1840-100
Comment Letter No. 13A

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U.S. Chamber of Commerce

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August 11, 2010

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
Norwalk, CT 06856-5116

Re: File Reference No. 1840-100, Proposed Accounting Standards Update, "Disclosure of Certain Loss Contingencies"

Dear Mr. Golden:

The U.S. Chamber of Commerce is the world's largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information.

The Chamber is committed to promoting effective and transparent financial reporting that enables capital markets to function efficiently. It welcomes the opportunity to comment on "Disclosure of Certain Loss Contingencies" (the "proposal") as released by the Financial Accounting Standards Board ("Board").

Summary

While we commend the Board for deleting some of the most prejudicial and burdensome elements of its June 2008 Exposure Draft, the Board's new proposal still contains a number of disclosure requirements that will prejudice registrants in ongoing litigation and infringe the attorney-client privilege and other confidentiality protections. More fundamentally, the proposal imposes extremely burdensome and costly requirements that cannot be justified, and that are plainly unwarranted in the current economic environment—especially in light of the large number of other new, and expensive, disclosure obligations that preparers will be required to undertake in the very near term. Accordingly, we respectfully request that the Board withdraw the proposal, for three basic reasons.

First, the proposal continues to require registrants to disclose information that will injure investors by impeding preparers' ability to defend themselves in ongoing litigation and by providing plaintiffs' lawyers with non-public information that can be used to subject preparers to new lawsuits. It makes no sense to turn disclosure requirements into a source of expanded liability and new lawsuits that will impose significant harm on preparers, and thus directly injure the financial interests of the very shareholders that the disclosure requirements are intended to protect.

Second, the proposal does not pass muster under any rational cost-benefit analysis—a requirement endorsed by the Securities and Exchange Commission's Advisory Committee on Improvements to Financial Reporting in 2008.

To begin with, the proposal's disclosure obligations would impose a tremendous practical burden on registrants. They reflect a significant lack of understanding of the realities of the litigation process and, as a result, will inflict very substantial costs upon preparers.

And any benefits are unclear and uncertain at best. Although the Board states that it has consulted with investors and that these investors perceive benefits from the proposal's requirements, it has not revealed which investors—or even which categories of investors—were consulted and the interests that supposedly are being addressed. A statement on investor consultation without transparency fails to credibly establish that a wide range of investor perspectives were taken into consideration; and leaves open the possibility that the Board is attempting to address only a narrow range of investor interests, and doing so at the expense of all public company investors.

The current proposal accordingly fails to satisfy cost-benefit and prudence standards. Such unjustified decision-making is arbitrary and capricious, is wholly inconsistent with prudent financial reporting policy, and harms investors.

Third, the Board cannot and should not consider the costs and benefits of this proposal in a vacuum. Registrants are facing a tidal wave of new disclosure-related requirements, each of which will carry increased costs—from the Dodd-Frank Wall Street Reform and Consumer Protection Act; from new standards already released, or likely to be released, by the Board; and from the impending decision regarding convergence with international accounting standards. Especially in the context of the current economic crisis—in which business investment is critical to job creation—the Board, and the country as a whole, simply cannot afford to ignore the total amount of financial resources being diverted away from investment to fund compliance with new disclosure requirements. Just as a business's overall resources limits the amounts that it may budget for research and development each year, there is a finite limit on the total amount of additional cost attributable to new disclosure obligations that American businesses can absorb without harming our economic recovery. The Board simply must consider this overall burden on registrants in making its cost-benefit determination, and that burden by itself demonstrates why this proposal must be withdrawn.

We understand that once the Board initiates a project, there is a desire to make some change to existing standards, rather than to reaffirm the status quo, in order to demonstrate a concrete "achievement" resulting from the resources invested in the project. In the context of the unprecedented new cost and other burdens that preparers face, however, the Board should insist on a very substantial benefit in order to justify imposing yet another incremental burden on preparers. There is no such benefit here, and accordingly, the proposal should be withdrawn.

Discussion

1. The Revised Proposal Requires Disclosures that will Significantly Increase Preparers' Litigation Exposure and Thereby Reduce Shareholder Value.

The Board deleted several requirements contained in the June 2008 Exposure Draft that would have put defendants at a disadvantage in litigation or required the disclosure of information that would have revealed defendants' litigation strategy.[1]

[1] For example, see paragraphs BC18-BC21 and BC23-BC24 of the proposal.

Several elements of the new proposal, however, have precisely the same effect and should be eliminated for the same reason.

For example, the proposal requires disclosure of "possible recoveries from insurance" if that information "is discoverable by either the plaintiff or a regulatory agency."[2] This obligation would be broadly applicable because insurance information must be disclosed under the rules applicable to lawsuits in federal courts, as well as those applicable in many state courts. When such disclosure occurs in connection with a lawsuit, however, it typically takes place pursuant to a protective order requiring the other parties to the litigation to keep the information confidential. That is because public disclosure of insurance coverage could well attract new lawsuits motivated by knowledge that the claim would fall within the potential defendant's coverage.

Requiring public disclosure in financial statements inevitably would have precisely that effect. It also could attract claims in excess of insurance coverage by plaintiffs, or plaintiffs' lawyers, seeking to place pressure on a company by forcing disclosures that would depress the price of the company's securities.

Similarly prejudicial is the requirement that "[i]f the insurance company has denied, contested or reserved its rights related to the entity's claim for recovery, an entity shall disclose that fact."[3] Insurance companies virtually always reserve their rights with respect to claims arising out of lawsuits. In many cases (for example, claims of intentional fraud), the facts alleged—if proven—might provide grounds for refusing coverage. Simple disclosure of a reservation of rights, standing alone, could well be confusing to financial statement users. The preparer inevitably will be obligated to disclose additional information—for example, the reasons for the reservation of rights, the preparer's view regarding the reservation of rights, etc.—which almost always will include non-public information relating to the underlying lawsuit, the precise category of disclosure that the Board claims it is seeking to avoid.

Next, the proposal's aggregation standards appear to impose disclosure requirements not applicable to individual claims. For example, the proposal refers to

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[2] See paragraph 450-20-50-1F(e)(5) of the proposal.
[3] See paragraph 450-20-50-1F(f)(3) of the proposal.

the "average settlement amount".[4] But settlement amounts typically are confidential. And disclosure of an average settlement for a category of litigation obviously would provide very valuable information to plaintiffs with pending claims—information that would significantly prejudice the preparer's defense in those cases.

The extension of these disclosure requirements to unasserted claims also would inflict significant prejudice on preparers by requiring the disclosure of confidential privileged information. It is sensible to require disclosure when public information indicates that the preparer may face litigation claims—as in the case of an accident likely to engender claims for compensation.

The proposal, however, would require disclosure based on "the existence of studies in reputable scientific journals . . .that indicate potential significant hazards related to the entity's products or operations."[5] Thus, a preparer would have to advertise its potential vulnerability to an entire category of lawsuits, none of which have yet been asserted—even though (as is likely to be the case) the preparer's assessment of any potential exposure rests on materials protected by the attorney-client privilege and even though the inevitable result would be the immediate filing of such claims triggered by the preparer's own disclosures. Again, this consequence is precisely the opposite of the result that the Board claims to be seeking.

The same analysis applies to all unasserted claims resting on non-public information. For example, basing a disclosure obligation on a preparer's concern about the possible assertion of intellectual property claims—when the potential plaintiff has "not even indicated an awareness of the possible infringement"[6]—similarly converts the disclosure process into a mechanism for alerting potential plaintiffs to the preparer's possible vulnerability to a lawsuit, inflicting serious harm on the preparer and its shareholders.

Finally, the tabular reconciliation process required for recognized loss contingencies will provide the preparer's litigation adversaries with an ongoing window into the preparer's assessment of the litigation.[7] Plaintiffs will be able to

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[4] See paragraph 450-20-55-1D(c) of the proposal.
[5] See paragraph 450-20-55-14(d) of the proposal.
[6] See paragraph 450-20-55-14(c) of the proposal.
[7] See paragraph 450-20-50-1F(g) of the proposal.

monitor the changes in accruals, and accompanying explanation, to gain important insights into the preparer's litigation strategy as well as its views of the merits of the case. That information—inevitably based on the privileged communications between the preparer and its counsel—will inflict very significant prejudice on the preparer.

In sum, although the Board has recognized the serious prejudice that can result from mandating litigation-related disclosures, the revised proposal contains a significant number of disclosure requirements that will inflict the very prejudice that the Board says that it wishes to avoid. Significant further modifications are necessary to accomplish that goal.

2. The Costs Imposed Upon Investors by the Revised Proposal Far Outweigh Any Potential Benefits.

The Board recognized that "the benefits of providing information for" financial reporting purposes "should justify the related costs," and concluded that "the benefits of the disclosures in the proposed amendments outweigh the costs."[8] The Board acknowledged that its assessment was "more qualitative than quantitative" because "there is no method to objectively measure the costs to implement accounting guidance or to quantify the value of improved information in financial systems." We respectfully submit that the Board's view of the balance here is clearly erroneous.

First, the Board recognized that "the effort for gathering the necessary data to provide the disclosures that would be required by the proposed amendments may be significant for some entities," but stated that "many entities already have the information necessary to fulfill those disclosure requirements and that including the information would not require substantial additional cost or effort."[9] That assessment is simply wrong.

The proposal rests on a significant misunderstanding of the litigation process. To take just one example, the proposal requires a preparer to disclose "if known" the "anticipated timing of, or the next steps in, the resolution of individually material

[8] See paragraphs BC49 and BC52 of the proposal.
[9] See paragraph BC51 of the proposal.

asserted litigation contingences."[10] The course of litigation is rarely clear: Parties may file various motions; courts may rule on those motions, or withhold ruling pending discovery; discovery may engender significant disputes; trial scheduling is often uncertain, etc. Requiring updates every quarter will impose a tremendous burden on preparers—and require the financial reporting process to obtain and assess for financial reporting purposes information that, to the extent it is possessed by the preparer at all, resides in the general counsel's office in a form useful for litigation oversight, which is very different from information sufficiently detailed to provide the necessary guidance to users of the financial information.

The proposal also requires disclosures to include "[p]ublicly available quantitative information, for example in the case of litigation contingencies, the amount claimed by the plaintiff or the amount of damages indicated by the testimony of expert witnesses."[11] Again, the proposal evidences a lack of understanding of the litigation process. In many if not most cases the plaintiff does not claim a specific amount of damages. Prior to trial, expert witness deposition "testimony" (or expert witness reports) typically is not publicly available: They are not filed with the court and often may be subject to a protective order. In addition, disclosure of these opinions will provide users with little useful information: The defendant typically asserts that it is not liable for any damages, so the testimony of its damages expert represents a fallback position in the event its "no liability" arguments are rejected. Similarly, the views of the plaintiff's expert are subject to (and virtually always are) challenged on multiple grounds. To make these disclosures understandable, and to avoid claims that its disclosures were misleading, the preparer will have to supply additional context, which will inevitably require it to reveal litigation strategy and other information protected by the litigation privileges.

Furthermore, all of this information must be audited. Auditors inevitably will require access to privileged information in order to assess the completeness and correctness of the preparer's disclosures. Such action places the preparer in the position of choosing between providing the information, and thereby risking a finding that it has waived the litigation privileges and prejudiced its legal position; or

[10] See paragraph 450-20-50-1F(b) of the proposal.
[11] See paragraph 450-20-50-1F(e)(1) of the proposal.

withholding the information to protect its privileges and risking a qualified audit opinion. That is a very substantial, and wholly unacceptable, cost.

The Board's assessment of the purported benefits of the additional disclosures is completely conclusory. The proposal states simply that the new disclosures would provide "relevant" information that would enable users "to make a more informed assessment of the likelihood, timing, and amount of future cash outflows relating to loss contingencies" and, in addition, that loss contingencies "can have a significant impact on an entity's financial statements."[12] But the Board does not provide a single example of a real-world situation in which such disclosures would have provided useful information to investors.

To the contrary, for the reasons we have discussed, the disclosures specified in the proposal are much more likely to be confusing rather than illuminating precisely because of the limitations imposed by the need to respect litigation privileges. And the frequently-changing nature of the disclosures, dependent on the vagaries of the litigation process would make them even less useful to users.

Given the cost, complexity, and risk associated with the proposed expanded disclosures, the Board should reconsider its decision to modify existing standards.

3. The Costs Imposed by the Proposal Cannot be Justified in View of the Large Number of Additional New Disclosure Burdens Faced by Preparers.

Public companies are facing an unprecedented number of new—and extremely expensive—disclosure-related obligations.

First, the new corporate governance obligations imposed by the Dodd-Frank bill include new mandates that will require significant rule making including:

- Proxy access rules;
- Disclosures relating to Chairman and CEO positions;

[12] BC52.

- "Say on pay" requirements;

- Compensation-related disclosures, including relationship between executive compensation and performance; calculation of median annual employee compensation; and ratio of that compensation to CEO compensation.

Indeed, one law firm has calculated that the Dodd-Frank law will trigger 95 new rulemakings by the SEC alone[13]; in contrast, the Sarbanes-Oxley statute triggered only 16 rulemakings in total.

Second, the new rules adopted by the Board and the projects nearing completion:

- Common fair vale measurement and disclosure requirements in U.S. GAAP and IFRS;

- Financial instruments and derivatives and hedging;

- Statement of comprehensive income;

- Revenue from contracts with customers;

- Disclosures about the credit quality of financing receivables and the allowance for credit losses;

- Effect of a loan modification when the loan is part of a pool that is accounted for as a single asset;

- Milestone method of revenue recognition;

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[13] Davis Polk, "Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act," at iii (2010), available at http://www.davispolk.com/files/Publication/7084f9fe-6580-413b-b870-b7c025ed2ecf/Presentation/PublicationAttachment/1d4495c7-0be0-4e9a-ba77-f786fb90464a/070910_Financial_Reform_Summary.pdf.

- Leasing;

- How investments held through separate accounts affect an insurer's consolidation analysis of those investments;

- Effect of denominating the exercise price of a share based payment award in the currency of the market in which the underlying equity security trades; and

- Scope exception related to embedded credit derivatives.

Third, there are a series of other regulatory initiatives that will impose significant new costs on companies, including the SEC concept release on proxy voting systems and international efforts to regulate financial markets.

Companies have limited resources to devote to complying with additional disclosure obligations. Funds used to comply with these rules mean less resources for a company to use in expanding its business and creating new jobs—something that must take priority given our continued economic and unemployment crisis.

Regulators simply must recognize that the resources available for compliance are not infinite, and prioritize among the various new obligations that they wish to impose, in the same way that business must prioritize in choosing among competing demands and individuals must do so as well in setting their household budgets. When that analysis is undertaken here, it is clear that the Board should terminate this project without any change in existing rules.

As we have discussed, the costs of the proposal are large. And, as proposed, any benefits would largely accrue to plaintiffs rather than investors generally. Otherwise, the benefits— i.e., of a proposal modified to eliminate the requirements that would prejudice preparers' litigation positions and intrude on privileged information—are, we submit, minimal when compared with current disclosure requirements. Once a project is undertaken, the desire to demonstrate that the project was worthwhile—as well as simple inertial force—typically lead to some change in existing standards imposing additional disclosure requirements. Especially in the current environment when businesses face unprecedented disclosure-related burdens and our country faces its greatest economic challenge since the Great Depression, the conclusion that change is not necessary is an equally worthy conclusion. We strongly urge the Board to follow that course.

4. Other Aspects of the Proposal Will Produce Significant—and Entirely Unjustified—Adverse Impacts.

Changing the reporting requirement for possible withdrawal liabilities for multiemployer plans is unnecessarily burdensome. The proposed amendments to Subtopic 715-80 change conditions governing when a company that sponsors a multiemployer plan must recognize liability for a potential withdrawal from a multiemployer plan. Specifically, the amendment deletes the phrase stating that an employer would need to disclose potential withdrawal liability only when such a contingency becomes "either probable or reasonably possible." By deleting that language, such reporting would become necessary even if there is only a remote possibility that withdrawal liability could be imposed. There has been no indication such reporting is necessary. Moreover, requiring reporting of such a remotely contingent event could negatively skew the financial picture of the company and negatively impact the financial credibility of multiemployer plan sponsors.

5. The Proposal's Unusually Expedited Effective Date is Inconsistent with Promoting Convergence and will Impose Huge Costs on Preparers.

The proposal contains an unusually early effective date—stating that it will be effective for fiscal years ending after December 15, 2010. That requirement ignores the fact that the IASB currently has under consideration a proposal to adopt a different standard applicable to these very same issues ("Exposure Draft ED/2010/1, Measurement of Liabilities in IAS 37").

Imposing a new U.S. requirement notwithstanding the ongoing IASB project will hinder convergence by creating yet another difference between international and U.S. standards. What is the sense of imposing this new requirement—and obliging U.S. preparers to incur all of the costs with establishing systems and controls needed to ensure compliance—when the U.S. standard could be replaced by an entirely different international standard, or even by some alternative standard. Instead of consciously rejecting coordination, the Board should make any new requirement effective at the earliest for fiscal years ending after December 15, 2011, or a later date determined by FASB or the SEC for the effective date of the convergence projects currently under consideration.

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For the foregoing reasons we believe that the proposal will not advance the interests of investors; indeed, it will harm investors by making companies more vulnerable to litigation and draining resources away from productive purposes to fund the work necessary to meet these unjustified requirements. Because the costs of the requirements so far outweigh the alleged benefits, we strongly urge the Board withdraw this proposal.

Sincerely,

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