

May 31, 2006

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LETTER OF COMMENT NO. 141

Subject: Comment Letter Regarding the FASB's Exposure Draft, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (File Reference No. 1025-300)

Dear Ms. Bielstein:

American Electric Power Company, Inc. (AEP) appreciates the opportunity to comment to the Financial Accounting Standards Board (FASB or the Board) on the Board's exposure draft in Phase 1 of its project on Postretirement Benefit Obligations, Including Pensions. AEP, a Columbus, Ohio based energy company, is one of the largest investor-owned utilities operating in the United States, with revenues of \$12 billion and 20,000 employees. We provide energy to approximately 5 million customers in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia and West Virginia.

AEP Position

We encourage the FASB to continue to reevaluate pension and other postretirement benefit accounting rules. However, we believe that in an attempt to do something "as quickly as possible," the FASB has proposed changes that would, if adopted:

- Dilute visibility or transparency of information about a plan's funded status and cause unwarranted investor concern,
- Understate the funded status to be recorded by using the PBO rather than the ABO, and
- Presuppose the outcome of the FASB's planned comprehensive review of pension and other postretirement benefit accounting rules prior to any due process deliberation on those issues.

We believe that the additional minimum pension liability provisions of SFAS 87 are sufficient as they stand today. Therefore, we recommend that the Board cancel its attempt to do something "as quickly as possible" until all pension and postretirement benefit accounting issues are properly deliberated.

Background

As we understand Phase 1 of the project, the FASB's objective for Phase 1 is, as quickly as possible, to improve the reporting of employers' obligations for pensions and other postretirement benefits by recording on the balance sheet an amount equal to all previously unrecognized items such as unamortized net actuarial gains or losses, regardless of a plan's funded status. The resulting additional liability or asset would be recorded as an after-tax reduction or increase, respectively, to common equity, generally through accumulated other comprehensive income (AOCI).

Our understanding of the future Phase 2 of this project is that the FASB plans to comprehensively reconsider the guidance in SFAS 87, Employers' Accounting for Pensions, and SFAS 106, Employers' Accounting for Postretirement Benefits Other Than Pensions, in order to improve the reporting of pensions and other postretirement benefit plans in the financial statements by making information more useful and transparent for investors, creditors, employees, retirees, and other users. Phase 2 will examine the potential elimination of the netting and smoothing aspects of SFAS 87 and SFAS 106. Generally, we have limited our comments herein to Phase 1 of your project.

Phase 1 Would Dilute Visibility or Transparency of Information about a Plan's Funded Status and Cause Unwarranted Investor Concern

We believe that plan participants, analysts, and the public are concerned that many pension plans are insufficiently funded and that the liability represented by substantially underfunded plans may not be given appropriate recognition in measuring the financial condition of a plan's sponsoring company. The FASB's proposed Phase 1 changes, if adopted, would recognize an additional pension liability and resulting AOCI charge to equity that appears to ignore a company's benefit plan funding level.

AEP and many other employers recently contributed substantial amounts to fully fund their qualified pension plans. In addition to providing employees and retirees security in their pension benefits, a significant driving force behind the decision to commit substantial cash to fully fund is to eliminate an additional minimum pension liability. AEP, for example, has made more than \$825 million of discretionary pension contributions over the last several calendar quarters in order to fully fund its qualified pension plans' minimum liabilities by the end of 2005. This voluntary funding represented a substantial use of cash that was made to address our commitments to plan participants. In addition, AEP's full-funding plan addresses and mitigates emerging concerns that have been recently expressed by the investor community about numerous other corporations' well-publicized and underfunded plans.

Under the exposure draft, a fully funded company and an underfunded company with similar plans and similar unrecognized actuarial loss experience would report the same equity reduction on their financial statements. Yet the company sponsoring the underfunded plan would have a future cash obligation to the plan that could be dramatically different for the fully funded plan's sponsor. Instead of creating more transparency, the Board's proposal could mislead financial statement users. We do not believe that this is an appropriate outcome.

The proposed changes in the FASB's exposure draft would not resolve an existing concern but instead would create the potential for misinterpretation of data regarding a plan's funded status. Fully funding a pension plan, as AEP did, gives plan participants the security that their pension benefits will be available in the future when they need them. It also gives investors, investment analysts, and credit

rating agencies assurance that a company's financial condition will not be diminished by substantial future cash outflows that may result from an unfunded pension liability.

The Board's proposal to require recognition of a large liability for plans with no minimum pension liability would result in unwarranted concern by investors and plan participants about pension funding shortfalls that do not exist. Although financial analysts understand the temporary nature of unrecognized actuarial losses that currently are disclosed in the footnotes, under the FASB's exposure draft most plan participants may not fully appreciate the minimal impact of this liability on a plan's ability to make good on its obligations. Furthermore, investors are left without the ability to transparently assess the financial condition implications of the shareholders' equity changes that may be recorded based on the Phase I proposals.

Phase 1 Would Understate the Funded Status to be Recorded By Using the PBO Rather Than the ABO

The minimum liability that SFAS 87 requires to be recorded for underfunded pension plans is based on the shortfall of the fair market value of plan assets versus the accumulated benefit obligation (ABO). The ABO is the appropriate measure because it is the current obligation based on current service and compensation. The larger projected benefit obligation (PBO) includes the effects of future pay increases that have not yet been earned or even awarded. Although these future raises are expected, the employer has no current obligation for either the salary increases themselves or the resulting effect on pension benefits. Accordingly, the exposure draft's use of the PBO instead of the ABO overstates the obligation and understates the funded status to be recorded on the balance sheet.

The PBO also does not meet the Board's definition of a liability in Concepts Statement 6, *Elements of Financial Statements*. Paragraph 35 of that statement defines liabilities as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." Paragraph 36 states that a liability's essential characteristics are that it (a) embodies a present duty or responsibility, that (b) leaves the entity little or no discretion to avoid, and (c) the transaction or event obligating the entity has already happened. An employer can avoid the effect of future salary growth included in the PBO by freezing its current pension plan, as many have done recently. Therefore, using the PBO understates a pension plan's funded status.

Phase 1 Would Presuppose the Outcome of the FASB's Planned Comprehensive Review of Pension and Other Postretirement Benefit Accounting Rules Prior to Any Due Process Deliberation on Those Issues

In our opinion, the proposed changes are premature given the Board's planned intent to address income statement smoothing and other issues in Phase 2. By going beyond the need to record a liability for underfunded plans, the Board appears to be making quick changes now based on its expected major revisions in Phase 2 of the project. However, since the Phase 2 issues have not yet been subject to due process deliberation, we believe that it would be inappropriate to make changes now that presuppose the results of Phase 2. Requiring in Phase 1 that all deferred actuarial losses be recognized on the balance sheet would be similar to requiring that all commitments under operating leases be recognized as liabilities before comprehensively reconsidering lease accounting.

Given the substantial effects that the FASB's proposal in Phase 1 would have on employers and plan participants, we believe that it would be far better for the FASB to continue to rely on the longstanding guidance in SFAS 87 and SFAS 106 until the changes anticipated in Phase 2 can be properly considered within an appropriate due process framework.

Conclusions

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In summary, we commend the FASB for addressing pension accounting, and we believe that the FASB's Phase 2 is a necessary component of the broad reporting debate related to pension and other postretirement benefit plans. We do not believe the FASB's proposed Phase 1 will improve financial reporting, and in fact, Phase 1 may have unintended consequences of undermining comparability between funded and unfunded plans.

Thank you for the opportunity to comment on the Board's exposure draft.