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August 18, 2010

*VIA EMAIL*

Financial Accounting Standards Board  
401 Merritt 7  
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**Re: Disclosure of Certain Loss Contingencies – File Reference No. 1840-100**

Ladies and Gentlemen:

The Association of Corporate Counsel (“ACC”) and the numerous leading in-house legal executives co-signing our comment letter appreciate the opportunity to present our views on the July 20, 2010 exposure draft, “Contingencies (Topic 450): Disclosure of Certain Loss Contingencies” (the “Exposure Draft”), in which the Financial Accounting Standards Board (the “FASB”) proposes amendments to Accounting Standards Codification Topic 450-20. In our view, and the view of our membership, any beneficial new disclosure as a result of the proposed modifications would be vastly outweighed by confusion for financial statement users, significant difficulties for companies and material disadvantages for shareholders.

ACC is a bar association serving and representing attorneys within the in-house legal departments of corporations and private-sector organizations worldwide. ACC has over 25,000 members employed by over 10,000 organizations across 70 countries. In addition, our membership brings to these important issues the unique views of in-house counsel who are often at the intersection of the outside lawyers, auditors and executive management in both the disclosure and litigation functions. As such, our membership speaks not only for in-house counsel, but also for the interests of their client organizations and the stakeholders who will be affected by the proposed amendments.

ACC’s membership has followed closely the proposed amendments to the standards governing the disclosure of litigation-related loss contingencies. The Exposure Draft, like the proposal put forward by the FASB in June 2008, has generated immense concern and an extraordinarily strong response from our members; with only a week’s notice more than 100 top company legal officers requested to co-sign this letter to underscore to the FASB the strength and depth of their shared concern that these proposals will do immense harm to companies and the disclosure process, without any meaningful improvement in the quality or transparency of disclosure. Because of the breadth of issues covered in this letter and the diversity of interests represented by this letter’s signatories, the in-house leaders who sign this letter may not endorse every point stated, but wish the FASB to understand that they are unified on the principle that these proposals do more harm than good, for the general reasons expressed.

## EXECUTIVE SUMMARY

The ACC believes that the Exposure Draft includes several important improvements from the June 2008 proposal, and we commend the FASB for its efforts in addressing some of our concerns expressed about the earlier proposal. Notwithstanding this progress, we still have significant concerns about certain aspects of the proposals in the Exposure Draft and believe that as a whole the Exposure Draft fails the key test for a change in standards as any foreseeable benefit from the proposal is far outweighed by the substantial problems that the proposal would create for public companies, their shareholders and financial statement users. In particular, we have serious concerns about the proposed requirement for disclosure of amounts accrued for individual loss contingencies and for disclosure of information about such accruals in a tabular reconciliation. We believe these requirements would harm shareholder and company interests as they would limit the ability to obtain shareholder-favorable settlements of litigation matters, otherwise hamper litigation strategy and potentially fuel additional litigation. We also are concerned that these accrual-related disclosure requirements could generate new tension surrounding issues of attorney-client privilege and work-product protections. The Exposure Draft also calls for enhanced disclosure of various information – disclosure of certain remote contingencies, amount of damages claimed, and insurance information – that has the potential to mislead financial statement users, on the one hand, and cause prejudicial impacts on litigation positions to the detriment of company and shareholder interests, on the other. For these reasons, we strongly encourage the FASB to withdraw the current draft proposal and reconsider its approach to modifying the accounting standards for loss contingencies, including as described below.

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The proposal requests comments on whether the proposed modifications to the accounting standards for loss contingencies are “operational.” ACC believes that the proposal presents a number of significant operational challenges and therefore urges the FASB to withdraw the current draft proposal and reconsider its approach to the proposed modifications.

***I. The Proposed Requirements for Disclosure of Accrual Amounts Would Harm Company and Shareholder Interests in Litigation and Could Create Tension Surrounding Attorney-Client Privilege and Work-Product Protection Issues.***

*Disclosure About Accrual Amounts Would Be Highly Prejudicial* – Proposed paragraph 450-20-50-1F.e.2 and the tabular reconciliation proposed under paragraph 450-20-50-1F.g of the Exposure Draft each require certain disclosures about the amount of accruals for loss contingencies. Under the current standard, a company must only disclose the individual amount accrued for a probable loss contingency if “necessary for the financial statements not to be misleading.” Requiring disclosure of individual amounts accrued for each loss contingency that is probable, even where there is no suggestion that the disclosure of such information is needed to make the financial statements not misleading, would be highly prejudicial and present a severe impediment to a company defendant’s ability to achieve settlement results that are beneficial to

investors as the disclosure will create a floor for settlement discussions.<sup>1</sup> Once a company has disclosed the specific amount accrued for a litigation contingency, no plaintiff would rationally settle for a lower amount, because the company itself has valued the claim at the accrued value. Indeed, it is even foreseeable that disclosure will not be the floor for settlement, but rather the escalator, as plaintiffs inevitably will seek to extract incremental amounts above the floor. This consequence leads to a separate concern about whether a company can reliably estimate an accrual if it has to disclose such amount; the mere act of disclosure might trigger a higher settlement demand, and with that, a corresponding risk that the initial amount disclosed would be viewed as misleading. This “observer effect” in which the process of evaluation itself impacts or determines the event observed, is neither desirable as a matter of disclosure policy nor beneficial to the company or its shareholders. In any event, once disclosure of an accrual amount is made, such disclosure will reduce the ability of company defendants, absent unusual circumstances, to present credible arguments in settlement discussions that there are substantial weaknesses in a plaintiff’s case. “Probable” does not mean “certain,” and company defendants should not be required, more than is necessary to make their disclosure not misleading, to concede the settlement amount at the point in time when it becomes probable that it will occur.

The proposed requirements for period-over-period reassessments of qualitative disclosures and for tabular reconciliations also would disadvantage defendant corporations in litigation disputes and loss contingencies involving regulatory matters. Ongoing adjustments in these disclosures would provide a window into management’s evolving view of the matter and provide plaintiffs’ attorneys with a road map of the company’s litigation strategy. These disclosures may even serve to deter settlement generally, hardening the posture of companies that have now committed publicly and potentially revealing when optimism about a case has diminished, for example through an accrual increase or revised qualitative disclosure. In addition, in relation to loss contingencies involving regulatory matters, we are concerned that the enhanced disclosure requirements could provide a roadmap for private litigants about such regulatory matters. Finally, we are concerned that disclosure about accrual amounts, either individually or through the tabular reconciliation proposal, could create a separate potential basis for liability to the extent the disclosure about such amounts when made is later perceived to be in error with the benefit of 20/20 hindsight.

*Aggregation, As Proposed, Does Not Cure the Problem* – Although paragraph 450-20-55-1A provides that certain classes of contingencies may be aggregated for disclosure purposes, we do not believe this provision in the Exposure Draft adequately addresses the difficulties

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<sup>1</sup> Our concerns about disclosure of accrual amounts also are exacerbated by the apparent ambiguity as to whether the disclosures required under paragraphs 450-20-50-1F.e.2 and 450-20-50-1F.g are required only if material, individually or in the aggregate, or if all contingencies are subject to the proposal. If the FASB decides to proceed with its proposal, we urge the FASB to clarify, at a minimum, that the final guidance is not applicable to individually immaterial loss contingencies, unless a class of such contingencies is material in the aggregate.

resulting from the proposed requirements to disclose accrual amounts. For example, if one or more cases have a far greater potential impact than others, then aggregation would not provide the intended shield because the more significant case or cases would dominate the aggregated group and the corresponding disclosure about changes related to a particular matter likely would provide the necessary clues for any reader as to which matter or matters caused the increase or decrease reflected in the reconciliation. In addition, some companies may have comparatively few litigation matters; may not be able to aggregate certain matters; or may have aggregated classes that contain only a few cases. And, even if the concept of aggregation could in theory provide some protection from the disclosure concerns, the guidance presented in the Exposure Draft seems to suggest that aggregation may be appropriate only in a narrow set of circumstances, thereby limiting its intended benefit. These limits on the ability to aggregate contingencies, at least under the proposed guidance, increase the risk that particularly large changes in accruals for contingent liabilities would stand out in the reconciliation table and could be used as levers in settlement negotiations.

*Privilege and Work-Product Protection Concerns* – Separate and apart from these significant practical concerns, we also are concerned that the operation of the disclosure requirements about accrual amounts could cause tension in relation to the fundamental protections of attorney-client privilege and the attorney work-product doctrine. The attorney-client privilege is the oldest privilege recognized at common law. The purpose of the privilege “is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice or advocacy serves public ends . . . .” *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981). Of nearly equal importance, particularly to the in-house lawyer, is the work-product immunity that protects from adversaries counsel’s analysis and mental impressions of litigation and potential litigation. *Hickman v. Taylor*, 329 U.S. 495 (1947).

As an initial matter, we applaud the FASB’s recognition in the Exposure Draft that the enhanced disclosure requirements are not intended to lead to waivers of protected information under either of these key protections. Nevertheless, we are still concerned that, notwithstanding this recognition, the protections inevitably will be threatened by the proposed disclosures about accrual amounts. On the one hand, if issuers adhere to the guidance in the Exposure Draft and refrain from disclosing any information that is privileged or subject to attorney work-product protection, then disclosures about accruals likely would be based on very limited information, without the benefit of in-house and outside counsels’ analyses of the risks and exposure. Disclosures based on such limited information not only would be laden with necessary disclaimers but also would not fulfill the goals of the Exposure Draft. Financial statement users would be disserved by such disclosures. On the other hand, the accrual disclosures and related information auditors may seek as part of the audit process in order to audit the accrual amounts or range of loss for each individual contingency could raise the risk that a court later will deem that these disclosures or communications constitute a waiver of privilege or work-product protection. Thus, the disclosure of accrual amounts for each litigation contingency that is

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probable and the related tabular reconciliations of such amounts present a realistic risk that privilege and work-product protections that form the bases for such information could be lost.

The tension resulting from concerns about waivers of privilege or work-product protection could have a number of harmful effects on key relationships. The proposed disclosures, particularly relating to accruals, could deter management from fully engaging with counsel on sensitive litigation matters to avoid risks of waiver, real or perceived, that the lawyer's involvement would create. The proposal thus could have the unintended consequence of chilling full and frank discussions between companies and their counsel (in-house and external), to the detriment of the company client. In addition, the proposal would complicate the relationship between companies and their outside auditors. If the auditors need to evaluate the legal analysis underlying a given disclosure, even if such analysis itself is not disclosed, this could increase the likelihood of a court determining that a waiver of privilege has occurred. The recent case *U.S. v. Textron, Inc.*, 577 F.3d 21 (1st Cir. 2009) (finding that tax accrual materials prepared by in-house lawyers primarily in order to obtain a final audit opinion would not be afforded work-product protection, even though the materials assessed litigation risk) presents in stark relief the serious dangers raised by the accrual-related disclosures in the Exposure Draft. Although we appreciate that the FASB's goal in pursuing its proposal is not to jeopardize these fundamental protections, we still have significant concerns that the accrual-related disclosures, if adopted as proposed, could lead to an outcome where plaintiffs' lawyers eventually are able to arm themselves with the thoughts and impressions of company counsel—a plainly unacceptable outcome that actually substantially injures the company and its shareholders.

For these reasons, we strongly urge the FASB to modify its final guidance to require disclosure of accrual amounts only “if necessary for the financial statements not to be misleading,” as under the current standard, and to remove the requirement for disclosure of accrual amounts in the tabular reconciliation.

## ***II. The Proposed Disclosures Would Mislead Financial Statement Users and Drive Litigation Outcomes to the Detriment of Companies and Their Shareholders.***

The proposal contains numerous enhanced disclosure obligations that depart in significant respects from the existing disclosure standards for loss contingencies. Among other potential negative consequences, some of these new requirements could mislead financial statement users, embolden plaintiffs' attorneys and shape litigation outcomes to the detriment of financial statement preparers and their shareholders. Significantly, and as discussed above, we believe the cumulative impact of the proposed enhanced disclosure requirements would create an imbalance between the desire for disclosure and the desire for parties to settle disputes and, as such, will have a detrimental effect on litigation for companies. As with the proposal for disclosure of accrual amounts, we are concerned that plaintiffs' attorneys will use the disclosures as a roadmap for litigation, armed with increased knowledge about what to ask for, how and when. And if the disclosures prove wrong, companies could be subject to additional liability exposure by virtue of these new requirements. In short, any marginal value to financial statement users of the proposed disclosure requirements as compared to the substantial risk of

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prejudice to companies that flows from having to provide this new information to plaintiffs' lawyers every quarter weighs against proceeding with these enhanced disclosure requirements and, in particular, those discussed below.

*Disclosure About Remote Contingencies* – The FASB's proposal to disclose information about remote contingencies that are potentially severe risks confusing longstanding concepts of materiality by requiring disclosure of information that a reasonable investor would likely find immaterial. Contrary to the principles espoused in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the proposed standard fails to recognize the importance of balancing the probability of an event against the magnitude of the event. This principle is significant because it helps to ensure that financial statement users are presented with meaningful disclosures and are not misled or confused by extensive reporting of less important information. Without giving regard to this principle, the proposal suggests that any remote contingency having a "potentially severe impact" may require disclosure, even if the likelihood of an unfavorable outcome is vanishingly small. Although we appreciate the interest in alerting financial statement users to risks of potentially severe occurrences, it would be imprudent to supplant the securities law standard of materiality, which requires consideration of both probability and magnitude in making disclosure judgments. Thus, we believe that the FASB's proposed standard would create confusion, as remote contingencies generally would not be considered important by a reasonable investor.<sup>2</sup>

The admonition that companies "will need to exercise judgment" in determining whether disclosures of remote contingencies would be required and the non-exhaustive litany of factors to be considered (not including the probability of occurrence) does not provide adequate guidance and would do little to help ensure that only material information is disclosed. More specifically, in exercising their "judgment," the Exposure Draft suggests that companies should take into account the potential impact on the entity's operations, the cost to the entity of defending its contentions and the amount of efforts and resources management may need to devote to resolve the contingency. The amount of damages claimed also is identified as a factor to be considered in making the judgment. This suggestion could encourage plaintiffs to inflate the amount of damages claimed in an effort to force disclosure, even if they assume that the likelihood of success is remote. The inexactness of this standard, coupled with the concern that plaintiffs may simply inflate their damages claims to extract disclosure, could result in disclosure that is little more than guesswork.

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<sup>2</sup> Although companies are afforded a safe harbor from liability for certain forward-looking statements under the Private Securities Litigation Reform Act of 1995, information contained in the financial statements and notes thereto is excluded from the safe harbor. This approach has traditionally made sense given that the financial statements and notes thereto focus on historical information. Because the FASB's proposed disclosures with respect to remote contingencies, as well as the proposal to disclose "other nonprivileged information that would be relevant to financial statement users to enable them to understand the potential magnitude of the possible loss," invite forward-looking and speculative disclosures, we are concerned that these disclosures, if adopted as proposed, could provide another avenue for possible litigation against companies.

To address these concerns, ACC strongly urges that, if the FASB moves forward with its standard-setting project, the final guidance should remove paragraph 450-20-50-1D and make clear that disclosures related to remote loss contingencies are not required. At a minimum, ACC requests that disclosures of remote contingencies be limited to those with a potential severe impact “in the near term,” as reflected in the FASB’s June 2008 proposal.

*Disclosure About Amount of Damages Claimed* – Paragraphs 450-20-50-1F.b, .e.1 and .f.1 would require companies to disclose “the amount of damages claimed by the plaintiff.” In the U.S. system of notice-style pleading and discovery, the amount claimed frequently bears little relation to the dispute’s facts and provides no reliable indication of the suit’s likely outcome.<sup>3</sup> The amount asserted is not determined by a neutral party, but rather an advocate, and the magnitude asserted can be driven by numerous extraneous factors, including intent to intimidate and induce settlement, to gain public attention or to extract some other tactical advantage. The amount asserted literally holds no meaningful value for financial statement users. Indeed, the required inclusion of inflated damage claims likely would mislead investors concerning any real exposure to the reporting company, particularly early in a dispute when there is little additional information upon which to evaluate the contingency. And yet, requiring disclosure of this untested amount would enable plaintiffs’ attorneys to apply increased pressure on corporate defendants, as issuers would be forced to include amounts claimed, no matter how outlandish, in their financial statements, as long as the disclosure threshold for the contingency has been met. Particularly enterprising plaintiffs’ attorneys may file claims right before the end of a quarter in an effort to make a defendant scramble to provide adequate disclosure in the next Form 10-Q, before the defendant has adequate time to assess all of the parameters called for by the Exposure Draft.

Similarly, the proposed requirement that issuers disclose the amount of damages indicated by expert witness testimony would generate problems. It would be haphazard and unhelpful to financial statement users to require companies to disclose amounts cited in expert testimony sponsored by plaintiffs or defendants (or even both, which are, of course, virtually always in conflict). Misleading disclosures could result, for example, from a trial in which the plaintiff’s experts testify in one quarter and the defendant’s experts take the stand in the next quarter (not an unusual situation), perhaps even with plaintiff’s rebuttal case, including additional expert testimony, falling in yet another subsequent quarter. Changing the disclosure in consecutive periods as the expert testimony was given would be unhelpful and potentially quite confusing to financial statement users, many of whom will be unable to decipher the meaning of these shifting numbers.

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<sup>3</sup> We note that in some jurisdictions, the complaint is not routinely part of the public record and therefore the damage amount claimed may not be viewed as publicly available. In these situations, it is not clear under paragraph 450-20-50-1F.b of the Exposure Draft whether the damages information would have to be disclosed.

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For these reasons, if the FASB moves forward with its standard-setting project, we encourage the FASB to remove from the final guidance any requirement that the company disclose the amount of damages claimed by the plaintiff or by the plaintiff's expert.

*Disclosures About Insurance and Other Recoveries* – The proposal also requires that preparers disclose information about possible recoveries from insurance and other sources for all litigation contingencies that are at least reasonably possible, to the extent that such information is discoverable. Although the value of this information to financial statement users is unclear, the proposed disclosure of this information would prove harmful to companies and shareholders. Determinations as to whether information is discoverable are made by courts rather than by the parties to litigation themselves. When a court has not yet made such a determination, forcing a company to decide whether information about recoveries is discoverable may disrupt this role of the courts and unfairly influence the course of a litigation matter to the detriment of the company. For example, a court may find the existence of disclosure relevant to whether insurance information is admissible during the course of litigation. In addition, even if discoverable, insurance information often is subject to confidentiality protections once it is provided to plaintiffs. This procedure is premised on the simple fact that disclosure of sensitive information about insurance coverage could lead plaintiffs' attorneys to parse the insurance coverage information for their benefit in other litigation matters. Thus, the proposed disclosure requirement in the Exposure Draft could unfairly prejudice companies in unrelated litigation disputes by giving plaintiffs' attorneys valuable information about the company's liability coverage.

For these reasons, if the FASB moves forward with its standard-setting project, we urge the FASB to remove this disclosure requirement in its final guidance. At a minimum, we urge the FASB to clarify that disclosure is only required where insurance coverage information has actually been provided to plaintiffs without a confidentiality obligation, as disclosure should not be premised upon a prediction of whether a court would ultimately find the information discoverable.

### ***III. An Exemption for the Disclosure of Prejudicial Information Is Needed.***

For the reasons expressed above, ACC strongly urges that the FASB reconsider its approach to the modifications of accounting standards for loss contingencies. If, however, the FASB elects to proceed with the proposal substantially in its current form, ACC requests that, as with its June 2008 proposal, the FASB include an explicit exemption for the disclosure of prejudicial information. Companies, and by extension their shareholders, could be seriously prejudiced in certain circumstances in a litigation dispute or regulatory matter by the disclosure of information required under the Exposure Draft, perhaps most notably the amount accrued for the contingency and the changes in the amount accrued as revealed through tabular reconciliation. ACC believes that an exemption for the disclosure of prejudicial information would be prudent and fair if the FASB determines to proceed with its current proposal.

***IV. The Proposed Effective Date Is Not Workable for Public Companies.***

The proposal states that, for public companies, the new standards for disclosures of loss contingencies would be effective for fiscal years ending after December 15, 2010, and interim and annual periods in subsequent fiscal years. ACC strongly urges the FASB to reconsider this effective date for public companies given the significance and scope of the proposed changes.

Implementing the proposed requirements would entail significant effort, well beyond preparing the actual disclosures. Companies would need to survey all litigation and other loss contingencies and develop new disclosure control processes. Audit committees, management and outside auditors also will need time to evaluate the final guidance and discuss implementation issues that are particular to the company. And, once developed, audit committees and the outside auditor will need to spend adequate time assessing and, in the case of the auditor, auditing the information relevant to the disclosures. In addition, public companies' compliance resources already are burdened as new and separate regulatory initiatives, including those arising under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, are taking hold in the very near term.

In light of these considerations, if the FASB moves forward with its standard-setting project, ACC strongly recommends that the FASB shift the effective date for public companies so that it is effective for fiscal years ending after December 15, 2011, and interim and annual periods in subsequent fiscal years.

**CONCLUSION**

Because of the significant problems that the proposal would cause for companies, their shareholders and financial statement users and the lack of any significant benefit, we urge the FASB to refrain from proceeding with the proposed amendments in their current form.

The following in-house counsel co-sign this letter in support of these comments. Please recognize that given the breadth of issues covered in this letter and the diversity of interests represented by its signatories, the in-house counsel who have signed this letter may not agree with every point stated, but wish to convey that they share the general concerns expressed.

Submitted on behalf of the Association of Corporate Counsel (ACC):



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Danette Wineberg  
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Werner Enterprises, Inc

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The Williams Companies

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