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CITY BAR

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FINANCIAL REPORTING

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August 8, 2008

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VIA EMAIL TO [DIRECTOR@FASB.ORG](mailto:DIRECTOR@FASB.ORG)  
Technical Director, File Reference No. 1600-100  
Financial Accounting Standards Board  
of the Financial Accounting Foundation  
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Norwalk, CT 06856-5116

Subject: File Reference No. 1600-100

Ladies and Gentlemen:

This letter is submitted on behalf of The Committee on Financial Reporting of The Association of the Bar of The City of New York (the "Committee") in response to the Exposure Draft of a Proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies (an amendment of Statements No. 5 and 141(R)) of the Financial Accounting Standards Board (the "Board") of the Financial Accounting Foundation. Our Committee is composed of lawyers with diverse perspectives on financial reporting matters, including members of law firms and counsel at major corporations, financial institutions, public accounting firms and institutional investors. A list of members of the Committee is attached as Annex A to this letter<sup>1</sup>.

Our Committee has focused on the impact that the proposed Statement would have on disclosures pertaining to legal proceedings. We welcome the Board's efforts to provide greater transparency regarding loss contingencies in this area. We support the Board's efforts to require greater disclosure about undisputed factual matters relating to loss contingencies, such as the description of the contingency, including how it arose, its alleged legal or contractual basis, and its current status. We note that these matters are broadly consistent with the approach taken by the Securities and Exchange Commission in Item 103 of Regulation S-K, which requires, for

<sup>1</sup> This letter does not necessarily reflect the individual views of each member of the Committee or of the institutions with which they are affiliated.

specified legal proceedings, a brief description of the proceeding, including the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought.

At the same time, we believe the interest of financial statement users in increased disclosure must be balanced against the legitimate interest of companies in preserving their rights in connection with pending or threatened litigation and other loss contingencies. As currently drafted, the proposed standard contemplates disclosure of certain information that has historically been protected by the attorney work product immunity and attorney-client privilege doctrines and thus risks upsetting the careful balance established in the law between the information that must be disclosed and the information that may be withheld from an adversary. As well, waiver of the privileged and work product-protected information supporting the company's assessment would be made more likely because of the risk of necessary disclosure to the company's independent auditor. The risks the standard poses to companies, and their investors, are particularly acute, because none of the forward-looking information required under the proposed standard would be protected under the Private Securities Litigation Reform Act, which does not extend its protection to forward-looking statements included in financial statements prepared in accordance with generally accepted accounting principles. See Section 27A(b)(2)(A) of the Securities Act of 1933 and Section 21E(b)(2)(A) of the Securities Exchange Act of 1934.

Against that backdrop, we believe the following elements of the proposed standard should be abandoned:

- A company should not be required to publicly disclose its qualitative assessment of the most likely outcome of a legal proceeding, the factors it believes likely to affect the ultimate outcome of a contingency and their relative weight or the significant assumptions underlying its estimates. Requiring disclosure of these matters would provide a roadmap to the company's adversaries that would almost surely prejudice a company's litigation posture and could result in a waiver of otherwise available privilege for attorney work product and attorney-client communications. The risk of such a waiver is only increased when one considers the additional information that will have to be provided to a company's auditors to document the additional disclosures. This would inevitably impact the ultimate result of the legal proceedings and adversely effect the relationship between the Company and its counsel.
- A company should not be required to estimate and disclose the maximum potential exposure from a contingency for which there is no stated claim or assessment. A company will often have no firm basis for making such an estimate, particularly in the early stages of an investigation or proceeding. Often, such estimates will not be reliable or probative, and they will accordingly not be useful to investors. Many factors can affect the outcome of litigation. In addition to the merits of any legal claim, some situations, such as certain securities class actions and environmental proceedings, involve multiple potential defendants with potential several liability and complex cross-indemnities. These factors cannot be evaluated in the abstract – discovery through the litigation process is often required to properly evaluate exposure. The disclosure of such an estimate may itself expose a company to litigation risk if the ultimate amount proves

higher than the estimate notwithstanding that such estimate was determined to be the "maximum exposure" at such time. Regardless of its value, this information could give a company's adversaries or potential adversaries a distinct informational advantage, and could adversely affect a company's ability to defend a lower amount.

- Similarly, we do not believe a company should be encouraged or required to provide information about its best estimate of the loss or range of loss. Providing this information is problematic for several reasons. First, a company that discloses such information may inadvertently create a floor for any potential settlement, jeopardizing the company's ability to obtain a favorable outcome. Second, the estimate may be wrong, which exposes the company to litigation risk. Particularly in the early stages of litigation, a company is unlikely to have sufficient information to make a reliable estimate – this information is unlikely to be particularly helpful to investors. We believe the existing FAS 5 standard on disclosure of loss estimates remains appropriate.

We also suggest that the Board abandon its proposal to require disclosure of otherwise excludable contingencies when they could result in a "severe impact" on the company and are expected to be resolved within a year. This disclosure is problematic for several reasons. First, it would require disclosure of information – *e.g.*, contingencies with a remote likelihood of loss – that would generally not be material to a reasonable investor. Second, disclosure of contingencies that could have a severe impact but have a low probability of success may encourage plaintiffs to pursue such claims where they would not otherwise have done so, including under circumstances that could deprive a company of a statute of limitations defense. Such disclosure would be particularly problematic when the claim has not been asserted, because it may lead a potential plaintiff to pursue a claim of which it might not have even been aware.

The Board should revise its proposed exemption for prejudicial information to eliminate the required minimum disclosure. Requiring these elements of disclosure renders the exemption effectively meaningless, because the minimum disclosure required will often include the very information that is prejudicial. The Board should also eliminate the language suggesting that the exemption should be used "rarely." If a company is unable to avoid disclosure of the prejudicial information by means of aggregation, the exemption should apply, without placing the company's judgment at risk of second-guessing that it did not satisfy a "rarity" standard that is presented without any criteria for its application.

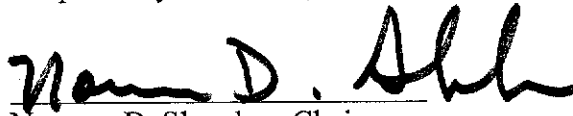
Before proceeding, the Board should conduct (or commission) a study to investigate the contention that current standards result in unsatisfactory disclosure. Based on our own informal assessments, we are not convinced that this is true, and in particular we believe that the market often successfully "factors in" the risks of pending or threatened litigation based on disclosure under the current standards. In any event, the Board should document the problem before overhauling this sensitive area of disclosure, and it should consider less radical changes that could elicit better disclosure, without creating the risks described above. As we have indicated, enhanced disclosure of undisputed factual matters does not raise the same concerns as disclosure of remote contingencies or other quantitative and qualitative disclosures that are inherently uncertain and could compromise irreparably a company's posture in litigation.

Finally, the Committee believes that if the proposed changes are adopted, their effectiveness should be delayed to provide time for issuers and their counsel and auditors to adjust their practices and possibly also their litigation strategies. The Committee believes that issuers and their counsel and auditors should have at least one full year to prepare for any new disclosure requirements.

### **Conclusion**

We appreciate the Board's desire to enhance disclosures regarding loss contingencies. However, we believe the potential adverse consequences to both issuers and their investors of the proposed Statement's remote contingency and certain other quantitative and qualitative disclosure requirements would significantly outweigh the benefits of this incremental public disclosure. We encourage the Board to take our comments into consideration in formulating its Statement. Members of the Committee would be pleased to answer any questions you may have concerning our comments.

Respectfully submitted,



Norman D. Slonaker, Chair  
Financial Reporting Committee  
Association of the Bar of the City of New York

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Annex A

Financial Reporting Committee

Richard Aftanas  
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Mark A. Cohen  
William G. Farrar  
Lisa Firenze  
Stuart D. Fishman  
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Additional Participants

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