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Technical Director
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Financial Accounting Standards Board
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1600-100

LETTER OF COMMENT NO. 138

Subject: **Comment Letter Regarding Disclosure of Certain Loss Contingencies**

Dear Director:

American Electric Power Company, Inc. (AEP) appreciates the opportunity to respond to the Financial Accounting Standards Board's (FASB or the Board) Exposure Draft (ED) on *Disclosure of Certain Loss Contingencies*, dated June 5, 2008. AEP, a Columbus, Ohio based energy company, is one of the largest investor-owned utilities operating in the United States, with revenues of over $13 billion and more than 20,000 employees. We provide energy to approximately 5 million customers in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia and West Virginia.

We support the Board's attention to the adequacy of disclosure requirements. However, we believe the additional disclosures proposed in the ED will not meaningfully assist financial statement users in assessing the timing and amount of future cash flows associated with loss contingencies. Several issues in particular concern us, as discussed below.

- Lawsuits frequently do not specify a claim amount when filed. In those cases, maximum exposure generally cannot be reliably determined. Any estimate of such exposure is purely speculative due to the typically complex nature of these types of dispute resolution. Additionally, plaintiffs in class action and other lawsuits with multiple defendants typically do not apportion liability. In such circumstances, requiring entities to estimate a maximum claim amount for all claims risks suggesting to financial statement users a certainty that cannot be supported by what will be a highly subjective "guesstimate" of exposure. Such speculation does not allow users to realistically assess the likelihood, timing or amount of future cash flows. The existing SFAS 5 disclosure requirements promote as clear a picture of exposure as is possible in these cases.

- New qualitative disclosures will be prejudicial, may negatively influence the results of cases (resulting in more cost) and adversely affect the rights of other parties to those cases and their insurance companies. These problems will be magnified in class action lawsuits. The Board should avoid requiring disclosures that will suggest a negotiating floor to claimants and risk materially affecting the outcome of the contingency by providing a window into the reporting company's confidential claims analysis that will give claimants an unacceptable advantage in settlement negotiations, trial preparations and at trial.

- As drafted, it is not practicable to implement the proposed new disclosure requirements by year- end. The new processes, coupled with the related financial reporting controls that will be required to ensure the completeness and accuracy of information in the new disclosure, will take significantly more time to develop and implement than the period of time from final issuance to year-end.

- We do not believe the ED will resolve the Board's concerns as expressed in paragraph A3 of the ED. Specifically,

    - *The concern that initial disclosure often does not occur until after a material accrual is recognized* – The current SFAS 5 requires disclosure of contingencies when there is at least a reasonable possibility of loss and SEC Regulation S-K, Item 103, Legal Proceedings requires disclosure of material pending legal proceedings. We believe these existing rules that are subject both to SEC review and to independent auditor review, provide for adequate disclosure of material contingencies before the time of accrual.
    - *The concern that the "at least reasonably possible" threshold is not sufficient* – As discussed in the attachment to this letter, we do not agree that providing additional disclosure of contingencies that are less than "reasonably possible" is useful to financial statement users.
    - *The concern that the option to state "an estimate of loss or range of loss cannot be made" is exercised too frequently* – It is not that companies choose not to disclose an estimate or range of loss. Rather, due to the inherently uncertain and unpredictable nature of contingencies, it is simply not possible to estimate the loss or range of loss in many cases. Principle-based standards must allow for the exercise of management judgment.
    - *The concern that recognized amounts are not transparent* – We believe this concern could be resolved by requiring information similar to that in the reconciliation table proposed in the ED.

- The proposed new qualitative disclosures go beyond what is required by IAS 37, and, therefore, do not promote international convergence.

We have attached responses to the specific questions raised in the ED. We also agree with the concerns expressed in the Edison Electric Institute comment letter.

Sincerely,

Joseph M. Buonaiuto

Attachment

Attachment

1. **Q. 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?**

   A. We do not believe the anticipated benefits of the proposed statement will materialize. Implementing the disclosure requirements as proposed will be at least as likely to be detrimental to financial statement users by suggesting to them (at least implicitly) that some degree of certainty exists in projecting disclosure amounts. Any imagined benefits do not justify the expected increase in cost due to disclosure of information prejudicial to the disclosing entity's financial interests. In addition, the proposals, if adopted, will require new time-consuming financial reporting processes and controls to ensure the completeness and accuracy of information in the new disclosure while adding little, if any, real value to users.

2. **Q. 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?**

   A. We agree that such obligations should be included in the proposed Statement and we suggest that the Board consider this issue in the context of pension plan disclosures.

3. **Q. 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?**

   A. We do not believe disclosure of remote loss contingencies is beneficial to users and suggest the Board converge with IAS 37 on this issue. Disclosures for remote contingencies are not a requirement under IAS 37.

4. **Q. 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?**

      A. No, we do not believe that the proposed change will result in an improvement in the reporting of quantitative information about loss contingencies. If there were no claim or assessment amount, estimating the maximum possible exposure to loss would be speculative and prejudicial to the reporting entity. For example, attempting to estimate the maximum exposure in a lawsuit that includes a claim for punitive damages sufficient to "punish" the defendant can be nothing more than a highly subjective "guesstimate" that would be purely speculative, even on the eve of trial. Similarly, determining the scope of claimed environmental damages requires protracted scientific and legal analysis and cannot be estimated coincident with the filing of a notice of a claim and until such analyses are completed and vetted. These are two of many similar examples of how the determination of a maximum amount of exposure would be inherently flawed and very likely misleading. The Board should recognize and consider the many variables in litigation to realize why any guesstimation process is so speculative and potentially misleading. These variables range from the discrepancies in the claimed and actual facts of a case, to the relative skills and abilities of counsel, to the quality and availability of witnesses, to the venue where the claim is filed, to the quality of empanelled if the case goes to trial, to the quality of the trial courts, to the competency of the appellate courts, to the size of dockets in the jurisdiction, to the existence and amounts of insurance coverage to name but a few.

With regard to the prejudicial nature of such a disclosure, we believe that estimating a maximum amount of exposure risks creating a self-fulfilling prophecy if plaintiffs' lawyers succeed in having that information admitted at trial either as an admission of liability or as the reporting company/defendant's own calculation of damages. Even if not ruled an admission of liability, the reporting company will have no chance for a fair and impartial trial on damage amounts. Even if the reporting is not admissible in court it will be seized upon by claimants as a starting point for negotiating damage settlements. IAS 37 does not require the disclosure of an estimated maximum claim amount and neither should the Board.

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?**

A. No, we believe disclosure of the possible loss or range of loss should be optional, again due to the risk of material prejudice to a reporting company through a claimant's ability to use such information at trial or in settlement negotiations. Additionally, required disclosure of the possible loss or range of loss could potentially jeopardize an entity's position with its insurer for coverage of the claim and result in limiting insurance recovery.

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?**

A. We believe disclosing the amount of any known claim or assessment for material contingencies would not be prejudicial as this information is generally publicly available.

5. **Q. 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?**

A. No, if there is not a claim amount, an entity will generally not be able to determine a reasonable estimate of maximum exposure for the reasons stated above in response to question 4a. Forcing a reporting entity to estimate the maximum exposure to loss before a matter is sufficiently developed through the judicial process or through an alternative dispute resolution process risks misleading financial statement users because an estimate without the benefit of sufficient vetting is no better than a guess. Moreover, such an estimate is likely to suggest a negotiating floor to claimants and materially affect the outcome of the contingency by providing a window into the reporting company's confidential claims analysis that will give claimants an unacceptable advantage in settlement negotiations, trial preparations and at trial.

6. **Q. 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?**

   A. Disclosure of settlement offers should not be required under any circumstances. Generally, settlement offers are confidential and are not admissible in legal proceedings. Public disclosure of settlement negotiations would rob the reporting entity of that protection and disrupt the normal processes for dispute resolution.

7. **Q. 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?**

   A. We believe the tabular reconciliation will be of limited use because material amounts accrued are generally already disclosed as contingencies. However, to promote international convergence and address user concerns, we support the tabular reconciliation, which is similar to the IAS 37 disclosure.

8. **Q. 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?**

   A. We believe the exemption from disclosing prejudicial information is crucial, and should apply to all the required disclosures. We believe the "limited exemption" from disclosing prejudicial information is basically ineffective, as sensitive information such as the amount of the claim or estimate of maximum exposure, anticipated timing of resolution and description of factors likely to affect the outcome must still be disclosed in most cases. We have described above many of the inequities such disclosures would cause. Such disclosures would tilt the playing field strongly in a claimant's favor and likely result in higher administrative, litigation and settlement costs. The considered disclosures are clearly prejudicial and the limited exemption proposed does not sufficiently protect reporting entities.

9. **Q. 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?**

   A. We agree with the two-step approach, but as stated above, we believe the exemption should apply to all the required disclosures.

10. **Q. 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?**

A. We believe that disclosure of all the required information would generally be prejudicial, and that no constraint on its use is necessary. We would be especially concerned if the language were changed to "extremely rare", because we believe that, in practice, the interpretation is likely to be so conservative that the intended prejudicial exemption would effectively not exist.

We also note that the IAS 37 disclosure requirements are not as excessive as those in the ED, and the IAS 37 prejudicial exemption applies to all the required disclosure, not just a subset. Additionally, IAS 37 disclosure of contingent liabilities and contingent assets is only required *where practicable.*

11. **Q. 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?**

    A. We agree with the description of prejudicial information.

12. **Q. 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?**

    A. We believe the additional disclosure, if any, should be required only annually due to the anticipated processes and controls, which need to be established and followed. Changes of facts applicable to material contingencies are already reported.

13. **Q. 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?**

    No, we do not believe other information about loss contingencies should be disclosed.

14. **Q. 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?**

    As drafted, it is not practicable to implement the statement for year-end. New processes and controls will be required to ensure the completeness and accuracy of information in the new disclosure. Entities do not normally make system changes in the fourth quarter due to Sarbanes-Oxley review of controls.