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August 23, 2010

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116
Via email: director@fasb.org

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

Dear Mr. Golden:

We are submitting this letter in response to the request of the Financial Accounting Standards Board (the "FASB") for comment on the FASB's proposed accounting standards update relating to disclosure of certain loss contingencies (the "Reproposal").[1]

Providing financial statement users with meaningful information to enable them to better assess the likelihood, timing and magnitude of loss contingencies is an important goal. However, this goal must be balanced against the additional costs and risks imposed on companies by changes to the existing standard. Insofar as companies are prejudiced by the new disclosures, the ultimate cost will be borne by shareholders. It is thus important to consider whether the proposed changes in fact are likely to result in more useful disclosure.

[1] Exposure Draft, *Proposed Accounting Standards Update – Disclosure of Certain Loss Contingencies*, File Reference No. 1840-100 (July 20, 2010) (the "New Exposure Draft").

The Reproposal addresses many of the most critical concerns presented by the FASB's original proposal on this topic issued in June 2008 (the "Original Proposal").[2] However, the approach set forth in the Reproposal still would require disclosures likely to be prejudicial to the company in the context of a particular litigation without a commensurate justification in terms of providing material information to investors. Accordingly, we recommend several changes to the standard outlined in the Reproposal, as described below.

1. In the absence of an exemption from disclosure of prejudicial information, the disclosure requirements should be modified to reduce the risk of prejudicial disclosures to the maximum extent possible.

We recognize the difficulties described in the Reproposal with respect to auditing a company's reliance on an exemption for prejudicial disclosure and the impact it could have on the attorney-client privilege. We also recognize that, as noted in the commentary to the New Exposure Draft, the Reproposal eliminates "many of the [Original Proposal's] proposed disclosures that are less factual and more speculative in nature." While the Reproposal represents a significant improvement in this respect, it does not go far enough. The Reproposal continues to call for disclosure that can be highly prejudicial to a company's litigation posture, particularly given today's high stakes litigation environment. For the reasons we discuss below, we believe the resulting harm to companies and their investors would outweigh the benefits to financial statement users. In the absence of an exemption for prejudicial disclosure, the disclosure requirements contained in the Reproposal should be further narrowed, as we describe below.

2. Aggregation of disclosure on an overall basis should be permitted for disclosure of accruals, including in the tabular reconciliation, and for estimates of possible loss or range of loss.

Companies should be permitted to aggregate information about accruals on an overall basis (rather than a class basis) in responding to any new quantitative disclosure requirements. To the extent disclosure permits users to determine accrual amounts relating to a particular litigation or proceeding, that information will operate as a "floor" for settlements of the relevant claims that might otherwise be resolved by the company on more favorable terms. Indeed, it is likely that accruals that can be linked to a particular litigation will be of greatest interest to the company's adversaries; shareholders, by contrast, would likely be more interested in the overall effect of loss accruals on the company's periodic results. This risk is also present in the case of the tabular reconciliation requirement, which calls for aggregation by class. In taking this approach, the FASB acknowledged the risk, noting that it had "decided to permit aggregation by class of contingencies to address concerns about prejudicial disclosure of individual contingencies."

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[2] 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 (June 5, 2008).

However, aggregation on a class basis, whether in the narrative disclosures or the tabular reconciliation, is an inadequate solution. For example, even when aggregated with one or more smaller claims, it will often be evident that a particular claim accounts for the bulk of an aggregated provision. This situation will arise more frequently if aggregation is permitted only on a class basis. The fine distinctions among classes contemplated by the Reproposal only heighten this concern, insofar as they may require companies to divide contingencies into narrower, smaller classes.[3] To the extent accruals or changes in accruals are traceable to a particular litigation or proceeding, disclosure will invite discovery by plaintiffs. If discovery is granted – a risk that cannot be excluded, at least in the United States – the disclosure could be outcome-determinative of the contingency itself.

For the same reasons, companies also should be permitted to disclose their estimates of possible loss or range of loss on an overall aggregate basis. As in the tabular reconciliation or other disclosure of accruals, disclosure aggregated on a class basis facilitates tying the amount of an estimated possible loss or range of loss to a particular contingency. Here, again, disclosure may often prejudice the company's litigation posture.

In this regard, we disagree with the FASB's view that the tabular disclosures are unlikely to be prejudicial to the reporting entity as compared to the current standard. The Reproposal cites the requirement in Accounting Standards Codification Topic 450 that disclosure of accruals may be required in certain cases to avoid misleading financial statements. Although we do not disagree with that standard, it does not justify a class-by-class presentation if the result would be disclosure about matters immaterial to the financial statements that would nevertheless be highly prejudicial to the company. This principle applies with additional force when a company discloses its estimate of possible loss or range of loss. In that case, the information provided is inherently less reliable than information about amounts accrued; there is correspondingly even less justification for exposing companies to a risk of highly prejudicial disclosure by requiring a class-by-class presentation. Accordingly, we believe overall aggregation of disclosure should be permitted for both accrual disclosure, including the tabular reconciliation, and estimates of possible loss or range of loss.

3. The nature and scope of the required narrative disclosures should be narrowed to eliminate disclosure that is unlikely to be useful to investors and may be prejudicial to companies.

The Reproposal eliminated many of the most problematic disclosures called for by the Original Proposal. However, the qualitative and quantitative disclosure requirements contained in the Reproposal are needlessly granular; as a result, they will be costly to comply with and will prompt lengthy disclosure that is of little use to investors or prejudicial to companies, or both. For the reasons outlined below, we believe the disclosure requirements set

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[3] We note that the distinctions among classes contemplated by the Reproposal are unworkable, needlessly burdensome to develop and likely to change over time, making period-to-period comparisons more difficult. In any event, if the FASB does not agree with our suggestion that aggregation be permitted on an overall basis, it should at least revise the Reproposal to permit aggregation based more simply on the nature of the contingency.

forth in paragraphs 450-20-50-1F(a)-(f) of the Reproposal should be limited to: (i) the contentions of the parties; (ii) if known, the anticipated timing of, or the next steps in, the resolution of individually material asserted litigation contingencies; (iii) for individually material contingencies, sufficiently detailed information to enable users to obtain information from publicly available sources such as court records; and (iv) the amount of damages claimed by the plaintiff or regulator, if any.

We recommend limiting the required narrative disclosures in this way because the other disclosures called for by the Reproposal present the following main concerns:

(a) The amount of damages indicated by expert testimony may not be useful disclosure. Litigation is an adversarial process that often features a "battle of the experts." A company is likely to challenge, not credit, testimony by a plaintiff's expert and will often challenge the expert's very qualifications to testify as such. For these reasons, it would not be unreasonable (or uncommon) for a company to conclude that the required disclosure would in fact be misleading. Even if mitigating disclosure were provided (*e.g.*, about the company's expert testimony), it is hard to see the value of presenting competing expert disclosure to investors, since it will present a necessarily incomplete and confusing perspective about the potential magnitude of the loss contingency.

(b) The Reproposal would require disclosure of other "publicly available" quantitative information, but does not provide any guidance about how this criterion should be applied. Publicly available quantitative information about potential loss may not be reliable, and even if the provision were limited to publicly available information in the proceeding, its credibility will be disputed in virtually all cases. The provision also does not explain how this element would relate to non-litigation contingencies, but we believe similar concerns could be present in those cases.

(c) The Reproposal would require disclosure of other "non-privileged" information relevant to an understanding of the potential magnitude of the possible loss and, in some cases, information relating to recoveries from insurance and other sources if it is "discoverable." We believe these requirements, like the uncabined requirement to disclose "publicly available" information, are overly broad and would involve a costly and time-consuming exercise that, given the absence of implementation guidance, would raise significant operational issues. For example, we question how these disclosures could be audited. In each case, it would seem that the audit procedures would require a review of legal judgments about the company's application of the attorney-client privilege or other protection. This in turn could affect the very ability of the company to preserve the privilege or protection, and, in some cases, also involve legal judgments regarding discoverability. We believe the FASB should instead recognize that litigation contingencies involve assertions of "facts" that are often the subject of vigorous debate. Introducing them into financial statement disclosure is likely, at best, to provide only minimal insight into a contingency and, at worst, to be confusing or misleading, and clearly would not justify the prejudicial impact on a company that disclosure of otherwise non-public information may have in the context of a litigation contingency.

4. The FASB should not prohibit companies from considering possible insurance or indemnification recoveries in determining whether disclosure of a loss contingency is required.

By prohibiting consideration of possible insurance or indemnification recoveries in determining the need for disclosure, the Reproposal will likely expand significantly the number of contingencies subject to disclosure. The Reproposal cites some commenters' views that insurance coverage is often "uncertain" and may be subject to litigation with the insurer. This argument is in our view wholly unpersuasive and fails to acknowledge the central role of insurance in risk management and timely claims resolution. Indeed, in U.S. federal courts, the importance of insurance to motivate settlement is reflected in mandatory discovery of certain insurance information.[4] Indemnification, contribution and similar arrangements have also become a key element of commercial transactions on which all parties rely in evaluating the transactions and resulting risk of loss. Indemnification and contribution arrangements in securities offerings and business combination transactions are just two examples. To ignore this business reality distorts the picture of a company's exposure. Moreover, loss contingencies are themselves uncertain; it seems inappropriately asymmetric to exclude consideration of these common mitigating factors on the grounds that they are also contingent. Indeed, insurance recoveries likely present a much less uncertain contingency in view of the significant body of case law in the insurance area. In a standard that is otherwise driven by highly fact-intensive inquiry, there is no principled justification for excluding consideration of these recoveries. Any new standard should instead caution companies to give due consideration to the likely timing and magnitude of recoveries, as well as factors that may prevent or delay them in whole or in part.

5. The FASB should make clear that companies may consider all potential mitigants in determining whether disclosure is required with respect to remote contingencies.

The Reproposal represents a significant improvement from the Original Proposal insofar as it does not require disclosure with respect to remote loss contingencies involving unasserted claims expected to be resolved within the next year. We also welcome the clarification that the amount of damages sought by a plaintiff is not, by itself, determinative of whether a contingency could have a severe impact, given the potential that a claim may be "frivolous with an artificially inflated amount." In making this clarification, the Reproposal takes better account of the fact that complaints may not specify an amount of damages or may specify an amount unrelated to the merits or likely resolution of the claim.

However, the requirement for disclosure about asserted remote contingencies that could expose a company to a "potential severe impact" still raises concerns. This requirement may ultimately force disclosure about matters that, since they represent remote risks, do not significantly aid an investor's understanding of the company's financial prospects. It is therefore particularly important that companies consider the totality of relevant circumstances in determining whether disclosure is appropriate. The Reproposal excludes a key input from this

[4] Fed. R. Civ. P. 26 (a)(1)(A)(iv).

analysis, namely, potential insurance and indemnification recoveries, which are the main ways companies seek to avoid financial disruption. As discussed above, the FASB should permit companies to consider insurance and indemnification recoveries in determining whether disclosure is appropriate. In addition, the FASB should make clear that any new standard adopted does not limit a company from considering other available ways to mitigate financial disruption. This would be consistent with the commentary in the New Exposure Draft explaining that a company should assess its "specific facts and circumstances" to determine whether disclosure should be made.

6. The FASB should modify the implementation timetable for the final standard so that it applies with respect to fiscal years beginning after December 15, 2010.

The proposed amendments will require significant adjustment to the procedures that companies now undertake with respect to potential loss contingencies, even if the issues we raise above are adequately addressed in the final standard. Particularly given the sensitive issues raised by the new disclosures, we believe that implementation of the new standard should allow companies to do this in a thoughtful way. Accordingly, we recommend that the effective date of the new standard be changed so that it applies with respect to fiscal years beginning after December 15, 2010.

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We would be pleased to respond to any inquiries regarding this letter or our views on the New Exposure Draft more generally. Please contact any of Leslie N. Silverman, Mitchell A. Lowenthal, Nicolas Grabar or Janet L. Fisher at (212) 225-2000.

Very truly yours,

CLEARY GOTTLIEB STEEN & HAMILTON LLP

cc: Messrs. Robert H. Herz
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