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LETTER OF COMMENT NO. 131

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Submitted to: director@fasb.org

Re: Exposure Draft – Proposed Statement of Financial Accounting Standards – Disclosure of Certain Loss Contingencies – an Amendment of FASB Statements No. 5 and 141(R)
File Reference No. 1600-100

The Edison Electric Institute (EEI) is submitting these comments in response to the above-referenced Exposure Draft (ED). In the ED, FASB has proposed amendments to its Statements No. 5 and 141 (R) addressing the disclosure of certain loss contingencies, including matters in litigation.

EEI is the association of U.S. shareholder-owned electric companies throughout the United States. EEI represents approximately 70 percent of the U.S. electric power industry, including companies that generate and transmit electricity and operate in electricity markets throughout the country. As publicly held companies typically subject to extensive federal and state regulation, our members keep accounting records and prepare financial statements and reports that conform to FASB standards as well as the requirements of various federal and state regulatory agencies. Therefore, EEI and our members have a direct interest in the ED and will be directly affected by it.

In the ED, FASB proposes to require companies to disclose all contingencies, other than certain asset, guarantee, insurance, or other types of contingencies exempted by the amendment. FASB would require disclosure of certain dollar amounts that may be involved (either the amounts sought in claims or, absent that, maximum exposures) as well as anticipated time to resolution, issues

involved, and other such details. All such information is of important strategic value in fair resolution of these contingencies with third parties.

EEI is deeply concerned about this proposal, which we believe increases the likelihood of additional loss exposures and requires disclosures that are onerous to the reporting entity without providing incremental value for the level of effort required to be exerted by the reporting entity. We strongly urge FASB to withdraw the proposal. If FASB is unwilling to withdraw it, we encourage FASB at least to consider some more workable alternatives.

The following comments address our aforementioned position. In addition, we have provided comments to the questions set forth by the FASB at pages ii-iv of the ED.

EEI's Position on the Exposure Draft

The EEI believes the proposed amendment to Statements 5 and 141(R) as presented is unnecessary and the effort required to prepare such voluminous disclosures will not provide additional benefit to investors. In fact, we believe it will harm companies and their investors. The proposed amendment would require companies to provide information in their financial statements that is subjective and, as such, unhelpful to investors (e.g., providing highly uncertain estimates in lieu of disclosures of why estimates of possible contingencies cannot be made). Moreover, the proposed amendment would require disclosure of information that, in particular with respect to legal proceedings, would compromise a company's positions in ongoing litigation, dispute resolution, and settlement negotiations. The amendment also would interfere with the proper exercise of attorney-client privilege and safeguarding of confidential information whose release can be quite detrimental to a company.

Under paragraph 7 of the ED, companies would be required to disclose information that is extremely sensitive. Absent a "claimed" amount (which is relatively uncommon), companies would be required to disclose their estimates of the maximum potential amount of a loss, as well as factors likely to affect the outcome of the loss contingency and the likely timing of resolution. This information goes directly to issues such as the size and strength of a third party's claim against a company – including evaluations of applicable statutes, regulations, and case law – that are very sensitive and generally kept confidential under the umbrella of the attorney-client privilege.

Furthermore, disclosure of such information could compromise the company's ability to seek a reasonable resolution of a dispute with a third party, essentially

arming the third party with details of company views of the strength of the party's claim. As a result, the disclosures will inevitably lead that party to seek the maximum amount stated as possible. This would do a disservice to the company in attempting properly to manage its own affairs in a business-like and responsible manner, as steward of its resources and as a fiduciary with responsibility to its shareholders. This also would do a disservice to investors, because the maximum potential exposure involved in a claim is often speculative and would require presentation of a worst-case scenario that without the disclosure would be relatively unlikely to occur.

Although the ED "nominally" allows some potential relief from its detrimental disclosure requirements, such "relief" in fact is minimal. Aggregation to a higher level than the "nature of the claim," and withholding information, would be allowed only in rare cases. Even then, the fundamentally harmful information discussed in the preceding paragraph would still have to be disclosed. This in fact provides no genuine relief.

To elaborate:

1. While meaningful disclosure with regard to loss contingencies is appropriate so investors can make informed investment decisions, that disclosure should not be prejudicial to the company. In short, disclosure should not aid those who could make, or who are making, claims against the company.

2. Certain information required by the proposed standard would be prejudical to the company's efforts to defend a claim (threatened or pending). Most plaintiffs do not specify damage amounts in sums certain. Instead, they request damages provable at trial and other relief the court may deem just, appropriate or equitable.

   For example, if the ED is adopted as proposed, the company would be required to disclose its "best estimate of the maximum exposure to loss". (See Paragraph 7(a) (2).) This estimate could exceed the claimant's *expectations (thereby raising the claimant's expectations with regard to* what the defendant would "consider" paying) or negate the company's negotiating position that the claimant has not suffered any or very little monetary damages. Obviously, this would not be in the company's or shareholder's interest.

3. Moreover, the company would be required to disclose, among other things, the legal basis for the claim, the anticipated timing of its resolution, a description of the factors that are likely to affect the ultimate outcome of the claim, the most likely outcome of the contingency and the significant assumptions made by the company in estimating the maximum amount of exposure. (See Paragraph 7(b).)

   Each of those factors would be useful and significant to plaintiffs.

   Often the company's position is that there is no basis for the claim; that is, under the facts as pled, there is no genuine cause of action for the plaintiff. Will a company be able to refer in its disclosure to damages sought by the plaintiff, or recite the plantiff's claim verbatim, without compromising its argument that the claim is without merit? Or will the company's disclosure, subject to a securities lawsuit, constitute an admission that there is in fact a legal basis for the plaintiff's claim?

   Disclosing the anticipated timing for resolution is also problematic. For example, if the company says it expects to resolve the matter in the short term or within the next six months, the information could be used by the plaintiff to the disadvantage of the company. The plaintiff could stall or refuse to settle to gain negotiating leverage.

   Describing the factors likely to affect the outcome of the claim could also help the plaintiff by pointing out the company's weaknesses in the matter. This would be very useful to a plaintiff. Similarly, describing the most likely outcome is problematic. Is the company going to say it expects to be unsuccessful? If so, that would be advantageous information for the plaintiff.

   Finally, discussing the "significant assumptions" also could be a roadmap for the plaintiff to the weaknesses in the company's case.

4. The exemption in Paragraph 11 attempts to address these concerns by allowing a company to aggregate disclosures at a higher level. However, it is not clear whether the last sentence of this paragraph is intended to qualify the ability of the company to aggregate disclosures generally or whether it is intended only to qualify the immediately preceding sentence dealing with a one lawsuit situation. Even if it were the latter, in that situation, the company would be forced to disclose the prejudicial information described above to its detriment.

5. *If the company were required to make these disclosures, the disclosures* should constitute forward-looking statements subject to safe harbor treatment.

6. In a similar vein, the forward-looking statements required by the proposed standard should not be deemed to be admissions against interest.

The disclosures that would be required by the proposed amendment raise serious concerns. *The disclosures would be subjective and potentially* misleading. Rather than informing and educating investors regarding management's judgments about these complex and subjective matters, the proposed disclosures would require investors to make probability judgments about the outcomes of loss contingency events before the events are actually resolved. We believe these matters of significant judgment should be made by an entity's legal counsel and management, which are then subject to further evaluation by a company's external auditor. Many investors may not be able to take into consideration all underlying factors essential to forming a plausible conclusion (e.g., management strategy and history of dispute resolution).

Furthermore, the proposed additional disclosures are unnecessary. Statements 5 and 141(R) already require disclosure of loss contingencies in general, but allow appropriate nondisclosure of subjective and harmful information. In addition, the Securities and Exchange Commission (SEC) requires disclosure of similar relevant information without requiring disclosure of the subjective and sensitive information the ED would require. The SEC Regulation S-K section 103, Legal Proceedings, already calls for a description of "...any material pending legal proceedings...[including] the name of the court or agency in which the proceedings are pending, ... a description of the factual basis alleged to underlie the proceeding and the relief sought."

EEI understands that the American Bar Association and its attorney-client privilege task force, the Association of Corporate Counsel, and others are equally concerned about the proposed amendment to FASB Statements 5 and 141(R) and may submit comments. We suggest that FASB include them as well as EEI in the upcoming roundtables to discuss the ED.

Recommended Solution

For all of these reasons, EEI urges FASB to withdraw the proposed amendment to Statements No. 5 and 141(R). We believe that the existing statements and SEC reporting requirements are sufficient to apprise investors of objective, likely

contingencies, without requiring disclosure of unhelpful, subjective, and sensitive information.

At a minimum, if FASB decides to proceed with the amendment, EEI encourages FASB to consider other alternatives such as:

- Focus on disclosure only of public information (court documents, etc) to avoid release of confidential information and prejudice.
- Focus on disclosure only of non-sensitive information, such as scheduled next steps in a case, or general discussion of the nature of the claim.
- Do not require disclosure or discussion of cases deemed remote, regardless of potential impact.
- Do not require disclosure unless a case is likely to have a material impact on the company's financial statement.
- Look for more focused ways to address the shortcomings in current reporting, as discussed in paragraph A3 of the ED.

Responses to FASB Questions

1. Question: Will the proposed Statement meet the project's objective of providing enhanced disclosures about loss contingencies so that the benefits of those disclosures justify the incremental costs? Why or why not? What costs do you expect to incur if the Board were to issue this proposed Statement in its current form as a final Statement? How could the Board further reduce the costs of applying these requirements without significantly reducing the benefits?

   Answer: The proposed amendment to Statements 5 and 141 (R) would not provide reliable enhanced disclosure about loss contingencies, but would impose substantial negative impacts that would far exceed any potential benefits. As discussed previously, the proposed amendment would require companies to provide extremely sensitive, attorney-client privileged, confidential, and subjective information about loss contingencies that primarily would benefit the third parties who file claims against companies. The information could harm investors by providing worst case scenarios that could become self-fulfilling prophecies, thereby increasing claims payments to the detriment of companies, their shareholders, and their customers. The Board's objective may be better met by including more guidelines around what is estimatable rather than a wholesale listing of all loss contingencies.

2. Question: Do you agree with the Board's decision to include within the scope of this proposed Statement obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations, which are currently subject to the provisions of Statement 5? Why or why not?

   Answer: These disclosures, if considered material, could be added to FAS 158 or FAS 132 (R) disclosures.

3. Question: Should an entity be required to provide disclosures about loss contingencies, regardless of the likelihood of loss, if the resolution of the contingencies is expected to occur within one year of the date of the financial statements and the loss contingencies could have a severe impact upon the operations of the entity? Why or why not?

   Answer: No, if a loss is remote, providing a worst case scenario would not be useful to investors and other users of financial statements, and could actually result in harm by causing unwarranted concern over an event that is unlikely to happen. If a severe loss is remote or relatively unlikely to occur, the company involved should be able to exercise judgment in not disclosing it, exactly as it does now under the existing rules. Otherwise, the simple fact of disclosure may cause harm to the company and its investors when the loss is unlikely to occur and in fact may well not occur. In addition, within one year of expected resolution, settlement negotiations in legal proceedings are likely to be especially sensitive, and the information that the Exposure Draft proposes to require be disclosed would be especially detrimental.

4. Question: Paragraph 10 of Statement 5 requires entities to "give an estimate of the possible loss or range of loss or state that such an estimate cannot be made." One of financial statement users' most significant concerns about disclosures under Statement 5's requirements is that the disclosures rarely include quantitative information. Rather, entities often state that the possible loss cannot be estimated. The Board decided to require entities to disclose the amount of the claim or assessment against the entity, or, if there is no claim or assessment amount, the entity's best estimate of the maximum possible exposure to loss. Additionally, entities would be permitted, but not required, to disclose the possible loss or range of loss if they believe the amount of the claim or assessment is not representative of the entity's actual exposure.
   a. Do you believe that this change would result in an improvement in the reporting of quantitative information about loss contingencies? Why or why not?

b. Do you believe that disclosing the possible loss or range of loss should be required, rather than optional, if an entity believes the amount of the claim or assessment or its best estimate of the maximum possible exposure to loss is not representative of the entity's actual exposure? Why or why not?
c. If you disagree with the proposed requirements, what quantitative disclosures do you believe would best fulfill users' needs for quantitative information and at the same time not reveal significant information that may be prejudicial to an entity's position in a dispute?

Answer: Same as answer to question 1. In addition, requiring disclosure of the maximum exposure to loss would give a skewed view of the value of the loss. Yet to refine the disclosure, as allowed by the proposed amendment, to expected loss would disclose the company's internal evaluations and bargaining position in ongoing litigation and other disputes with third parties. The better course is to retain the current Statement 5 and 141(R) disclosure provisions, which give companies appropriate discretion not to disclose skewed or sensitive information. Statement 5 currently requires accrual of probable losses and disclosure of amounts of reasonably possible losses that can be estimated. Providing a range of loss or maximum loss for a loss which cannot be estimated does not provide investors with meaningful information.

5. Question: If a loss contingency does not have a specific claim amount, will an entity be able to provide a reliable estimate of the maximum exposure to loss (as required by paragraph 7(a)) that is meaningful to users? Why or why not?

   Answer: It is unlikely that a company could provide a meaningful estimate of maximum exposure due to the unpredictable nature of the U.S. litigation system. Estimates of maximum exposure just present worst-case scenarios that are more inflammatory than helpful to investors. We believe it would be more helpful and appropriate to stay with the current requirement of disclosing the most likely outcome.

6. Question: Financial statement users suggested that the Board require disclosure of settlement offers made between counterparties in a dispute. The Board decided not to require that disclosure because often those offers expire quickly and may not reflect the status of negotiations only a short time later. Should disclosure of the amount of settlement offers made by either party be required? Why or why not?

Answer: The disclosure of settlement offers made between counterparties in a dispute should not be required. Such offers are treated as confidential by federal and state courts under virtually all circumstances and are not subject to use against the parties in litigation or other forms of dispute resolution, for good reason. Not disclosing the offers encourages the parties to work toward reasonable resolution of a dispute, confident that they will not be bound by the results unless and until both parties agree.

7. Question: Will the tabular reconciliation of recognized loss contingencies, provided on an aggregated basis, provide useful information about loss contingencies for assessing future cash flows and understanding changes in the amounts recognized in the financial statements? Why or why not?

   Answer: The tabular recognition of loss contingencies could be a reasonable way to present information, if the information is left within the discretion of the company preparing the financial statement under current Statements No. 5 and 141(R). But the tabular recognition should not require disclosure of sensitive information.

8. Question: This proposed Statement includes a limited exemption from disclosing prejudicial information. Do you agree that such an exemption should be provided? Why or why not?

   Answer: If FASB adopts an amendment requiring greater disclosure of loss contingencies, that amendment must include a broad exemption allowing companies not to disclose prejudicial information. At a minimum, information protected by attorney-client or other legal privilege must be exempted so the information can be kept confidential, to avoid harm to a company, its investors, and its customers, and to avoid upsetting the attorney-client relationship. In addition to the items that would already be exempt from disclosure under the amendment, the legal basis and quantitative amounts should be exempted from disclosure when the information is deemed to be prejudicial.

9. Question: If you agree with providing a prejudicial exemption, do you agree with the two-step approach in paragraph 11? Why or why not? If not, what approach would you recommend and why?

   Answer: The approach suggested in paragraph 11 is not sufficiently protective. It would limit aggregation beyond the nature of the claim, or withholding of information, to rare circumstances. Aggregation would only work for a company with a large number of claims. A company with only one

large claim and a few small claims would not be able to successfully disguise the sensitive information through aggregation. In addition, the types of information the ED would require to be disclosed are commonly sensitive, confidential, and protected by attorney-client and other privileges. So to allow the information not to be disclosed in discrete form only in "rare" cases does not reflect reality. In addition, even in such "rare" cases, paragraph 11 would require the disclosure of the most sensitive information, such as amount of exposure, nature of claim, factors likely to affect the outcome, and anticipated timing of resolution. At a minimum, FASB should delete the reference to "rare" and the minimum disclosure requirements, and in their place allow companies to continue to exercise appropriate discretion to protect their legal interests.

10. Question: The International Accounting Standards Board (IASB) continues to deliberate changes to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* but has not yet reconsidered the disclosure requirements. The existing disclosure requirements of IAS 37 include a prejudicial exemption with language indicating that the circumstances under which that exemption may be exercised are expected to be *extremely rare.* This proposed Statement includes language indicating that the circumstances under which the prejudicial exemption may be exercised are expected to be *rare* (instead of *extremely rare*). Do you agree with the Board's decision and, if so, why? If not, what do you recommend as an alternative and why?

    Answer: Same as answer to question 9. A provision allowing exemptions only in "extremely rare" circumstances would be even more inappropriate than the proposed "rare" circumstance provision. Because the U.S. does not operate in the same legal environment as other countries, legal information here is more sensitive to defendants and plaintiffs. We recommend disclosing only minimal information if a claim is deemed to be prejudicial.

    Also, with the expected move toward adoption of international accounting and reporting standards by companies in the United States, although we believe the proposed amendment is unnecessary, the release of this ED is at least premature and the concerns about loss contingency disclosures might be better addressed in a convergence project with the IASB.

11. Question: Do you agree with the description of *prejudicial information* as information whose "disclosure . . . could affect, to the entity's detriment, the outcome of the contingency itself"? If not, how would you describe or define *prejudicial information* and why?

Answer: Prejudicial information certainly includes information whose disclosure could affect, to the entity's detriment, the outcome of the contingency itself – especially if properly interpreted to include information harmful to the dispute resolution process, misleading to investors, or indirectly harmful to company investors or customers. But that may not be the limit of information that can be harmful and inappropriate to release. For example, information that could harm property owners, employees, or others also can be prejudicial to release, and should be covered by any exemption.

12. Question: Do you believe it is operational for entities to disclose all of the proposed requirements for interim and annual reporting periods? Should the tabular reconciliation be required only annually? Why or why not?

    Answer: If required, any new loss contingency disclosures and any tabular reconciliations should be required only annually, not more frequently. This would help to reduce the burden of preparing this additional information, which is most likely to be useful when kept in the context of an annual statement. Furthermore, FASB should not require information that arises after the close of the statement period but prior to issuance of the statements to be added to the statements, through pro forma statements or otherwise. This information should continue to be evaluated under the existing subsequent event criteria. We do not believe there is any need to single out this type of information outside the normal compilation process for the financial statements beyond existing, and entirely workable, subsequent events disclosure and recognition requirements.

13. Question: Do you believe other information about loss contingencies should be disclosed that would not be required by this proposed Statement? If so, what other information would you require?

    Answer: No other information should be required. Instead, EEI urges FASB to withdraw the proposed amendment and to rely instead on existing loss contingency reporting requirements in Statements 5 and 141(R), the SEC Regulation S-K, et al.

14. Question: Do you believe it is operational for entities to implement the proposed Statement in fiscal years ending after December 15, 2008? Why or why not?

    Answer: Given the sensitivity of the issues raised by the ED, and concern among the regulated business community that the proposed amendment would create significant problems, we urge FASB to withdraw the draft. At a

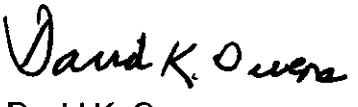
minimum, if the proposed amendment is not withdrawn, FASB needs to engage in substantial further dialogue about the content and scope of the proposed amendment with affected companies, including EEI and our members. We strongly disagree with the proposal to have the amendment take effect for financial statements for fiscal years ending after December 15, 2008. A minimum of an additional year is needed for FASB to engage in further discussions and come up with a reasonable alternative, and for companies to adapt to any such alternative, including reviews of the internal recordkeeping to ensure continued accuracy, as required by the Sarbanes-Oxley Act of 2002 and other applicable legal requirements. A considerable amount of time by the legal and accounting departments also will be needed to ensure all contingencies are properly evaluated and disclosed. In addition, companies face substantial new burden created by disclosures that will be required with respect to nonfinancial assets and liabilities under Statement 157 and derivatives and hedging under Statement 161. Together, these new requirements involve too many changes occurring at the same time.

Conclusion

In sum, EEI strongly urges FASB not to adopt the proposed amendment to its Statements No. 5 and 141(R) set out in the ED. Instead, we urge FASB to withdraw the proposed amendment, leaving the two existing statements unchanged.

If FASB needs additional information or has any questions about these comments, please contact me, EEI Director of Regulatory Legal Issues Henri Bartholomot at 202-508-5622 or hbartholomot@eei.org, or EEI Director of Accounting David Stringfellow at 202-508-5494 or dstringfellow@eei.org.

Respectfully submitted,



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