

Sending in the Reserves: Litigator Interactions with Finance/Audit

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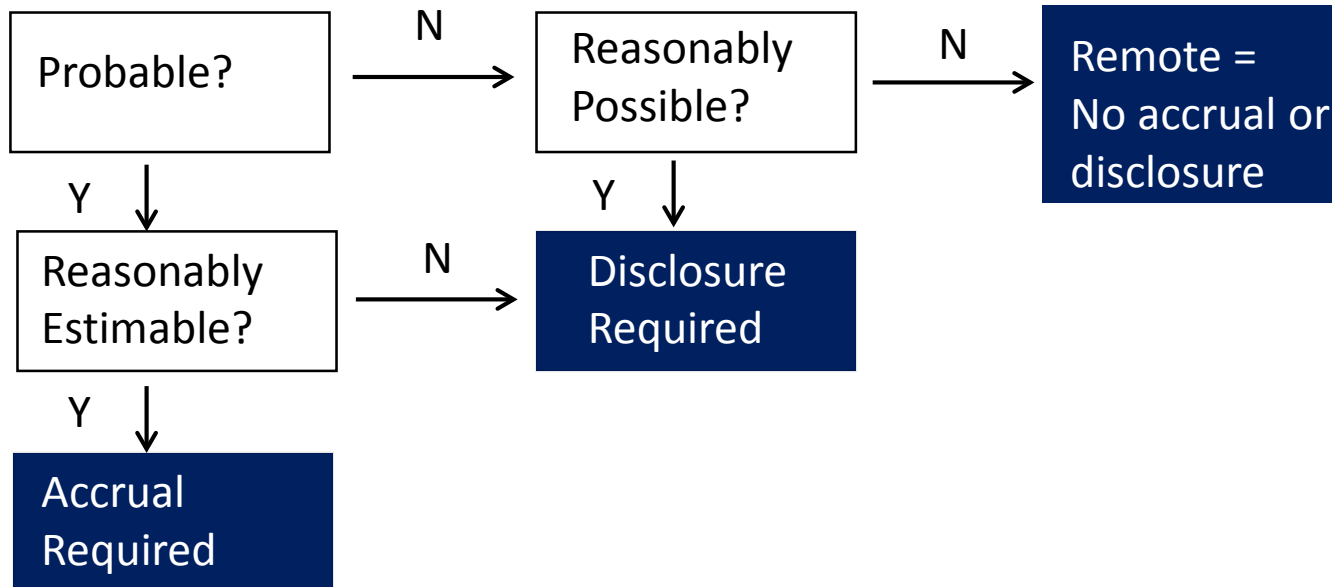
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Loss Contingencies

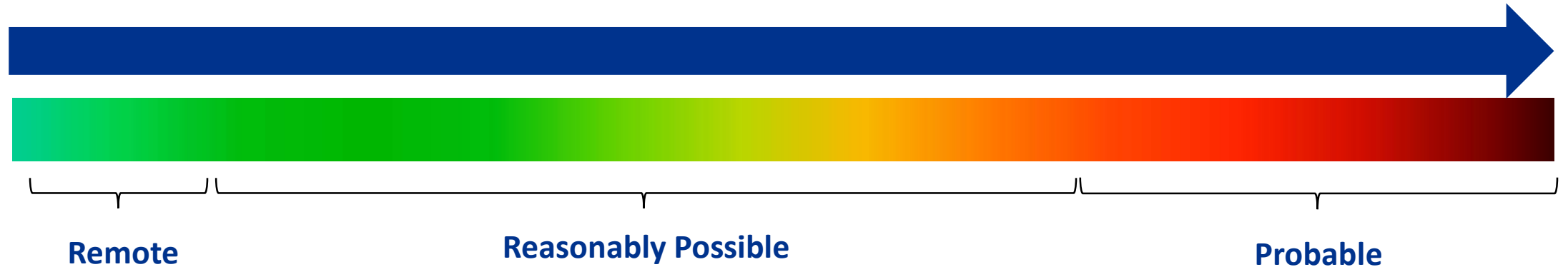
Accounting and Disclosure

Loss Contingencies

- Accrue amounts that are probable and estimable
- Disclose loss contingencies that are more than remote



Probable and Estimable



When a range of possible outcomes is estimable:

- Accrue the best estimate within the range
- If no amount within the range is a better estimate than any other amount, then accrue the minimum within the range

Roles and responsibilities

- Financial statement preparer responsibilities
 - US GAAP or IFRS; SEC regulations S-X and S-K as applicable
- Auditor responsibilities
 - PCAOB AS 2505 / Auditing Interpretation 17
 - AICPA AU 337 / Auditing Interpretation 9337
- External counsel responsibilities
 - Contractual terms of engagement
 - American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information

RESERVE SCENARIOS

Questions for Discussion:

Take Reserve?

Disclose?

Scenario 1 – Product Liability Mass Tort

- Litigation triggering event
- 10,000 total claims threatened
- 4 big plaintiff firms have approached (2,000 claims in each inventory; 2,000 others among many firms)
- Have not seen medical records
- Company to vigorously defend
- Science issues likely to be determined at trial
- 1A: You know mass torts of this size often resolve for hundreds of millions but no way to tell how this one will play out.
- 1B: You vet and settle one 2,000 claim inventory for \$X. 3 similar-sized inventories remain but you've not seen records.
- 1C: In the inventory settled, injury X had an average value of \$Y. You know injury X is alleged in the other inventories.
- 1D: You offered \$Y but it was rejected.
- 1E: If all plaintiffs would accept \$Z, you might consider settling but you know this would be rejected.

Scenario 2 – Single Trial

- Company tries case
- Very large plaintiff verdict
- 2A: You are confident case will be reversed or reduced on appeal.
- 2B: You lose in state intermediate appellate court but remain confident state supreme court will correct.
- 2C: The state supreme court doesn't take the case, but you remain confident US Supreme Court will reverse. However, you know certiorari petitions are rarely granted but you feel good about this one.
- 2D: Verdict reduced by trial court, but plaintiff appeals the remittitur

Scenario 3 – Multiple Legal Opinions

- Government investigation
- Threat of criminal and civil penalties
- Good prospects to negotiate civil only resolution
- National coordinating counsel estimates \$X
- Local counsel from team who formerly worked in that US attorney office estimates \$X times 50.

Scenario 4 – Inherent Uncertainty

- Complex international commercial contract arbitration
- Multiple contracts at issue, tort claims asserted
- Multiple claims and counterclaims
- Several tricky choice of law issues
- Demand from opponent for \$X
- 4A: Very little discovery permitted. You feel like your exposure is limited to \$X, but you are concerned you will be surprised at arbitration.
- 4B: If the claim is X and the counterclaim is nearly the same as X's value, reserve required?
- 4C: Prior to arbitration, you learn of evidence that weakens defenses to the claim.