



September 20, 2010



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Re: File Reference No. 1840-100: Proposed Accounting Standards Update of Topic 450 (Disclosure of Certain Loss Contingencies)



Dear Sirs,



We are the general counsels and senior litigation counsels for a number of large U.S. corporations. As in-house lawyers, we see firsthand the risks and costs to our stockholders and other stakeholders arising out of litigation, and believe we have particular insight into the complexities and challenges of crafting accurate and reliable litigation-related disclosures without compromising the company's ability to defend itself. We therefore appreciate both the opportunity to comment on the July 20, 2010 Exposure Draft of a Proposed Update on Topic 450 (Disclosure of Certain Loss Contingencies) ("Proposal") and the additional time FASB provided to do so.\*



The Proposal and related discussion reference several principles that we consider fundamental to the reporting of litigation contingencies, including, most significantly, that companies should not be prejudiced by the reporting requirements. As lawyers, we particularly appreciate the recognition that companies should not be required to waive attorney-client privilege to comply with reporting requirements, nor be forced to disclose management's predictions about the outcome of litigation. While we recognize that the Proposal was modified from the 2008 Exposure Draft in part to try to minimize this problem, the Proposal still is at odds with these important principles.



In particular, the new requirement that companies disclose the amount of an accrual related to a particular contingency will effectively result in the disclosure—to the company's great prejudice—of management's predictions about the resolution of the contingency, and will threaten the attorney client and attorney work product assessments that underlie those predictions. Other key components of the Proposal also will significantly prejudice companies



\* We wish to acknowledge the assistance of the Jones Day law firm in the preparation of this letter.



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and do not account for the nature of the American litigation process. We believe that this prejudice, when considered realistically, significantly outweighs any benefits of the Proposal.

While we appreciate that the Proposal tries to minimize the prejudice to companies by allowing aggregation, the aggregation contemplated by the Proposal far too often will be inadequate to prevent prejudicial disclosures. The required periodic updating of the tabular reconciliation, for example, could let adversaries decipher a company's assessment of the controversy. Other aspects of the new disclosure requirements likewise will harm companies by providing advantages to opposing parties, and yet others will unnecessarily require heavily burdensome and often confusing updates of inconsequential (or even misleading) developments in particular litigation.

These problems with the substance of the Proposal are compounded by the December 15, 2010 effective date, which does not provide enough time for companies to incorporate the extensive changes required by the 2010 Proposal. As just one example, the new requirement to evaluate remote contingencies that may have a severe impact will require companies to develop procedures for an entire category of contingencies that was never previously reported. As described below (and as was explained in many comment letters in 2008), this new requirement is ill-advised. But in all events it is not realistic to implement it effective December 15, 2010.

We believe that adoption of the 2010 Proposal will result in prejudice and burdens that vastly outweigh any countervailing benefits. Accordingly, we urge FASB to neither change the disclosure standards for contingency accruals nor require any tabular reconciliation. We also believe that, if FASB adopts any changes to the existing disclosure rules, at a minimum the Proposal should be changed to (1) create an exception to disclosure for prejudicial information; (2) eliminate the proposed disclosure of remote contingencies and the requirement that insurance information be disclosed in every instance; (3) limit the disclosure of litigation contingencies to directing users to publicly available information from court or similar records; and (4) provide an effective date at least twelve months after the new standard is promulgated in final form.

## **I. The Proposed Disclosure Requirements will Prejudice Reporting Entities**

A company's assessment of the potential outcome and loss associated with a litigation contingency is, in many complex cases, the single most useful piece of information an adversary might obtain. For this reason, the new requirement to disclose litigation accruals and changes to accruals suffers from the same fatal flaw as the 2008 proposal: significant prejudice to the company and its shareholders from disclosure of management's predictions of the outcome of a litigation contingency.

The proposed disclosures would give litigation opponents a significant informational advantage in litigation, and may provide ammunition in other cases and invite new litigation by additional parties. Further, where there are potential recoveries from insurance or indemnities, disclosures related to the underlying dispute may be used against the company in its effort to seek recovery. Finally, the disclosures may generate new litigation challenging the adequacy of the disclosures themselves.

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At the same time, the proposed disclosure of accruals offers little benefit to the users of financial statements. For reporting entities that are also SEC registrants, users obtain information about loss contingencies not just from the Legal Proceedings section, but also from the Risk Factor discussion and from the Management's Discussion and Analysis, as well as other public sources.

In short, we believe the Proposal has struck the wrong balance—overestimating the likely incremental benefit and underestimating the likely harm from the proposed additional disclosures.

#### **A. Prejudice From Required Disclosures Regarding Accruals**

Despite the acknowledged risk of prejudice and an apparent intent *not* to add any new disclosure requirements based on management's predictions, the Proposal requires substantial new disclosures regarding accruals. ¶ 450-20-50-1F(e)(2) & 1F(g). In contrast to the current requirement to disclose material accruals where necessary for the financial statement not to be misleading, ¶ 450-20-50-1, the Proposal takes a categorical approach to disclosing material accruals, seeming to require that “[a]n entity shall disclose,” “[f]or all contingencies that are at least reasonably possible . . . the amount accrued, if any.” ¶ 450-20-50-1F.

Accrued amounts necessarily reflect management's evaluation of the probable resolution of a contingency. In almost any litigation contingency, that evaluation will be based—perhaps in significant part—on counsel's understanding of the facts that will be proved at trial and the strength of the adversary's legal claim. The overwhelming majority of the comment letters to the 2008 Exposure Draft demonstrated how disclosing the details of such evaluations would prejudice the entity and ultimately hurt the entity's shareholders. Apparently responding to these concerns, the Proposal reports a decision “not to add any new disclosures that are based on management's predictions about a contingency's resolution.” BC24. Unfortunately, accrued amounts *are* management's predictions and disclosing them will have the same detrimental effect as any other disclosure of a company's assessment of a contingency. Moreover, disclosures about one pending matter will often prejudice the company in other cases, or cause potential claimants to file similar or related claims.

The Proposal itself provides an apt example. Example 3 explains that Entity A made a proper disclosure when it stated: “[T]he court . . . rejected Entity A's motion to dismiss. On the basis of this ruling, Entity A believes a loss related to this matter is probable.” 450-20-55-42.<sup>1</sup> Let us assume that Entity A has also, based upon consultation with in-house and outside counsel, determined to accrue \$2 million for the potential loss. Under the Proposal, Entity A may be forced to disclose that accrual and to update any changes in its assessment (and the reasons for those changes) in the tabular reconciliation required each quarter.

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<sup>1</sup> Although we use this example as stated in the Proposal, in most complex litigation, an entity's determination that a loss is probable rarely is triggered by a single, easily describable development in the case, such as losing a motion to dismiss.

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Those disclosures are highly likely to prejudice Entity A:

- The plaintiff will now have a significant negotiating advantage in settlement discussions, because the \$2 million will become the floor for negotiations;
- Entity A's ability to assert defenses will be undermined, as the plaintiff will portray Entity A's disclosure as an admission of liability or of a lack of confidence in its defense;
- Other plaintiffs with similar claims will be encouraged to file actions because Entity A has publicly proclaimed its estimate of a substantial likely recovery;
- In the subsequent period, if Entity A increases its accrual to \$4 million based on developments in the case, the plaintiff or others with similar claims will discern that Entity A views the development as increasing the possible loss. This information may encourage existing plaintiffs to increase demands or others to file new claims;
- If the claim is settled for \$6 million, Entity A may face additional litigation over whether the accrual was appropriate and whether its related disclosures were misleading; and
- There is a risk of waiver of attorney-client privilege and attorney work product—through either the disclosure itself or the process of auditing it—which could cause the otherwise-privileged information and assessments underlying the disclosure to be discoverable by the plaintiff.

In short, there are multiple ways in which disclosure of the accrual may substantially increase the loss incurred by the company. The resulting harm to the company and its stakeholders should—we submit—be an important part of evaluating whether requiring such disclosure is likely to be beneficial.

### ***Aggregation***

The Proposal suggests that aggregation will avoid or minimize the prejudice from certain of the required disclosures. *See* BC10 (“The Board added the aggregation principle . . . to mitigate concerns regarding disclosure of individual contingencies that may be prejudicial to the reporting entity.”); BC31 (similar). The Proposal also asks whether “an explicit exemption from disclosing information that is ‘prejudicial’ . . . is not necessary” because of the putative protection provided by aggregation. Question 3. The short answer is that such an exemption remains necessary, because there are far too many cases in which aggregation will not solve, or significantly mitigate, the prejudice of disclosure.

The belief that aggregation will suffice to prevent prejudice is wholly unrealistic. Aggregation would be ineffective to prevent prejudice in the most significant cases—where a single litigation contingency dwarfs all others, where a new lawsuit creates a need for disclosing

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a new “class” or “type” of contingency, or where a company has only a few material accruals to disclose—and would do nothing to prevent prejudice from disclosures that act as a waiver of privilege or work-product protection. Likewise, based on the Proposal’s guidance and commentary on the appropriate level of aggregation, it is unclear whether aggregation will be permitted, even for companies that face many claims, if the claims relate to different products, different time periods, different types of plaintiffs, individual or class claims, different insurers, different jurisdictions, and single-defendant or multiple co-defendants charged with the same liability. *See* ¶ 450-20-55-1(A). Moreover, the mere process of aggregation and disclosure of the “basis for aggregation,” ¶ 450-20-50-1(B)(b), itself invites lawsuits, which plaintiffs’ lawyers may use to force disaggregation to serve their own interests, not the interests of financial statement users.

### ***Tabular Reconciliation***

As noted above, the Proposal also requires a tabular reconciliation of accrued loss contingencies. Where an entity has only a few cases in a class, an increase in an accrual for the class may be easily traced to a specific development in the relevant period, prejudicing the company by disclosing its assessment of the potential loss. Even with multiple claims filed, claimants may be able to determine the average value of the claims if they can assess how many such claims were filed in the period.

The tabular reconciliation will also be prejudicial when changes to the accrual reveal how the company has assessed a contingency in response to developments in the litigation. Returning to Example 3, the tabular reconciliation of Entity A’s additional accrual (from \$2 to \$4 million) increases the risk that litigation opponents will be able to identify the development that caused the additional accrual, particularly if the change is deemed to be “significant” and thus requires the entity to describe the change. Numerous comments to the 2008 Exposure Draft’s tabular reconciliation requirement further explain how tabular reconciliation might prejudice the disclosing entity. That prejudice remains unabated in the Proposal, and is exacerbated by the Proposal’s requirement that the tabular reconciliation be “by class.” ¶ 450-20-50-1F(g).<sup>2</sup> Tabular disclosure by class will be especially prejudicial where an entity has a docket of significant, but sufficiently dissimilar cases, such that tabulation “by class” will effectively be tabulation by case.

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<sup>2</sup> In implementing FASB Interpretation No. 48 - Accounting for Uncertainty in Income Taxes (“FIN 48”), FASB rejected a potential concern raised by certain constituents that the tabular reconciliation of unrecognized tax benefits required by FIN 48 would provide a “roadmap” for taxing authorities. In dismissing that concern, however, the Board specifically distinguished the role of a taxing authority (which acts “in the broader public interest”) from that of a litigation opponent (who acts “in its own particular interest”) and concluded that the consolidated nature of the information required by FIN 48 would not reveal information about individual tax positions. *See* FIN 48, App. B ¶ 64. As discussed, neither of these considerations applies to the tabular accrual disclosures set forth in the Proposal.

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The current standard appropriately focuses on whether the financial statement is misleading absent disclosure of an accrual. Where disclosure is not necessary to make a financial statement not misleading, the minimal value of disclosure to users would not justify either the prejudice to the entity of disclosure or the risk that the information will be misleading. The Proposal therefore is deeply flawed to the extent it categorically requires that material accruals and changes to material accruals be disclosed.

**B. Prejudice from Disclosure of other Qualitative and Quantitative Information called for by the Proposal**

The requirement that entities provide sufficient details to allow interested parties to access the court docket for material litigation makes sense. It will facilitate access to publicly available information by interested users. Several of the Proposal's other required disclosures, however, again are at odds with the American litigation process.

*Disclosure of defenses*

Companies should not be required to disclose their defenses except to the extent that the defenses are laid out in public information. The litigation process defines when and how a party to a case is required to respond. Many aspects of a company's defense need not be disclosed at the outset of a case. For example, if an entity intends to defend a case by undermining the claimant's veracity, such a defense generally would not be disclosed to the claimant until it is executed during the entity's cross-examination of the claimant at trial. Earlier disclosure of this strategy would severely undermine the strategy's likelihood of success and may dissuade the entity from pursuing such a defense.

Accelerating the time when a defendant must identify its defenses would also have the effect of usurping the role of a court or other tribunal in determining the rules for resolving a dispute fairly. This is especially unfair given that the Proposal's public disclosure requirements may not apply to all the parties in a lawsuit, resulting in a significant litigation advantage for those parties who are not subject to the requirements.

*Disclosure of specific quantitative information*

Financial statement disclosure of specific information may prejudice the disclosing entity even if the information has been disclosed to a litigation opponent.

Information is not public simply because it has been disclosed to other parties to a litigation or to a government entity in an investigation. Often, proprietary or other sensitive information that may be critical to understanding or evaluating the key issues is subject to confidentiality protections. Further, many contingencies may be determined in a non-public proceeding, such as arbitration. And even if the trial will be a public proceeding, the documents

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exchanged in discovery, including expert reports and the depositions taken in preparation for trial, typically will not be filed with the court or otherwise be publicly available.<sup>3</sup>

Disclosure of damage claims and expert reports regarding one case may prejudice the entity by giving other plaintiffs a roadmap for proving similar claims or inviting new plaintiffs to file claims, resulting in additional contingencies. In addition, disclosure of the required information may mislead users.<sup>4</sup>

The disclosures in the Entity A example illustrate this risk. After Entity A makes the additional accrual, it discloses the \$4 million accrual. But the plaintiff's expert report may contain a conclusion that the loss is in the range of \$25 million to \$50 million because the plaintiff and/or the expert does not properly understand the underlying products, injuries, or law. While the expert's estimated range of loss is quantitative information, it is dramatically different from Entity A's accrual. Entity A cannot give context to the expert's estimate without publicly disclosing its litigation position earlier than litigation requires, therefore prejudicing its litigation position and revealing the work product or privileged communications of its counsel. Further, disclosing supplemental information to offset a potentially misleading expert report would make disclosures extensive and cumbersome, possibly confusing users and further prejudicing the entity.

Where the required disclosures would be misleading if made in isolation, an entity will be faced with the dilemma of either (1) prejudicing its litigation position by disclosing its view (and perhaps assessment) of the relevant risk factors so that the user can more reliably assess the probability (or not) of a loss, or (2) making a disclosure that complies with the disclosure requirements but threatens to mislead users by lacking information necessary to put the required disclosures in context. Reporting entities should not have to make such a choice.

The Proposal's disclosure examples do not have to grapple with this dilemma because the examples involve relatively simple and straightforward disputes. But complex litigation involves numerous, interrelated questions of law, questions of fact, and questions of how the law applies to the facts. These questions ultimately will not be decided until trial. The Proposal's simple examples do not provide helpful guidance on how an entity can make the required disclosures without undermining the entity's defense in ways that the rules of litigation would never require.

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<sup>3</sup> Moreover, the Proposal's requirement that an expert's estimate of damages be disclosed further fails to appreciate the fluidity inherent in the litigation process, where even quantitative facts are subject to revision. Expert reports are often the subject of motions testing admissibility based upon their methodology and are frequently modified during pre-trial proceedings or even during trial, to account for errors or other inadequacies exposed during litigation proceedings. Given the fluidity of litigation, an expert's untested estimate of damages should have little value for a user.

<sup>4</sup> As discussed in response to the 2008 Exposure Draft, most states prevent or restrict plaintiffs from making a specific damages claim because such claims frequently are inflated by plaintiffs to gain publicity, pressure defendants, and influence judges and juries. *See* Letter filed by Counsel for Twelve Corporations at 5 (File Reference 1600-100, Letter # 155).

### ***Threat to privileged information***

We appreciate the significant revisions made since the 2008 proposal to reduce the threat to privileged information or attorney's work product, but we remain concerned that ambiguity in the Proposal might be interpreted as requiring disclosure of such information. If the proposal is interpreted as requiring disclosure of privileged information, the prejudice to the reporting entities far outweighs any benefits of the increased disclosures.

Although several substantive disclosure requirements are specifically limited to nonprivileged information, other disclosures are not explicitly qualified. For example, the requirement that an entity disclose "the possible loss or range of loss and the amount accrued, if any," or "a statement that an estimate cannot be made and the reason(s) why" does not limit the required disclosure to information that is not privileged or work-product protected. *See* ¶ 450-20-50-1F(e)(2) & (3); *see also* ¶ 450-20-50-1F(b) (requiring an entity to disclose, without limitation, "the contentions of the parties", including "the basis for the entity's defense"; "additional information about a potential unfavorable outcome [as it] becomes available"; and, if known, "the anticipated timing of, or the next steps in, the resolution" of individually material contingencies). If these provisions were to be interpreted as requiring disclosure of privileged or work-product protected information, they would suffer from the same problems that plagued the 2008 proposal.<sup>5</sup>

### ***Required disclosure of possible insurance recoveries***

The requirement that a company disclose "[i]nformation about possible recoveries from insurance and other sources," including whether the insurance company has denied, contested, or reserved its rights related to the entity's claim for recovery, is misconceived: it risks prejudicing the disclosing entity and may result in misleading or unwieldy disclosures.

Even in cases in which a litigation opponent could have, or has, discovered information about possible recoveries from insurance, public disclosure may prejudice the entity. For example, publishing an entity's insurance coverage may encourage would-be plaintiffs to file suits of dubious merit in hopes that the entity will be more willing to settle covered claims. Disclosing whether an insurance company has denied, contested, or reserved its rights related to the entity's claim for recovery may give the plaintiff an unfair advantage in litigation or settlement by revealing divergent interests of the entity and its insurer, or give the insurer an advantage in litigating the coverage dispute.

Additionally, in some circumstances, it will be misleading or unwieldy to disclose possible insurance recoveries. Myriad factors may influence whether a claim will be covered by insurance. For example, among other factors, coverage limits, retrospective rating issues, the existence of multiple layers of coverage, and the number of successful claims or realized loss contingencies made with respect to any policy year may effect coverage. Depending on the

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<sup>5</sup> We refer the Board to the Letter filed by Counsel for Twelve Corporations at 5-6 (File Reference 1600-100, Letter # 155) and the Letter filed by the ABA at 9, 11-12 (File Reference 1600-100, Letter # 36), for a description of the ways in which the 2008 proposal threatened attorney-client privilege.

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extent of these uncertainties, disclosing the possibility of an insurance recovery may be misleading, while a complete, non-misleading disclosure regarding potential insurance would overwhelm the financial statement with detail. An entity should have flexibility to disclose information regarding insurance recoveries where appropriate to make the financial statement not misleading.

## **II. Burden of New Threshold for Disclosure: Asserted But Remote Loss Contingencies with a Potential Severe Impact**

The new proposed requirement that entities disclose certain contingencies even when they are remote will add very substantially to the burdens of disclosure while offering little offsetting benefit.

Because such contingencies previously have not been disclosed, implementation of this new requirement will require entities to create systems to identify, track, and evaluate a wide range of contingencies that are—by definition—highly unlikely to occur, and correspondingly difficult to reliably identify and describe. Such a substantial burden is not justified by any real benefits from the additional disclosure.

In addition to the added burden of disclosure, the Proposal's requirement may prejudice the disclosing entity by, *inter alia*:

- increasing the cost to the entity of not settling a remote liability;
- encouraging frivolous suits and outlandish demands by opportunistic plaintiffs who hope to extort unwarranted settlements based on the threat that their claims would need to be disclosed;
- generating litigation over whether the entity failed to disclose a remote contingency that should have been disclosed; and
- generating litigation over whether the disclosure of a remote contingency, without substantive analysis of the contingency, is misleading.

Examples of remote contingencies with potentially severe impact could include claims that an entity's significant products infringe the claimant's intellectual property based on a novel interpretation of law or an extension of a legal theory to new circumstances, or claims that a substance previously used at an entity's facility causes personal injury based on statistical data with no scientific support or on new scientific theories without evidence of causation. Although the likelihood of any loss to the entity resulting from the claims in these examples is remote, the potential impact could lead to the conclusion that they would need to be disclosed under the Proposal. In both examples, plaintiffs could attempt to use the potential for disclosure of these questionable claims to extract a quick settlement from the entity before the end of a reporting period. The disclosure itself also creates a risk of further expensive, but frivolous litigation by others.

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Several comments to the 2008 Exposure Draft addressed the prejudice to the entity, burden on the entity, and risk of misinformation of disclosing remote contingencies. Yet, despite the concerns raised in response to the 2008 Exposure Draft, the new disclosure threshold, either as proposed in 2008 or as currently proposed, was not field tested. We believe that a field test would have confirmed the problems identified in 2008 and outlined above. Without a field test to assess the effects of a new disclosure threshold, there is no principled basis for disregarding the numerous concerns raised in 2008 or for expecting any material benefits from the proposed additional disclosures.

Moreover, even at a theoretical level, the proposed requirement bears little relationship to its purported justification. The 2010 Exposure Draft notes that users believe the current disclosure threshold “results in delayed disclosure of relevant information about loss contingencies,” BC11, and that the “disclosure of certain asserted remote loss contingencies” will “improve the timeliness of disclosures about loss contingencies.” BC14. This solution is, at best, a blunt instrument to address any problem of delayed disclosures. While the new threshold may sometimes prompt earlier disclosure of a contingency that eventually becomes a “reasonably possible” liability, it will generally prompt disclosure of numerous contingencies that will never become “reasonably possible.”

If users believe that contingencies are being disclosed too late, the most effective and targeted solution would be to issue new guidance with respect to the “reasonably possible” standard or to enforce the standard more stringently. The Proposal’s new standard will not be effective at creating useful earlier disclosures, will impose excessive burdens on disclosing entities, and likely will result in substantial confusion and little enlightenment for users of financial statements.

### **III. The Proposed Effective Date is not Feasible Because the Proposal Requires Significant Additional Disclosures.**

Based on our experience making litigation-related disclosures, we believe that the proposed effective date leaves far too little time for many reporting entities to fully understand the new requirements and to adapt existing disclosure protocols and internal controls to the new requirements. For example, under the current disclosure standards, an entity is not required to draw any distinctions among the category of “remote” contingencies. Under the Proposal, however, an entity will have to identify and review all remote contingencies to determine whether disclosure is required. The Proposal emphasizes that whether to disclose remote contingencies depends on judgment exercised using a variety of factors, so the process to determine which remote contingencies to disclose needs careful consideration.

In addition, most entities will have to implement new disclosure control procedures to: collect and confirm the specific information required to be disclosed; determine what, if any, aggregation is necessary or appropriate; and establish audit guidelines and procedures with respect to the information.

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At a minimum, a delayed effective date of at least twelve months after promulgation of the standards is required to implement the necessary internal control and disclosure control procedures so that entities can reliably disclose the new information.

#### IV. Conclusion

We appreciate the careful attention that FASB has given to disclosures of litigation-related loss contingencies. But we respectfully submit that the Proposal strikes the wrong balance between the value of the additional requirements and the detrimental effect of those new requirements on reporting entities and their stakeholders.

Respectfully submitted,

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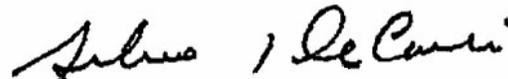
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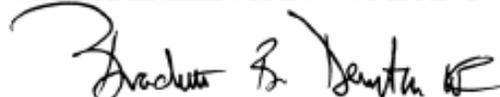
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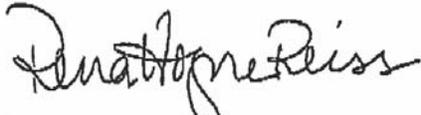
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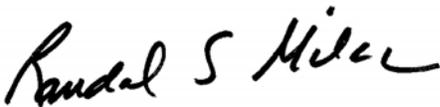
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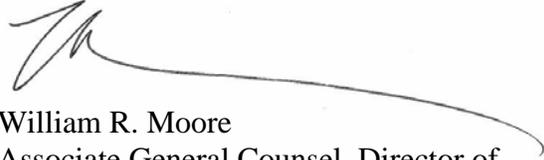
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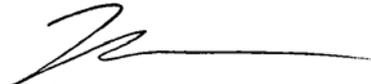
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