



September 20, 2010

Via E-Mail to director@fasb.org

Russell Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 1840-100

Dear Mr. Golden:

We write on behalf of two major manufacturers of tobacco products – Lorillard Tobacco Company and R.J. Reynolds Tobacco Company – to comment on the July 20, 2010, “Exposure Draft, Proposed Accounting Standards Update: Contingencies (Topic 450) – Disclosure of Certain Loss Contingencies,” or simply the “Exposure Draft.” Literally thousands of smoking and health product liability lawsuits have been filed against these companies and other cigarette manufacturers since the 1950s, and the great majority of those cases to proceed to resolution have been dismissed either voluntarily or through judicial action with no payment to plaintiffs. Accordingly, we hope to provide the views and perspective of entities that have, for long periods, been involved as defendants in significant litigation.

Initially, we approve of the deletion of the proposed requirement in the June 2008 exposure draft that, when “there is no claim or assessment amount” in a complaint, the reporting entity provide its “best estimate of the maximum exposure to loss.”¹ Disclosure of reporting

¹ That requirement was set forth in ¶ 7(a)(2) of the June 5, 2008, “Exposure Draft, Proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies, an amendment to FASB Statements No. 5 and 141(R),” File Reference No. 1600-100.

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entities' internal assessments of their possible litigation exposures necessarily would have revealed privileged and protected information and, for that reason, would have prejudiced them in litigation to the ultimate detriment of their shareholders.

We have three remaining concerns, however, about the Exposure Draft's proposed disclosure requirements relating to litigation loss contingencies. First, the Exposure Draft requires disclosure of quantitative information about pending litigation, including "the amount claimed by the plaintiff or the amount of damages indicated by the testimony of expert witnesses."² (450-20-50-1F(e)(1); *see also* 450-20-50-1F(b)). Under this rule, investors will receive the plaintiffs' or their experts' calculations of damages and, in many instances, that may be the only information provided. That information is of no real value because plaintiffs' actual recoveries, particularly in aggregated actions or those involving personal injury and punitive damage claims, bear little resemblance to plaintiffs' damage claims or their experts' damage calculations.

For example, in the RICO class action against the United States cigarette manufacturers relating to "light" cigarettes, the plaintiffs' experts calculated damages for the class at roughly \$800 billion. And the district court certified a nationwide class of "light" cigarette purchasers covering a period from 1971 forward. *Schwab v. Philip Morris USA, Inc.*, 449 F. Supp. 2d 992 (E.D.N.Y. 2006). Two years later, however, the Second Circuit Court of Appeals decertified the class. *McLaughlin v. American Tobacco Co.*, 522 F.3d 215 (2d Cir. 2008). Thus, the recovery for a certified class that was estimated to be \$800 billion effectively was reduced to \$0.

Further, requiring disclosure of these amounts may encourage litigation plaintiffs to assert ever-higher damage claims so as to require defendants to disclose them into their financial statements. Similarly, aggregating highly-inflated damage claims across large numbers of matters will compound the problem and result in astronomical estimates that bear no relation to the plaintiffs' likely actual recoveries. At bottom, there is meaningful quantitative information about litigation loss contingencies when the requirements for accrual have been satisfied (*i.e.*, that a loss contingency be probable and reasonably estimable). Conversely, there is no accrual for many loss contingencies precisely because the amounts are not reasonably estimable. In that context, providing investors with unreliable information that appears to, but does not accurately quantify the loss contingency is misleading and, although it provides an illusion of more fulsome disclosure, does not meaningfully improve investors' information base.

² We note that many jurisdictions prohibit requests for specific amounts of damages in initial complaints. Ariz. R. Civ. P. 8(g); Cal. Civ. Proc. Code § 425.10; Colo. R. Civ. P. 8(a); Conn. Gen. Stat. § 52-91; Fla. Stat. §§ 768.042(1), 768.72; 735 Ill. Comp. Stat. Ann 5/2-604.1; Ind. R. Trial P. 8(A)(2); Iowa R. Civ. P. 1.403(1); Kan. Stat. Ann. §§ 60-208, 60-3703; Mich. Ct. R. 2.111(B)(2); Minn. Stat. §§ 2.111(B)(2), 549.191; Mo. Rev. Stat. § 509.050; N.J. Court R. 4:5-2; N.Y. C.P.L.R. § 3017(c); Ohio R. Civ. P. 8(a); Pa. R. Civ. P. 1021(b); Tex. R. Civ. P. 47; U.S.D.C. D. Del. L.R. 9.4, U.S.D.C. D.N.J. L. Civ. R. 8.1; U.S.D.C. M.D. Pa. L.R. 8.1; U.S.D.C. W.D. Pa. L.R. 8.1. Accordingly, this information may be unavailable for many pending matters for substantial periods and may become available only as, for example, plaintiffs' experts' reports are provided. For that reason, accurately tracking and compiling this information across large numbers of cases would be time-consuming and burdensome.

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Second, we have two concerns about 450-20-50-1F(e)(1)'s requirement that reporting entities disclose "the possible loss or range of loss and the amount accrued, if any," when the amount of the loss "can be estimated." First, since this provision appears to (and should) track the requirements for accrual (*see* 450-20-25-2(b)), the word "estimated" in 450-20-50-1F(e)(1) should be qualified by the word "reasonably."³ Second, the requirement in 450-20-50-1F(e)(1) that, when an accrual is required, the entity disclose "the possible loss or range of loss" is problematic. As several other comment letters have explained at some length, disclosure of the amount accrued for a particular piece of litigation is highly useful information to litigation adversaries and, for that reason, disclosure of that information would prejudice the reporting entity. To the extent that this prejudice is to be avoided through aggregation as provided for in 450-20-55-1A through 1D, then we see little value in requiring separate disclosure in the first instance. And, to the extent that aggregation does not completely mask or obscure the amounts accrued for particular actions or types of actions, which seems likely, then reporting entities will suffer the very prejudice that the aggregation rule was designed to avoid. Further, requiring disclosure of the "possible ... range of loss" for accrued loss contingencies requires reporting entities to divulge still more information about their private, privileged and protected assessments of pending litigation, which will be prejudicial.

Finally, the reporting entity, under 450-20-50-1F(b), must, "[d]uring early stages of asserted litigation contingencies, [disclose] at a minimum, the contentions of the parties." But, in "subsequent reporting periods, disclosure shall be more extensive as additional information about a potential unfavorable outcome becomes available, for example, as the litigation progresses toward resolution, if the *likelihood* or *magnitude* of loss increases, or both." (*Id.* (italics added)). Fundamentally, we do not understand what types of additional information this provision contemplates being disclosed. Certainly, disclosing the reporting entities' actual assessments of the "likelihood" or "magnitude" of potential loss contingencies (or changes in those assessments) would prejudice the reporting entities by requiring them to divulge privileged and protected information, and that presumably is not required. Other than those assessments themselves, however, very little reliable, non-privileged information becomes available in later stages of litigation that is not available earlier. Indeed, merely requiring additional disclosures when a reporting entity concludes that the likelihood and magnitude of a loss has increased means that, whenever there is such a disclosure, litigation adversaries can deduce that, in the reporting entity's view, the probability or size of the adversary's recovery has improved.

³ The immediately following provision, 450-20-50-1F(e)(2), presents the identical issue.

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We support the Financial Accounting Standards Board's efforts to ensure that financial statement users be provided reliable, non-misleading, and non-injurious information about loss contingencies. In our view, however, the Exposure Draft's proposed disclosure rules require disclosure of information that is neither reliable nor meaningful to financial statement users.

Very truly yours,

/s/ Martin L. Holton III

Martin L. Holton III
Senior Vice President and
General Counsel
R.J. Reynolds Tobacco Company

/s/ Ronald S. Milstein

Ronald S. Milstein
Senior Vice President, Legal
and External Affairs,
General Counsel and Secretary
Lorillard, Inc.