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The Financial Accounting Standards Board (FASB) is holding long-awaited roundtable discussions today at its Norwalk, CT headquarters, regarding a controversial proposal to amend Financial Accounting Statements (FAS) No. 5 and 141(R). These rules govern corporate disclosures of certain loss (and in this case, litigation-related loss) contingencies.

The Association of Corporate Counsel (ACC),¹ and the undersigned corporate legal leaders, urge FASB to reject the proposed amendments, arguing that they fail the key test for any standards change: the grave problems they create far outweigh any doubtful benefit they may purport to offer.

The proposed amendments are a “solution in search of a problem.” There is no systemic failure that warrants the proposed change. Investors are not suffering from inadequate disclosure of litigation-related loss contingencies in financial statements. Furthermore, detailed disclosure that implies an ability to predict with accuracy litigation outcomes that are inherently uncertain creates additional risk that investors will feel misled when unexpected outcomes inevitably occur.

“Guestimating” the numbers does not support accuracy or transparency in disclosure: Even if the disclosure of litigation-related loss contingencies were a serious systemic problem, it is extremely doubtful that compelling companies and their lawyers to attempt to more specifically quantify litigation risks earlier in the process of assessing potential liabilities would yield more accurate financial statements. As every trial lawyer knows, litigation is inherently unpredictable. The reaction of a single juror, the late introduction of a previously unknown fact, or the delivery of a ruling in an unrelated case can have a dramatic and unanticipated impact. As a result, requiring the lawyer or company to better quantify what is inherently unpredictable is still – at best – guessing. This does not provide more accurate disclosure to investors, and can actually mislead them when lawyers predictably guess the numbers wrong in some percentage of matters.

¹ ACC is the in-house counsel bar association, with over 23,000 members in over 80 countries, who serve as in-house lawyers to over 10,000 private sector businesses and non-profit organizations. ACC filed comments in August 2008 (available at <http://www.acc.com/advocacy/news/advocacynews080808.cfm>), and was invited to present its views as one of the few organizations offered a seat in the roundtable hearings. Representing ACC is one of its leading litigator members, Alex Dimitrief, Chief Litigation Counsel to General Electric. To learn more about ACC, please visit www.acc.com. For more information about this release or ACC's position contact Susan Hackett at hackett@acc.com.

Forcing more extensive and detailed disclosures in a far broader range of cases than FAS 5 now requires will cause serious harm to the disclosing companies and their shareholders. The proposed disclosures create a substantial risk of waiver of the attorney-client privilege and work-product immunity, potentially creating damaging collateral consequences to the corporation and stakeholders reliant on the company's legal and financial health. Confidential legal advice, lawyer thought processes, and legal analysis disclosed in public filings could be used by an adversary in litigation to argue that a waiver has occurred which would entitle the adversary to review the files and strategies of the company's defense counsel. Opposing parties can easily leverage such information to extort higher settlements or otherwise disadvantage the corporation and its reputation. This would inflict serious damage on the company and its shareholders. Additionally, by requiring disclosure of the corporation's "qualitative assessment of the most likely outcome" of a case, the anticipated timing of resolution of the case, and the assumptions made by the corporation in providing a loss estimate, while at the same time not mandating disclosure of such information by the opposing party, the amendments tip the scales of justice in favor of the opponent who doesn't have to report, ultimately affecting the outcome of major litigation with corporations.

If forced to quantify outcomes based on insufficient information, lawyers responsible for corporate disclosures are likely to feel substantial pressure to exaggerate the potential likelihood and magnitude of a bad outcome rather than risk failing to predict a large loss. Bad numbers could also create new potential liability for the company and lawyers whose stakeholders relied on mistaken estimates. To avoid these failures, the natural tendency for those responsible for estimates may be to err on the side of caution, resulting in "safe" (i.e., high) estimates, and thus inflated loss reserves. Unnecessarily high loss reserves run the risk of becoming a self-fulfilling prophecy: the well-advised corporation will settle for that figure (now known to potential plaintiffs because it is reported) rather than force the business through the disruption and brand damage caused by litigation, even if the odds of an unfavorable verdict or judgment are low. Thus, the new pressures generated by the evaluation and disclosure process mandated under these amendments may, themselves, negatively impact the outcome of the litigation (or more likely force higher cost settlements of otherwise specious claims) – a variant of the "observer effect."

The many harms caused by the proposed amendments, requiring disclosure in a broad range of cases where it would not currently be required by FAS 5, are not accompanied by any appreciable benefits, or by any evidence that the current rules are broken or require improvement to address quantifiable concerns. We urge FASB to reject these amendments.

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