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Letter of Comment No: 88  
File Reference: 1082-300  
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**VIA E-MAIL:** [director@fasb.org](mailto:director@fasb.org)

**Signed Copy by Mail**

Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116  
Attention: TA & I Director  
File Reference No. 1082-300

Re: Exposure Draft Proposed Interpretation  
Consolidation of Variable Interest Entities  
A Modification of FASB Interpretation No. 46

Dear Members of the Board:

As some of you will recognize, I have been an active participant from the public sector in the consideration of issues addressed in FASB Interpretation No. 46 ("FIN 46"). That has included submission of written comments and related observations regarding the original Exposure Draft Interpretation on "Consolidation of Certain Special-Purpose Entities" dated June 28, 2002 (the "SPE Exposure Draft"), participation in the Open Roundtable held on September 30, 2002 regarding the SPE Exposure Draft, proposed FASB Staff Positions (each, an "FSP") under FIN 46, and various related correspondence. Members of the Board and the FASB Staff have obviously put in a great deal of effort and deliberation on issues arising under FIN 46 and on preparation of the above-referenced Exposure Draft dated October 31, 2003 which covers many of those issues by modifying or amending it (the "Exposure Draft Amendment").

There are, however, various issues regarding practical implementation of FIN 46 which still merit further consideration by the Staff and deliberation by the Members of the Board. This letter is confined to addressing only one of those issues: consolidation of assets and liabilities of a "variable interest entity" (a "VIE") which actually are legally isolated from the consolidating party. Members of the Board and of the Staff will recognize that this comment letter reflects continuity of issues and concerns initially raised in connection with the SPE Exposure Draft.<sup>1</sup> I appreciate having this opportunity to supplement those comments with this letter and, in so doing, correlate them with other issues under consideration by the Board and/or pending initiatives of the FASB with respect to them.

1. Potentially Misleading Financial Statements and/or Disclosure

From the outset, there has been concern that consolidation of a VIE could result in a serious risk that creditors and/or shareholders of the consolidating enterprise would receive an

<sup>1</sup> See, Letter of Comment No. 78A dated September 26, 2002 (particularly section 4 thereof), and Letter of Comment No. 78C dated October 14, 2002 (particularly section D.1.(d) thereof and Attachment B to that letter entitled "Bankruptcy-Remote Indicia").

incorrect impression of the financial condition of the consolidating company.<sup>2</sup> If the assets and liabilities of the VIE are actually isolated from the consolidating company and the reach of its creditors and shareholders, presentation in financial statement which leaves a contrary impression runs the risk of liabilities such as those arising under Sections 11, 12 and 17 of the Securities Act of 1933, as amended; those arising under Section 10(b) of the Securities Exchange Act of 1934, as amended, including regulations adopted pursuant thereto; etc.

The undersigned understands that the Staff of the FASB has been made aware of instances of filings with the Securities and Exchange Commission in which the issuer/reporting company has presented information corresponding to the current requirements of FIN 46 applicable to a "primary beneficiary" of a VIE but has found it necessary to disclose in footnotes to financial statements (as well as in Management's Discussion and Analysis) that the results of such consolidation did not accurately reflect the financial condition of the issuer/reporting company. In such instances of which the undersigned is aware, that problem would have been avoided if FIN 46 had included a exemption from the consolidation requirements based on legal isolation of the assets and liabilities of the VIE and/or the "bankruptcy remote" status of the VIE.

2. Nexus with Proposed Amendments to SFAS 140 / Isolation of Assets Transferred to Qualifying Special Purpose Entities

There was substantial commentary submitted on the SPE Exposure Draft as to the nexus of it with the consolidation provisions of SFAS 140 specifically applicable to Special Purpose Entities utilized in the context of asset securitization and meeting the qualifications under it for such treatment (a "QSPE"). Some of the overlap and/or areas of potential uncertainty corresponding to it were addressed in the Exposure Draft dated June 10, 2003 regarding a proposed amendment to SFAS 140 (the "QSPE/140 Exposure Draft"). The issues which arose with respect to the impact of legal isolation of assets resulted in a decision by the Board to publish a revised version of the QSPE/140 Exposure Draft in time for its final adoption prior to the end of the current year, but that is apparently no longer possible.

Ideally, the issues of asset isolation which have arisen in that context would also be reflected in a revision to FIN 46. Although there may well be sound substantive reasons to treat QSPEs differently than FIN 46 VIEs, the characteristics of each which might justify that are virtually (if not actually) transparent as to the fundamental legal question of whether any particular assets are available to creditors for satisfaction of a debt or whether any particular liabilities may be asserted against an entity not otherwise directly incurring them. In whatever manner the final amendment to SFAS 140 comes out, issues and procedures specified in it will have significant applicability under FIN 46. As a practical matter, however, it seems unlikely that resolution of those issues will be achieved in time to be included in the final modification and amendment to FIN 46. It would therefore be appropriate for the Staff of the FASB as well as the Member of the Board to take cognizance of the overlap in issues when completing the FIN 46 amendment and to accomplish that modification in a manner which would allow FIN 46 to "grow" with that resolution rather than subject it to still another round of amendments.

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2 *See, for example, Letter of Comment Nos. 25, 42, 90 & 127 submitted in connection with the SPE Exposure Draft, as well as the attachment to Letter of Comment No. 46 which was also attached to several other Letters of Comment. See also, section 3 of Letter of Comment No. 78A submitted by the undersigned.*

3. Form Over Substance

The initial impetus for FIN 46 was a series of very public instances of apparent financial abuses and scandals. In the context of investigations into the Enron collapse, Senator Carl Levin concluded that there was “compelling evidence that current SPE accounting rules are inadequate to stop material accounting deceptions ....”<sup>3</sup> His submission to the Board on the SPE Exposure Draft set forth a litany of instances in which the deceptions cited by him were achieved because form had been allowed to prevail over substance.

Unfortunately, FIN 46 as currently written has the very realistic potential for propagating an obverse form of such “form over substance” result. It does so by focusing on relatively rigid standards of applicability independent of the principles upon which they are based, while failing to reflect the economic substance of the relationship between a VIE and the entity determined to be its “primary beneficiary.” That relationship may give rise to some strategic or operating benefits to the consolidating entity which, however, provides it with no quantifiable value to which creditors can look for satisfaction of debt obligations or to which shareholders can look in assessing the investment prospects of the consolidating entity. The Board may yet conclude that the integrity of financial statements would be enhanced by shifting the focus from financial statement consolidation to disclosure (including by means of financial statement footnotes) when the assets and liabilities of a VIE are legally isolated from the “primary beneficiary.”

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For the reasons set forth above, I urge the Board to give specific consideration to the issue of asset isolation when completing its deliberations on the FIN 46 Exposure Draft Amendment. By way of example, an amended FIN 46 might appropriately include a new provision specifying that the assets and liabilities of a VIE would not be consolidated under FIN 46 in instances where such assets and liabilities meet specified characteristics of legal isolation to be promulgated in the future by the FASB in the form of one or more FSPs. That would permit this issue to be settled for FIN 46 VIEs very promptly after completion of the pending amendment to SFAS 140 rather than require still another modification to FIN 46 once the Board has come to its final conclusions regarding asset isolation for purposes of SFAS 140.

If the Board decides to hold hearings on issues arising in the public comment process on the FIN 46 Exposure Draft, I request the opportunity to appear and be accompanied by one of the partners in my law firm (Davis Wright Tremaine LLP) specializing in insolvency matters. If the Board decides to hold a Public Roundtable as it did for the SPE Exposure Draft, I request the opportunity to yield the position at such event to which this letter qualifies me to such colleague.

Thank you for your consideration.

Very truly yours,

/s/

Steven K. Hazen

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3 See, Letter of Comment No. 36 dated August 28, 2002, submitted on the SPE Exposure Draft by Senator Levin as the Chairman of the Permanent Subcommittee on Investigations of the United States Senate Committee on Governmental Affairs.