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August 8, 2008

PRIORITY MAIL/RETURN RECEIPT REQUESTED

LETTER OF COMMENT NO. 74

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: File No. 1600-100

Dear Sirs:

I enclose two letters from Dewey & LeBoeuf LLP that relate to the proposed amendments to FAS No. 5 and No. 141 (R). One letter deals with the impact on corporations in general, and the other more specifically with the impact on insurance and reinsurance companies.

Please note that we submitted a timely request to make a presentation to the panel and continue to want to do so.

Thank you.

Yours truly,

Steven Levitsky

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August 8, 2008

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

Re: File No. 1600-100

Dear Mr. Herz:

Dewey & LeBoeuf LLP represents many major international insurance companies. As an advisor to them, we have discussed the proposed amendments to FAS No. 5 and No. 141 (R) with a wide variety of insurers of differing size, structure, specialization, and financial condition. All had similar concerns.

For these reasons, along with many of our clients, we join in the comments of The Association of Corporate Counsel.

The adverse effects described by The Association of Corporate Counsel apply to all companies. But they become dramatically compounded for the insurance industry. To protect themselves, members of our society funnel risk through insurance companies. In exchange for premiums, insurance companies undertake to defend their clients and, if necessary, pay their claims. As a result, insurance companies stand behind the defense of a very significant proportion of the major claims in this country.

These insurance companies and their insureds are entitled to the same rights as other litigants, including due process, equal protection, and attorney-client and work-product privileges. Insurance companies rely on these rights to protect their economic interests in courts, arbitrations, or settlement negotiations.

As a practical matter, the proposed amendments very significantly threaten to change the balance of our litigation system. They will shift strategic litigation advantages to the plaintiffs' bar; and, at the same time, significantly restrict the practical ability of insurance companies to defend their clients and themselves. Even if an insurance company were ultimately to win a case, the proposed amendments will have made it more difficult and more costly for them, even when there were genuine and good-faith defenses to a claim. The amendments would increase the operating costs of insurance companies; threaten the investment position of insurance company shareholders (the very "users" to

whom the exposure draft refers); and increase overall insurance costs for all policyholders.

We know that Appendix A8 of the proposals appears to provide an insurance exemption. That exemption does *not* cover all insurance companies and almost certainly will *not* cover the typical large class action or social-issue cases that make up the biggest dollar claims. As a result, the "insurance exemption" is not any type of "solution" for insurance companies. They, like virtually all U.S. corporations, will suffer severely under the impact of the proposals, and indeed, will suffer greater harm because they are involved in more litigation.

The issue here is *not* whether investors should get meaningful information that is relevant to their investments. To the contrary, the real issue is whether the proposed amendments would do more *harm* than good. We strongly suggest that the very concerns that interest you — giving users meaningful information — can be fully achieved through the framework of existing FAS No. 5.

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By way of background, our firm has specialized in insurance law for over 40 years. We have represented most of the world's insurance and reinsurance companies, including life, property and casualty, title, and health insurers. We are leaders in both insurance and reinsurance law and corporate and securities law applicable to insurance companies, insurance regulatory matters, the organization of insurance companies, restructurings, liquidations, demutualizations, the organization of captive insurers, the formation of newly-capitalized off-shore insurers following 9/11, and litigation involving all types of insurance issues. Many of our clients consider us one of the preeminent insurance law firms in the world. We mention this only because our work has given us significant insights into the workings of insurance companies.

The proposals would have a severe and discriminatory impact on all insurance and reinsurance companies for the following reasons.

I. The Insurance Contract Exemption has No Practical Value

Appendix A8 appears to exempt insurance company insurance claims from the proposed amendments. Its supposed "protections" are illusory.

A8 states:

> The Board does not intend to change the accounting and disclosure requirements for insurance and reinsurance entities in this project. Accordingly, liabilities for unpaid claim costs related to insurance contracts or reinsurance contracts of an insurance entity or a reinsurance entity are outside the scope of this proposed Statement.

The scope of this exemption is unclear — and therefore, cannot be relied on with confidence. It appears to exempt insurance or reinsurance "entities," but not the insurance or reinsurance claims themselves.

As a result, the proposed exemption is arguably restricted to operating insurance companies. On its face, the exemption does *not* cover insurance holding companies whose insurance "entities" (included in their consolidated financial statements) may have the same type of insurance or reinsurance claims. Yet most major insurance companies have a holding company structure. The proposed exemption would, obviously, create arbitrary and discriminatory treatment of the identical loss contingency, based purely on the happenstance of how a company is organized.

Aside from the discriminatory effects, the "exemption" would do little even for the licensed insurance companies that are supposedly "protected." Many of the claims — most important, many of the *larger* claims — are typically class actions that allege fraud, bad faith, or other illegal patterns or practices. These claims are likely to be considered extra-contractual or tort and not literally "related" to the underlying insurance contracts. The "exemption" would not exempt them at all.

As a result, even an insurance or reinsurance company that supposedly falls under the "exemption" would have to disclose loss contingencies involving those types of claims. This means that the only way for a company to protect its litigation strategies would be to invoke the "prejudicial information" exemption, which, the proposals tell us, is to be invoked only "rarely." The bottom line is that the proposals would routinely give credibility to massive — but frivolous — claims that carry large dollar tags.

The proposal leaves insurance and reinsurance companies — companies in the business of litigating and negotiating claims — with the burden to include enough detailed information so that the financial statement user can make meaningful judgments about the value of the claim. As many commentators have already noted, the claimant will be able to read the identical information and make the identical judgments. And, if the informa-

tion is "aggregated" by type of claim, then the aggregation will not be valuable to users. In other words, any meaningful disclosure to the "users" will help the plaintiffs against the users themselves — the intended beneficiaries of the proposals. We find it difficult to see how handing this "roadmap" to plaintiffs ultimately benefits users. In fact, it will inevitably cause them significant harm.

II. Even Under the "Insurance Exemption," The *Insureds* Would Have to Reveal the Information

Even if the insurance exemption were effective — and it is not — that would still not exempt the *insured* itself from having to disclose all the required information in *its* financial statements, if it is required to make its financial statements public. Furthermore, an insured that is *not* required to publish its financials could find that its own insurer had published confidential information about the company's litigation.

The bottom line is that strategic information on the defense of any claim with a significant dollar tag will still have to be publicly disclosed (unless, "rarely," it is buried in the "prejudicial information" exemption).

III. Insurance Companies are Special "Targets" for Frivolous Claims

As the FASB is of course aware, any major insurance company could easily have thousands of litigations on its roster at any moment. Many of those cases are brought, *knowing* that (and indeed perhaps *because*) there is an insurance "deep pocket" whose assets may far exceed the ability of the insureds themselves to pay.

In effect, insurance companies provide higher "credit ratings" for potential defendants. Many complaints are tailored specifically to make the insurance companies liable for broad social woes, claims that would almost certainly never be made in the absence of deep insurance coverage.

The existing FAS No. 5 standards at least allow insurance companies the chance to learn about the actual risks involved before making any loss disclosures. Under the proposed standards, the companies would, in most cases, not be able to learn enough about a new case soon enough to avoid disclosing it under the "remoteness" exception. And, even if the risk of a loss is "remote," the company would still have to disclose the contingency if it is "expected to be resolved in the near term" (meaning one year), and if it could have a "severe impact" on the company, regardless of the likelihood.

Of course, the proposed amendments offer the "Prejudicial Information" exception with one hand, but remove it with the other (warning that the exception must be used only "rarely"). In any event, it is highly likely that any use of the "Prejudicial Information" exception will itself lead to more litigation.

The result is that insurance companies will be required to choose between invoking the exception *or* disclosing loss contingencies. But most filed cases will inevitably cause the disclosure of loss contingencies, worthless or not. Indeed, if the plaintiffs actually put an extortionately high price tag on their claim (however unrealistic), that only increases the likelihood that it will need to be disclosed (because there is an "amount" to the claim, including punitive damages). Taking such a step is essentially costless to the plaintiff, since it will generally not have to make the kind of disclosures that the defendant does.

This forced increase in total disclosed loss contingencies would not necessarily have any relationship to the actual loss contingencies the insurance company faces. But it *will* affect the insurance company's rating, *will* affect its ability to attract customers, *will* affect the company's borrowing costs, and *will* affect the value of investments in the company.

In other words, even though real-world loss contingencies may not have changed by one dollar, insurance companies will be saddled with real burdens, real costs, and real competitive disadvantages. The proposals, intended to benefit investors, will damage the very companies in which they invest.

IV. The Proposed Amendments Would Increase Insurance Costs Across-the-Board

The proposed amendments will effectively change the litigation balance between plaintiffs and the insureds who are the defendants. To put it bluntly, the proposed amendments will facilitate extortion. Many companies, faced with the threat of disclosing a frivolous but absurdly-priced claim, would settle it just to keep it off the books. The proposed amendments would shift many claims into that potential extortion category — even though, based on their own "merits," those claims do not merit disclosure.

This change in litigation balance will, naturally, increase insurance costs. Higher premiums will be needed:

- to pay for the newly-imposed duties to make premature "judgments" about loss contingencies;
- to cover the threat of future litigation over these premature "judgments";

- to cover the threat of future litigation over use of the "prejudicial interest" exemption; and

- to cover the higher cost of settlements made so that the company can avoid disclosing huge — but weak or frivolous — claims.

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These are our objections to the proposed amendments based on their discriminatory impact on insurance companies.

The Proposals will Severely Affect *all* Companies

Many of our insurance and non-insurance clients have joined in the general objections of The Association of Corporate Counsel and other law firms. We do not need to elaborate on those general arguments made elsewhere, but do wish to make the following points:

- The filing of a lawsuit does not mean that the litigation will ever rise to a serious level or generate any recovery at all. But few litigators, faced only with a newly-served complaint, will ever give an opinion that the chances of an adverse outcome are "remote." The proposed amendments will, therefore, almost always require the company to make a disclosure of the claimed amount, or include an estimate of the loss contingencies, whenever a lawsuit is filed.

- These loss contingency estimates will almost certainly have to be prepared *before* the company has any meaningful information about the claim, including *before* any chance to take discovery.

- Litigation is always highly unpredictable and evolving. A facially non-frivolous complaint can be demolished by a motion to dismiss, through discovery, at the summary judgment stage, or at trial. But only rarely can a company credibly assess the factors likely to affect the ultimate outcome, or their potential effect on the outcome, let alone the most likely outcome itself.

- The proposed amendments threaten to severely stress attorney-client relationships. Few, if any, outside counsel will be prepared to offer premature opinions to their clients. In fact, under current ABA guidelines on auditors' inquiries, they are *not* required to do so. Consider the issues that will arise when a company's outside counsel are unable or unwilling to respond to an audit inquiry letter.

- The result is that the proposed amendments put companies in the untenable position of having to try to make these assessments themselves, *without* the benefit of perspectives their outside counsel may have on certain matters.

- What will happen when outside counsel tell their client (after having refused to express an opinion of their own) that the client's proposed disclosure does not go far enough, or may be inaccurate?

- The "worst case" damages disclosure requirement will invariably be used against the company in any settlement negotiations. In practice, the proposals would force companies to reveal to their adversaries their negotiating strategy and the amount they might be willing to pay to dispose of a claim, however frivolous. The plaintiffs, on the other hand, would have complete privacy over their own strategic litigation tactics. The damage and disruption this would cause to reasonable settlement efforts cannot be overestimated.

- The additional disclosure requirements may also impose on underwriters, who may be held liable under sections 11 and 12 of the Securities Act of 1933, liability for any false or misleading statements in a prospectus or registration statement.

- How will underwriters be able to perform due diligence on matters that are speculative? And how will they do so without intruding on the attorney-client privilege and work-product doctrine?

- The proposed amendments will allow plaintiffs to coerce settlements that companies would not consider under current standards. Forcing companies to make the required but speculative "disclosure" creates a strong incentive for those companies to settle a newly-filed claim, to which a plaintiff has assigned a huge, but purely fictional, "amount." The proposals would, in effect, create a new market for strike suits, and breathe new life into the very types of practices that the Private Securities Litigation Reform Act of 1995 was intended to end.

- Good-faith, but inaccurate and premature "quantitative" and "qualitative" assessments of a claim, compelled by the proposed amendments, could create a new form of claim against a company whose premature assessments turn out to be wrong in hindsight.

- The speculative nature of the premature disclosures certainly seems to be of "such dubious significance that insistence on its disclosure may accomplish more harm

than good." *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976).

- The "Prejudicial Information" exemption is supposed to limit the value of the information to claimants who are suing the company. But, if this exemption works effectively, and prevents the claimants from extracting valuable strategic information from the financial statements, the exemption will also have stripped out any value for the user.

- The proposed amendments warn that the "Prejudicial Information" exemption should be invoked "rarely." But the exception will inevitably swallow the rule, since most prudent lawyers would probably urge their clients to invoke the exception whenever they can. The result is that we will likely end up with no more disclosure than we have now, perhaps less, but certainly have much more internal debate and hand-wringing.

- The proposal does not spell out the consequences of failing to follow the rule. What should auditors do if a company refuses to make the required disclosures and invokes the "Prejudicial Information" exception? Can they withhold their opinion?

- The "qualitative" and "quantitative" disclosure requirements threaten companies with the prospect of disclosing to their adversaries what should be protected by the attorney-client or work-product privileges. These privileges exist for good reason: they protect the company and its investors from prejudicial disclosure to adversaries who, obviously, do not have the company or investors interests at heart. It is ironic that, while the legal profession and Congress are assailing the Department of Justice for forcing companies to waive privilege to show "cooperation," the FASB is proposing a rule that could have the same result.

- There is no requirement that, if a defendant must disclose its evaluation of litigation against it, the plaintiff must do so as well.

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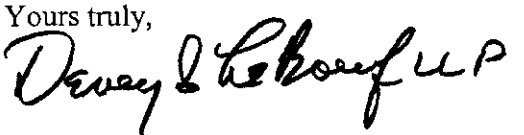
The impact of the proposed amendments goes far beyond mere accounting disclosures. They very significantly threaten the way our litigation system operates, and very significantly compromise important legal rights that litigants have always enjoyed. They will severely affect all companies; impose a disproportionate impact on insurance companies;

and will raise everyone's insurance costs. This proposal is bad for *all* of our clients; will increase transaction costs; erode the attorney-client relationship and the attorney-client privilege; and provide one-sided support for the plaintiffs' bar.

There is no empirical evidence that FAS No. 5 needs any overhauling. Given the very severe adverse effects of the proposed amendments, we, and many of our clients, strongly believe that the very concerns that interest you — giving users meaningful information — can be fully achieved by enforcing existing FAS No. 5.

If you have any questions regarding this letter, please feel free to contact Richard W. Reinthaler (212-259-6090; rreinthaler@dl.com); John M. Schwolsky (212-259-8667; jschwolsky@dl.com); Joseph L. Seiler III (212-259-8137; jseiler@dl.com); James P. Smith III (212-259-7594; jpsmith@dl.com); or Steven Levitsky (212-424-8309; steven.levitsky@dl.com) in our New York office.

Yours truly,



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August 7, 2008

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

Re: File No. 1600-100

Dear Chairman Herz:

Dewey & LeBoeuf LLP appreciates the opportunity to comment on the June 5, 2008 Exposure Draft setting forth proposed amendments to Statement of Financial Accounting Standards ("FAS") Nos. 5 and 141(R). Dewey & LeBoeuf LLP is an international law firm headquartered in New York with more than 1,400 lawyers in 13 countries. We represent clients in virtually every major industry sector, including financial services, energy, insurance,[1] life sciences and healthcare, media and entertainment, and telecommunications. We write to express our deep concerns about the proposed amendments and to urge the FASB not to adopt them.

In our view, there is nothing demonstrably wrong with the current standard that "needs fixing." The current standard requires companies to report loss contingencies where the likelihood of an adverse outcome of a pending or threatened litigation is both probable and estimable. The existing standard does not require firms to speculate about the outcome of litigation which, by its very nature, is inherently unpredictable, particularly at the early, pre-discovery stage. It does not require companies to estimate and disclose the potential "worst-case" outcome of litigation where the likelihood of an unfavorable outcome is "remote," unknown, unpredictable or unquantifiable. It does not pressure companies to reveal, even in general terms, their legal defense strategies, internal assessment of the likelihood of success and other information that may be covered by the attorney-client privilege or work product doctrine. The current system has been in place for many years, and there is no empirical evidence to suggest that it has not worked well.

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[1] Because the proposed amendments, if adopted, would likely have a unique and disproportionate impact on one of our largest client constituencies – insurance and reinsurance companies – we are submitting a separate letter setting forth our concerns with respect to the unique impact the proposed amendments would have on that constituency.

In general, we believe that the proposed amendments, if adopted, would fundamentally alter the relationship between opposing parties in litigation without corresponding benefits to investors. The additional information that companies would be required to disclose (which under the current rule would not be disclosed) would provide plaintiffs with a new source of otherwise privileged information without plaintiffs (if not themselves public companies) having to make similar revelations. This imbalance in information (also seemingly inconsistent with the rules of procedure governing litigation) could be used to extract early, in terrorem settlement of claims (in some cases, simply to avoid having to make the required disclosures). They will also have a chilling effect on the attorney-client relationship and increase transaction costs for all concerned. Revealing this type of information may also provide investors more insight into litigation strategy than ultimate outcomes, may confuse or mislead investors into believing cases have more merit than is warranted, and could thus cause investments to unnecessarily decrease in value. There is a difference between justly having to compensate an opponent and being forced to compensate an opponent because disclosure requirements are neither evenly balanced nor in basic accord with the underlying principles of adversarial litigation.

We set forth below the most significant concerns our clients have expressed to us regarding the proposed amendments to FAS No. 5 and why we believe those amendments should not be adopted.

(1) The additional information required to be provided would be speculative, uncertain and unreliable.

The new rule, if adopted, would (a) require disclosure with respect to a far broader range of loss contingencies than is currently required, and (b) greatly expand the nature and scope of the disclosures required with respect to each of those contingencies. Both aspects raise significant concerns.

First, by requiring disclosure of all contingencies except those for which the company has affirmatively determined that the likelihood of an adverse outcome is "remote," the proposed amendments would effectively mandate disclosure any time anything other than a clearly immaterial lawsuit is filed. Based on our experience, companies (and their outside litigation counsel) are simply not in a position to opine at the early, pre-discovery, pre-motion stage of a litigation (no matter how strong a defense they may believe they have to the claims asserted) that the likelihood of an adverse outcome is "remote." They are not in a position to do so because litigation is inherently unpredictable. Cases evolve over time, plaintiffs' theories and claims change as a result of discovery, as do defense strategies, and clients often discover that assumptions made at the outset of a case may not be correct or tell the entire story. The proposed amendments do nothing to provide more certainty to what is by its very nature a highly uncertain, evolving process. Rather than provide investors with more concrete factual information about a loss contingency that is likely to occur, or

probable of occurring, companies would, under the proposed amendments, be compelled (absent invoking the "prejudicial information" exception) to make detailed disclosure at the outset of litigation of speculative, unreliable and uncertain information concerning loss contingencies that, in the end, years later, may or may not turn out to be correct and/or have a material financial statement impact. Even in those rare instances in which a company may be able to conclude that the likelihood of an unfavorable outcome is "remote," the proposed amendments would *still* require disclosure if the contingency could have a "severe impact" (*i.e.*, a "significant financially disruptive effect," whatever that means) within the next year. This would represent a radical departure from current practice under FAS No. 5, as it would require companies to make disclosures about frivolous lawsuits and cases that they fully expect to win.

Second, given the inherent uncertainty and unpredictability of litigation, it is unlikely that requiring companies — at the outset of a case — to make the sorts of detailed "quantitative" and "qualitative" assessments contemplated by the proposed amendments will lead to more accurate financial statements. Rarely, for instance, will a company be in a position to make a credible assessment at the pleading stage regarding "the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome," let alone provide "a qualitative assessment of the most likely outcome" and the anticipated timing of resolution.

Nor are companies generally in a position at the start of a case to make a reliable estimate of their potential exposure. The current rule recognizes this fact. Under current FAS No. 5, a company must either provide an estimate of the loss (or range of loss) or state that such an estimate cannot be made. Under the proposed amendments, however, a company would have to either (a) disclose the amount sought in the complaint (however unreasonable or inexplicable) or (b) in situations in which the complaint does not state an amount certain (or where the company believes that the amount demanded is not a realistic estimate of its exposure), provide its own "best estimate of the maximum exposure to loss." In other words, even where a company concludes that the loss cannot be estimated, it would nevertheless be required to provide an estimate anyway, before it has had any meaningful opportunity to analyze the proper measure of damages, much less conduct discovery or engage experts to assist in the process.

Third, the proposed amendments would also require disclosure of available insurance and indemnification arrangements covering any possible loss, including caps, limitations and deductibles. Public companies have historically not disclosed such information as a matter of course, nor has the SEC required such disclosure in interim or annual financial statements or accompanying MD&A disclosures. The proposed amendments would thus appear to require disclosure of information not currently required by the SEC and impose a disclosure regime inconsistent with existing SEC rules. In addition, public companies will often not be in a position to make the required disclosures regarding the amount of available insurance,

indemnification rights, etc., at the early stages of litigation, as insurance companies often take time to review claims and then send "reservation of rights" letters, laying out all of the exclusions or other reasons why coverage may not be available. Under the proposed rule, the pressure on companies to make the required disclosure may bring insurance coverage disputes (but not their resolution) to the surface much sooner. Similarly, indemnification rights are often contractual in nature, and frequently not clear-cut.

In short, the principal result of the expanded disclosures, if made, would, in our view, be to bombard investors (and other "users of financial statements") with speculative and unreliable information that under current law would not be considered "material." This is directly contrary to FASB's stated goal of "providing enhanced disclosures about loss contingencies," and is something that the Supreme Court counseled against long ago. *See TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49, 453 (1976) (holding that "[s]ome information is of such dubious significance that insistence on its disclosure may accomplish more harm than good" and warning against disclosures that would "bury the shareholders in an avalanche of trivial information, a result that is hardly conducive to informed decision making"). Indeed, to avoid misleading investors, any required disclosure would have to be heavily caveated, thereby further diminishing its utility.

(2) The extensive and detailed disclosures mandated by the proposed amendments would harm companies in pending and threatened litigation.

The additional information required to be disclosed under the proposed amendments may very well prejudice companies in their defense of litigation. There are two ways in which this may happen. First, the proposed amendments would require a company to disclose, *inter alia*, "a description of the factors that are likely to affect the outcome of the contingency along with their potential effect on the outcome; the entity's qualitative assessment of the most likely outcome of the contingency; and significant assumptions made by the entity in estimating the amounts disclosed in [the quantitative assessment] and in assessing the most likely outcome." Companies would thus have to publicly predict the outcome of litigation and reveal why they may lose. Truthful, detailed disclosure of a corporate defendant's qualitative assessment of a claim and of the assumptions underlying it would provide the plaintiffs' bar with an insight into its adversary's thinking that is not currently enjoyed, and tilt the playing field unfairly in favor of plaintiffs. It is difficult to envision how any disclosure that would help a strike suit plaintiff build a case would benefit investors. It is equally difficult to discern how a company could make such disclosures without compromising the protections afforded by the attorney-client privilege and work-product doctrine. Plaintiffs are sure to claim that the additional quantitative and qualitative disclosures required under the proposed amendments somehow constitute a waiver of the attorney-client privilege, not just with respect to the particular disclosures made, but as to the entire subject matter. An entire cottage industry of privilege waiver litigation is likely to emerge.

Consider also the adverse impact the proposed amendments would likely have on the attorney-client relationship. Clients may become reluctant to disclose information to their lawyers at the outset of a case in light of the FAS 5 requirement that "more" be disclosed, in order to (a) avoid or minimize the risk of a privilege waiver, and/or (b) avoid having outside counsel tell them that they must disclose more than the client is willing or wants to disclose. Counsel, meanwhile, will often have no choice but to decline to opine on many of the matters required to be disclosed in response to an audit inquiry letter (because, as a matter of professional responsibility, they will simply not be in a position to do so), forcing the client to make judgments and substantive disclosures on its own, without the ability to rely on the advice of counsel as a defense. Indeed, outside counsel may end up in the uncomfortable position of having to advise a client, in reviewing a disclosure document or SEC filing (after having declined to express an opinion of their own), that the proposed disclosure does not go far enough or appears inaccurate in some respect. Consider, moreover, the problems this sort of additional disclosure may pose for underwriters, who may be sued under sections 11 and 12 of the Securities Act of 1933 for any false or misleading statements in a prospectus or registration statement. How will underwriters be able to perform due diligence on matters that are as speculative as those required to be disclosed by the proposed amendments without requiring disclosure of information that may implicate the attorney-client privilege and work product doctrine? Indeed, it strikes us as somewhat ironic that, at the same time the legal profession and Congress are assailing the Department of Justice for forcing companies to waive the attorney-client privilege to show "cooperation," the accounting profession is proposing a rule that could conceivably lead to the same result.[2]

Disclosure of this sort of information (whether or not it results in a waiver of privilege) would clearly disadvantage companies in settlement negotiations. Without question, a company's "best estimate of the maximum exposure to loss" would be used against it by plaintiffs' counsel to support larger and more outrageous settlement demands. It is equally evident that a company's negotiating position on the merits would be eroded by any public, frank disclosure of the quantitative factors and assumptions that it believes are likely to affect the outcome of a case. How investors would benefit by disclosure of information that may increase the out-of-pocket cost to companies settling claims is difficult to discern.

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[2] A possible alternative to the proposed amendments would be the enactment of legislation or rule-making making clear that any disclosure of privileged information to accountants does not constitute a waiver of the attorney-client privilege or work product doctrine (thus encouraging such disclosure), coupled with some additional rule-making or modest modification to FAS 5 relating to what "contingencies" have to be included in a general, aggregated "loss contingency" reserve. Investors could thus rely on the fact that the auditors have satisfied themselves, without waiving the privilege, as to whether a company's litigation reserve is adequate.

(3) The disclosures mandated by the proposed amendments could themselves become a source of litigation and/or liability.

There is also a risk that the expanded disclosures required by the proposed amendments may themselves become a source of additional litigation and/or liability, as investors who claim to have relied on a company's estimates of "maximum exposure to loss" and/or its assessment of "most likely outcome" will be able to bring suit when those estimates turn out, in hindsight, to have been wide of the mark. In this regard, a company's good-faith "quantitative" and "qualitative" assessments of a claim could lead to a new form of securities litigation, and the company's directors and officers – the individuals who will be called upon to make these sorts of inherently unpredictable estimates and assessments – will undoubtedly be charged with having to defend the subjective judgments they made. Under current law, these types of disclosures may not be protected by the Private Securities Litigation Reform Act's "safe harbor" for "forward-looking statements." *See* 15 USC § 78u-5(b)(2)(A) ("Except to the extent otherwise specifically provided by rule, regulation, or order of the Commission, this section shall not apply to a forward-looking statement . . . that is . . . included in a financial statement prepared in accordance with generally accepted accounting principles."). Thus, although any disclosure of forward-looking information would almost surely be accompanied by meaningful cautionary language, no lawyer could safely opine that any company making such disclosure would be "home-free."

(4) The "prejudicial information" exception, if invoked "rarely," as envisioned, would do little to alleviate these concerns.

The proposed amendment's limited exception for "prejudicial information" is, in our view, unworkable. First, aggregating disclosures will rarely help to avoid prejudice. For many companies, the case or subset of cases that pose the greatest risk are often of a different nature than the rest of its contingencies, such that aggregated disclosure may still permit litigation adversaries to draw a link. Second, the limited exception available in situations where aggregated disclosure would still be prejudicial is insufficient, since it would require a company to disclose why the information has not been disclosed and to provide a description of the factors that are likely to affect the ultimate outcome of the contingency. This information is itself likely to be prejudicial. Finally, there is also a concern that invoking the "prejudicial exception" could give rise to an adverse inference with which the company would have to contend in litigation.

In any event, notwithstanding the foregoing, and the admonition that the "prejudicial" exception should be used "rarely," it is clear beyond peradventure that the exception would in practice swallow the rule, as the one piece of advice all lawyers will most assuredly provide their clients is to invoke the exception whenever possible – and it will almost always be at least arguably applicable. Consequently, the proposed amendments may produce only minimal additional disclosure, while generating a lot more internal discussion, debate and

hand-wringing in order to get there. Finally, to the extent the exemption is invoked, and prevents claimants from extracting valuable strategic information from the financial statements, the proposed amendments would provide no significant value to the user, thus defeating their stated purpose.

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In summary, in our view there is nothing wrong with the current standard, which is well-understood, has withstood the test of time, recognizes the importance of, and strives to maintain, the attorney-client privilege and work product doctrine, provides no discernable advantage to either side in our adversarial system, and provides financial statement users with non-speculative information that does not force companies to reveal their litigation strategies or "worst case" assessments of litigation. The purported benefits sought to be achieved by the proposed amendments would be far outweighed by the fundamental alteration of the relationship between opposing parties in litigation that would result, without corresponding benefits to investors. The proposed amendments would, we respectfully submit, create significant problems for clients and attorneys alike, would increase transaction costs, unduly complicate disclosure decisions, require detailed disclosure of information that has historically been viewed as "immaterial," place undue pressure on the attorney-client relationship and attendant privileges and protections from disclosure, increase litigation risk for public companies and create an imbalance in information between opposing parties that could be used to extract larger settlements of class action, mass tort or other potentially significant litigation. Given these very real, practical and legal concerns, it is highly likely that the "prejudicial information" exception, despite the drafters' exhortation that it be invoked only "rarely," will swallow the rule. In short, the proposed amendments appear to provide little if any real benefit to users while raising a host of concerns and new disclosure requirements that are neither evenly balanced nor in basic accord with the underlying principles of adversary litigation.

We appreciate the opportunity to provide our views and, as previously indicated, look forward to the opportunity to participate in a roundtable discussion of these issues.

If you have any questions regarding the foregoing, please feel free to contact Richard W. Reinthaler (212-259-6090; rreinthaler@dl.com); John M. Schwolsky (212-259-8667; jschwolsky@dl.com; Joseph L. Seiler III (212-259-8137; jseiler@dl.com) or James P. Smith III (212-259-7594; jpsmith@dl.com) in our New York office.

Very truly yours,

Dewey & LeBoeuf LLP