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

To Whom It May Concern:

Lawyers for Civil Justice is a national organization of corporate counsel and defense attorneys dedicated to improving the civil justice system. LCJ's membership consists of in-house corporate counsel, outside defense counsel, and the leadership of the DRI, Federation of Defense & Corporate Counsel, and the International Association of Defense Counsel. LCJ has long promoted consideration of issues that directly impact the problems confronting corporate and defense counsel and has always sought to achieve solutions that fairly and reasonably address the needs of the defense bar. LCJ is committed to working with other members of the legal community to appropriately address issues of imbalance in the civil litigation system.

Because of its concern for these issues, LCJ has closely followed the Board's consideration of revised standards regarding disclosure of loss contingencies. LCJ submitted a comment letter regarding the Board's June 2008 Exposure Draft. That letter detailed how the 2008 Exposure Draft would disrupt the delicate information balance in our civil justice system. LCJ appreciates the Board's effort to address the issues raised by LCJ and others, and recognizes that some of the more troublesome provisions of the 2008 Exposure Draft have been removed from consideration. But the current Exposure Draft retains provisions that will endanger the information balance and harm shareholders by prejudicing the entity's ability to defend itself in litigation. LCJ therefore urges the Board to make further revisions to the Exposure Draft to ensure that the current information balance is maintained and that the disclosure requirements do not adversely affect an entity's ability to defend itself.

At the outset it is important to understand that litigation contingencies differ from other types of loss contingencies. On one hand, prudence demands that an entity facing a litigation contingency evaluate all potential legal theories and arguments that could be asserted by the other side. On the other hand, the adversarial nature of litigation mandates that internal evaluations of the claim be kept confidential. Disclosure of this internal evaluation would prejudice the entity's litigation position in several ways: (1) it may suggest legal theories and arguments that the opposing party had not considered; (2) the opposing party

Defense Trial Lawvers Dedicated to Excellence and Fairness in the Civil Justice System A coalition of DRI, Federation of Defense & Corporate Counsel, and International Association of Defense Counsel could try to use the internal evaluation as an admission of liability or damages; and (3) the opposing party could use the internal evaluation as leverage in settlement discussions.

As a result, virtually all jurisdictions in the United States recognize that this internal evaluation should be protected from disclosure through the work-product privilege. For example, Federal Rule of Civil Procedure 26(b)(3)(A) protects such work product from discovery in federal cases. One federal court has explained that this protection exists to "establish a zone of privacy for strategic litigation planning and to prevent one party from piggybacking on the adversary's preparation." *U.S. v. Adlman*, 68 F.3d 1495, 1501 (2nd Cir. 1995). This zone of privacy is essential to a litigant's ability to fully investigate a claim and to prepare and present a vigorous defense.

### The proposed disclosures are not operational or auditable.

The proposed disclosures are not operational or auditable because the required disclosures threaten the attorney-client and work-product privileges that are key to our adversarial litigation system. LCJ recognizes that the Board attempted to address disclosures that could impair these privileges, but the current Exposure Draft still presents several threats. The Board suggests that the 2010 Exposure Draft "eliminate[s] many of the speculative or predictive disclosures that were proposed in the" 2008 Exposure Draft. While this is true, the 2010 Exposure Draft retains one of the most potentially prejudicial speculative or predictive disclosures: the estimate of the loss.

The tabular reconciliation specifically requires specific tabular notation of any increases or decreases in accruals "resulting from changes in estimates of the amounts of loss contingencies." Estimates, by definition, are speculative and predictive. Moreover, estimates of amounts of loss contingencies in litigation necessarily involve the counsel and advice of an entity's attorneys. This counsel and advice is precisely the information that is so carefully guarded by the attorney-client privilege. Moreover, estimates would necessarily involve information protected by the work-product privilege because it would involve substantive evaluations of the case performed by an entity's employees and by its outside counsel.

Entities should not be required to disclose these internal evaluations in their financial statements. Such disclosure would have a disastrous impact on the information balance in litigation. It would provide opposing counsel with two kinds of information. First, it would provide them with the entity's evaluation of the strength of the claim. Second, as the evaluation changes over the course of the litigation, the tabular reconciliation would provide a "road map" to the entity's approach to the litigation.

Moreover, the fact of disclosure could be used by opposing counsel to argue that the attorney-client privilege had been waived, which would allow the opposing party to seek discovery on other information that would otherwise be protected by the privileges. Finally, disclosure of the entity's loss estimate will significantly alter the dynamics of settlement discussions. It will give the opposing party a significant informational advantage because the entity will have no way to learn the opposing party's evaluation of the case. Ultimately, this information imbalance will lead to increased settlement costs.

In sum, there is no question that a tabular reconciliation will be prejudicial to the entity and will ultimately harm shareholders by harming the entity's ability to defend itself and by increasing settlement costs.

Moreover, these disclosures are not auditable without threatening the attorney-client and work-product privileges. Auditors will certainly want to know the basis of the entity's estimates and the cause of any subsequent changes to those estimates. But disclosing that information will necessarily involve disclosure of attorney-client communications and internal work product.

Although the Board has indicated that it will work with the PCAOB, the AICPA, and the ABA to address how these disclosure requirements will impact auditing practices, it is not clear that the issues can be resolved. On the one hand, the information supporting the estimates must be carefully guarded to avoid waiver arguments. On the other hand, auditors may be unwilling to agree to the estimates without knowing the underlying basis. At a minimum, the Board should postpone adoption of any new standard until these issues are satisfactorily resolved.

## An exemption from disclosing "prejudicial" information is still necessary.

The Board suggests that an exemption for prejudicial information is no longer necessary because of the changes made in the 2010 Exposure Draft. But this belief rests on unfounded assumptions. For example, the Board states that the disclosures "[g]enerally focus on information that is publicly available." But this assumption does not withstand scrutiny. Several of the categories of information that would be subject to disclosure may not, in fact, be publicly available. First, the Exposure Draft seems to assume that expert opinions are publicly available. But frequently, expert opinions are subject to protective orders that prohibit disclosure beyond those involved in the litigation. Such orders are designed to protect entities' trade secrets or other confidential information. In fact, in some cases, certain categories of information are restricted to the entity's counsel and may not even be disclosed to the entity. At a minimum, the Exposure Draft should be revised to account for expert opinions that are covered by protective orders.

Second, the draft requires disclosure of insurance coverage information, even if that information has not been provided to the plaintiff in discovery. This is problematic for at least three reasons. First, this requirement would put entities in the position of determining whether the information is discoverable. Ordinarily, discoverability is a question for the court, not the parties. And in the event of a dispute between the parties about discoverability, the determination should be made by the court, not by the parties. Second, the mere fact that the information might be discoverable does not mean that it will be made public. If a plaintiff does not request such information in discovery, then the entity will have no obligation to provide it. Third, even if such information is disclosed to the plaintiff, it may be covered by a protective order and therefore not subject to public disclosure.

In short, the Board's assumption that the disclosures include only public information is unfounded. An exception must be provided for information that is subject to a protective order or otherwise not publicly available.

The Board also incorrectly assumes that the ability to present information on an aggregated basis precludes the necessity for an exemption for prejudicial information. The ability to aggregate the disclosures by the nature of the contingency does not adequately protect against disclosure of prejudicial information. First, because litigation matters are largely fact specific, it is unclear how the qualitative disclosures would be aggregated. Even if a large number of cases share a similar fact basis, there will necessarily be case-specific information that cannot be aggregated. Second, many entities' litigation exposure is made up of one large claim or group of claims (such as mass tort litigation). In those instances, aggregation will not prevent the information from being used by the entity's litigation adversaries.

Because the Board's underlying assumptions do not hold, the conclusion that no exemption is needed for prejudicial information must also fail. If the Board is going to require such extensive disclosures, then entities must be given the ability to protect information that could adversely impact their ability to defend the litigation.

#### The proposed effective date is not operational.

Because of the many issues that remain in the 2010 Exposure Draft, the proposed effective date is not realistic. LCJ suggests that, if the Board is determined to make changes to the current disclosure requirements, additional discussions with preparers and attorneys are necessary to ensure proper protection of the attorney-client and work-product privileges. And no changes should take effect until after these additional discussions have taken place.

Moreover, even if the Board intends to adopt the 2010 Exposure Draft without any further revision (which LCJ does not recommend), the proposed effective date is still not operational. The 2010 Exposure Draft states that "[t]he FASB staff will continue to work with the Public Company Accounting Oversight Board, the American Institute for Certified Public Accountants, and the American Bar Association (ABA) to identify and address any potential implications of the proposed requirements for the U.S. auditing literature and the ABA's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information." Because the proposed disclosure requirements will materially change the information that auditors will need from attorneys, the proposed changes should not be implemented until "any potential implications" have been identified and resolved. And the resolution of such issues should be open for public comment before adoption. Because it is impossible that this process can be completed before December 2010, the effective date should be delayed.

# The proposed disclosures will not enhance or improve the information provided to financial statement users.

LCJ appreciates the Board's recognition that the proposed disclosures in the 2008 Exposure Draft "would require judgments that are more predictive or speculative in nature rather than factual." Because these disclosures would not be helpful to users, the Board properly decided not to require those disclosures in the 2010 Exposure Draft. But the some of qualitative disclosures required by the 2010 Exposure Draft are still more speculative than factual, and they will not improve the information provided to financial statement users.

For example, the 2010 Exposure Draft would require inclusion of plaintiffs' claimed damages. But claimed damages amounts are frequently inflated and speculative and bear little relation to the actual potential loss at issue. Inflated damages allegations are often intended to garner media attention or to bully a defendant into a quick settlement. Indeed, if this disclosure requirement becomes effective, plaintiffs' counsel may further inflate damage allegations in the hope of using the disclosure requirement as additional pressure to settle. Moreover, some jurisdictions simply require plaintiffs to plead a maximum amount of damages. In these jurisdictions, plaintiffs often make inflated allegations before conducting any discovery or having sufficient information to make an educated estimate.

Although entities and their attorneys fully understand the shortcomings of damages allegations, an untrained financial statement user may not. For such a user, inclusion of plaintiffs' damages allegations would not enhance or improve the disclosures. In fact, inclusion of damages allegations would likely mislead such users. The mere act of including the allegations in the financial statements will unduly elevate the perceived accuracy and importance of the information. Users may be led to believe that they have been given facts, when in reality they have nothing more than speculation and puffery.

Additionally, the 2010 Exposure Draft would require disclosure of damages opinions given by expert witnesses. This is problematic for at least four reasons:

• First, as discussed above, expert opinions are not always public information.

- Second, because of the timing of expert disclosures and depositions, it is likely that the plaintiff's
  expert opinions on damages will be available before the defendant's expert opinions are
  finalized. This may result in disclosure of only one side's expert opinions. And such one-sided
  disclosure would be more misleading than enlightening.
- Third, expert opinions are best understood in the proper context. Experts are frequently asked to
  make assumptions and to use certain methodologies. Explaining these underlying assumptions
  and methodologies would impose significant costs on entities, but simply providing damages
  estimates without background assumptions and methodologies could be misleading.
- Fourth, expert opinions are frequently subject to challenge based on the expert's credentials or methodologies. Requiring disclosure of expert opinions without accounting for the fact that the expert may not even be allowed to testify could be misleading.

In sum, the disclosures required by the Exposure Draft are not likely to provide any additional meaningful information to financial statement users. In fact, the disclosures may lead to a false sense of security. Although users may believe that they have a more complete disclosure, in reality, they will have incomplete information and speculation. Thus, instead of aiding users, this information will more likely hamper their efforts to understand the potential impact of the litigation contingency.

#### Conclusion

Although the 2010 Exposure Draft is an improvement over the 2008 Exposure Draft, significant issues remain. LCJ recommends that the Board simply retain the current disclosure requirements as to loss contingencies arising from litigation. These requirements properly balance the need for disclosure of accurate information about potential loss contingencies, the uncertainty of litigation, and the need to protect internal evaluations of those uncertainties from disclosure to litigation adversaries. Alternatively, LCJ recommends that the effective date of any new requirements be delayed until after FASB staff has finished its work with the PCAOB, the AICPA, and the ABA to address the issues raised here and in other comment letters.

Sincerely,

Wohn H Martin

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