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VIA ELECTRONIC MAIL

Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merrit 7, P.O. Box 5116 Norwalk, CT 06856-5116 E-mail: director@fasb.org

Re: <u>File Reference No. 1840-100, Proposed Accounting Standards Update:</u>

Contingencies (Topic 450), "Disclosure of Certain Loss Contingencies"

Dear Mr. Golden:

This letter is written by the undersigned general counsel of Sheppard, Mullin, Richter & Hampton LLP, a law firm consisting of over 500 lawyers. Our firm includes lawyers experienced in securities law, financial reporting issues and litigation whose input I have sought in connection with this letter. What follows are preliminary comments to the proposed Accounting Standards Update ("ASU") to Accounting Standards Codification Topic 450—Disclosure of Loss Contingencies ("Topic 450"). I presume that if additional reporting requirements are imposed upon issuers of financial statements, they will look to counsel, like our firm, to provide compliance advice and guidance, particularly in this post-Sarbanes-Oxley era.

As set forth below, a preliminary analysis of the proposed changes reveals that certain underlying assumptions are flawed and that those assumptions need to be examined, reviewed and tested before such fundamental changes are proposed, much less adopted. The new proposals contain disclosure requirements that if implemented will prejudice publicly held entities in ongoing and future litigation and result in serious privilege-waiver issues while providing little, if any, useful information to investors.

A. Proposed New Disclosure Thresholds

Under the proposed ASU, the FASB now specifies that disclosure of a "remote" litigation contingency "may be necessary" to inform users about a "severe impact" and indicates that an entity "will need to exercise judgment" in determining whether disclosure is necessary. Three factors are considered when making such a judgment: (1) "the potential impact on the entity's

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operations;" (2) "the cost to the entity for defending its contentions;" and (3) "the amount of effort and resources management may have to devote to resolve the contingency."

Requiring reporting entities to disclose "remote" loss contingencies will result in rampant speculation that will vary significantly from entity to entity, particularly as issuers must decide whether or not "disclosure about a remote contingency is necessary." The proposal overestimates the predictive powers of attorneys. In recent years, lawsuits have grown in complexity and finders of fact have become less predictable. "Runaway" juries still exist. It is difficult enough estimating loss contingencies when the likelihood of loss is "reasonably possible." Where the likelihood of loss is "remote," any benefits from speculative disclosures are unclear and uncertain at best.

Moreover, given the strictures of the attorney-client privilege and attorney work product-protections, it is difficult for lawyers to provide anecdotal information about what may have been their "best guess" about the actual outcome of a trial or other proceeding. Anyone who reads news reports of trials or of jury verdicts will quickly see the vast difference between what the plaintiffs contended was the value of its claims, after full discovery and trial, and the contentions of defense counsel about what may be awarded, if anything, by a judge or jury. When litigators hear a question that begins with "is it possible," most reflexively shout, "objection, calls for speculation." The point is that once one gets into the area of "remote," both judgment and information are supplanted completely by speculation.

B. Qualitative Disclosure Requirements

The proposed ASU is also problematic insofar as it requires the disclosure of "[q]ualitative information to enable users to understand the loss contingency's nature and risks." Accordingly, during early stages of litigation, the financial statement issuer would be required to disclose "at a minimum, the contentions of the parties." In subsequent reporting periods, the disclosure would be "more extensive as additional information about a potential unfavorable outcome becomes available" and would include the "anticipated timing of, or the next steps in, the resolution" of the disclosed contingency. In addition, the entity would be required to disclose "sufficiently detailed information to enable financial statement users to obtain additional information from publicly available sources, such as court records."

These new mandatory qualitative disclosures would greatly disadvantage reporting entities in litigation and risk invasion of legal privileges. Essentially, reporting companies will be forced to identify and disclose all information that that company believes is "relevant" to enable financial statement users to reach the same understanding that the company has with respect to its potential liability. The proposed "catch-all" amendment, 450-20-50-1F(e)(4), is particularly problematic insofar as it supplements other disclosures with "information that would be relevant . . . to understand, the potential magnitude of the possible loss." Quite clearly, a company cannot identify and disclose its views – formed through legal analysis – of the full

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range of information relevant to its understanding of a potential litigation loss without telegraphing the same information to an adversary, thereby disadvantaging the company in both litigation and settlement negotiations as well as invading significant legal privileges, such as the attorney-client privilege and attorney work-product protections.

C. Quantitative Disclosure Requirements

Under the proposed ASU, for all contingencies that are at least "reasonably possible," the following quantitative information would be required: (1) "Publicly available quantitative information" like "the amount claimed by the plaintiff or the amount of damages indicated by the testimony of expert witnesses;" (2) "If it can be estimated, the possible loss or range of loss and the amount accrued, if any;" (3) "If the possible loss or range of loss cannot be estimated, a statement that an estimate cannot be made and the reason(s) why;" (4) "Other nonprivileged information that would be relevant to financial statement users to enable them to understand, the potential magnitude of the possible loss;" and (5) "Information about possible recoveries from insurance and other sources only if, and to the extent that it has been provided to the plaintiff(s) in a litigation contingency, it is discoverable by either the plaintiff or a regulatory agency, or relates to a recognized receivable for such recoveries."

For one, the current standard does not require entities to disclose the "amount of damages indicated by the testimony of expert witnesses." By mandating such disclosure when the expert's testimony is "publicly available," the new rules would require entities to publish their adversary's expert damages claims in financial statements no matter how baseless those claims might be. Disclosure of expert opinions will provide financial statement users with very little useful information. Typically, plaintiffs' experts proffer "best case scenario" views of damages that are almost always challenged by defendants and their experts on multiple grounds. Defendants, on the other hand, often assert no liability whatsoever, and submit their expert damages projections as a fallback or rebuttal position. In other words, financial statement users will not benefit from such disclosures because the figures will diverge dramatically, are often unrealistic and skew towards extremes.

Equally troublesome, the proposed requirement that information about possible insurance recoveries be disclosed is also highly problematic. Often insurance companies defend a claim with a reservation of rights and any insurance recovery is not known until a case is concluded. In any event, a defendant's insurance coverage is generally subject to discovery and therefore would almost always have to be disclosed under the new proposed standard. This would certainly prejudice companies by requiring them to broadcast their liability coverage terms to other potential litigation adversaries. It would likely generate additional meritless lawsuits, and attract claims seeking quick settlements within insurance policy limits, by plaintiffs or their lawyers, who would become privy to this information.

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Indeed, this new proposal would be highly prejudicial and will give litigation adversaries a significant advantage in settlement negotiations and in litigation to the extent an entity attempts to take a position inconsistent with its assessment. In addition, it will undoubtedly result in privilege-waiver issues because the amount of any accrual is often based on advice of, and communication, with counsel.

D. Tabular Reconciliation

The proposed amendments to Topic 450 also require reporting entities to present in each reporting period, a tabular reconciliation of accrued loss contingencies including: (1) carrying amounts of accruals at the beginning and end of the period; (2) amount accrued during the period for new loss contingencies recognized; (3) increases and decreases for changes in estimates for loss contingencies recognized in prior periods; and (4) decreases for cash payments or other forms of settlements during the period.

A tabular reconciliation process, such as this, is precarious because it would give litigation adversaries a window into changes in the size of any accrual established for a particular case or class of litigations. It would provide opponents an ongoing view of the reporting entity's assessment of a litigation. This information would very seriously intrude on litigation privileges meant to protect disclosure of confidential strategy. It would also likely undercut companies' settlement strategies and the ability to settle costly litigation for an amount beneficial to an entity and its shareholder.

Before going forward, the FASB should first examine data and test the implicit assumption that issuers and their attorneys have somehow in the face of more complex suits and difficult circumstances as well as the unpredictability of juries, become better able to predict the outcome and the consequences of complex litigation. They have not. These proposed changes impose burdensome and costly requirements that not only prejudice publicly held entities in both litigation and settlement negotiations but their questionable benefits pale in comparison to the threat caused to reporting entities. In particular, the proposed changes risk invading significant litigation privileges. For these reasons, we respectfully suggest that the FASB withdraw its proposed ASU to Topic 450 and not implement the proposed modifications.

Respectfully yours,

Ronald Ryland Sox

for SHEPPARD, MULLIN, RICHTER & HAMPTON LLP