



D I S T R I C T O F C O L U M B I A B A R  
*S e c t i o n s*

August 7, 2008

**By E-mail**

Technical Director -- File Reference No. 1600-100  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, Connecticut 06856-5116

Re: File Reference No. 1600-100/Exposure Draft, "Proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies (an amendment of FASB Statements No. 5 and 141R)"

Dear Sir or Madam:

On behalf of the Steering Committee for the Litigation Section of the District of Columbia Bar,<sup>1</sup> I am providing you with comments about the Financial Accounting Standards Board's (the "Board") above-referenced Exposure Draft. The Corporation, Finance and Securities Law Section of the District of Columbia Bar joins as a co-sponsor of these comments. Both Sections thank you for the invitation to offer comments.

The Litigation Section of the District of Columbia Bar is made up of more than 3,000 attorneys who actively engage in litigation and trial work in both state and federal courts across the country. The Corporation, Finance and Securities Law Section has more than 2,500 attorneys who practice corporate, finance and securities law and may be directly affected by the proposed changes.

Disclaimer: The views expressed herein represent only those of the Litigation Section and the Corporation, Finance and Securities Law Section and are not those of the D.C. Bar or of its Board of Governors.

It is the view of the Litigation and Corporation Sections of the District of Columbia Bar that the Exposure Draft's approach to disclosure of non-financial liabilities, particularly those involving litigation, would be cumbersome and expensive to apply, could be prejudicial to reporting entities, would be subject to error, could lead to meaningless volatility in financial

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<sup>1</sup> The Steering Committee members are the following: Eric Angel, Theresa A. Coetzee, David Favre, Charles C. Lemley, David T. Ralston, Lorelie S. Masters, Mary L. Smith, Bruce V. Spiva, and Moxila A. Upadhyaya.

disclosures, and would in fact be a backward step in efforts to achieving more transparent, timely and useful financial reports. We believe that current SFAS 5, as augmented by the “Treaty” between the ABA and the AICPA<sup>2</sup>, represents a good, long tested, and well understood balance between appropriate protection of a company’s legal rights and interests and the needs of investors for current, meaningful financial information.

We have reviewed the comments on the Exposure Draft prepared by the American Bar Association (the “ABA”) and the Chicago Bar Association (“CBA”) and are in agreement with the ABA’s and CBA’s comments and conclusions.

The Litigation and Corporation Sections of the D.C. Bar provide the following comments:

As an initial matter, we support the Board’s goal of improving the transparency, timeliness and usefulness of financial information that is disclosed to investors and other users of financial statements. However, we believe that the Exposure Draft, particularly as applied to contingencies arising from pending and threatened legal claims, raises a number of problems and may have unintended but seriously adverse consequences for reporting entities. The Litigation and Corporation Sections of the D.C. Bar are particularly concerned with its requirement to provide current quantitative disclosures concerning the maximum possible loss or an estimate of the range of possible losses and qualitative disclosures about the likely future course of events in pending claims.

**The Exposure Draft fails to account for inherent uncertainties in litigation.** As explained in more detail in the ABA comments, the United States adversarial system of justice makes it very difficult to make predictions about the outcome of a pending or threatened claim, particularly early on in a proceeding. Myriad factors may affect the ultimate exposure presented by a claim, many of which are unpredictable until late into the adjudication process. Any quantitative assessment of threatened or pending matters could give a false sense of comfort to financial statement users, when the quantitative assessments may in fact not accurately predict actual outcomes.

**The Exposure Draft’s requirement that reporting entities provide their own estimate of maximum possible loss or an estimate of a likely range of losses would seriously disadvantage reporting entities without providing benefits to users of financial statements.** Reporting the amount claimed by party in a publicly filed document does not present difficulty, and is typically disclosed under current practice. However, litigation adversaries do not always specify the amount claimed, and many jurisdictions preclude or limit specific *ad damnum*

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<sup>2</sup> The “Treaty” is comprised of two documents: the ABA Statement of Policy Regarding Lawyers’ Responses to Auditors’ Request for Information, adopted by the ABA Board of Governors in 1975, and the AICPA Statement on Auditing Standards No. 12, adopted in 1976 and supplemented up to 1998.

amounts.<sup>3</sup> Requiring a reporting entity to provide either its maximum potential loss or a range of potential losses where the plaintiff has not quantified the claim presents a number of problems. The estimate itself would tip the reporting entity's hand regarding its own evaluation of the claim, including where a plaintiff may not be able to value the claim itself. The disclosure itself could be deemed an admission against interest that could be used against the reporting entity at trial or otherwise, could distort the possible course of settlement by establishing a floor for negotiations, and could force settlements rather than allow the matter to be resolved in the ordinary course. To the extent that disclosures and estimates turn out to be wrong as a result of changes that occur in the course of the proceeding, those disclosures themselves may be the basis for additional liability. The disclosures required by the Exposure Draft also would not be of benefit to users of financial statements because estimates of potential financial impact, updated on a periodic basis, would be volatile and misleading. Because complex litigation can involve many interim developments that can increase or reduce possible exposures at a point in time before final resolution, disclosures required by the Exposure Draft would have to be re-evaluated periodically and possibly changed a number of times before a final outcome is reached. Entities would be required to change their estimates based on what may prove to be transient events in litigation. Estimates based on interim developments in litigation, particularly in the early stages of litigation, could give a very misleading view compared to the ultimate outcome of the matter. Such volatile and potentially misleading disclosures would not provide useful and accurate information to users of financial statements.

**The proposed standard threatens to erode the protections of the attorney-client privilege and work product doctrine, and would create additional tension between reporting entities and their auditors.** The Exposure Draft's call for both additional quantitative and qualitative disclosures regarding contingent liabilities threatens to open to discovery highly sensitive analysis that is traditionally protected from discovery by the attorney-client privilege and the work product doctrine. Quantification of litigation exposure will necessarily be based on numerous subjective factors that go into an assessment of a lawsuit, including an assessment of uncertain future events. Non-attorneys are not in a good position to assess many of these factors. To the extent that a disclosing entity bases its estimates on communications from its counsel, either in-house or outside counsel, auditors may feel obliged to seek out those communications to test the disclosures. To the extent that these communications are made for the purpose of assessing and defending litigation, they are absolutely protected by the attorney-client privilege and receive substantial protection by the work product doctrine. Currently, there is no federal common law protection that would enable reporting entities to disclose these communications in a way that would preserve the attorney-client privilege, and the case law regarding work product is unsettled, without controlling appellate court case law. To the extent that a disclosing entity obtained counsel's views for the specific purpose of providing a basis for disclosures in its

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<sup>3</sup> See, e.g., N.J. R. Civ. Prac. 4:5-2 ("If unliquidated money damages are claimed in any court, other than the Special Civil Part, the pleading shall demand damages generally without specifying the amount."); Wis. Stat. § 802.02(1m) ("With respect to a tort claim seeking the recovery of money, the demand for judgment may not specify the amount the pleader seeks"); 735 Ill. Comp. Stat. 5/2-604 ("Every complaint and counterclaim shall contain specific prayers for relief . . . except that in actions for injury to the person, no *ad damnum* may be pleaded except to the minimum extent necessary to comply with the circuit rules of assignment. . . .").

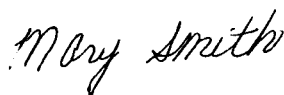
financial statements, the risk of waiver with respect to work product could be increased substantially. The Exposure Draft's requirement of additional qualitative disclosures would increase the risk that litigation adversaries would ask courts to declare that such disclosures constitute broad subject matter waiver, which could open these highly sensitive analyses to discovery to the substantial detriment of disclosing entities' ability to defend themselves in litigation.

**The existing standard of SFAS 5 works reasonably well, is consistent with basic accounting concepts, and strikes the right balance between transparency in reporting and reporting entities' interests in protecting their ability to defend themselves against threatened and on-going litigation.** Under SFAS 5, a contingency must be disclosed when its occurrence is "reasonably possible," but it only needs to be valued if it is capable of being valued. The "reasonably possible" standard is being applied consistently and effectively today. As the ABA notes, it is the experience of the organized bar that affected constituents understand the current disclosure practices as they relate to legal matters and understand that detailed descriptions and predictions about such matters would not only be imprecise and potentially wrong, but could prejudice the disclosing entity. The current standard has the advantages of ease of application, cost effectiveness, protecting the legal rights and strategies of the disclosing entity and auditability. We believe that the proposed standard falls short under each of these measures and is inconsistent with reliability and consistency in financial reporting and avoidance of unnecessary volatility.

In summary, the Litigation and Corporation Sections of the D.C. Bar are concerned that the Exposure Draft's approach to disclosure of non-financial liabilities, particularly those involving litigation, would be cumbersome and expensive to apply, could be prejudicial to reporting entities, would be subject to error, could lead to meaningless volatility in financial disclosures, would undermine the well established relationship between disclosing entities, their attorneys, and their auditors, and would actually undermine the effort to achieve more transparent, timely and useful financial reports.

Thank you for your consideration of these comments.

Sincerely,



Mary L. Smith  
Co-Chair, on behalf of the  
Litigation Section of the District of Columbia Bar