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August 17, 2010

Technical Director File Reference No 1840-100 FASB 401 Merritt 7 P. O. Box 5116 Norwalk, CT 06856-5116

Subject: Proposed Accounting Standards Update: Disclosure of Certain Loss Contingencies, Contingencies (Topic 450)

### Dear Technical Director:

Pfizer is a research-based, global pharmaceutical company with its principal place of business in New York. We develop, manufacture and market leading prescription medicines for humans and animals, as well as nutritional products and many of the world's best-known consumer products. The Company's 2009 total revenues were \$50 billion and its total assets as of December 31, 2009 were \$213 billion. We appreciate the opportunity to respond to the FASB Exposure Draft on Contingencies (Topic 450): Disclosure of Certain Loss Contingencies (the "ED").

We appreciate the time and consideration that the Board has given to the 2008 comment letters as well as its openness to understanding the very thorny issues connected with this topic. Further, we are pleased that this latest draft does not include some previously proposed requirements, such as disclosure of maximum possible losses and the requirement to make quantitative predictions regarding the resolution of the contingency.

Nonetheless, we remain concerned about the proposed requirements and as a result, we wish to assist the Board in understanding the real consequences of the current proposed rules. While we understand the inherent difficulties in balancing the views of the varying constituencies and the desire to ensure that users obtain timely and transparent information, we believe that "SFAS 5" has served all constituencies well when followed in good faith. Given the litigious nature of our society and our adversarial legal system in the U.S., we believe that, despite improvements, the expanded disclosures will more likely than not have far reaching, unintended and, in our view, negative consequences for U.S. companies and their investors that far outweigh any potential benefit to users of financial statements.

In our response to the June 2008 exposure draft, we stated several key concerns that we believe remain relevant to the present proposals:

The proposed requirements could negatively influence the outcome of litigation. For example, we believe that the additional disclosures could hinder the ability of public companies to negotiate settlements and/or pursue available defenses and could encourage potential litigants to commence litigation when they otherwise would not have done so. Furthermore, the expanded disclosures will be very costly to prepare and will require extensive time and effort.

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• Litigation and other contingencies are inherently uncertain. Requiring disclosures regarding remote contingent liabilities, unasserted claims and assessments and expanded quantitative information will prove more misleading than helpful to users of financial statements by giving credence to matters that may not ever evolve into meaningful contingencies and creating a false sense of certainty or expectation around future outcomes. In this way, the financial statements are more likely to lead a user to conclusions that are inherently incorrect. The only effective way to remedy this would be for a financial statement preparer to give users a full understanding of their defense strategy. This will, without question, severely disadvantage companies by providing adversaries with this information.

- The required expanded quantitative information, even at an early stage of litigation, will become "sound bites," that will be repeated by the media and lodged in the minds of the reader, despite that fact that the initial damages claimed in a litigation action are often exorbitant and have no relationship to the final outcome or settlement. While the initial damages claimed may be interesting to a user, we contend that users cannot assess the appropriateness of that information to any final outcome without the detail context and knowledge of the law in the specific jurisdiction.
- We believe existing standards work as intended when followed in good faith. Management has a duty to assess the various litigation and make determinations based whether it has relevant and reliable information to form an opinion on probability and whether an amount may be estimable or not. While we understand users' desire to know and understand each item of litigation, they simply will never be able to make their own independent assessments and will be more likely to draw erroneous conclusions. We also note that even for management, the assessments are extremely difficult given the many variables and factors that weigh into the types of litigation.
- Legal contingencies involve adversarial proceedings and the requested information could *unwittingly* aid plaintiffs at the expense of the Company and its investors.

For your convenience, at the end of this letter, we have provided an extract of the concerns originally outlined in our June 2008 letter (edited to reflect changes in the proposed requirements).

### General Comments on Current Exposure Draft

In addition to the above concerns, which we believe have continuing relevance, we believe the requirement to present a tabular disclosure of changes in estimates for loss contingencies should be reconsidered for the following reasons:

• Current financial reporting and disclosure requirements already compel preparers to disclose material activity associated with loss contingencies and require classification as either short or long-term according to their nature. We do not believe that a tabular reconciliation will serve to advance the ED's stated objectives of ensuring that users understand the nature of the loss contingencies, their potential magnitude or their potential timing (if known). Instead, a tabular reconciliation, aggregated by class, will serve to provide detailed prejudicial information to litigation adversaries by providing a view as to the amount of the accrual established for a particular litigation or class of litigations, and any changes thereto. Since accrued amounts generally reflect management's estimates regarding the probable resolution of a litigation,

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such disclosure will provide a litigation adversary with a significant tactical advantage, and may invite additional litigation by plaintiffs seeking to obtain recoveries similar to the amounts accrued.

- Changes over time in litigation-related estimates and required explanations could be used by plaintiffs to ascertain the company's mindset as to the strength of its position with respect to certain litigation, the company's legal and settlement strategies and possibly result in attempts for larger settlements than would otherwise be reached. It will also hinder a company's ability to mediate disputes or resolve them outside the expensive process of full-blown litigation. The incentives for a company to negotiate resolutions will be greatly reduced, because practically, it may be difficult for a company to settle a lawsuit for an amount that is lower than the amount of the accrual for such litigation in its financial statements.
- Aggregation does not provide full protection for the disclosing party. For example, given the caveats outlined in the ED, for a company involved in a single legal dispute or for companies with diverse litigation actions, the ability to aggregate claims may be limited, or may not be possible at all. Even when aggregated with one or more smaller claims, it will often be evident that a particular claim or group of claims accounts for the bulk of an aggregated provision, hence providing insight into the company's mindset as to the value of such claims. Given that the examples provided in the ED provide a high standard for aggregation, these scenarios are highly likely to occur. Furthermore, the suggested disclosure in the ED of the total number of claims outstanding, the average amount claimed and the average settlement amount for claims in each class will provide prejudicial information to litigation adversaries and may be used by such adversaries as leverage in negotiating settlements with the company.
- Certain types of legal settlement negotiations are facilitated by agreements to keep terms confidential and it is unclear what impact these disclosure requirements will have on those matters.
- The tabular reconciliation disclosing the company's accrued loss contingencies may constitute, and may result in communication with the company's auditors that constitutes, a waiver of the attorney-client privilege and attorney work product protection with respect to such information. Such a waiver would subject the company to discovery related to the attorney work product and attorney-client communication that was produced in order to determine the disclosed accrual amount. Plaintiff's requests for discovery involving auditor workpapers is not theoretical, but a practical reality of the environment in which we operate.

We have addressed additional concerns more fully below in the responses to questions, including concerns raised by the proposals related to the disclosure of remote contingencies and the proposed expanded quantitative disclosure for contingencies.

We understand that the Board assessed the proposed costs in analysis, however, the costs which were assessed are primarily around the mechanics of collecting and tabulating the information. While those efforts will have additional costs attendant to them, we believe that there are greater and more significant costs involved, such as the real risk of providing data to adversaries to permit them to gain advantage, the increased potential of incurring additional litigation from discussions of remote or unasserted matters as well as the extensive time and effort by our Legal

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department, our outside counsel, our Finance personnel, our Board of Directors and our auditors. Balanced against this cost is a notable absence of articulated and measured benefit to investors or shareholders. The proposal will result in potentially enormous costs to companies in terms of compliance and the cost of litigation itself, without measurably advancing the quality or usefulness of the information already disclosed on the topic by companies who apply the existing standards in good faith.

We do not believe that a final standard issued in Q4 and effective for Q4 (for most companies) adequately appreciates the complexity of the disclosure process or the extraordinary sensitivity of the proposed disclosures, such as judgments required for aggregation decisions, determination of whether certain contingencies require disclosure under the new standards and the collection of information required under the expanded disclosure requirements. Moreover, we believe that the operationalization of the standard is not possible without finalization of cooperative effort with the American Bar Association to identify and address any potential implications with respect to the ABA's Statement of Policy Regarding Lawyers' Responses to Auditors' Reugests for Information.

### **Final Comments**

We believe that any benefits to investors of providing the new information proposed to be required by the ED are far outweighed by the highly prejudicial nature of such information. Litigation is an adversarial and unpredictable process that often ends in the parties entering into a settlement prior to a verdict by a court. The disclosure proposed in the ED will provide plaintiffs with negotiating leverage and insight into the company's litigation strategy that will have the effect of harming the company and its investors. Furthermore, we believe that the adoption of the ED will result in the loss of attorney-client privilege and attorney work product protection with respect to certain significant information.

We believe the existing "SFAS 5" framework handles the uncertain nature of contingencies fairly and adequately. Going into great levels of detail as proposed by this ED could be prejudicial to the company's defense, will create overly detailed and lengthy litigation disclosures and will provide readers with a false sense of certainty regarding such inherently unpredictable contingencies.

Our responses to "Questions for Respondents" below explain our views in more detail. We appreciate this opportunity to comment and encourage the FASB to continue to engage its constituents.

We would be happy to discuss these matters further or to meet with you if it would be helpful.

Sincerely,

Loretta V. Cangialosi

Loretta V. Cangialosi Senior Vice President and Controller

Attachments

cc: Frank D'Amelio

Senior Vice President and Chief Financial Officer

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## **Questions for Respondents**

# 1. Are the proposed disclosures operational? If not, please explain why.

We believe that proposed disclosures are not operational, do not materially improve the existing "SFAS 5" framework and could prove prejudicial to public reporting companies and their investors. We also believe the incremental costs will be enormous.

- <u>Aggregation</u> As discussed above, aggregation will not provide complete protection from disclosing unduly prejudicial information to plaintiffs, and the additional suggested disclosure with respect to classes will provide additional prejudicial information. In addition, the aggregation guidelines (in 450-20-55-1A) may require the company to aggregate in a way that is inconsistent with how the company manages the contingencies.
  - Furthermore, "strik[ing] a balance between obscuring important information ... and overburdening financial statement users ..." will prove 'easier said than done.' For reference, the disclosures for legal proceedings and contingencies in our 2009 Financial Report required approximately 10 pages. We can't be sure what the expanded disclosure would require but we would anticipate additional pages devoted to this topic.
- <u>Insurance or Other Recoveries</u> We note the proposed requirement that the company disclose information related to recoveries from insurance if such information is discoverable with respect to a claim. Since such information is almost always discoverable, we believe that disclosure is prejudicial to the company because potential third party litigants could use such information about the company's insurance policies in crafting their claims.
- Remote Contingencies We believe the proposed disclosures for certain asserted remote loss contingencies are of particular concern, because providing the required disclosures could give credence to exorbitant claims with only a remote chance of recovery and could inspire a plaintiff to commence or continue a litigation that might otherwise have been dropped or settled for a nominal amount. Furthermore, such disclosure would require the company to make judgments very early on in the litigation process as to whether chance of recovery is "remote," a determination that would likely require additional information than what typically appears in a complaint. In addition, such judgments would likely result in communication between the company and its auditors that could result in the waiver of attorney-client privilege or attorney work product protection. Lastly, disclosure of "remote" contingencies would mislead readers of the financial statements, because by definition, such contingencies are not likely to result in a loss.
- Additional Quantitative Disclosure The requirement that a company disclose "publicly available quantitative information" with respect to a loss contingency does not alleviate the prejudice that would be derived from such disclosure. For example, disclosure of amounts claimed and the amount of damages indicated by the testimony of expert witnesses in a company's financial statements, even if publicly available, could mislead readers by giving more credence to the amounts than they deserve. Amounts claimed in complaints often far exceed and bear little relation to final damages or settlement amounts. Furthermore, companies may be required to disclose the testimony of a plaintiff's expert witness, no matter what the basis for such testimony.

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In addition to misleading readers by providing credibility to amounts that may not truly reflect the potential outcome of the case, required disclosure of these amounts could in some instances necessitate further disclosures about why management does not believe those amounts to be realistic, and such additional context could prove prejudicial to the company by revealing its litigation strategy.

- <u>Unasserted Claims/Assessments</u> The Board has proposed that companies disclose unasserted claims if it is probable that a claim will be asserted and it is reasonably possible that the outcome will be unfavorable. While we understand the Board's motivation with respect to unasserted claims and assessments, we believe that disclosing unasserted claims and assessments will be a self-fulfilling prophecy. We are particularly concerned about the proposed guidance related to a company being "aware of the existence of studies in reputable scientific journals..." Such disclosure could result in an asserted action by potential litigants who would not have otherwise commenced litigation, hence opening the company up to additional litigation exposure. Such disclosure may also be misleading to readers. Particularly in the pharmaceutical industry, where scientific journals frequently publish studies about products, determining whether the subject of such studies is probable to result in an asserted claim and whether it is reasonably possible that the outcome will be unfavorable, will be an imperfect science and require insight into the studies that may not be available. In practice, assessments of this kind are extremely difficult to make even after litigation has been commenced, much less when claims have not even yet been asserted.
- Tabular Reconciliation For reasons discussed above, we do not believe that tabular reconciliation of contingencies should be required in any period. We strongly believe that, to the extent that changes in accruals could be identified to a particular action, which is highly likely, the disclosure itself can become "outcome-determinative." We believe that current requirements for disclosure of material events are sufficient.

## 2. Are the proposed disclosures auditable? If not, please explain why?

We believe that the basic facts available from public filings and the tabular rollforward would be auditable, but not necessarily meaningful and, perhaps, misleading.

The disclosure of unasserted claims/assessments and asserted claims/assessments that are deemed remote but significant, will not be easily auditable, and could also prove to be prejudicial and/or misleading. We believe that auditors will continue to need to rely on legal confirmations to verify the detailed disclosures and ongoing case developments that are proposed. But, we are concerned that this long-standing practice will prove insufficient as counsel may be reluctant or unable to provide meaningful confirmations about <u>unasserted</u> claims/assessments and <u>remote</u> contingencies. This will add to the time, expense and complexity to the preparation of financial statement disclosures.

3. The June 2008 FASB Exposure Draft, *Disclosure of Certain Loss Contingencies*, had proposed certain disclosures based on management's predictions about a contingency's resolution. The amendments in this proposed Update would eliminate those disclosure requirements such as estimating when a loss contingency would be resolved and the entity's

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maximum exposure to loss. Do you agree that an explicit exemption from disclosing information that is "prejudicial" to the reporting entity is not necessary because the amendments in the proposed Update would:

- a. Not require an new disclosure based on management's predictions about a contingency's resolution
- b. Generally focus on information that is publically available
- c. Relate to amounts already accrued in the financial statements
- d. Permit information to be presented on an aggregated basis with other similar loss contingencies

# If not, please explain why.

No. If the expanded disclosures are required, we ask that the prejudicial exemption be restored. However, the exemption should not be viewed as a "cure-all."

For many entities, either a single claim or a group of claims (such as a group of mass tort claims or a major shareholder class action suit) will constitute a disproportionate part of the total exposure from such matters, with the consequence that aggregation may not provide a meaningful shield for the information.

Frequently, large claims are known publicly and anyone evaluating the aggregate disclosure is likely to know that the great bulk of the exposure comes from a particular claim or group of claims. In addition, to the extent that all estimates of claims are uncertain, aggregation may merely compound the possibility of error that is inherent in each individual evaluation, leading to a composite disclosure that is prone to error and nearly meaningless.

Also, we believe that even disclosing information that is publicly available could be prejudicial, since including the proposed disclosures in the context of a financial statement footnote gives a level of <u>prominence and credibility</u> to plaintiff's claims that may not be warranted and could prove damaging to a company's reputation and perhaps even adversely affect its stock price.

Furthermore, as discussed above, disclosure of certain information in the company's financial statements may give rise to a waiver of the company's attorney-client privilege or attorney work product protection.

### 4. Is the proposed effective date operational? If not, please explain why.

As stated above, we believe that complying with the ED as written will require extensive time, effort and cost by our Legal department, our outside counsel, our Finance personnel, our Board of Directors and our auditors. We do not believe that a final standard issued in Q4 and effective for Q4 (for most companies) adequately appreciates the complexity of the disclosure process or the extraordinary sensitivity of these disclosures.

5. Do you believe that the proposed disclosures will enhance and improve the information provided to financial statement users about the nature, potential magnitude and potential timing (if known) of loss contingencies?

No. We believe that existing "SFAS 5" framework currently provides an appropriate level of disclosure regarding the nature, potential magnitude and potential timing of material loss contingencies.

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The current standard of disclosure requires meaningful information. Presenting amounts that are probable and estimable is meaningful; presenting the range of reasonably possible loss in excess of amounts recorded is meaningful; and asserting that such estimates cannot be made is *especially* meaningful.

We do not believe that disclosure of remote contingencies or amounts claimed will prove meaningful; in fact, it is likely that they will be misleading and/or confusing. Contingencies deemed to be remote have no place in financial statement disclosures and will encourage plaintiffs to bring even larger and more frivolous claims in the hope of achieving settlements. Furthermore, requiring the disclosure of the amount claimed by plaintiffs will mislead users into believing that such recoveries are possible even when management believes them to be baseless or inflated. Moreover, required disclosure of amounts claimed by plaintiffs could in some instances necessitate further disclosures about why management does not believe those amounts to be realistic; however, such additional context could prove prejudicial to the company by revealing its litigation strategy.

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## **EXTRACT FROM JUNE 28, 2008 COMMENT LETTER**

<u>Uncertainty should not be masked</u> - We posit that "uncertainty" is often a basic fact associated with contingencies and that the disclosure of that uncertainty *as* uncertain may be the most relevant and reliable disclosure. The current standard of disclosure requires meaningful information. Presenting amounts that are probable and estimable is meaningful; presenting the range of reasonably possible loss in excess of amounts recorded is meaningful; and asserting that such estimates cannot be made is *especially* meaningful. We do not believe that some of the proposed disclosures, such as amounts claimed, will prove meaningful; in fact, it is likely that they will be misleading and/or confusing.

The expectation gap should not be widened - The inability to meaningfully estimate most contingencies (legal contingencies, in particular) is often reflective of the astonishingly high number of complex and subjective variables involved, most of them unknown for extended periods of time, each of which can impact the outcome, timing and financial impact of a contingency. We note that some litigation can take decades to resolve and that overturned, vacated or modified verdicts are fairly common occurrences. To force disclosures of amounts claimed and/or contingency amounts deemed to be remote, we believe would serve to inflate the expectation gap beyond recognition as these amounts may have no basis in reality (if they did, SFAS 5 would already capture them). Requiring companies to disclose these amounts in their financials, widens the expectation gap by giving credence to these numbers. Financial statement users attempting to play "arm-chair lawyers" by using such information are likely to make very poor decisions because they would not have the full breadth of understanding despite the disclosure suggested.

Amounts claimed will become sound bites - We do not believe that disclosing amounts claimed will enhance a financial statement user's ability to assess the "likelihood, timing and amount of future cash flows." And, no amount of qualitative disclosure will erase those numbers from the minds of readers once disclosed, and the financial media will run with the sound bite - - perpetuating myth. We believe that the current disclosure requirements (probable, reasonably possible, can't estimate) are the better mechanism for meaningful disclosure.

Good faith application of SFAS 5 remains appropriate—SFAS 5, a principles-based standard, has served U.S. markets well for decades when applied in good faith. We know that capital markets penalize companies for uncertainty - - this is rational. In fact, for public companies, it is not unusual for stock prices to rise upon the recording of an amount related to a settlement or other resolution, as the removal of uncertainty has great value. Therefore, we would posit that if managements were rational and were driven to improve stock prices and shareholder return, they would be anxious to provide estimated amounts if they were really estimable. We believe that capital markets can be reasonably efficient when dealing with uncertainty as long as there is appropriate disclosure of the *uncertainty*.

We are aware that the SEC and the FASB believe that SFAS 5 leads to "late accruals" - - this perception being informed, in part, by "sudden settlements". In truth, settlements are often sudden - - this is a real-world situation, particularly in the United States - - and may not necessarily reflect the SFAS 5 liability: That is, management may not believe that the likelihood that the future event will result in the incurrence of a liability is probable. Given unlimited resources, a company confident in its defenses would litigate for as long as courts would entertain the action. However, recognizing the limits on resources, companies often enter into

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settlements that are nothing more than an accommodation of the cost/benefit analysis of the litigation decision and a practical response to concerns about (1) the exorbitant cost of proving the "absence of liability", (2) negative publicity, (3) the impact of uncertainty on the stock price, and (4) management distraction among other factors. In short, "settlement" is not shorthand for "liable." There may be no liability related to prior activities, but there may be a settlement which is based on a current, valid business decision.

We believe SFAS 5 works as intended when applied by good-faith preparers.