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August 5, 2008

LETTER OF COMMENT NO. 30

Mr. Robert H. Herz Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: Disclosure of Loss Contingencies (Exposure Draft of June 5 on Proposed Amendment of FASB Statement Nos. 5 and 141(R)), File Reference No. 1025-300

Dear Mr. Herz:

I wish you and the other Board members my best as you seek to reconcile the many comments you are receiving on the June 5 exposure draft on FAS 5. Rather than covering all the strengths and weaknesses of the draft, which are being more than amply discussed by other commentators, I'd like to step back from the details and simply offer a bit of perspective.

At the risk of stating the obvious, what is really going on here – at least insofar as the exposure draft is applicable to loss contingencies arising from litigation – is a fundamental difference between two cultures. One is the culture of financial reporting and its commendable commitment to transparency. The other is the culture of our adversary system of justice which necessarily balances the objective of transparency against prejudice to litigants seeking to have their day in court. It should not be surprising, therefore, that commentators on this exposure draft can offer such differing, but well-intentioned and genuinely held, views.

I believe that the two cultures may be reconcilable for purpose of FAS 5. But as a starting point for any attempted reconciliation, one aspect of the exposure draft, in my view, requires serious modification. That aspect involves the exposure draft's requirement that the financial statement preparer publicly report predictive information regarding the outcome of its litigation. I would respectfully submit that such a requirement should be eliminated for at least two reasons. First, such predictive information would almost inevitably influence the outcome of the proceeding — either through its admissibility against the preparer at trial or its use against the preparer in pre-trial settlement discussions. Second, in seriously litigated disputes, predictions of outcome are often impossible.

It is to the Board's credit that it seeks to mitigate these concerns through the possibility of aggregation. While that attempt is commendable, however, it doesn't really solve the problem. The prominence of

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large litigation often cannot be disguised by aggregation, and both large and small litigation would presumably be the subject of robust discussion with the outside auditor in disaggregated form, thereby making highly prejudicial information potentially available to adversaries through loss of the attorney-client privilege. Of course, the approach of aggregation is incapable of dealing with the problem of coming up with predictions to begin with.

I hasten to add, though, that elimination of the predictive aspect of the exposure draft need not compromise the quality of informative disclosure. For instead of statements of prediction, the preparer in most cases (I'll get to the unique challenges of class action litigation in a moment) could set forth objective circumstances allowing the reader transparently to evaluate the amount of money in dispute. I offer the following as an illustration, based on the hypothetical disclosure of a contract dispute:

"We entered a contract to provide 1,000 widgets for \$1 million. Lightening struck our manufacturing plant and we did not deliver the widgets. The would-be recipient has sued us based on a contention that we breached the contract. It is our contention that our performance was excused by an act of God."

This kind of disclosure – which is basically built on the historical information sought through exposure draft paragraph 7(b) – contains no predictive element but, nonetheless, gives the user a fair sense of what is going on in the litigation and the amount of money in dispute. Insofar as virtually all predictions are based on existing circumstances and historical experience, the more productive approach is to focus on those features, as the non-predictive aspects of paragraph 7(b) obviously seek to do. My point is that loss of the element of prediction need not compromise the usefulness of the disclosure.

Now we get to class actions. The challenges here are many, for the precise contours of class action liability are often uncircumscribed, damages theories are often entirely speculative, and meaningful information as to exposure is unavailable. Again, I seek to make the point with an example of illustrative disclosure, this one involving litigation against a hypothetical manufacturer of paint cans:

"From 1957 through 1959, we owned a subsidiary that manufactured paint cans. Some of those cans were used by manufacturers of lead-based paint. We are one of 141 defendants that have been sued in a world-wide class action litigation allegedly brought on behalf of all individuals in the world who, from 1947 through 1972, were allegedly harmed by lead-based paint."

The simple fact is that, however one might try, there is no way a preparer can put forth meaningful disclosure as to the amount at issue. An analogous problem is posed in much securities class action litigation in which a decline in stock price over a period of months or years might be attributable to a number of economic and business circumstances with the preparer being completely incapable of isolating that part of the decline the plaintiffs would eventually contend to be attributable to the alleged securities law violation at issue. In these kinds of situations, perhaps the best approach might be along the lines of the disclosure contemplated by FIN 47 ¶ A13.

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I do not mean to suggest by this letter that it is clear to me that the current standard, and disclosure pursuant to it, are inadequate. I understand that objective data on that issue will be submitted by some of those commenting on the exposure draft. As that data is evaluated, I would urge one caveat. I would caution against extrapolating to the general population of litigation from the unique frustrations resulting from class action litigation. For the reasons described above, class action litigation presents particular challenges, among them that quantification is often impossible and, when a resolution is struck, things tend to come together very quickly, sometimes within days or even hours. Understandable user frustration with class action litigation (they are not alone) should not drive the Board's reevaluation of FAS 5.

All of that having been said, if improvement is warranted, I would suggest that the Board seek a middle ground that both seeks to accommodate the objectives of users while preserving the ability of preparers to have their day in court without undue prejudice. I have every confidence that the Board will rise to the challenge.

Very truly yours.

Michael R. Young

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