



Letter of Comment No: 22  
File Reference: FSPFIN46RC

November 30, 2005

Mr. Lawrence W. Smith  
Director, Technical Application and Implementation Activities  
Financial Accounting Standards Board  
401 Merritt 7  
P. O. Box 5116  
Norwalk, CT 06856-5116

**Re: Proposed FASB Staff Position, FIN 46(R)-c, "Determining the Variability to be Considered in Applying FASB Interpretation No. 46(R)"**

Dear Mr. Smith:

FPL Group, Inc. appreciates the opportunity to comment on the Financial Accounting Standards Board's proposed staff position intended to clarify the variability to be considered in applying FIN 46(R). Our principal subsidiary, Florida Power & Light Company, is a rate-regulated utility engaged in the generation, transmission, distribution and sale of electric energy. The Company also owns and operates independent power facilities through its wholesale electric generation subsidiary, FPL Energy, LLC.

We appreciate the effort undertaken by the staff to provide clarification for the application of FIN 46(R). While we conceptually agree that consideration of the "design" of the entity should be the driving factor in determining whether an entity is a variable interest entity and which interests in the entity constitute variable interests, we find the application of the proposed FSP to be difficult at best. The concepts of variability, and the concepts of creation and absorption of variability, should be more fully defined in the FSP to ensure a consistent understanding of the terms and the intent of the FSP.

Attached is an example demonstrating our preliminary understanding of how the proposed FSP would be applied to a contract in our industry. This may provide assistance to the Board in determining whether the proposed FSP is effective in setting forth the principles to be followed in applying FIN 46(R).

We note that at mid-day on November 30, 2005 (the comment deadline), no comment letters on this proposed FSP have been posted on the FASB website. We caution the Board not to consider the lack of comment on the proposal a sign of unanimous consent. We suspect that others in the preparer and user communities may be struggling as we are to fully comprehend the intent and consequences of the proposed guidance.

Thank you for the opportunity to express our concerns.

Sincerely,

**K. MICHAEL DAVIS**  
K. Michael Davis  
Controller and Chief Accounting Officer

## **EXAMPLE**

### **Assumptions:**

- Entity A, an independent power producer, builds a coal-fired power plant
- Entity A enters a contract to sell power to the electric utility (Utility B) in whose service territory the plant resides
  - Utility B will purchase all power generated by the plant
  - Entity A will only produce power when requested by Utility B
  - Utility B pays a monthly capacity payment (fixed, unless the plant is unable to meet certain performance requirements).
  - Utility B pays a variable energy payment for each megawatt hour of power purchased. The energy payment is indexed to the market price of coal and includes an adder designed to cover variable operating and maintenance costs.
  - The contract has been approved by Utility B's regulators and the payments are recovered dollar-for-dollar from Utility B's customers through a cost recovery clause mechanism; should the regulator ever determine that the contractual payments will not be recovered, the contract price will be adjusted to an amount that will be recovered, or the contract will be terminated.
- Entity A is funded with 90% fixed-rate debt (secured by the plant and contract) and 10% equity

### **Risks (from Entity A's perspective):**

- a) Commodity price risk inherent in the purchase of coal to burn as fuel in the plant
- b) Commodity price risk inherent in the variable energy payment for the sale of power
- c) Credit risk associated with possible default of Utility B under the power sales contract
- d) Commodity price risk inherent in the fair value of the power plant
- e) Other operating cost risk
- f) Regulatory risk that Utility B's regulators will subsequently disallow recovery of the contractual payments for power, thus amending or terminating the contract

### **Analysis of Design of the Entity:**

- Entity A was designed to provide equity investors with a return inherent in the fixed capacity payment.
- Entity A was designed to be essentially neutral with respect to coal price risk; that is, as the market price of coal increases or decreases, so will the variable energy payment received for the sale of power. Entity A is indifferent to whether or not Utility B requests the delivery of power, as the variable energy payment is designed to cover the incremental cost of producing that power.
- To the extent that Utility B defaults on payments for power or that Utility B's regulators disallow recovery of amounts to be paid under the contract, thus voiding the contract, the debt investors and equity investors will be at risk.

- The risks of increased other operating costs, operational issues resulting in decreased availability of the plant, environmental law changes requiring significant capital improvements to the plant are all borne by the equity investors, and potentially the debt investors.
- The fair value of the fixed-rate debt will fluctuate due to changes in market interest rates. Because that variability is not directly caused by changes in the value of the entity's net assets exclusive of variable interests, it should not be considered when analyzing this entity.
- The fair value of the power plant will fluctuate primarily due to changes in the market price of power. Because that variability is not directly caused by changes in the value of the entity's net assets exclusive of variable interests, it should not be considered when analyzing this entity.

Based on the above analysis, it can be determined that the entity was designed to create and pass along risks c, e and f to the equity investors and debt investors, who are Entity A's variable interest holders. The power sales contract creates variability for Entity A due to the fixed capacity payment.