SHEPPARD MULLIN
SHEPPARD MULLIN RICHTER & HAMPTON LLP
ATTORNEYS AT LAW

Four Embarcadero Center | 17th Floor | San Francisco, CA 94111-4106
415-434-9100 *office* | 415-434-3947 *fax* | *www.sheppardmullin.com*

Writer's Direct Line: 415-774-3201
rryland@sheppardmullin.com

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Our File Number: 000E-105139

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Ct. 06856

LETTER OF COMMENT NO. 136

Re: Your File Reference No. 1600-100 (Disclosure of Certain Loss Contingencies)

Gentlepersons:

Preface. I am the general counsel of Sheppard, Mullin, Richter & Hampton LLP, a 525 lawyer firm. I write this letter not on behalf of the Firm or any of its clients, but as a concerned member of the bar who has practiced for more than thirty years under the Accord reached between the American Bar Association and the AICPA in 1975 and who regularly deals with the Accord, both when representing clients and when advising members of the Firm. What follows are my preliminary comments on the proposed amendments to FASB Statements No. 5 and 141(R) (the "Proposal"). While the Proposal does not purport to change the Accord, I presume that if additional reporting requirements are imposed upon financial statement issuers, they will be looking to their counsel to provide additional information, particularly in the post Sarbanes-Oxley era.

You will certainly receive thoughtful comments by many other commentators and organizations. It is regrettable that the public was given only 64 summer days to comment. As set forth below, I submit that certain key factual assumptions underlying the proposed changes are flawed and that those assumptions should be tested before such fundamental changes are proposed, much less adopted.

The Accord recognized the difficulties in predicting the outcome of lawsuits and their possible economic consequences. The ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Request for Information (the "Statement") states in part:

> In view of the inherent uncertainties, the lawyers should normally refrain from expressing judgments as to outcome except in those relatively few clear cases where it appears to the lawyer that an unfavorable outcome is either "probable" or "remote". . . .

As to the potential amount of loss or range of loss in the event of an unfavorable outcome, the Statement said in part "[i]t is appropriate for the lawyer to provide an estimate of the amount or range of potential loss (if the outcome should be unfavorable) only if he believes that the probability of any inaccuracy of the estimate of the amount or range is slight."

Thus, more than thirty years ago, there was a clear recognition that lawyers did not have crystal balls, and except in those rare cases where the likelihood of an unfavorable result is clear, they should not predict the outcome of litigation. Lawyers were similarly cautioned not to opine as to the amount or range of potential loss unless the probability of any inaccuracy was slight. In the three decades since the Accord was promulgated, the complexity of litigation has grown exponentially.

Reliance Upon Prayers Will Not Work. The Proposal does, I believe, presume that the prayers in complaints will provide useful information that can form the basis for disclosures. That is, I submit, an untested and inaccurate assumption. While simple actions on promissory notes and the like may contain a specific dollar prayer (which numbers may already be reflected in the company's financial statements), the most serious lawsuits brought against companies do not contain specific prayers. It is common for complaints simply to allege "damages in excess of the jurisdictional limit of the court to be proven at trial" or "damages, as provided by federal and state antitrust laws . . . to be trebled."[1] In those situations, will defendants be required to perform and disclose their own internal damages estimates? If so, that would put defendants at a great disadvantage in their litigation and settlement strategy. In other cases, plaintiffs state exorbitant damages amounts without any rational basis in an effort to intimidate the defendant. By requiring defendants to account for and disclose irrational, exorbitant damages demands, the proposed changes would provide plaintiffs with added leverage against defendants, thereby encouraging and rewarding that inappropriate conduct. Further, as you know, the vast majority of cases settle before trial for amounts that are orders of magnitude below the demands made by plaintiffs. I respectfully submit that requiring companies to account for and disclose wildly inflated damages demands would mislead investors.

I would make a modest proposal: Many of the most material cases involve the federal antitrust or securities laws or are brought as class actions in federal court (or are removed there) under one or another consumer or employee protection statute. Accordingly, I would invite FASB to review a few hundred recently filed (or removed) federal court complaints. They are available on line through Pacer. How many of those complaints have specific prayers and how

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[1] In certain cases, indeed, plaintiffs are prohibited by statute from stating the alleged amount of actual or punitive damages in their complaint. *See, e.g.*, California Code of Civil Procedure § 425.10, relating to personal injury and wrongful death actions.

useful is that information in those few that do? Separately, I would invite FASB to review complaints filed five years ago that did have specific prayers and compare the prayers to the ultimate judgment or settlement, if known.

Lawyers Cannot Give Useful Estimates; Numbers Experts Cannot Agree. Similarly, I would invite the FASB to look at the expert damage testimony given in those large cases that actually go to trial. That testimony often comes after large teams of economists and accountants spend millions reviewing materials. The witnesses are often prominent economists or other scholars. My point is that if two world class scholars can swear to completely divergent positions, how can lawyers be expected to provide meaningful information about the likely damage award in the event of an unfavorable outcome?

The foregoing addressed information relating to damages at or near the time of trial. The Proposal would seek information much earlier than that. Yet, in many, many cases, a defendant cannot even obtain good information from the plaintiff regarding what it contends are its damages. Interrogatories seeking such information are routinely posed and the routine response is that plaintiff can not respond pending analysis by its experts. That position may remain unchanged until a very few weeks before trial when expert reports need to be exchanged.

An example of some of the complexities may be helpful. In the case of alleged price fixing, there are many permutations and combinations. Here are just some in the case of a product that is incorporated into larger products, e.g., an electronic component or a chemical. Under federal law, only U.S. sales count. Many times, manufacturing using the components occurs off-shore, so the product may or may not have been purchased in the U.S. As to those products that were, there will always be a swearing contest among experts as to "but for" pricing, i.e., how much did the alleged collusion affect prices and what is the "delta." Then, there is the question of who has claims. Is it only "direct purchasers" or do "indirect purchasers" also have claims? Indirect purchasers do not have federal law claims but they may have claims under the law of some states but not others and the nature of those claims may vary by state. For example, does the state allow a "pass-on defense", i.e. the argument that the buyer passed the delta along to its customer. The foregoing relates only to damages; it says nothing about whether plaintiff can in fact prove liability or in the case of purported class actions, succeed in obtaining class certification and if so, who will or will not be within the class.

Outcomes Cannot be Predicted. The Proposal seems to assume that the predictive powers of lawyers have improved markedly in the last three decades. I know of no evidence of that. To the contrary, I would suggest that lawsuits have both grown in complexity and that fact finders have become less predictable. Runaway juries exist. Who would have predicted the machinations that we have seen in recent years relating to parties seeking a favorable venue for their product liability, patent infringement, bankruptcy or other suits? That is simply one of many factors that makes predictions of outcome into "wild guesses."

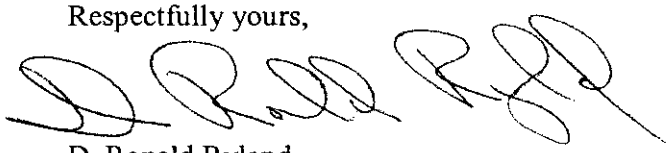
Given the strictures of the attorney client privilege, it is difficult for lawyers to provide anecdotal information about what may have been their "best guess" and the actual outcome of a trial or other proceeding. However, anyone who reads news reports of trials or of jury verdicts will quickly see the vast difference among what the plaintiff contended was the value of its claim after full discovery and trial, the contentions of defense counsel and the amount awarded, if any, by the judge or jury. Just look at the cases where seven figures were offered in settlement and the jury ruled in favor of the defense. Those data alone should be enough to conclude that the proposal while well intentioned, will not achieve its goals and will at best be mischievous. (Of course, the proposed change would require "guesses" much earlier than trial.)

Doomsday Scenarios. The Proposal asks for the worst case scenario regarding matters that will arise within the next twelve months even if the likelihood of that outcome occurring is remote. When litigators hear a question that starts with "is it possible," many reflexively shout, "objection, calls for speculation, anything is possible." The point is that once one gets into the area of "remote," there seem to be no limits. Is the likelihood of unfavorable outcome more or less likely than a Florida hurricane, a San Francisco earthquake or the meltdown of the mortgage market?

Attorney-Client Privilege Issues. The ABA and other groups will, I am sure, comment upon the attorney-client privilege and the risks that the Proposal poses to that privilege. Even in the absence of that issue, anytime a company would make the disclosure required by the Proposal, it would likely provide great benefit to its adversaries. Many times aggregation will not work. In any event, picture the company's CFO on the stand being cross-examined by the plaintiff's attorney as to the company's view of the likely outcome of the matter and its economic consequences as reflected in the company's financial statements. Does the FASB not expect that to happen? In many instances, there will not be a sufficient number of matters so that aggregates will be helpful. Furthermore, assume that a drug company has 1,000 pending cases and discloses a $2 billion contingency. At the first trial, the question will be whether the case is or is not average, *i.e.*, worth $2 million. Even if there are meaningful distinctions as to that particular case, that testimony will taint future cases, most of which are by definition average.

I therefore respectfully suggest that before going forward, the FASB first look at data designed to test the implicit assumption that over the last three decades lawyers have, in the face of more complex suits and more difficult circumstances, somehow become better able to predict the outcome and the consequences of complex litigation. In the absence of compelling evidence on that point, it is, I submit, inappropriate to promulgate additional disclosure requirements.

Respectfully yours,



D. Ronald Ryland

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