



**BlueCross BlueShield  
Association**

**An Association of Independent  
Blue Cross and Blue Shield Plans**

8 August 2008

Robert H. Herz, Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5166  
Norwalk, Connecticut 06856-5116



LETTER OF COMMENT NO. 99

RE: File Reference No. 1600-100: Proposed Amendment to FASB Statement No. 5

Dear Chairman Herz:

We write today on behalf of America's Health Insurance Plans (AHIP) the nation's foremost association representing nearly 1,300 member companies and the Blue Cross Blue Shield Association (BCBSA), representing 39 independent member Plans. Member companies of AHIP and independent member Plans of BCBSA provide health, long-term care, dental, disability, and supplemental coverage to more than 200 million Americans. AHIP and BCBSA member companies have significant concerns regarding the proposed amendments to Financial Accounting Statement No. 5 ("FAS 5"), specifically as those amendments relate to disclosure of litigation contingencies. We ask that the proposal be significantly modified to address the important and far-reaching negative impact that these amendments would have on a company's ability to conduct its business operations and to defend itself in ongoing litigation.

The existing language of FAS 5 requires companies to disclose a loss contingency<sup>1</sup> if there is "at least a reasonable possibility that a loss...may have been incurred." Once this reasonable possibility standard has been met, companies must also disclose the nature of the loss contingency and the range of the potential loss.

By contrast, the proposed amendments to FAS 5 will require far-reaching, potentially speculative, and highly confidential information to be made publicly available. According to paragraph 4 ("Disclosures") the purpose of the disclosure is "to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies that are (or would be) recognized as liabilities in a statement of financial position." We suggest, however, that with respect to the vastly expanded litigation disclosure requirements, the only readers who will find this information useful will be individuals either involved or about to be involved in litigation with the company. The purpose of FASB disclosures should not be to place companies in a worse financial position because of the disclosures, but this is precisely the effect these new amendments will have.

---

<sup>1</sup> "Loss contingency" is defined in paragraph 2 of the "Objectives" section as including "losses that may result from the loss or impairment of an asset or the incurrence of a liability." This broad definition will sweep in all litigation in which a company may find itself a defendant.

Under the proposed amendments companies will be required to make a “quantitative” and a “qualitative” disclosure with respect to pending litigation. “Quantitative information” is described in paragraph 7 thus:

Quantitative information about the entity’s exposure to loss from the contingency (including any amounts already recognized in the financial statements but excluding potential recoveries disclosed under paragraph 7(c)), as follows:

- (1) The amount of the claim or assessment against the entity (including damages, such as treble or punitive damages), if applicable
- (2) If there is no claim or assessment amount, the entity’s best estimate of the maximum exposure to loss.

“Qualitative information” is then described as:

*Qualitative information about the contingency sufficient to enable users to understand the risks posed to the entity. This information shall include at a minimum, a description of the contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution; a description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome; the entity’s qualitative assessment of the most likely outcome of the contingency; and significant assumptions made by the entity in estimating the amounts disclosed in paragraph 7(a) and in assessing the most likely outcome.*

The disclosures therefore require companies to make public their internal litigation strategies to the very entities who are involved in the lawsuits against them.

### **Prejudicial Disclosures**

FASB recognizes that disclosures about litigation strategies are “best estimates” of maximum claims exposure, and “factors that are likely to affect the ultimate outcome of the contingency” will in many circumstances be prejudicial to the entity making the information public. Paragraph 11 outlines exemptions from disclosure, “such as pending or threatened litigation.” In those cases, the reporting entity may “forgo disclosing only the information that would be prejudicial to the entity’s position” but in no case may the entity

*forgo disclosing the amount of the claim or assessment against the entity (or if there is no claim amount, an estimate of the entity’s maximum exposure to loss); providing a description of the loss contingency, including how it arose, its legal or contractual basis, its current status and the anticipated timing of its resolution; and providing a description of the factors that are likely to affect the ultimate outcome of the contingency along with the potential impact on the outcome.*

Entities may aggregate disclosures at “a higher level,” which is intended to avoid the prejudicial impact of disclosures about specific litigation events. It will not. The ability to aggregate the enhanced disclosures is an illusory shield. Knowledge that the information has been aggregated also is knowledge that the information exists in its non-aggregated form; there is no ability to shield the non-aggregated information, once it is developed for financial reporting purposes from the reach of discovery and exploitation by the opposing party or parties. The overall exemption does not go far enough and does not protect enough. We urge FASB to retain the existing rule for litigation disclosures.

A significant portion of the litigation involving health insurance plans concerns claims for unliquidated, extracontractual damages, including damages for bad faith and punitive damages. The requirement for

an entity to provide its “best estimate of the maximum exposure to loss” is unlikely to produce an estimate that has the same credibility as the type of quantitative information usually associated with financial statements, as evidenced by the present inability in many instances to provide accurate estimates of loss or even ranges of loss under the current version of FAS 5. However, the disclosure itself is significantly more prejudicial. The “best estimate of the maximum exposure to loss” and the enhanced disclosure of qualitative information go directly to the heart of the advice provided to an entity by its counsel. There is no way that the entity can provide the required enhanced disclosure without disclosing the substance of the advice of its attorneys. Requiring this level of disclosure is fundamentally unfair and seriously jeopardizes the ability of an entity to adequately defend itself.<sup>2</sup>

It is important to keep in mind that these issues present a particularly high risk of prejudice to the insurance industry, because the quantitative and qualitative information that is required to be disclosed is the very type of information that an opposing party seeks to establish and enhance upon in its extra-contractual claims in litigation. The instances in which the disclosure of this type of information could be severely prejudicial and ‘affect, to the entity’s detriment, the outcome of the contingency itself’ will be the rule rather than a rare occurrence as contemplated by FASB.

We note also that in order for the financial statements to be accurately completed under the new rules, significant internal communications from company attorneys will be necessary. FAS 5 may inadvertently create an environment in which attorneys representing companies in litigation will be faced with the dilemma of either violating the requirements of their Code of Ethics or forcing a company to fall out of compliance with the proposed disclosure requirements.

Even under the existing rules, the requirement that attorneys disclose loss contingencies to third parties outside the confines of attorney-client communications has generated significant controversy and discussion. As succinctly stated in the *American Bar Association Statement of Policy Regarding Lawyers’ Responses to Auditors’ Requests for Information*, AU Section 337C:

[A] policy of audit procedures which requires clients to give consent and authorize lawyers to respond to general inquiries and disclose information to auditors concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client. The institution of such a policy would inevitably discourage management from discussing potential legal problems with counsel for fear that such discussion might become public and precipitate a loss to or possible liability of the business enterprise and its stockholders that might otherwise never materialize.

The new disclosures are significantly more onerous and as such, intrude more significantly on the ability of companies to maintain open and free communications with their attorneys. This is underscored by the fact that these disclosures are subject to not only review by the company’s internal auditors, but also by the independent auditors responsible for undertaking the Sarbanes-Oxley review of internal control reporting. By creating such a broad disclosure requirement, FASB has increased the danger to companies involved in litigation by placing them in a position where their self-defense may be jeopardized and simultaneously increased the cost and the compliance efforts necessary to create the disclosures. Companies should not be placed in a position where the very disclosures intended to assist investors put the company in a worse position than had the disclosure never occurred.

---

<sup>2</sup> See, *American Bar Association Statement of Policy Regarding Lawyers’ Responses to Auditors’ Requests for Information*: “Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission.” *Policy Statement (1) c.*

The disclosure requirements will have long-term implications for companies, and their investors. By requiring disclosure of the underlying claim amount, FASB has created an environment that will at the very least encourage significant increases in plaintiffs' initial litigation demands. It is generally understood in the litigation arena that amounts claimed in lawsuits are often put in simply for effect and not because they have any real meaning. This new requirement, however, highlights and underscores these initial demands; it gives them the credence of a required disclosure that carries with it the implication that FASB believes they are meritorious and contain important investor information. This is incorrect and misleading. The only party to benefit from these new disclosures will be the plaintiffs who will be encouraged to file claims with extraordinary demands in order to force companies to early settlement so as to eliminate disclosure. This is a windfall for those attempting to sue companies subject to FAS 5, but detrimental for their investors.

### **No Rationale for Disclosures**

When the prejudicial impact of the proposed disclosures on a company's ability to defend itself is coupled with the lack of real information the disclosures ultimately provide the investing public, one is led to conclude that there is no real rationale for these amendments. The existing requirements of FAS 5 have been in effect for decades, and were thoughtfully crafted to balance the needs of the investor community and the needs of the companies in which they will invest. The amendments, by contrast, take the needs of neither party adequately into account. By requiring the publication of sensitive *internal decisions and discussions regarding pending litigation*, companies are placed at a disadvantage in litigation, which ultimately hurts the position of their investors. At the same time, the information that is disclosed is of little use to investors because of its speculative nature.

We believe that the litigation risks to company filers are well articulated in the letter dated December 4 2007 submitted by the senior litigation attorney of Pfizer and a dozen other major United State companies ("Letter of Comment No. 2"). As that letter points out,

We do not believe that the fair value of contingent assets and liabilities related to litigation can be reliably measured in many cases, especially in the early stages of an asserted claim. ... Litigation is inherently unpredictable... Moreover, determining when during litigation the probability of loss changes and by how much is highly judgmental. The [existing] SFAS standard of recognizing a liability only when it is probable and estimable embraces this judgment. ...

Accordingly, recognizing these potential assets and liabilities at fair value at the outset of the matter would be both flawed and misleading. ... We do not believe that it is helpful to users of financial statements to require assets or liabilities to be recorded for what might, and in some instances most likely will not, happen.

Financial statement readers will not be placed in a better position by these "enhanced" disclosures and the companies themselves clearly will be placed in a worse position. Given the inherent uncertainty in litigation outcomes, the objective to provide better information to assist financial statement users in assessing the likelihood, timing and amount of future losses associated with litigation is unlikely to be realized. Instead, a real possibility exists that, in addition to prejudicing the outcome of the litigation itself, disputes regarding the accuracy and adequacy of the new disclosure will spawn their own litigation against the company and all who participate in the preparation and presentation of the disclosure and financial statements in general. This is clearly not the outcome to be supported.

## Conclusion

We recognize that FASB's desire to enhance disclosures for loss contingencies is intended to create a financial statement that will have increased benefit for the investor community. While the goal is a laudable one, we suggest that the method of enhancing these disclosures should be reconsidered. With respect to litigation, requiring disclosure of the very information that the lawsuit is attempting to prevent from being made public will by its very nature cause the harm the company seeks to prevent. We make no suggestions regarding other disclosures in other areas of business operations, but in the context of litigation contingencies, we urge FASB to leave the existing FAS 5 language unamended.

We thank you for the opportunity to present the views of AHIP, BCBSA and our membership. Please feel free to contact the undersigned should you have any questions or comments.

Sincerely

Randi Reichel  
America's Health Insurance Plans  
(301) 774-2268  
[Rreichel01@comcast.net](mailto:Rreichel01@comcast.net)

Carl Labus  
Blue Cross Blue Shield Association  
312-297-5875  
[carl.labus@bcbsa.com](mailto:carl.labus@bcbsa.com)