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August 1, 2008



LETTER OF COMMENT NO. 24

Technical Director
File Reference No. 1025-300
Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Exposure Draft: Disclosure of Certain Loss Contingencies

Dear Director:

I write in response to the FASB's invitation to comment upon the exposure draft, "Disclosure of Certain Loss Contingencies." My comments are limited to loss contingencies arising out of litigation. I write from the perspective of a partner and general counsel of the law firm of Montgomery, McCracken, Walker & Rhoads, LLP. The views expressed herein are solely my own, and not those of the Montgomery McCracken firm.

I will start with three general observations, and then will turn to the Board's specific questions #1 and ##4-14, inclusive.

First, the threshold question is whether or not the outcome of litigation contingencies can be forecast with sufficient reliability to make quantitative disclosures relevant to financial statement users. To be relevant, quantitative information about the possible loss or range of loss from litigation contingencies should be representative of the entity's actual exposure. Many sophisticated clients regularly develop litigation forecasts themselves and/or request and receive such forecasts from outside counsel. Presumably they find the quantitative information useful, even allowing for the inherent uncertainty of the exercise. Thus, the goal of providing more timely and relevant disclosures about litigation contingencies to financial statement users may be achievable. Whether that goal is achievable at a reasonable cost is an entirely different matter.

Second, an entity's "best estimate" of "maximum exposure" arising out of litigation contingencies appears to be an inherently contradictory concept, because a highly improbable boxcar number representing what might happen in the worst of all worlds is not a best estimate.

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Technical Director

August 1, 2008

Page 2

Thus, the proposed Statement's expansion of disclosures about litigation loss contingencies will not advance the goal of assisting financial statement users in assessing the likelihood, timing, and amount of future cash flows associated with litigation.

Third, disclosure of an entity's actual exposure to litigation contingencies would be enhanced by incorporating defense costs into the analysis. Much litigation is non-meritorious, yet expensive to defend. Hence, defense costs can represent a significant amount of an entity's litigation exposure. Moreover, aggregation of a reasonable estimate of expected defense costs in quantitative information about litigation loss contingencies would be less prejudicial to the entity making the disclosure. It may well be that the entity intends to defend claims to the hilt. Thus, an adversary could not draw inferences about the entity's strategy, view of the merits or opinion of the settlement value of a particular claim from disclosure of an aggregate best estimate.

Question #1: Will the Statement Meet the Project's Objective?

In its current form, I do not believe that the proposed Statement will meet the project's objective of providing enhanced disclosures about litigation loss contingencies because aggregation of an entity's "maximum exposures" will produce a meaningless, inflated and unreliable estimate.

Providing a realistic assessment of maximum exposures is not a mechanical exercise of copying numbers from filed Complaints. (See further response to Questions #4 and #5, below.) If outside lawyers were required to respond to auditor's inquiries and/or to assist their clients in developing maximum exposure estimates, the legal fees charged for such responses or assistance would increase substantially. In order to justify that cost, the Board should focus upon whether it is practicable to increase the benefits to financial statement users by disclosing realistic estimates, instead of maximum estimates, of the outcome of litigation contingencies and the associated costs of litigation.

Question #4: Are the Amounts Claimed as Damages or Maximum Exposures of Claims Relevant?

a. The amounts stated in litigation claims or assessments are not necessarily correlated to an entity's litigation exposure. Indeed, in many jurisdictions it is improper to plead a specific dollar amount of unliquidated damages. *See, e.g.,* Pa. R. Civ. P. 1021(b) ("Any pleading demanding relief for unliquidated damages shall not claim any specific sum"); N.J.R. 4:5-2 ("If unliquidated money damages are claimed in any court, other than the Special Civil Part [where the amount in controversy does not exceed \$15,000], the pleading shall demand damages

Technical Director
August 1, 2008
Page 3

generally without specifying the amount"). Thus, in many types of litigation, such as mass tort, product liability, personal injury, defamation, securities, there are no "claim amounts," and entities would be required to spend a lot of time, effort and money to develop maximum exposures.

If time, effort, and money are required to be spent, the goal should be to develop a realistic exposure analysis.

b. If "best estimates" are optional, then the enhanced disclosures of the proposed Statement are no better than the disclosures that are made today.

c. If, but only if, preservation of the attorney-client privilege and attorney work product protection in state and federal courts can be assured through appropriate legislation and/or rule-making, I would require quantitative disclosure of the best estimate of the aggregated settlement value and costs of defense of the entity's pending or threatened litigation. The best estimate could be a range. Maximum exposure would not have to be disclosed unless an entity was exempt from disclosing its best estimate because such disclosure would be prejudicial.

Protection of the attorney-client privilege and attorney work product in state and federal courts is a prerequisite to disclosure of an aggregate best estimate of litigation contingencies. If the analyses (or component parts thereof) prepared by clients and counsel are discoverable, then the costs of the proposed Statement and of the alternatives proposed in this Memorandum will outweigh any benefits. Federal legislation, such as the bill proposing enactment of Federal Rule of Evidence 502, or conceivably SEC regulation would in all likelihood be required to bind the state and federal courts.

Question #5: Will an Entity Be Able to Provide a Reliable Estimate of Maximum Exposure?

Entities, with the assistance of counsel, can provide estimates of maximum exposure to loss, whether an amount of damages is pled in a Complaint or not. The real question is whether the aggregate of these maximum exposures is meaningful to users of financial statements. I very much doubt that it would be, because unless the entity has only a few litigation contingencies (in which rare case, disclosure of the estimates is likely to be prejudicial and hence exempt), there is no way for a financial statement user to assess the probability of loss or the reasonable range of exposure.

Assuming that the forecast will be prepared with input from persons who have given substantive attention to the litigation, the incremental cost of forecasting the entity's realistic

Technical Director

August 1, 2008

Page 4

range of exposure to litigation loss contingencies over the cost of forecasting its maximum exposure should not be great. To get from the worst case to a realistic scenario, the strength of the entity's defenses, its probability of succeeding on the merits, the settlement value of similar cases (if known), and the costs of defense should be factored into the analysis. In all likelihood, the entity's inside and outside counsel will have done, or will be doing, that analysis in the context of defending the litigation.

Question #6: Should Disclosure of Settlement Offers Be Required?

Settlement offers generally are considered confidential, and required disclosure of offers could have the unintended consequence of prolonging litigation and making advantageous settlements more difficult to reach. The costs of this idea are likely to outweigh the benefits.

If a "best estimate" paradigm were in place, settlement offers would inform an entity's judgment of the amount or range of expected loss in a particular litigation contingency.

Question #7: Tabular Reconciliation of Recognized Loss Contingencies

Traditionally, under the American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information and Statement on Auditing Standards #12 (the ABA/AICPA "Treaty"), a lawyer will not express any opinion in audit response letters on the outcome of a litigation loss contingency or the extent of possible exposure unless the lawyer concludes that liability is either probable or remote. In my experience, it is rare for a lawyer to have sufficient information to reach such a conclusion. Because the criteria for recognition of litigation loss contingencies frequently are not met until the outcome (settlement, verdict or judgment) is known, a tabular reconciliation limited to recognized litigation loss contingencies may have little predictive value in assessing future cash flows.

A tabular disclosure of changes in the forecast of litigation outcomes and costs of defense, similar to that proposed in paragraph 8(a)-(d) of the Statement for recognized loss contingencies, could tell a reader of financial statements a lot about litigation trends affecting the entity and how well the entity manages its litigation exposure.

Question #8: Should There Be an Exemption from Disclosing Prejudicial Information?

Yes. Litigation adversaries are not intended beneficiaries of an entity's financial statement disclosures. In the absence of an exemption, the costs to the entity's constituents, including the users of its financial statements, will outweigh the benefits of the proposed Statement.

Technical Director
August 1, 2008
Page 5

Questions #9 and #10: Two-Step Approach to Reduce Prejudicial Effects of Disclosure

I would modify the Statement's approach. An entity's quantitative disclosures should be aggregated at the highest (*i.e.*, the entity) level to reduce the prejudicial effect of disclosure. Qualitative disclosure of material litigation contingencies should continue to be made as it is today.

I agree that there should be a second-step exemption for entities, especially smaller companies, that do not encounter litigation contingencies on a routine basis and whose aggregated disclosures could be reverse engineered by an adversary to gain otherwise protected information about the entity's strategy or exposure to identifiable pieces of litigation.

I could not predict the frequency in which the second-step exemption would properly apply.

Question #11: Definition of Prejudicial Information

I agree with the definition.

Question #12: Interim and Annual Reporting Periods

There are two apparent operational difficulties.

First, it is impractical to prepare reasonable quantitative estimates of "maximum exposure" or, under the approach advocated in this letter, settlement value and defense costs, by the end of the quarter in which the litigation contingency becomes known. The difficulty is inherent in the fact that in many cases, there is no specification of a specific dollar amount claimed by the plaintiffs. The difficulty increases along with the novelty, size and complexity of the particular litigation. Thus, reporting entities should be allowed reasonable lead time--not less than six months in my view--to prepare initial estimates.

Second, depending on the type of evidential matter that an entity will be required to have to support its litigation estimates, the costs of interim disclosures may be prohibitive. Responses in conformity with the Treaty as it stands today provide evidence of the existence of litigation contingencies, the progress of the litigation, and the entity's response, but rarely provide information about the maximum exposure or likely outcome of litigation. If the Exposure Draft's

Technical Director
August 1, 2008
Page 6

approach or something like it were to be adopted, the Treaty has to be amended to take FAS #16x into account.

For example, the Treaty could be amended to permit outside counsel to confirm to the entity's auditors that the entity's quantitative estimates for matters to which counsel have devoted substantive attention have been reviewed and that, in the opinion of counsel, those estimates are not unreasonable. Such a response to auditor's inquiry would provide some comfort, beyond the entity's representation, about the entity's quantitative estimates. Amending the Treaty in this respect would be less expensive for the entity than an alternative regime in which the auditor would engage (or require the entity to engage) separate counsel or valuation experts to sample the components of the entity's quantitative disclosure of litigation contingencies for reasonableness. Both approaches entail considerably more work, and expense to the client, than the standard responses under the Treaty require today.

Question #13: Should Other Information About Litigation Loss Contingencies Be Disclosed?

For the reasons stated above, I believe that quantitative disclosure of the entity's best estimate of its reasonable exposure to litigation loss contingencies is a superior alternative to the Statement's requirement of disclosure of the entity's maximum exposure. The disclosure would be further improved, and its publication would be less prejudicial to the entity, by including the entity's best estimate of defense costs in the aggregate.

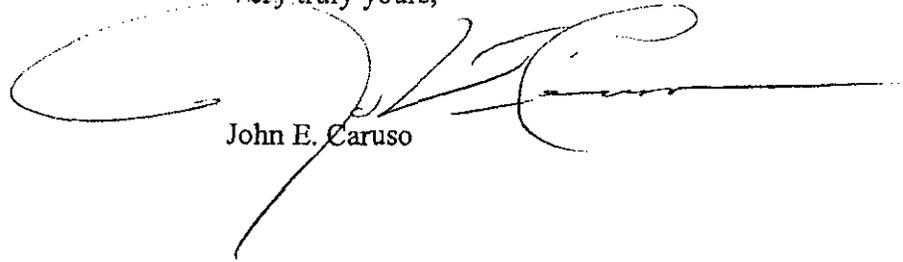
Question #14: Is It Feasible to Implement the Statement for Fiscal Years Ending After December 15, 2008?

No. December 15, 2008 is far too ambitious as an effective date. Consensus among clients, regulators, accountants and lawyers should first be reached on the threshold questions of whether or not the outcome of litigation contingencies can be forecast with sufficient reliability to make quantitative disclosures relevant to financial statement users, and whether the benefits of disclosure of the aggregate of such forecasts outweigh the increased costs and possible prejudicial effects of preparing, auditing and publishing them. If a consensus exists that quantitative disclosures are reliable and useful despite their inherent uncertainty, and that the benefits of including them in financial statements exceed the costs and risks, then implementation issues have to be addressed, such as: (a) should outside lawyers have a role in responding to auditors' inquiries about maximum or most likely litigation exposures on an annual or an interim basis; (b) if not, how are the entity's disclosures to be audited; (c) if so, how should the Treaty be amended; and (d) if evidential matter is to be obtained from directly or indirectly

Technical Director
August 1, 2008
Page 7

from counsel representing the entity, how can attorney-client privilege and work product protection be assured.

Very truly yours,

A handwritten signature in black ink, appearing to read "John E. Caruso". The signature is written in a cursive style with a large initial "J" and "C".

John E. Caruso

JEC:cbb