

November 30, 2005

Director of Technical Application and Implementation Issues
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

RE: Proposed FASB Staff Position No. FIN 46(R)-c: Determining the Variability to Be Considered In Applying FASB Interpretation No. 46(R)

PG&E Corporation is pleased to see that the proposed Staff Position (FSP) has been added to the Financial Accounting Standards Board (the Board) agenda and we strongly support the Board in its efforts to clarify what variability should be considered when applying Interpretation No. 46(R). We have reviewed the proposed FSP, and would like to offer our comments.

PG&E Corporation is an energy-based holding company with approximately \$11 billion in annual revenues, and \$35 billion in assets at December 31, 2004. PG&E Corporation conducts its business primarily through its main subsidiary Pacific Gas and Electric Company, a utility that provides natural gas and electricity service in Northern and Central California.

PG&E Corporation submitted an unsolicited comment letter to the Emerging Issues Task force in September 2004 in support of the "By Design" approach which was contemplated in Issue 04-7. PG&E Corporation continues to support the Board's position to incorporate an analysis of the design of an entity in determining what variability should be considered in applying Interpretation No. 46(R). The purpose of the entity, whether or not it was established to meet specific economic needs of certain interest holders, and how the transaction was marketed to potential investors is critical to the assessment of an enterprise's involvement with a VIE. PG&E Corporation's primary concerns center around the application of the approach suggested by the FSP. We believe additional guidance and more robust examples would be useful. We would like to address the following three areas:

- Effect of Regulation
- Access to Information
- Interaction with Lease Accounting

Effect of Regulation:

The evaluation of a long term power purchase agreement (PPA) that is executed by a regulated utility and an independent power producer (IPP) exemplifies our issue. A regulated utility that buys power to satisfy its legal requirement to supply electricity, typically analyzes its counterparty as a potential VIE if the pricing provisions of the contract expose the utility to commodity price risk and credit risk. Generally, regulated utilities have not considered regulatory recovery mechanisms provided by regulators in their analysis of an IPP's expected variability. We believe this to be inconsistent with the economic reality of many of these transactions. An in-depth analysis of the fundamental economic and financial design of power markets reveals that the effect of regulation is inseparable from the design of the IPP in many situations. The facility supplying the power pursuant to the PPA is often designed and financed primarily based on the support that the regulator provided the regulated utility. A regulated utility will not sign a PPA unless it has been approved by a regulator that provides for recovery of reasonable costs associated

with the contract. Paragraph 12 of the proposed standard indicates that an analysis of the entity's design should incorporate, "what type of risks and rewards it is asking its interest holders to be exposed to". If the design of the entity is approved by regulators and reasonable recovery of costs have been approved concurrent with the execution of the contract, then we believe the regulatory mechanism in place should be considered as a component of the entity's design.

Currently, most industry participants disregard cost recovery permitted by regulators in the evaluation of commodity price risk and credit risk. PG&E Corporation believes the FSP as written supports a broader view. In situations where a regulator provides for reasonable recovery of expenses associated with the PPA and that recovery is probable, a utility is not exposed to commodity price risk or credit risk. Accordingly, we believe the "By Design" approach should include the regulatory design of such PPAs. It would be beneficial if the Board would reaffirm or refute the view that "By Design" regulatory mechanisms may mitigate expected variability related to commodity price risk and credit risk would be acceptable in applying the proposed FSP.

Access to Information:

Current application of Interpretation No. 46(R) requires a long term buyer of power to evaluate a power purchase agreement as though it may have a variable interest in a VIE. The information required in evaluating a contract and its counterparty as noted in paragraph 12 of the FSP includes, "original formation documents, governing documents, marketing materials, and other contractual arrangements entered into by the entity and provided to potential investors." The proposed FSP fails to acknowledge that this information is proprietary, commercially sensitive and would often times not be made available to non equity participants. PG&E Corporation supports the view that an evaluating enterprise must make exhaustive efforts to obtain appropriate information to assess a potential VIE. However, situations will arise whereby an evaluating enterprise will not be able to implement the standard because they do not have access to appropriate information. In these situations we believe the Board should extend the scope exception provided in paragraph 4(g) of Interpretation No. 46(R). Additionally, it would be beneficial if the Board would provide an example that contemplates a non equity participant applying the analysis recognizing that they will not have access to the information required.

Interaction with Lease Accounting:

Many PPA contracts are accounted for as operating leases subsequent to the effective date of Emerging Issues Task Force Issue 01-8, when the purchaser of power has contracted for 100% of a specified asset's output. Currently, industry participants apply paragraph B24 of Interpretation No. 46(R) in determining whether the lease is a variable interest, which states:

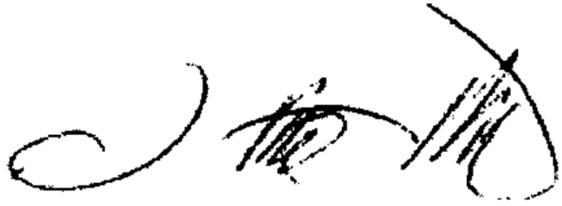
"Most operating leases do not absorb variability in the fair value of an entity's net assets because they are a component of that variability. Guarantees of the residual values of leased assets (or similar arrangements related to leased assets) and options to acquire leased assets at the end of the lease terms at specified prices may be variable interests in the lessor entity if they meet the conditions described in paragraph 12 of this Interpretation."

In applying this paragraph many industry participants consider an operating lease outside the scope of Interpretation No. 46(R) provided the lease does not contain a fixed purchase option or a residual value guarantee. PG&E Corporation believes that paragraph 11 of the proposed FSP might be interpreted by some parties to conflict with the original guidance in saying, "an analysis of the nature of the entity's interests issued should include consideration as to whether the interest, regardless of its legal form or *accounting designation*, (emphasis added) transfers substantially all of the risk or return (or both) of certain assets or operations of the entity." It would be beneficial if the Board reaffirmed its view of

paragraph B24 given the context of the statement in paragraph 11 of the proposed FSP to ensure the consistent application of Interpretation No. 46(R).

We would be pleased to discuss our comments with the Board or its staff at your convenience. Thank you for your consideration.

Sincerely,



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