October 8, 2008

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Comments on the Financial Accounting Standards – Disclosure of Certain Loss Contingencies: An Amendment of FASB Statements No. 5 and 141(R)

Dear Mr. Golden:

Intellectual Property Owners Association (IPO) appreciates the opportunity to comment on the Financial Accounting Standards Board (FASB) Proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies – an amendment of FASB Statements No. 5 and 141(R). We will limit our comments to those aspects of the proposed amendments concerning issues with loss contingencies involving litigation.

IPO is a trade association representing companies and individuals in all industries and fields of technology who own or are interested in intellectual property rights. IPO’s membership includes more than 200 companies and more than 10,000 individuals who are involved in the association either through their companies or as IPO inventor, author, executive, law firm, or attorney members. IPO’s corporate members file about 30 percent of all patent applications filed annually in the United States Patent and Trademark Office by U.S. nationals.

IPO understands and agrees with the goal of improving transparency by providing shareholders, investors, and the outside public (collectively, “the public”) relevant and meaningful information concerning contingent liabilities of a company. However, IPO shares many of the concerns about the proposed amendments that are identified in the comments provided by the American Bar Association, the Association of Corporate Counsel, and companies that own patents.

As noted in the attached comments, IPO has specific concerns that these amendments would alter the disclosure requirements too drastically, resulting in unintended harmful consequences to the reporting entities. A major concern is the risk of placing the reporting entities at significant disadvantages in litigation and exposing them to additional litigation stemming from estimates that are significantly different from what the actual loss turns out to be.
At the same time, the proposed amendments would not result in more reliable disclosures and therefore would not benefit the public whom the disclosures are meant to assist. It is our opinion that the current SFAS 5 disclosure requirements are effective and adequately provide information concerning contingent liabilities.

Estimating the maximum potential loss from a contingent liability is difficult to accomplish and may present unintended risks and prejudicial consequences for the reporting entity. Therefore, IPO opposes the proposed amendments.

We thank you for the opportunity to provide comments. Please feel free to contact me or Herbert Wamsley, Executive Director of IPO, if you would like to discuss these issues in more detail.

Sincerely,

Steven W. Miller
President
IPO’s Detailed Comments on the Financial Accounting Standards – Disclosure of Certain Loss Contingencies: An Amendment of FASB Statements No. 5 and 141(R)

The aspects of the proposed amendments concerning issues with loss contingencies involving litigation would not further the goal of having disclosing parties provide reliable financial information. Moreover, the new requirements would result in additional risks to the reporting entity that would outweigh any benefits obtained from additional disclosures. ¹

Estimating the maximum potential loss from a contingent liability is difficult to accomplish and may present unintended risks and prejudicial consequences for the reporting entity because:

A. Litigation is Unpredictable

The outcome of a pending or threatened claim is difficult to predict, especially early in a case when discovery is ongoing, and in view of myriad factors impacting the claim (such as venue and forum selection, choice of law, court orders, claim construction orders in patent cases, expert analysis and reports, and deposition testimony). Litigation is a very dynamic process with uncertain and unexpected developments, forcing a party to change its positions and case assessments over time. Further, trial outcomes can be impossible to predict. Judges and juries can reach surprising and unanticipated results. Many of those results are modified during the appeal process, particularly in patent cases.

Therefore, any disclosures by the reporting entities and their counsel will be highly uncertain, extremely unreliable, and based on inherent uncertainties, resulting in information of extremely limited value for its intended beneficiaries, i.e., the public.

B. Reporting Entities May Lack the Required Information to Identify a Maximum Potential Loss

Plaintiffs often do not state the specific amount of the awards that are they seeking. In fact, the Federal Rules of Civil Procedure state in the comments that parties need not estimate the amount of damages in patent cases. However, the proposed amendments might force defendants to estimate potential liability. In the end, such a requirement will likely: (1) result in disclosures that are speculative, (2) provide the plaintiff with damages estimates that it would not otherwise have access to, (3) disadvantage the disclosing party in settlement or mediation, and (4) force a disclosure of privileged information (see below).

¹ Further, because the proposed disclosures would work to the disadvantage of companies having an obligation to report, they would thereby place public companies at a disadvantage, as private companies are not subject to these disclosure rules.
Even if plaintiffs specify the amount of damages sought, this amount can be (and, in patent litigation, often is) significantly higher than what is reasonable. A defendant should not be in a position to have to respond to such unreasonable demands in a disclosure. Such a rule would fuel litigation-driven demands designed to pressure a defendant into settlement.

Moreover, the reporting entity may not have all of the required information to make a reasonable estimate of the potential liability. For example, in patent cases, information relating to damages may be in the possession of the plaintiff (e.g., other license agreements evidencing a reasonable royalty or evidence relating to lost profits). Under such circumstances, reporting entities are in no position to make an estimate, but the proposed rules would seem to require one.

C. It Will Risk Waiving the Attorney-Client Privilege and Work Product Immunity

The policy underlying the attorney-client privilege and work product immunity is to encourage open and honest communication between clients and attorneys. The attorney-client privilege is considered as one of the strongest privileges available under law. Therefore, in all but a few exceptions, those communications remain confidential and need not be disclosed to the adversary. Indeed, our legal system attempts to strike a balance between the fundamental attorney-client privilege and work product immunity, enabling a party to withhold protected information from a party’s adversary, and the need to disclose information to an adversary. The proposed amendments threaten to disrupt that balance because they increase the likelihood that these privileges will be waived. For example, counsel’s assessment of a claim and formulation of defenses may need to be included in the disclosure statements, which may be deemed a waiver of the privilege by the courts, especially if the reporting entity is required to share those case assessments with an independent auditor when providing the basis for the disclosure.

The attorney-client privilege is one of the most important rules in American jurisprudence. The invasion of it could have a prejudicial and chilling effect on a reporting entity’s ability to seek and obtain legal advice and representation. Consequently, clients may be less willing to disclose relevant information to their lawyers for fear it will be disclosed under the proposed amendments.

D. Disclosure Will Be Used to the Detriment of the Reporting Entity

Under the proposed amendments, a reporting entity would be required to provide both quantitative and qualitative disclosures of contingent exposures. Not only would this require the entity to disclose the claim amount or an estimate of the maximum potential exposure to loss, this analysis would also require the reporting entity to describe the factors that would impact the litigation, such as a description of
how the claim arose, the factors likely to affect the ultimate outcome of the contingency, the strengths and weaknesses of available defenses, and assumptions made by the company in estimating the amounts disclosed. This analysis would provide a roadmap to an adversary, revealing key aspects of the reporting entity’s litigation strategy and, thus, extremely prejudicing the reporting entity. Plaintiffs would seek to admit these disclosures into evidence and litigating this issue would increase the expense of litigation.

Another prejudicial impact of disclosing the company’s estimated loss is that it might lead to a higher judgment and may complicate settlement discussions by providing plaintiffs with a minimum settlement value for resolving the dispute. This could jeopardize a company’s ability to resolve a claim fairly.

E. The Likelihood of Shareholder Lawsuits Will Increase and Defendants Will be Pressured to Overestimate Potential Liability

If a reporting entity’s estimate significantly differs from the actual amount of the loss, the company may be exposed to shareholder or investor lawsuits. Given the inherent uncertainty of litigation, this is a likely scenario.

In addition, disclosing parties are likely to err on the side of overestimating potential liability in order to minimize shareholder lawsuits. Therefore, the proposed amendments will fail to achieve the goal of providing reliable financial information and lawsuits will have an unnecessary and depressive effect on the valuations of companies making such disclosures.