



THE CHICAGO BAR ASSOCIATION

321 South Plymouth Court
Chicago, Illinois 60604-3923
Tel (312) 554-2000
Fax (312) 554-2054
www.chicagobar.org

July 28, 2008

By Electronic Mail to director@fasb.org

Technical Director -- File Reference No. 1600-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116



LETTER OF COMMENT NO. 19

Re: File Reference No. 1600-100/Exposure Draft, "Proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies (an amendment of FASB Statements No. 5 and 141R)"

Dear Sir or Madam:

I write on behalf of The Chicago Bar Association (the "CBA") regarding the above-referenced Exposure Draft of the Financial Accounting Standards Board (the "Board"). The CBA believes that the Exposure Draft should be rejected because its approach to disclosure of non-financial liabilities, particularly those involving litigation, would be cumbersome and expensive to apply, could be unfairly prejudicial to reporting entities, would be subject to error and misleading to investors, could lead to meaningless volatility in financial disclosures, and would in fact be a significant backward step in efforts to achieve more transparent, timely, and useful financial reports. The CBA believes that current SFAS 5, as augmented by the "Treaty" between the ABA and the AICPA,¹ represents a sound, long-tested, and well-understood balance between appropriate protection of a company's legal rights and interests and the needs of investors for current, meaningful financial information.

The CBA supports the Board's goal of improving the transparency, timeliness, and usefulness of financial information disclosed to investors and other users of financial statements. However, the Exposure Draft raises a number of problems and may have unintended but seriously adverse consequences for reporting entities. The CBA is particularly concerned with the requirements to provide current quantitative disclosures concerning the maximum possible loss or an estimate of the

¹ The "Treaty" is comprised of two documents: the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Request for Information, adopted by the ABA Board of Governors in 1975; and the AICPA Statement on Auditing Standards No. 12, adopted in 1976 and supplemented up to 1998.

BOARD OF MANAGERS: Victor P. Henderson • Michael P. Rohan • Carolyn D. Amadon • Carolyn H. Cliff • William F. Conlon
Maurice Grant • Hon. Thomas L. Hogan • Patricia Brown Holmes • Robert A. Merrick, Jr. • Susan A. Pipal • Dan L. Boho
Hon. Joel M. Flaum • Mara S. Georges • Arthur S. Gold • Megan Healy McClung • Mary L. Smith • John S. Vishneski, III • Elizabeth M. Wells

Terrence M. Murphy, EXECUTIVE DIRECTOR
Benjamin M. Manaloto, CONTROLLER

range of possible losses, and qualitative disclosures—really predictions—about the likely future course of events in pending claims. The approach reflected in the Exposure Draft fails to take into account certain fundamental realities about the adversarial litigation process in the United States, and threatens to put disclosing entities at a serious disadvantage in that process.

The CBA supports and joins in the comments on the Exposure Draft prepared by the American Bar Association (the “ABA”). The following comments are intended to highlight and, in some respects, supplement certain of the ABA’s concerns.

The Exposure Draft fails to take into account the inherent uncertainties of litigation. As explained in more detail in the ABA comments, the adversarial system of justice in our country makes it exceptionally difficult to make predictions about the outcome of pending or threatened claims, particularly early on in a proceeding. There are myriad factors that may affect the ultimate exposure presented by a claim, including venue, forum, choice of law, class certification, the survival of claims, admissibility of evidence, availability of witnesses, and a host of similar matters, many of which may not be clarified until a claim has progressed for years and nears or is in the midst of a trial or other adjudicative process. Quantitative assessments of threatened or pending matters would frequently provide a false sense of comfort or unduly alarm users of financial statements.

The Exposure Draft’s requirement that reporting entities provide their own estimate of maximum possible loss or an estimate of a likely range of losses will seriously disadvantage reporting entities without providing benefits to users of financial statements. Reporting the amount of damages sought by a litigant in a publicly filed document does not present difficulty, and is typically disclosed under current practice. However, litigation adversaries do not always specify the amount claimed, and many jurisdictions preclude or limit specific *ad damnum* amounts.² Requiring a reporting entity to provide either its maximum potential loss or a range of potential losses where the plaintiff has not quantified the claim presents a number of problems. Such an estimate could be deemed an admission that could be used against the reporting entity at trial or otherwise, and could distort the possible course of settlement by establishing a floor for negotiations. To the extent that disclosures and estimates turn out to be wrong as a result of changes that occur in the course of the proceeding, those disclosures themselves may be the basis for additional liability. Moreover, the disclosures required by the Exposure Draft would not benefit users of financial statements because estimates of potential financial impact would be volatile and misleading.

² See, e.g., N.J. R. Civ. Prac. 4:5-2 (“If unliquidated money damages are claimed in any court, other than the Special Civil Part, the pleading shall demand damages generally without specifying the amount.”); Wis. Stat. § 802.02(1m) (“With respect to a tort claim seeking the recovery of money, the demand for judgment may not specify the amount the pleader seeks”); 735 Ill. Comp. Stat. 5/2-604 (“Every complaint and counterclaim shall contain specific prayers for relief . . . except that in actions for injury to the person, no *ad damnum* may be pleaded except to the minimum extent necessary to comply with the circuit rules of assignment. . .”).

Litigation can involve many interim developments that increase or reduce possible exposures at various points in time before final resolution. Accordingly, disclosures required by the Exposure Draft would have to be re-evaluated periodically and possibly changed a number of times before a final outcome is reached, on the basis of what may prove to be transient events in litigation. Estimates based on interim developments, particularly in the early stages of litigation, could provide a misleading view compared to the ultimate outcome of the matter. Such volatile and potentially misleading disclosures would not provide useful and accurate information to users of financial statements.

The proposed standard would result in disclosures that are very difficult to audit, would increase potential erosion of the protections of the attorney-client privilege and work product doctrine, and would create additional tension between reporting entities and their auditors. The Exposure Draft's call for additional quantitative and qualitative disclosures regarding contingent liabilities threatens to open to discovery highly sensitive information that is traditionally protected from discovery by the attorney-client privilege and the work product doctrine. The overwhelming majority of lawsuits settle, and there is little information that could be more valuable in settlement negotiations than knowing opposing counsel's assessment of the likely range of loss—i.e., the likely range of settlement—associated with the case.

Quantification of litigation exposure will necessarily be based on numerous subjective factors, including an assessment of uncertain future events. To the extent that a disclosing entity bases its estimates on communications from its counsel, auditors may feel obliged to seek out those communications to test the disclosures. Normally, communications between attorneys and clients made for the purpose of assessing and defending litigation are absolutely protected by the attorney-client privilege and receive substantial protection by the work product doctrine. Reporting entities cannot share these communications with auditors without jeopardizing the protection provided by the attorney-client and work product privileges. Indeed, a disclosing entity required to obtain counsel's views for the specific purpose of providing disclosures in its financial statements would encounter a risk of waiver even if the communication from counsel is not directly shared with the auditors, in that the substance of such attorney-client communications would have been intended to be disclosed to third parties and, thus, arguably was not confidential. The risk that a particular assessment could be obtained by an opposing party is heightened by the fact that the applicable state or federal law regarding the scope and waiver of the attorney-client and work product privileges may vary depending upon the particular forum in which the litigation is pending. Even worse, the Exposure Draft's requirement of additional qualitative disclosures would increase the risk that litigation adversaries would ask courts to declare that such disclosures constitute broad subject matter waiver, which could lead to discovery of litigation analyses that were not prepared for use in connection with audits.

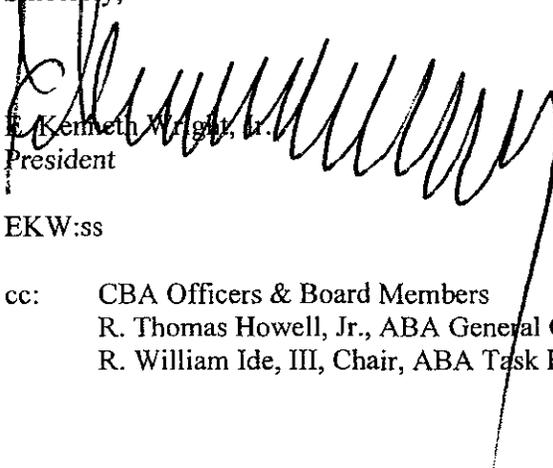
The existing standard of SFAS 5 works reasonably well, is consistent with basic accounting concepts, and strikes the right balance between transparency in reporting and reporting entities' interests in protecting their ability to defend themselves against threatened and on-

going litigation. Under SFAS 5, a contingency must be disclosed when its occurrence is "reasonably possible," but it only needs to be valued if it is capable of being valued. The "reasonably possible" standard is being applied consistently and effectively today. As the ABA notes, it is the experience of the organized bar that affected constituents understand the current disclosure practices as they relate to legal matters and understand that detailed descriptions and predictions about such matters would not only be imprecise and potentially wrong, but could prejudice the disclosing entity. The current standard has the advantages of ease of application, cost effectiveness, protecting the legal rights and strategies of the disclosing entity and auditability. The CBA believes that the proposed standard falls short under each of these measures and is inconsistent with reliability and consistency in financial reporting and avoidance of unnecessary volatility.

In summary, the CBA is concerned that the Exposure Draft's approach to disclosure of non-financial liabilities, particularly those involving litigation, would be cumbersome and expensive to apply, could be prejudicial to reporting entities, would be subject to error, could lead to meaningless volatility in financial disclosures, would undermine the well established relationship between disclosing entities, their attorneys, and their auditors, and would be a backward step in the effort to achieve more transparent, timely, and useful financial reports. The CBA therefore urges the Board to reject the Exposure Draft.

The CBA would like to participate in one of the Board's Roundtable meetings regarding the Exposure Draft. This request is also contained in a letter that has been submitted under separate cover. The CBA appreciates the Board's consideration of that request and the comments contained in this letter.

Sincerely,



E. Kenneth Wright, Jr.
President

EKW:ss

cc: CBA Officers & Board Members
R. Thomas Howell, Jr., ABA General Counsel
R. William Ide, III, Chair, ABA Task Force on Attorney-Client Privilege