



District Court Dismisses Claim that Potential Litigation Disclosure Was Required

Posted by Kobi Kastiel, Co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Tuesday November 19, 2013

Editor's Note: The following post comes to us from [Eric M. Roth](#), partner in the litigation department at Wachtell, Lipton, Rosen & Katz, and is based on a Wachtell Lipton memorandum by Mr. Roth.

A recent decision of the Southern District of New York is noteworthy in its rejection of the plaintiffs' argument that disclosure of a threatened suit in which the potential loss could have reached \$10 billion was required under either the federal securities laws or Accounting Standards Codification 450. See [In re Bank of America AIG Disclosure Sec. Litig., C.A. No. 11 Civ. 6678 \(JGK\) \(S.D.N.Y. Nov. 1, 2013\)](#).

In January 2011, BofA and AIG entered into an agreement to toll the statute of limitations on fraud and securities claims arising out of BofA's sale of mortgage-backed securities ("MBS") to AIG. In February 2011, AIG provided BofA with a detailed analysis of its potential claims in which it claimed to have lost more than \$10 billion. Later that month, BofA's annual report disclosed that it faced "substantial potential legal liability" relating to sales of MBS, which "could have a material adverse effect on [its] cash flow, financial condition, and results of operations," but cautioned that BofA "could not estimate a range of loss for all matters in which losses were probable or reasonably possible." BofA did not disclose the tolling agreement with AIG or the magnitude of its potential exposure to AIG. On August 8, 2011, AIG had filed a complaint against BofA seeking damages of at least \$10 billion. BofA's stock price dropped 20% in a single day.

Purchasers of BofA stock filed suit under Section 10(b) and Rule 10b-5, claiming that BofA was "required to disclose the imminence and amount of the AIG suit" in its annual report and subsequent SEC filings. In a thoughtful decision granting BofA's motion to dismiss, Judge John Koeltl of the Southern District of New York held that "no regulatory provision created an affirmative duty to disclose the allegedly omitted information." Rejecting plaintiffs' argument that BofA was required to disclose the potential AIG suit under ASC 450, Judge Koeltl noted that ASC 450 requires disclosure of a loss contingency if it is "reasonably possible," in which event

disclosure must include both the “nature of the contingency” and either an estimate of the loss or range of loss or a statement that an estimate cannot be made. The court reasoned that, even if BofA could have known that some liability to AIG was “reasonably possible,” plaintiffs had made no plausible allegation that BofA could have reasonably estimated the amount of loss before AIG’s complaint was filed. The court further held that ASC 450 was not violated because “BofA adequately disclosed the nature of the contingency at issue—namely, loss from pending and threatened litigation arising from the sales of MBS—and stated that it could not estimate losses for certain litigations that would have included the AIG suit.”

Judge Koeltl also rejected the argument that BofA had a duty to disclose the imminence and amount of the AIG suit under Item 303(a)(1) of Regulation S-K, which requires the disclosure of “known trends ... or uncertainties that will result in or that are reasonably likely” to have a material effect on liquidity. The court held that “no such disclosure was required under Item 303 because the imminence and amount of AIG’s suit were insufficiently certain.” Thus, plaintiffs failed to allege that, prior to August 8, 2011, the eventual filing of the AIG suit was ever “presently known” to BofA or that the AIG suit was “‘reasonably likely’ to generate any loss, let alone a material loss.”

Judge Koeltl’s decision represents an important precedent should other shareholder plaintiffs seek to hold companies liable for failing to disclose the imminence or potential magnitude of threatened litigation before it is filed.