential liability.

Although not yet definitively settled by the courts, the law affords a strong basis for protecting from disclosure under the attorney/client privilege and work product doctrine a reporting entity's liability estimates, including case reserves. *See, e.g., Simon v. G.D. Searle & Co.*, 816 F.2d 397 (8th Cir. 1987); *In re Pfizer Inc. Sec. Litig*., 1993 WL 561125 (S.D.N.Y. Dec. 23, 1993). Several courts have held that even aggregate reserves pertaining to all litigation matters may be protected from disclosure as privileged and/or work product. *See, e.g., Rhone-Poulenc Rorer Inc. v. Home Indem. Co.*, 139 F.R.D. 609 (E.D. Pa. 1991); *State of W. Va. ex. rel.*

Erie Ins. Prop. & Cas. Co., 648 S.E.2d 31 (W. Va. 2007). Lawyers and clients justifiably consider the continued, full and inimpaired vitality of the attorney/client privilege and work product doctrine to be fundamental to their relationship and essential for lawyers to be able to provide, and clients to benefit from, legal advice and services.

Maintaining existing protections for liability estimates is vitally important for at least two important reasons. First, estimates of liability (including litigation accruals) necessarily reflect lawyers' judgments and advice on substantive, procedural, strategic, and tactical legal issues. Disclosure of estimates or accruals not only may result in waiver of the protections applicable to the accrual itself but also open the door to examination into the lawyer-client communications and lawyer analyses that resulted in the disclosure. Second, an entity's estimate of its potential liability – like strategic military information about troop strengths and dispositions – can be used by adversaries to undermine the company's vigorous and effective defense of validly contestable claims in our adversary system. It would be extremely prejudicial for an entity to deliver its liability estimates into the hands of its opponents in hard-fought litigation and efforts to settle asserted and unasserted claims. Disclosure of good faith aggregated estimates is amply sufficient for the fair presentation of financial statements.

The Exposure Draft's requirements would expose reporting entities to significant harm by requiring disclosure of *all* accruals for "reasonably possible" litigation contingencies, whether or not disclosure is necessary for the financial statements not to be misleading. Under proposed Paragraph 450-2-50-1F(e)(2), disclosure would include "the possible loss or range of loss and the amount accrued, if any," for "all contingencies that are at least reasonably possible." "Reasonably possible" is a vague, speculative, and easily second-guessed concept. The required disclosures would be an exercise in what, at best, is informed guesswork.

Proposed Paragraph 450-2-50-1F(a) also would require disclosure of qualitative information sufficient to "describe the nature of the accrual, such as estimated liability." These disclosures would be quite specific. That proposed Paragraph would require "reconciliations by class, in tabular format, of recognized (accrued) loss contingencies to include . . . carrying amounts of the accruals at the beginning and end" of annual and interim reporting periods, along with the "amount accrued during the period for new loss contingencies recognized" and increases or decreases in accruals recognized in prior periods. Of course, no equivalent disclosures are or would be required of the reporting entity's actual and potential adversaries, creating a highly unbalanced field in sensitive, validly disputed, and often highly complicated matters.

These disclosures will tell adversaries and their counsel to a high degree of accuracy how much the company has accrued for specific actual and potential claims and lawsuits. The proposed rule's permission to "aggregate disclosures about similar contingencies (for example, by class or type) so that disclosures are understandable and not too detailed," does not eliminate this harm for several reasons.

First, aggregation "by class or type" may or may not be possible or effective to avoid identification of case-specific reserves, depending on the numbers and types of claims for which

reserves have been accrued.[2] Second, aggregated litigation accruals will change quarterly as litigation matters are resolved and reduce the aggregated accrual while new matters are added and increase the accrual. Specific accruals for new litigation contingencies would be particularly apparent in light of the proposed requirement of qualitative disclosures about new litigation contingencies specifying "the amount claimed by the plaintiff or the amount of damages indicated by the testimony of an expert witness." Review of the disclosures over a span of time will identify all, or virtually all, specific matter accruals. If the qualitative disclosures are supplemented with more extensive disclosure under the proposed Paragraph "as the litigation progresses towards resolution," pinpointing a reporting entity's specific litigation accruals, strategies, and tactics will become a tool for its adversaries to increase the reporting entity's risks and costs in legitimately disputed matters. This certainly is not a benefit to the reporting entity, its investors, or its creditors, and does not provide any more relevant clarification of the reporting entities' financial statements.

Third, the proposed aggregation rule will often require disclosure of information otherwise protected the attorney/client privilege and work product doctrine and will risk waiver of privilege and protection pertaining to the analyses and evaluations supporting the disclosed conclusions. Under current law and practice, privilege and protection are not exposed to waiver and discovery if specific liability estimates or accruals are "impossible to trace back and uncover" from an aggregated disclosure. *Simon*, 816 F.2d at 402. If the Exposure Draft were adopted, however, specific accruals will be easy to trace from an aggregated list as a simple arithmetic calculation because proposed Paragraph 450-2-50-1F(g) would require tabular disclosure of accruals, updated for every interim and annual reporting period.

Fourth, disclosure of litigation accruals also will adversely affect reporting entities' ability to reach satisfactory resolution of contingent exposures with adversaries for less than the amount accrued, even if, after accrual, the entity and its counsel conclude that defenses or damages calculations support a lower outcome. Adversaries who know the estimated amount set aside for a contingency will not be likely to agree to less than that amount, forcing a settleable matter into, or protracting, litigation unnecessarily. Further, if the accrual is disclosed to a court, arbitrator, mediator, or jury, the prejudicial impact on the reporting entity's presentation of its liability and damages defenses will be severe. These risks will convert the process good faith accrual estimation into a tactical battle, with the accrued amount becoming a monetary and evidentiary floor, if not a barrier, to resolution, even in the face of valid counterarguments.

The kinds of evaluations the Exposure Draft contemplates are often merely "educated guesses." The Exposure Draft threatens real prejudice to reporting entities and their investors and creditors without any serious reason to believe it would lead to better financial statements or better understanding of financial statements. FASB should not tilt the field against reporting entities.

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[2] Aggregation of accruals may harm smaller reporting entities even more than larger ones if they have a small number of litigation contingencies to which aggregated accruals may apply. For an entity with only a few contingencies, grouping them together (assuming that the entity were permitted to do so because they are of a similar class or type) will not protect the confidentiality of the specific amount accrued for each.

3. Disclosure of an Entity's Legal Defenses Should Be Limited to Asserted Defenses.

Paragraph 450-20-1F requires disclosure of "*the basis for* the entity's defense or a statement that the entity has not yet formulated its defense." (Emphasis added.) We urge the Board to reconsider this proposal. It would significantly impair the adversary system by requiring public disclosure of a reporting entity's strategies and tactics that have not yet been fully decided or revealed to the adversary or adjudicating tribunal. The adversary, of course, would have no corresponding obligation to disclose to the reporting entity the "basis for" its claims. The requirement also would severely impair the full discussion between attorney and client that the attorney/client privilege was adopted to protect and the effectiveness of our nation's chosen system of adversarial resolution of claims and litigation that the work product doctrine was designed to promote.

Allegations, theories, and defenses change over the life of a claim. Lawyers and clients continually adapt strategy and tactics to fit new facts, legal developments, and practical factors like the availability of evidence and witnesses. The adaptive process and the communications involved in that process are protected by the attorney/client privilege and work product doctrine, and often by additional protections from disclosure. Requiring disclosure of the "basis for the entity's defense" beyond the current practice of identifying the defenses asserted would vitiate those protections, intrude into, and substantially impair the effective development and presentation of legitimate defenses to validly disputed contingent claims.

We believe the better rule is the identification of defenses that have been asserted. This is fair and balanced disclosure and does not undermine the legitimate defense of claims. It could be accomplished, as the Exposure Draft suggests, by disclosing public sources of information about the lawsuit, such as court records. This serves the goal of disclosure to investors and creditors and allow them to reach their own conclusions about contingent outcomes while protecting the reporting entity's lawful and proper defense of adversarial claims.

In addition, we strongly urge the Board to reconsider the proposed requirement to disclose "the amount of damages indicated by the testimony of an expert witness." Expert witness opinions often rely on highly sensitive, hotly disputed, and confidential business information. Expert witnesses are hired without any obligation, or need, on their part to consider the impact of their opinions on trading and financing markets, reporting entities, or investors and creditors. And expert witness testimony is often rejected or revised in federal and state courts and other tribunals as a result of challenges to the proposed expert witness' qualifications, methodologies, or factual bases and assumptions. If an expert's damages opinions are rejected and ruled inadmissible, they have no probative value and provide no useful information to financial statement readers. If expert witness testimony is relevant, it is only after the expert witness' opinions have survived challenge and been ruled admissible by a tribunal acting as the "gatekeeper" of expert testimony explained by the Supreme Court's *Daubert* decision and subsequent rulings. The proposal rule should be changed to require disclosure of expert

opinions, if at all, only after they have been found admissible. Otherwise, expert opinions have no more signifiance than anyone else's opinion.[3]

4. Blanket Disclosure of "Possible" Recoveries from Insurance is Unwarranted and An Encouragement of New Claims and Lawsuits and Inflated Demands.

The Exposure Draft would require reporting entities to disclose "information about *possible* recoveries from insurance and other sources" if that information "has been provided to the plaintiff(s) in a litigation contingency *or is discoverable*" by a plaintiff or regulatory agency. (Emphasis added.) Because applicable insurance policies are "discoverable" in most cases, the "discoverability" clause effectively becomes the whole rule, even though the insurance information that is "discovered" is most often protected by order or rule to protect the providing reporting entity and its insurer. We believe that expanding the obligation of public disclosure of insurance coverage will harm reporting entities with no offsetting benefit to financial statement uses. There are several reasons.

First, information about "possible recoveries" does not provide much if any insight into the amount the insurer actually is likely to pay the adversary or reimburse the reporting entity when the time comes for it to do so. Insurers are not obligated to reveal their assessments and plans or their own reserves, which often bear scant resemblance to the policy limits. Second, expected insurance contributions are presumably already considered in the reporting entity's reserve accrual decisions. Publication of additional insurance information does not improve or assist in understanding the financial statements or the fairness of their presentation. Third, even though insurance policies are routinely disclosed to adversaries in lawsuits, they are normally disclosed under orders prohibiting further disclosure to third parties: the reason is that there is a correlation between policy limits and the amounts adversaries and potential claimants seek regardless of the merits of their claims.

Requiring public disclosure of the terms and limits of insurance coverage, which is what "possible recovery" in the proposed rule really amounts to, would advertise information about the reporting entity that will attract claims and encourage demands at and above the policy limit to increase settlement pressure. There is little, if anything, about this aspect of the proposed rule that can truly be said to improve financial statement disclosure or understanding, and much that would harm reporting entities and their investors, creditors, and insurers

Conclusion

A balance must be struck between the benefits of changes to the current disclosure rules and the harms that those changes will or may cause. We believe it is very hard to identify a real

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[3] We note that the Exposure Draft does not address the fact that the rules and orders of some tribunals, such as many arbitration authorities' rules and most court confidentiality orders, prohibit reporting entities and their adversaries from disclosing claims, defenses, alleged damages, and other information about a case. FASB should deal directly and specifically with the possibility that compliance with the proposed requirements of the Exposure Draft would require violation of rules or orders, or *vice versa*. The Exposure Draft does not do so.

benefit to financial statement users from disclosure of the information the Exposure Draft would require in the areas discussed in this letter. On the other hand, we think it is very easy to identify the real harm to reporting entities and their investors, creditors, and insurers. When the balance is properly struck, justification for these aspects of the proposal is lacking.

We appreciate the opportunity to express our views.

Sincerely,

E. William Bates, II

Sincerely,

Richard A. Cirillo