MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Disclosure of Certain Loss Contingencies (Milne ext. 393)
Subject:	Minutes of the March 6, 2009 Morning Session Roundtable Meeting: Disclosure of Certain Loss Contingencies
Date:	May 26, 2009
cc:	FASB: Bielstein, Golden, Stoklosa, Proestakes, Leisenring, Elsbree, Lott, Posta, Glotzer, C. Smith, Mechanick, Hood, Brickman, Fanning, Milne, Gabriele, Chookaszian, Klimek, Galloway (GASB), Intranet; IASB: Brown, Baldurs

The Roundtable minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FASB Staff Position.

Topic:	Disclosure of Certain Loss Contingencies
Basis for Discussion:	Exposure Draft, *Disclosure of Certain Loss Contingencies* FASB Roundtable Agenda and Examples of Disclosures (See Appendixes 2 and 3)
Length of Discussion:	9:00–11:30 a.m.
Attendance:	See Appendix 1

Objective of Meeting:

1. The objective of this meeting was to solicit feedback from constituents regarding the proposed improvements to disclosures of certain loss contingencies. The basis for discussion was the FASB Exposure Draft, *Disclosure of Certain Loss Contingencies*.

Statement 5—Guidance or Implementation

2. Mr. Golden posed the question of whether there is a problem with the disclosures requirements in FASB Statement No. 5, *Accounting for Contingencies,* or whether the problem lies with the implementation of Statement 5.

3. Mr. Finnegan began by referring to a survey the CFA Institute discussed in its comment letter in which investors assessed the importance of contingency disclosures. He noted that based on the survey, there appears to be an information gap between the importance investors place on these disclosures and the quality they believe is actually provided. He stated that investors are not necessarily looking for management's specific estimates of possible loss, because they recognize that disclosure of that information may not be in their best interest if it will prejudice the position of the company. He said that improvements need to be made and should focus on the following areas:

   a. Material contingencies that are remote should be disclosed and there should not be a time frame requirement.
   b. Qualitative information should be easier for investors to find. Publicly available information, which often is not readily accessible, should be presented in a synthesized and organized fashion. He also suggested that companies provide an electronic link in the notes to the financial statements to more detailed case descriptions;
   c. Cost of disclosures should not be an excuse for lack of disclosures. The nature of the contingency needs to be understandable to users.

4. Mr. Kabureck stated that the alleged problems with contingency disclosures are not a result of deficiencies in Statement 5. Statement 5 is a principles-based standard that works. He believes the goals in the Exposure Draft are unattainable because of the adversarial nature of the U.S. legal system. He noted that any new information beyond what is disclosed today could be prejudicial, and although the Exposure Draft has a prejudicial exemption, it also states that its use should be rare. He believes that its use would not be rare. He asserted that many times claims are exaggerated and that large, frivolous amounts would be disclosed under the Exposure Draft, which would prove to be unreliable because the actual settlements often are significantly different.

5. Ms. Seidman referred to Example 1 as a very limited disclosure and Example 2 as a very robust disclosure, even though they were both provided under current GAAP.[1] She asked what the arguments are for companies not to make disclosures more consistent with Example 2, which includes some very large numbers. She wondered why there is resistance to the types of disclosures that are already being provided by some companies.

6. Mr. Kabureck responded that the cases disclosed in Example 2 were cases that received a lot of press coverage, but the majority of companies do not have this level of prominence in the financial press. The main concern is about providing evidence to a company's adversaries. When there is a significant charge to income, as there is in Example 2, usually that is going to be disclosed.

7. Mr. Keller commented that Example 2 is good disclosure and is easy disclosure to make because the numbers were fines that already had been assessed. It would be more interesting to go back to a point in time before the fines had been assessed to see what the company disclosed then. He also responded to Mr. Golden's question about some people's characterization of this project as "a solution in search of a problem." The problem, which he said already has a solution, is

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[1] The examples discussed are included in Appendix 3, *Examples of Disclosures for Discussion Purposes*, which was circulated to roundtable participants.

balancing competing interests of disclosure costs with the value provided by disclosures. Statement 5 pursues that balance. He asked what should be expected of disclosures given the uncertainties in the judicial system and the reliability of disclosures that are based on outrageous claims. He stated that disclosure could always be improved and referred to the improvements in environmental disclosures after the SEC issued guidance in the 1980s. He suggested that guidance be issued outlining common deficiencies in disclosures and setting forth the expectations about what is appropriate disclosure.

8. Mr. Huber noted that the Exposure Draft would require the same information to be disclosed about a case at the beginning as it requires toward the end of a case. Even when there is a track record of cases (for example, asbestos) things can happen that change the entire circumstances, such as an unexpected court decision. He said there are uncertainties in every case. He cited the Supreme Court decision with respect to Wyeth[2] earlier in the week as an example of a decision that nobody could have predicted. He stated that Regulation S-K, Item 103 was written to complement Statement 5 and to include, in a narrative, facts investors wanted but were not found in the financial statements. He said that putting the information into financial statements and requiring it to be subject to audits and reviews may result in unintended consequences.

9. Mr. Quaadman stated that information about court cases can be difficult to get but claimed it is a problem with court administration, not financial reporting. He cited a study authored by Professor Joseph A. Grundfest,[3] which concluded that investors already have enough information about litigation, as indicated by stock price movements. He said that disclosing insurance or indemnification arrangements notifies others who the *deep pockets* are and results in defendants having to play the game with an open hand, which generally is constitutionally not allowed.

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[2] See *Wyeth v. Levine* Opinion of the Supreme Court of the United States.
[3] See Comment Letter No. 85.

10. With regard to the question whether certain contingencies whose likelihood of loss is remote may be material to users, Mr. Bell stated that a defendant often does not know the likelihood and effect of a case, especially in a tort liability case or if it is the company's first litigation of that type.

11. Commenting on asbestos disclosures, Mr. Lewis noted that some companies ignored the results of other companies' cases and, as a result, underestimated their liabilities. He also noted that *remote* is in the viewpoint of management, who may be in denial about the case. He stated that cases that have the potential to be severe should be disclosed in a narrative regardless of whether the risk is near-term or long-term. There needs to be an approach to require adequate disclosure of emerging hazards.

12. Mr. Larkins indicated that nobody argues with the need for high-quality disclosure of relevant contingencies. He noted that preparers wrestle with the tradeoff between relevance and reliability. Many concerns are about initiating disclosures early in the case when the disclosure is based on speculation, which would further result in conflicting disclosures as the case evolves over time. It is important that cases that have a potential for large amounts be disclosed prior to a verdict being reached, and he believes under the existing standard most companies follow a rule that there should be no surprises for investors. He thinks that adequate disclosure can be given within the construct of the existing Statement 5. Current investors would not be pleased with a disclosure standard that would cost the company more money.

13. Mr. Keller noted that *materiality,* as defined by the Supreme Court, involves a combination of magnitude and probability. He believes that thinking of cases in terms of *materiality* would result in better disclosures. In this context, there may be cases that are material to users even though a loss is considered remote, because they are *bet-the-company* kinds of cases. There are different kinds of litigation patterns and it would be virtually impossible to have one rule for every pattern. He suggested creating a principle-based approach, supported by guidance

that recognizes the different patterns. For example, with regard to asbestos litigation, using a framework of industry standards and numbers based on historical data would allow users to have relevant data on how cases have resulted in the past without requiring management to make predictions. On the other hand, one-off cases do not have the same type of historical data and do not lend themselves to prediction.

14. Mr. Hurwich stated that in litigation there are divergent interests between the reporting entity and its shareholders. He said that those divergent interests cause the nature of reporting to be questioned. He raised the question of what triggers should be in place to protect shareholders from management's interests getting in the way of disclosing information that they do not want to report but that is important to shareholders.

15. Mr. Golden went back to Mr. Larkins' point about the interests of a current investor versus a future investor. He asked Mr. Hurwich if there needs to be a distinction between a current investor and someone who is contemplating becoming an investor. Mr. Hurwich responded that he thinks there is no conflict of interests between current and future investors. He stated that disclosure needs to be based on the fiduciary responsibilities to shareholders and the probability and magnitude of the outcome.

16. Ms. McEnally stated that investors need to understand the operations and risks of a company. She asked why the information sometimes is not provided to enable investors to distinguish between low-risk and high-risk companies. She said that Statement 5 tends to produce disclosures similar to Example 1 rather than Example 2. Even though the company in Example 2 is high profile with global, continuous litigation, the disclosure goes beyond what might be considered the requirements of Statement 5. She pointed specifically to the disclosure of a possible additional exposure of $2.2 billion. As an investor, this is 99.9 percent of what she wants to know. This, in combination with the qualitative disclosure and her understanding of the company's operations, gives her the ability to evaluate

the potential severity of the risk. She said she understands that small companies rarely can provide disclosure like Example 2. She went on to say that even for most large companies, like the company in Example 2, the disclosures often are boilerplate like in Example 1. She asked what can be done that does not destroy American business but still provides investors with an understanding of the company's risks exposure profile.

17. Mr. Levi responded that what is available for disclosure depends on the stage of a case. He suggested that the cases in Example 2 are likely far enough along so that such estimates can be made, and that that is not always the case. He noted that an important question involves companies' definition of *remote* because some companies have different definitions. He noted that disclosures will improve as the case progresses towards resolution.

18. Mr. Larkins clarified that he thinks there should not be different disclosure requirements for current and future investors. He noted that there are different risks and rewards for current investors versus future investors. He also raised the point that there seems to be an underlying presumption that if there is an unpleasant surprise with regard to litigation, inherently that means that the previous disclosure was inadequate. He questioned that presumption, while acknowledging that management should try to minimize surprises.

19. Mr. Huber stated that he believes Statement 5 is producing the necessary information that investors need. He said there are other early warning systems under the federal securities laws that provide the disclosures about the issues that seem to be the cause of complaint.

20. Mr. Golden asked investors if Item 103, *Legal Proceedings*, and Item 303, *Management's Discussion and Analysis of Financial Condition and Results of Operations* (MD&A), of Regulation S-K provide the information they need.

21. Mr. Finnegan recommended that the SEC and the FASB staffs work to develop a streamlined approach to disclose loss contingencies without compromising full

disclosure. He noted a tabular presentation would be useful to summarize data about the nature of loss contingencies. He said that there is a lot of soft information available in the public domain that could be disclosed and suggested that investors would not object to moving those disclosures out of the financial statements so that it would not have to be expertized.

22. Mr. Huber stated that the point is the ability to quantify, to reasonable estimate, and to have a reasonable basis for any estimation. He noted that there are too many uncertainties and the quantification issue will be the same whether the disclosure is in Item 103 or in the footnotes. He commented that inaccurate estimates may result in additional liability.

23. Mr. Siegel asked whether the information is available and whether there is a difference between current and future investors. He noted that in his previous role analyzing financial statements, he needed to hire a legal analyst to actually go to court and report the information back to him because the information was not readily available even though the information was public. He noted that investors usually do not want to wait for reporters or go to the courts themselves.

24. Mr. Lewis stated that in his research Regulation S-K does not provide investors sufficient disclosure of product toxicity and product liability suits. He also cited a University of Arkansas study that concluded that 73 percent of companies are not complying with the SEC rules on environmental enforcement proceedings. He noted that this raises questions about enforcement.

25. Mr. Hurwich noted that a better framework needs to be developed but a standard cannot mandate good management. The ultimate responsibility lies with the shareholders and their ability to hold management responsible for not providing appropriate disclosure.

26. Ms. Minke-Girard said she had looked at some filings prior to the roundtable and noted that many companies had little disclosure in the Legal Proceedings sections of their Form 10-Ks even when they had significant disclosure in the footnotes.

She addressed those constituents who believe the SEC should improve disclosures and asked what they would like the SEC to do to effect those improvements.

27. Mr. Keller noted that there are a variety of things the SEC can do. One of the reasons why there may not be robust disclosure in Item 103 is that it is only part of the total financial reporting package. MD&A, Item 103, and the footnotes to the financial statements may all have information about loss contingencies. He asked whether the baseline information is available for investors to do their own analysis and exercise judgment. He said that securities class action lawsuits would have astonishing maximum exposure to loss, but the reality is that they often settle for only about 2–5 percent of such an amount. Investors know this and factor it into their analyses. Referring to the environmental disclosures, he noted that if companies are not complying, it is not because there is not a clear rule. Rather, it is a matter of implementation and holding management responsible. This process involves auditors, enforcement, civil litigation, and shareholder voting.

28. Mr. Huber commented that before the current environmental disclosure requirement, there was a requirement to disclose *all* environmental claims against a company. He said that U.S. Steel once had 12 pages of such disclosure in its proxy statement. This raises the issue of inundating users with information, so the question of how much disclosure is appropriate needs to be constrained by what is material. Regarding relevance and reliability, the disclosures need to tell users what management *knows*, not what they *think*.

Threshold for Disclosure

29. Mr. Golden moved on to the threshold for disclosure and asked if there should be a different level of disclosure for remote contingencies.

30. Mr. Crawford said the issue here is trying to draw the line between disclosing what is known and disclosing the extent to which there is information that is not known. What is not known is probably more relevant and important to users. Presuming a common

understanding of the term *remote*, it is reasonable to assume that the level of specificity in the disclosures would inherently be less than if a loss contingency is reasonably possible. That is presuming there is a requirement to disclose contingencies deemed to be remote, and he clarified that he was not making a statement about whether he believes it would be appropriate to require disclosure of remote contingencies.

31. Mr. Keller asked whether there is even an issue about remote contingencies. He said that in the hundreds of attorneys' letters he has reviewed, everything seems to end up in the middle—reasonably possible—and attorneys rarely assess a case to be probable or remote.

32. Many participants agreed that this is true but that it is also problematic. Mr. Crawford noted that almost everything falls in the *reasonably possible* category, and that this represents a wide spectrum.

33. Mr. Keller asked whether that was really a problem. If a loss is reasonably possible, it is required to be disclosed. The real issue becomes what a company can disclose about that case.

34. Mr. Crawford acknowledged Mr. Keller's point but noted that the issue is that for nearly every case, the loss is categorized not just as reasonably possible but also as not estimable.

35. Mr. Evans stated that his firm sees very few contingencies that go from being remote to being a loss. The issue seems to arise when (a) a loss is reasonably possible and not estimable and, therefore, there is no quantitative disclosure and (b) subsequently a loss is recognized.

36. Mr. Kabureck commented that the issue is not the assessment of *remote* versus *reasonably possible* but whether or not management can even assess the likelihood. Some claims may be remote with some legitimacy, while other cases may be completely frivolous. He asked whether there is a way to articulate in a standard how to distinguish between remote and frivolous. He commented that there may need to be different degrees within the category *remote*.

37. With regard to hazardous substances, Mr. Lewis raised concerns that companies may be relying on their own scientists to assert that risks related to those substances are remote, despite the existence of studies that indicate otherwise. He stated that disclosures need to identify that there are existing, unasserted claims that could result in severe risk to the company, even when those risks are long-term. He observed that companies that issued collateral debt obligations may have assessed the risk that housing prices would decline as remote.

38. Mr. Quaadman stated that the Exposure Draft is trying to require people to know the unknowable. In Example 2, the facts are known. He said there are too many uncertainties in litigation and asked how to quantify a surprise. He questioned the value of requiring an entity to disclose information that would be harmful to it if it believes it has meritorious defenses. Ms. Seidman said that there is a lot of room for improvements from Example 1 to Example 2 regardless of the stage of the case. She noted that Example 1 did not provide qualitative information. Mr. Golden asked why a company could not explain in disclosures why it believes it has meritorious defenses. Mr. Quaadman said that this type of disclosure would reveal a company's defense strategies, tip off the plaintiff as to the entity's limits in terms of potential settlement, and effectively start negotiations out in the open.

39. Mr. Linsmeier commented that it is hard to write a standard that would account for every type of contingency at every point in time. He exaggerated that some issuers and their counsel seem to believe all suits are frivolous, nobody understands what is going on, and there is no need for disclosure. On the other hand, he observed that investors often overreact by asserting that everything is known by management ahead of time and everything is a surprise to the investors. He said the difficultly is trying to write a standard that works throughout a case's progression and provides users with information at an earlier stage of the case than they are getting it customarily today. He also stated a belief that it is natural human bias for things to appear a little more optimistic or uncertain to defendants and their attorneys. The issue is not about frivolous cases, but rather about the cases that result in losses. He also indicated that he thinks that a distinction between current and future investors is not meaningful.

40. Mr. Leisenring commented that even public information is currently difficult for users to find.

41. Mr. Smith noted that Example 1 indicates only that there are claims against the company but does not indicate the types of claims. He stated that there is factual information that is not prejudicial and could be disclosed to enable users to figure out if the type of claim would affect the fundamental business activities or products of the company. He urged for a meeting of the minds about what information can be provided without damaging a company. In response to those who would say that Statement 5 is adequate and merely needs to be complied with properly, he suggested that maybe the FASB needs to do something to reemphasize the current requirements or perhaps improve upon those requirements.

42. Mr. Herz said that sometimes people are too optimistic as a natural tendency. One way of dealing with that is to force disclosure of more factual information. On the other hand, the FASB does not want to require disclosures that would create negative self-fulfilling prophecies.

43. Mr. Young stated that there is a distinction between *contentions* and *predictions*. He said it would be useful disclosure for the company to say: we have been sued, these are the circumstances, this is what the plaintiff contends, we believe we have meritorious defenses, these are our defenses, and this is the amount of money at stake if there is a quantification. This information would be in the public domain and not prejudicial. He noted that the danger comes when a company tries to make predictions. There needs to be a balance between the users' desire for information and the prejudice and difficulty of predictions. He said that by thinking in terms of contentions—which provide useful, factual information—and distinguishing them from predictions, a lot of the tension and stress goes away. Many participants seemed to agree with Mr. Young's view.

44. Mr. Finnegan noted that there are some cases with very unique circumstances to the company, and then there are cases in which the circumstances apply broadly to an entire industry. He said that when the latter type of case begins to settle and there is a methodology to the settlements, that information would be useful information to help a

user gauge the potential exposure. He noted that, based on his discussions with other analysts, there were cases of nondisclosure by companies in advance of material settlements, even though it was broadly known that investigations were taking place. He also stated that the nature of the qualitative disclosure requirements proposed in the Exposure Draft (description of the nature of the contingency, how it arose, and its legal or contractual basis) is not invasive.

45. Mr. Keller said that regarding Mr. Young's point, the problem lies with what will be mandated. He stated that just because there is a claim amount in a complaint and it is publicly available information, that does not mean it should be mandated in the disclosure. It could cause a distortion even with qualifications because once the amount is disclosed in the financial statements, it takes on a life of its own and could be distortive. Companies have to be able to exercise judgment on a materiality basis whether to disclose that number.

46. Mr. Leisenring asked how a number gets a different meaning and "takes on a life of its own" if it is simply lifted from the court filing and included in the financial statements.

47. Mr. Keller stated that presentation is an important part of disclosure. It goes to tabular presentations of unreliable information. There is a distortive quality and preparers have to be in a position to exercise judgment. He clarified that he is not saying that a claim amount should never be disclosed. With regard to Example 1, he said these are likely run-of-the-mill lawsuits that do not deserve to be called out.

48. Mr. Golden stated that there is some concern that the disclosure of the claim would cause plaintiffs to set extraordinarily high claims to force quick settlements.

49. Mr. Reinphaler stated that a company's obligation to investors is to minimize the risk that it would have to payout large sums of money in judgments or in settlements. He said any rule of disclosure that would increase the risk that a company would have to pay out a large amount to resolve litigation would harm investors. He noted that attorneys have certain times in litigation when disclosures are required, for example, when defendants have to lay out their theories of the case. Any rule that would require the defendant to lay out its theories of defense prior to when disclosure is required by the litigation rules would provide the plaintiffs with an unfair advantage. He further stated that requiring a company to estimate what its exposure would be if the company lost the case would send a message to the plaintiff's attorney about settlement strategy. This would make it difficult to negotiate the best deal possible and would precipitate early, less advantageous settlements.

50. Mr. Reinphaler went on the say that litigation is very uncertain and virtually no case can be predicted as having a remote or probable chance of success. He stated that his firm's clients do not tend to make judgments for disclosure based on probability or remoteness but rather on materiality.

51. Ms. Seidman asked how disclosing the claim amount, a publicly available fact, is prejudicial or damaging to an entity. She also noted that part of the response to her earlier question about the difference between Example 1 and Example 2 was that in Example 2, the cases were prominently reported in the media. She raised the question of whether companies are therefore at the whim of the media to decide which cases to disclose. In other words, if the media does not report a case, then a company may conclude it does not have to disclose it, but if the case is in the media, the company will disclose it and the information will not be prejudicial.

52. Mr. Reinphaler stated there are some cases with an addendum clause (for example, seeking $1 billion), and the attorney can make a judgment on whether the amount represents a material piece of litigation or is just a number with no rational basis. He said that in the latter case, disclosing that amount or concluding that the litigation is material and therefore disclosing the case merely because of the amount could do a lot of harm to an entity.

53. Mr. Herz asked Mr. Reinphaler if there was a standard for making the determination whether a claim amount is material and has a reasonable basis. Mr. Reinphaler replied that professional judgment and common sense are used when evaluating the amount.

54. Ms. Seidman and Mr. Linsmeier asked Mr. Reinphaler why investors cannot discern irrational claim amounts. Mr. Reinphaler replied that the issue is whether the case is a material litigation. He asked why a company should have to disclose a case with an extremely large claim amount if the company believes the actual exposure is insignificant.

55. Mr. Lewis agreed that a claim amount may be unreliable but that it is often the only publicly available figure. He suggested that the claim amount may be one option for disclosure and that companies could be allowed to come up with another way to disclose their risk exposure. He agreed with Mr. Young that certain predictions, particularly the impressions defense attorneys are forming, should not be required disclosures. He asserted, however, that some predictions could be disclosed without revealing prejudicial information. He suggested that an entity should look at comparable cases of other companies to evaluate the possible risk exposure. He also suggested the possibility of using a third party to assess cases at given times during a case's lifespan. This assessment would not be prejudicial because the third party would not have access to the lawyers' privileged information. He would not make this a universal requirement but suggested that it might be a solution for significant cases.

56. Mr. Keller commented that a company first needs to assess whether it needs to report the litigation, and that this assessment may or may not be affected by the amount of the claim. He said that if an entity does have to report the claim, he would draft guidance that says that ordinarily the amount of the claim should be stated unless the company has concluded that the amount is unrealistic and it would be misleading to include it in the disclosure.

57. Mr. Kabureck stated that in its comment letter, FEI supported standardizing disclosures when reasonably possible. He commented that disclosing some facts about a case—the venue, estimation of timing, the body of law—would be an improvement. He said that whether or not to disclose information that is already publicly information is a value call about what is useful to financial statement users. He stated that there must be an element of judgment used for disclosure, even if an amount is in the public record. It will not be useful to investors if it is a very large, irrelevant number.

58. Mr. Herz indicated that there seems to be a presumption that some users are going to be misled by factual information. This may be true, but it is a challenging issue when the objective is to improve disclosure.

59. Mr. Lamonte said that if a claim is not at least reasonably possible to result in a material loss, usually it is irrelevant and does not need to be disclosed. The exception is when the case is prominent in the press. In those circumstances, disclosing that it is a frivolous claim helps investors understand that a risk really does not exist. He stated that if a claim is reasonably possible to result in a material loss, the claim amount should be disclosed and explained.

60. Ms. McEnally commended Mr. Young for his distinction between contentions and predictions, stating that much of the resistance for improved disclosure is because of predictions. She said that information in the public domain should be considered for disclosure. She noted that most investors know what is frivolous and are able to evaluate what is within the realm of possible outcomes for a case.

61. Ms. McEnally pointed to the prediction in Example 2 (the possible additional loss amount) and asked why this particular company would disclose the prediction. Mr. Herz replied that due to the public nature of the company, they were probably motivated to put a box around the risk to reduce the uncertainty. Mr. Young clarified that he does not favor a rule against predictions and supports including predictions if they are meaningful but stated that it is extremely difficult to predict the outcome of a case. He said that predictions should not be mandated. He liked the fact that the alternative model proposed disclosing a *sense* of the magnitude of the case.

Settlement Offers

62. Ms. McEnally asked Mr. Young about his views on disclosing settlement offers. Mr. Young replied that settlement offers are unbelievably nuanced and delicate and any disclosure would most likely affect the negotiations. If a company discloses that it received a settlement offer for $20 million, that disclosure will influence the settlement discussions. He stated that it seemed the participants could agree that disclosures should not influence the outcome of the litigation.

General Comments

63. Mr. Quaadman raised a question about what the company in Example 2 disclosed before they reached the significant settlement. Mr. Golden stated that the FASB staff would go back and look at that.

64. Mr. Keller said that Example 2 is easy disclosure for a very large company with many claims because it is able to aggregate the cases to alleviate prejudicial information. He also noted that the additional possible loss disclosed ($2.2 billion) was not material to this company. He cautioned against drawing too many conclusions about Example 1, and, while acknowledging that Example 2 was good disclosure, he also cautioned against drawing broad general principles based on Example 2.

65. Mr. Smith stated that aside from settlement offers, there appeared to be broad consensus among the roundtable participants, and that Mr. Young had crystallized the views with his comments about contentions versus predictions. He noted that the views of the various parties did not appear to be as far apart as he originally thought. Mr. Smith said that if it were required to disclose the claim amount, management would learn how to disclose the information so that (a) users could decide when the numbers were deemed frivolous and (b) the information would not be harmful. He stated that the issue of requiring disclosure of settlement offers needs to be debated further, because it appears that disclosing the amount of a settlement offer could have negative consequences and be prejudicial. He said that, based on discussions he has held with attorneys, he is aware of cases in which settlement offers were made and subsequently withdrawn, and the ultimate resolution of the cases were significantly different from the amount of the settlement offers.

66. Mr. Huber speculated about the debate that may have taken place when the company in Example 2 decided on the amount of its accrual as well as the disclosure about the additional possible loss amount. He expressed concern about the unintended consequences that would result from mandating disclosure of quantitative information.

Settlement Offers (continued)

67. Mr. Lamonte noted that he sometimes struggles to understand the timeline of cases and asked how problematic it would be to disclose that settlement negotiations are taking place and that the case could be settled in the near-term. He noted that this is very important information to investors because it affects a user’s assessment of the timing of the related cash flows.

68. Mr. Young explained that settlement discussions are very nuanced and subtle. He said he appreciated users' frustration when settlements are announced shortly after financial statements were published that gave no indication of a potential settlement. Speaking from his own experience in defending large securities class action litigation, the attorneys for each side may be millions of dollars apart in terms of their settlement expectations and may speak to each other in a nuanced, non-numerical code, and then in a very short time frame they may reach an agreement. He stated that negotiations are very susceptible to being influenced, and he would be nervous about drafting a standard that attempts to capture the aspects of settlement negotiations.

Insurance Recoveries

69. Mr. Golden raised the issue of disclosing potential insurance recoveries. He noted that in the comment letters, users stated that they consider the information to be important, while preparers raised concerns that the information could be prejudicial to the defendant's case.

70. Mr. Bell responded that it depends on the facts and circumstances. He said that his company frequently finds that disclosing the insurance coverage affects the outcome because it becomes a question of how deep are the pockets. If a company is not at the point of negotiations and is about to disclose how much coverage is available, it could be harmful.

71. Mr. Reinphaler stated that, as a point of fact, whether a defendant has insurance and, if so, the amount of that insurance are discoverable in litigation. In federal litigation, a defendant is required to provide its adversary with copies of applicable insurance policies. A defendant is not required to disclose to the plaintiff whether there are disputes with the insurance carrier or whether the carrier has reserved its rights, both of which often happen. The information about insurance is not publicly disclosed, but adversaries generally know about the defendant's insurance limits in federal litigation and in some, but not all, state courts.

72. Mr. Young said that in his experience, the rules notwithstanding, most defendants are extremely reluctant to provide insurance information. This seems to indicate that defendants themselves see disclosing the information as prejudicial. He noted that it is a difficult balance because he understands users' desire for insurance recovery information.

73. Mr. Keller indicated that because the rules in this area differ from state to state, this is an area of judgment. Some companies might be willing to disclose their insurance coverage or factor the coverage into their assessment of whether the litigation could have a material adverse effect on the company, subject to uncertainties if the coverage is disputed by the carrier.

74. Mr. Levi noted that it is not certain that a loss will be recoverable under an insurance policy, and disclosing a potential recovery amount before the outcome of the case is known may be premature. Mr. Bell stated that often an insurance company will not guarantee recovery until after the case has been settled.

75. Mr. Reinphaler said a company usually has multiple layers of insurance but only hears from the primary carrier initially and then hears from the other carriers after the limits of the primary policy have been exhausted.

76. Mr. Elsbree asked whether the availability of insurance could be disclosed in the footnotes once it has been disclosed to the counterparty, because then it presumably would not be prejudicial. Mr. Bell responded that this disclosure would still be harmful to a company if a dispute about the insurance coverage is upheld in the insurer's favor and the company therefore did not have the coverage it had disclosed. Mr. Keller said that in a jury trial, knowledge about insurance coverage could affect the jury's deliberations.

77. Mr. Lewis asked whether it would be possible to require disclosure when the company has no insurance, the risk in question has been excluded, or there are very stringent policy limits set. Mr. Finnegan said these disclosures would be very beneficial because it shows how management approaches the issue of risk.

78. Ms. Seidman stated this information is germane regardless of a lawsuit because it is part of a company's overall strategy.

79. Mr. Scates asked whether a company, if it is self-insured, should already be disclosing that fact in the MD&A. Mr. Finnegan said that although this information is required to be in MD&A, the enforcement of and compliance with the disclosure requirement is poor. He suggested to Ms. Minke-Girard that better coordination and examination by the SEC is needed. Ms. Minke-Girard stated that this information is probably a *risk factor* and agreed that it should be disclosed.

80. Mr. Keller noted that there is a difference between broad, generic disclosures and how a company is addressing a particular litigation matter.

The Treaty and Auditability

81. Mr. Golden asked how the Treaty[4] works today, what information the auditors receive under the Treaty, and what aspects of the Treaty may need to be updated.

82. Mr. Formica supported the disclosure of factual information because predictions are difficult to audit. He noted that the primary audit evidence available to corroborate management's assertions in this area is the attorney's letter in response to the auditor's request. Accordingly, the Treaty, which limits the kind of information an attorney will communicate to the auditor, is a fundamental aspect of this whole process. He recommended that the Board keep in mind that the proposed disclosures need to be auditable.

83. Mr. Golden asked whether the Treaty affects disclosures in SEC filings that are outside of the audited financial statements.

[4] The term *Treaty* refers collectively to AICPA Statement on Auditing Standards No. 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments* (codified as AU Section 337), and the American Bar Association's *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* (ABA Statement of Policy).

84. Mr. Keller noted that the underlying reason for the Treaty was the problem of the inherent waiver of attorney-client privilege when attorneys provide information to the auditors regarding the company's litigation posture. In particular, there were concerns about subject-matter waivers that some courts have applied whereby if an attorney discloses anything about the case to a third party, all of the attorney's advice about that case becomes discoverable. In the mid-1970s, the issuance of financial statements came to a standstill because, without sufficient audit evidence for litigation matters, auditors were withholding audit reports. Attorneys were not providing the information because of concerns about putting their clients at risk. The SEC Chairman asked the legal and auditing professions to resolve the matter. In response, the existing framework was developed with three categories: remote, reasonably possible, and probable. If a case is remote or probable, it is not worth worrying about. In the middle range, the attorneys tell the auditors which issues they are handling and what information they can about those cases without waiving privilege. Most importantly, the attorneys confirm to the auditors that they have fulfilled their professional responsibility to advise the client on its disclosure obligations. By virtue of the attorneys' having provided a response letter, auditors can place reliance on the attorneys' having satisfied themselves that the matters they are handling have been properly disclosed.[5] This framework was considered to be the best that could be done in the area of attorney-auditor communications in light of the competing public policy interests. He noted that courts' views on the protections afforded those communications are varied. He cited the *Textron* case in the First Circuit, in which the court held that, although privilege generally had not been waived, documents in the auditors' possession were no longer protected.

85. Mr. Formica asked to what extent incremental disclosures would cause additional strain on the ability of the attorneys to communicate with the auditors. Mr. Keller stated that incremental disclosures should take place as a result of attorneys advising their clients on good disclosures. He stated that he thinks this can work under the existing framework whereby the attorneys (a) indicate to the auditors the cases on which they

[5] The Treaty contains specific guidance related to unasserted claims and assessments in paragraphs .09(f)–(g) of AU Section 337 and in paragraph 6, "Lawyer's Professional Responsibility," of the ABA Statement of Policy.

should focus and (b) confirm that they have fulfilled their professional responsibilities in advising the company on disclosure.

86. Mr. Leisenring stated that if the Treaty is operating the way it was intended, the environment has not changed in a way that would require the Treaty to be changed, even with the proposed incremental disclosures. Mr. Keller agreed but noted that incremental disclosure requirements would increase the pressure on the way the Treaty operates. He said that if the underlying purpose of the Treaty is recognized, it would not have to be changed.

87. Mr. Crawford noted that some in practice feel the Treaty is not operating the way it was intended. All too often, the communications that auditors rely on from both external and in-house counsel as corroborative evidence for these disclosures drop to the lowest common denominator.

88. Mr. Leisenring said that a recurring comment from participants has been that judgment needs to be applied. He asserted that if adequate judgment had been exercised properly over the last 30 years, users would not be complaining about the quality of disclosure. He indicated he does not think it is rewarding to say, "Let's just rely on judgment."

89. Mr. Keller noted that a difference must be recognized between good disclosure and inherent limitations on auditability (whereby the auditors must rely on the attorneys). He stated that what is really needed is a clearer articulation of the auditors' ability to do so and the responsibly of attorneys to make the system work. He noted that attorneys' professional responsibilities are more robust now based on the Part 205 rules under Section 307 of the Sarbanes-Oxley Act.

APPENDIX 1

DISCLOSURE OF CERTAIN LOSS CONTINGENCIES ROUNDTABLE

Norwalk, CT

March 6, 2009

Session 1

9:00–11:30 a.m.

Participant List

Participants		Comment Letter Numbers
	Regulator:	
Jenifer Minke-Girard	Securities and Exchange Commission	N/A
	Auditing Standards Setters:	
Greg Scates	Public Company Accounting Oversight Board	N/A
Hiram Hasty	American Institute of Certified Public Accountants	N/A
	Auditors:	
John Formica	PricewaterhouseCoopers	174
Craig Crawford	KPMG	217
Chuck Evans	Grant Thornton	147
	Lawyers:	
Stan Keller	American Bar Association	36
Michael Young	Willkie Farr & Gallagher	30
Robert Myers or Richard Reinphaler	Dewey & LeBoeuf	74
	Preparers:	
Gary Kabureck	Financial Executives International	106
D. Keith Bell	Travelers	195
David Levi	Bristol-Myers Squibb Company	200
Tom Larkins	Honeywell International	43
Tom Quaadman	U.S. Chamber of Commerce	189
John Huber	Securities Industry and Financial Markets Association	165

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DISCLOSURE OF CERTAIN LOSS CONTINGENCIES ROUNDTABLE

Norwalk, CT

March 6, 2009

Session 1

9:00–11:30 a.m.

	Users:	
Sanford Lewis	Investors Environmental Health Network	121
Pat Finnegan	CFA Institute	51
Rebecca McEnally	Investors Technical Advisory Committee	229
Mark Lamonte	Moody's	N/A
Adam Hurwich	Calcine Management LLC	N/A

Bob Herz	FASB Board Chairman
Thomas Linsmeier	FASB Board Member
Leslie Seidman	FASB Board Member
Marc Siegel	FASB Board Member
Larry Smith	FASB Board Member
Jim Leisenring	IASB Board Member
Russell Golden	FASB Director and Moderator
Peter Proestakes	FASB Assistant Director
David Elsbree	FASB Practice Fellow

Financial Accounting Standards Board

FASB ROUNDTABLE MEETING AGENDA
Disclosure of Certain Loss Contingencies

March 6, 2009

Norwalk, Connecticut

Threshold for Disclosure

1. Are there some contingencies that are material to users of financial statements, and therefore should be disclosed, even though the likelihood of loss is remote? If so, do such loss contingencies require the same level of disclosure as those for which the likelihood of loss is more than remote (that is, at least reasonably possible)?

Quantitative Disclosure

2. Paragraph 10 of FASB Statement No. 5, *Accounting for Contingencies,* requires entities to "give an estimate of the possible loss or range of loss or state that an estimate cannot be made." Users have indicated a need for quantitative information about loss contingencies and feel that entities too often provide no quantitative information and state that an estimate cannot be made. Preparers have indicated that, in fact, an estimate of the range of loss often cannot be made and even in circumstances in which an estimate can be made, disclosing that estimate may be prejudicial to the entity.

    a. If an estimate of the possible loss or range of loss can be made, should disclosure of that estimate be required? Should there be a prejudicial exemption from providing such an estimate?
    b. In circumstances in which an estimate of the possible loss or range of loss cannot be made (or would be prejudicial to the entity), what other relevant quantitative information that would be useful to users could be provided?
    c. Is there a meaningful way to convey to users the potential magnitude of a contingency using qualitative information rather than quantitative information?

Qualitative Disclosure

3. What qualitative information about loss contingencies would be useful to users? Are there different types of disclosures that should be required for different types of cases?

4. Some preparers have expressed concerns about disclosing information in the notes to the financial statements that is already available in public documents (for example, court filings). What is the basis for those concerns?

Recoveries from Insurance or Other Arrangements

5. Financial statement users have indicated that they would like disclosures to include information about possible recoveries of loss contingencies through insurance, indemnification, or other similar arrangements. Some preparers and attorneys have indicated that this information could be prejudicial. Do you believe that such information should be required to be disclosed? Why or why not? Under what circumstances would such information be prejudicial, and how could those circumstances be addressed?

Tabular Reconciliation of Recognized Loss Contingencies

6. Does a tabular reconciliation of recognized loss contingencies, on an aggregated basis, provide meaningful information to users? What is the appropriate level of aggregation? Would it be appropriate to omit the table if it would be prejudicial to include it (for example, if any entity has only a limited number of cases outstanding)?

Private Entity Matters

7. What is the appropriate level of disclosure about loss contingencies for private entities in their general purpose financial statements? Do users of private entities' financial statements require the same level of disclosure? Why or why not?

Audit Considerations

8. How would enhanced disclosures of the kind that are being considered by the Board affect the audit process? Will auditors be able to obtain adequate audit evidence and satisfy the requirements of PCAOB Auditing Standard No. 3, *Audit Documentation*?

Costs of Enhanced Disclosures

9. Preparers have indicated that the costs of enhanced disclosures about loss contingencies could be significant. Those costs would include additional losses from litigation because of the disclosures putting them in a disadvantageous position, as well as costs associated with additional litigation that may result from the disclosures. How can the quality of disclosures about loss contingencies be enhanced while minimizing the cost of those disclosures? To what extent are investors willing to absorb the costs associated with enhanced disclosures?

Financial Accounting Standards Board

FASB ROUNDTABLE MEETING
Disclosure of Certain Loss Contingencies
Examples of Disclosures for Discussion Purposes

March 6, 2009

Norwalk, Connecticut

Note: The example disclosures set forth below are taken from publicly available SEC filings and are included for discussion purposes only. Neither the Board nor the staff has evaluated these disclosures for compliance with generally accepted accounting principles.

Part 1: General Examples

Example 1

The Company and its subsidiaries are involved in a number of legal and arbitration proceedings, including class actions, concerning matters arising in connection with the conduct of their respective business activities. The Company believes it has meritorious defenses to each of these actions and intends to defend them vigorously. In the course of its business, the Company and its subsidiaries are also subject to governmental examinations, information gathering requests, subpoenas, inquiries and investigations. The Company believes that it is not a party to, nor are any of its properties the subject of, any pending legal, arbitration, regulatory, tax or investigative proceedings that would have a material adverse effect on the Company's consolidated financial condition or liquidity. However, it is possible that the outcome of any such proceedings could have a material impact on results of operations in any particular reporting period as the proceedings are resolved.

Example 2

Government competition law matters. In March 2004, the European Commission issued a competition law decision that, among other things, ordered us to license certain Windows server protocol technology to our competitors. In March 2007, the European Commission issued a statement of objections claiming that the pricing terms we proposed for licensing the technology as required by the March 2004 decision were "not reasonable." Following additional steps we took to address these concerns, the Commission announced on October 22, 2007 that we were in compliance with the March 2004 decision and that no further penalty should accrue after that date. On February 27, 2008, the Commission issued a fine of $1.4 billion (€899 million) relating to the period prior to October 22, 2007. In January 2008, the Commission announced that it was opening two new competition law investigations. These investigations relate primarily to interoperability with respect to our Microsoft Office family of products and the inclusion of various capabilities in our Windows operating system software, including Web browsing software. These investigations were precipitated by complaints filed with the

Commission by a trade association of Microsoft's competitors and a firm that offers Web browsing software. In May 2008, we filed an application with the European Court of First Instance to annul the February 2008 fine. We paid the $1.4 billion (€899 million) fine in June 2008.

We are subject to a Consent Decree and Final Judgment that resolved lawsuits brought by the U.S. Department of Justice, 18 states, and the District of Columbia in two separate actions. The Consent Decree imposed various constraints on our Windows operating system businesses. Portions of the Consent Decree were scheduled to expire on January 31, 2008; we voluntarily agreed to extend other elements of the Consent Decree to November 2009. In October 2007, some states filed a motion with the U.S. District Court for the District of Columbia seeking to have most of the remaining provisions of the Final Judgment in the action to which they are party extended for five years. The U.S. Department of Justice and other states advised the Court that they would not seek any extension of the Final Judgments to which they are party. In January 2008, the court issued a decision granting the states' motion to extend these additional provisions of the consent decree until November 2009.

In other ongoing investigations, various foreign governments and several state attorneys general have requested information from us concerning competition, privacy, and security issues.

Antitrust, unfair competition, and overcharge class actions. A large number of antitrust and unfair competition class action lawsuits have been filed against us in various state, federal, and Canadian courts on behalf of various classes of direct and indirect purchasers of our PC operating system and certain other software products. We obtained dismissals of damages claims of indirect purchasers under federal law and in 15 states. Courts refused to certify classes in two additional states. We have reached agreements to settle all claims that have been made to date in 19 states and the District of Columbia.

Under the settlements, generally class members can obtain vouchers that entitle them to be reimbursed for purchases of a wide variety of platform-neutral computer hardware and software. The total value of vouchers that we may issue varies by state. We will make available to certain schools a percentage of those vouchers that are not issued or claimed (one-half to two-thirds depending on the state). The total value of vouchers we ultimately issue will depend on the number of class members who make claims and are issued vouchers. The maximum value of vouchers to be issued is approximately $2.7 billion. The actual costs of these settlements will be less than that maximum amount, depending on the number of class members and schools that are issued and redeem vouchers.

The settlements in all states have received final court approval. Cases in Arizona, Mississippi and Canada have not been settled. We estimate the total cost to resolve all of these cases will range between $1.7 billion and $1.9 billion. The actual cost depends on factors such as the quantity and mix of products for which claims will be made, the number of eligible class members who ultimately use the vouchers, the nature of hardware and software that is acquired using the vouchers, and the cost of administering the claims. At June 30, 2008, we have recorded a liability related to these claims of approximately $900 million, which reflects our estimated exposure of $1.7 billion less payments made to date of approximately $800 million, mostly for administrative expenses, vouchers, and legal fees.

Other antitrust litigation and claims. In November 2004, Novell, Inc. filed a complaint in U.S. District Court in Utah, now transferred with other cases to Maryland, asserting antitrust and unfair competition claims against us related to Novell's ownership of WordPerfect and other productivity applications during the period between June 1994 and March 1996. In June 2005, the trial court granted our motion to dismiss four of six claims of the complaint. Both parties appealed, and in October 2007, the court of appeals affirmed the decision of the trial court, remanding the case to that court for further proceedings.

Patent and intellectual property claims. We are vigorously defending more than 45 patent infringement cases. Microsoft and Alcatel-Lucent are parties to a number of legal proceedings relating to certain patents of each of the companies. Some of these actions began before the merger of Alcatel and Lucent in 2006. For simplicity, we refer to the post-merger entity as Alcatel-Lucent throughout this discussion.

- In 2003, we filed an action in U.S. District Court in California seeking a declaratory judgment that we do not infringe certain Alcatel-Lucent patents. Alcatel-Lucent has asserted claims under these patents against computer manufacturers that sell computers with our operating system and application software pre-installed. In February 2007, the jury returned a verdict in Alcatel-Lucent's favor in the first of a series of patent trials, and awarded $1.5 billion in damages. In August 2007, on our motions for judgment as a matter of law, the trial court overturned the jury verdict and entered orders dismissing plaintiff's claims on multiple grounds. Alcatel-Lucent appealed. The trial court previously dismissed Alcatel-Lucent's claims with respect to a second group of patents and two patents in a third grouping. In April 2008, a jury returned a verdict in Alcatel-Lucent's favor in a trial on a consolidated group of video and user interface patents. The jury concluded that Microsoft had infringed two patents and awarded $367 million in damages. On June 19, 2008, the trial judge increased the amount of damages to $512 million, which includes the $367 million of damages and $145 million of interest. Microsoft will appeal the verdict.
- In March 2006, Alcatel-Lucent filed a lawsuit against us in U.S. District Court in California, claiming Windows Vista, Windows Media Player, and the Xbox 360 infringe one of its patents. In response, we asserted counterclaims that Alcatel-Lucent infringes 10 Microsoft patents by its sale of various products. The case went to trial in April 2008 on Alcatel-Lucent's video patent and four Microsoft counterclaim patents. The jury returned a verdict in Microsoft's favor on June 4, 2008, finding no infringement of Alcatel-Lucent's patent. The jury also found no infringement of Microsoft's counterclaim patents.
- In November 2006, Alcatel-Lucent filed two patent infringement cases against us in U.S. District Court in Texas, asserting Mediaroom and various networking functionalities violate seven of its patents. In April 2007, we asserted infringement counterclaims based on four of our patents relating to functionality similar to that accused by Alcatel-Lucent. The trial on all of the patents is set for January 2009.

- In February 2007, we filed a complaint against Alcatel-Lucent with the International Trade Commission claiming Alcatel-Lucent is infringing four Microsoft patents related to our unified communications technology and seeking to prevent the import into the U.S. of certain Alcatel-Lucent unified communications products. Trial of this matter took place in October 2007. The administrative law judge ruled that Alcatel-Lucent infringed one of the four asserted patents. The Commission reversed that decision in May 2008. We are appealing that ruling to the U.S. Court of Appeals for the Federal Circuit.
- In April 2007, the Multimedia Patent Trust filed a complaint against Microsoft, Dell, and Gateway in San Diego, California accusing the parties of infringing three video-related patents that originally belonged to Alcatel-Lucent. Alcatel-Lucent created the Multimedia Patent Trust prior to the companies' merger and transferred the patents at issue to the trust. In June 2008, the plaintiff dismissed one of the patent claims.

The actual costs to resolve these cases will depend upon many factors such as the outcome of post-trial motions, any appeals, and the results of the remaining trials. Adverse outcomes in some or all of the matters described in this section may result in significant monetary damages or injunctive relief against us that would adversely affect distribution of our operating system or application products. We may enter into material settlements because of these risks.

Other. We are also subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in aggregate, will not have a material adverse impact on our financial position, our results of operations, or our cash flows, these matters are subject to inherent uncertainties and management's view of these matters may change in the future.

As of June 30, 2008, we had accrued aggregate liabilities of approximately $600 million in other current liabilities and approximately $500 million in other long-term liabilities for all of the contingent matters described in this note. While we intend to vigorously defend these matters, there exists the possibility of adverse outcomes that we estimate could be up to $2.2 billion in aggregate beyond recorded amounts. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact on our financial position, results of operations, and cash flows for the period in which the effects become reasonably estimable.

Part 2: Examples of Specific Types of Disclosure (Relevant Excerpts Only)

Example 3 – Range of Possible Loss

The range of environmental remediation costs that is reasonably possible is \$24.6 million to \$61.2 million, which is subject to change in the near term.

Example 4 – Estimate of Loss

Based on the Company's experience and analysis of trends in asbestos bodily injury litigation, the Company has endeavored to project the number and ultimate cost of all present and future bodily injury claims expected to be asserted, based on actuarial principles, and to measure the probable and estimable liabilities under generally accepted accounting principles. The Company has accrued \$973.2 million at December 31, 2002, as its estimate of the cost to resolve all asbestos-related bodily injury cases in the future, and all pending property damage cases for which sufficient information is available to form a reasonable estimate of the cost of resolution.

Example 5 – Quantitative Information about the Amount Sought

The grand jury charges that the conspiracy took place from 1976 to 2002 and also charges that the alleged endangerment to the areas surrounding Libby continues to the present day. According to the U.S. Department of Justice, the Company could be subject to fines in an amount equal to twice the after-tax profit earned from its Libby operations or twice the alleged loss suffered by Libby victims, plus additional amounts for restitution to victims. The indictment alleges that such after tax profits were \$140 million. The Company has categorically denied any criminal wrongdoing and intends to vigorously defend itself at trial.

Example 6 – Quantitative Information about the Amount Sought

Although the complaint does not specify the amount of damages sought, plaintiffs have stated in recent court filings that they intend to seek a verdict of more than \$20 billion in alleged damages. Plaintiffs' expert witness on damages has generally testified to that effect in the pending jury trial. While there are many potential outcomes of the pending trial, in the event of a final, non-appealable, and enforceable judgment against the Company that is in an amount commensurate with the Plaintiffs' maximum theory of damages, it would not have sufficient assets to pay such a judgment.

Example 7 – Quantitative and Qualitative Information

Mr. Hennigan brought a claim in the United States District Court for the District of Arizona. Mr. Hennigan claims the exclusive right to sell our products to many of the largest law enforcement, corrections, and military agencies in the United States. He seeks monetary damages that may amount to as much as \$400 million against us allegedly arising in connection with his service to us as a distributor. His claims rest on theories of our failure to pay commissions, breach of contract, promissory estoppel, breach of fiduciary duty, and on related theories. No written contract was ever signed with Mr. Hennigan. We also believe that he has no reasonable basis for claims based on informal or implied contractual rights and will be unable to prove his damages with reasonable certainty…. We believe that the claims against the Company are without merit and that the litigation will have no material adverse effect on the Company's business, financial condition or results of operations.

Example 8 – Qualitative Information

Smoking and Health Litigation

Overview: Plaintiffs' allegations of liability in smoking and health cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, nuisance, breach of express and implied warranties, breach of special duty, conspiracy, concert of action, violations of deceptive trade practice laws and consumer protection statutes, and claims under the federal and state anti-racketeering statutes. Plaintiffs in the smoking and health actions seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, statutes of limitations and preemption by the Federal Cigarette Labeling and Advertising Act.

Smoking and Health Class Actions: Since the dismissal in May 1996 of a purported nationwide class action brought on behalf of allegedly addicted smokers, plaintiffs have filed numerous putative smoking and health class action suits in various state and federal courts. In general, these cases purport to be brought on behalf of residents of a particular state or states (although a few cases purport to be nationwide in scope) and raise addiction claims and, in many cases, claims of physical injury as well.

Class certification has been denied or reversed by courts in 57 smoking and health class actions involving PM USA in Arkansas (1), the District of Columbia (2), Florida (2), Illinois (2), Iowa (1), Kansas (1), Louisiana (1), Maryland (1), Michigan (1), Minnesota (1), Nevada (29), New Jersey (6), New York (2), Ohio (1), Oklahoma (1), Pennsylvania (1), Puerto Rico (1), South Carolina (1), Texas (1) and Wisconsin (1). A class remains certified in the *Scott* class action discussed above.

In addition to the cases brought in the United States, three smoking and health class actions have been brought against tobacco industry participants, including certain PMI subsidiaries in Brazil (2) and Israel (1). In one class action in Brazil, a consumer organization is seeking damages for smokers and former smokers, and injunctive relief. The trial court found in favor of the plaintiff in February 2004. The court awarded R$1,000 (currently approximately U.S. $500) per smoker per full year of smoking for moral damages plus interest at the rate of 1% per month, as of the date of the ruling. Actual damages are to be assessed in a second phase of the case. The size of the class is currently unknown. Defendants appealed the decision to the São Paulo Court of Appeals and the case, including the judgment, is currently stayed pending appeal. In addition, the defendants filed a constitutional appeal to the Federal Supreme Court on the basis that the consumer association does not have standing to bring the lawsuit. Both appeals are pending.

There are currently pending two purported class actions against PM USA brought in New York (*Caronia*, filed in January 2006 in the United States District Court for the Eastern District of New York) and Massachusetts (*Donovan*, filed in March 2007 in the United States District Court for the District of Massachusetts) on behalf of each state's respective residents who: are age 50 or older; have smoked the *Marlboro* brand for 20 pack-years or more; and have neither been diagnosed with lung cancer nor are under examination by a physician for suspected lung cancer. Plaintiffs in these cases seek to impose liability under various product-based causes of action and the creation of a court-supervised program providing members of the purported class Low Dose CT Scanning in order to identify and diagnose lung cancer. Neither claim seeks punitive damages. Plaintiffs' motion for class certification is pending in *Caronia*.

Example 9 – Insurance Arrangements

The Company has product liability insurance for claims brought in the Vioxx Personal Injury Lawsuits of up to approximately $630 million after deductibles and co-insurance. This insurance provides coverage for legal defense costs and potential damage amounts that have been or will be incurred in connection with the Vioxx Personal Injury Lawsuits. The Company believes that this insurance coverage extends to additional Vioxx Personal Injury Lawsuits that may be filed in the future. Certain of the Company's insurers have reserved their rights to take a contrary position with respect to certain coverage and there could be disputes with insurers about coverage matters. The Company currently believes that it has at least approximately $190 million of Directors and Officers insurance coverage for the Vioxx Securities Lawsuits and the Vioxx Derivative Lawsuits, and at least approximately $275 million of insurance coverage for the Vioxx ERISA Lawsuits. Additional insurance coverage for these claims may also be available under upper level excess policies that provide coverage for a variety of risks. There may be disputes with insurers about the availability of some or all of this insurance coverage.

Example 10 – Insurance Arrangements

We are substantially self-insured with respect to general, product liability, and securities claims. The absence of significant third-party insurance coverage increases our potential exposure to unanticipated claims or adverse decisions. Product liability claims, product recalls, securities litigation, and other litigation in the future, regardless of their outcome, could have a material adverse effect on our financial position, results of operations, or liquidity.

Example 11 – Insurance Arrangements

Our insurance coverage will not cover our total liabilities and expenses in these lawsuits, in part because we have a significant deductible on certain aspects of the coverage.