



August 8, 2008

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116



LETTER OF COMMENT NO. 8

File Reference No. 1590-100

Re: Exposure Draft of Proposed Statement of Financial Accounting Standards on Accounting for Hedging activities an amendment of FASB Statement No. 133

Dear Technical Director:

Nortel Networks Corporation (Nortel) appreciates the opportunity to comment on the Financial Accounting Standards Board Exposure Draft, "Accounting for Hedging Activities an amendment of FASB Statement No. 133." Nortel supports the Board's attempt to simplify accounting for hedging activities and resolve major practice issues related to hedge accounting.

Nortel is a global supplier of communications equipment, software and services, serving both telephone service provider and business and governmental enterprise customers, with over \$10 billion in revenues. While Nortel is incorporated under the laws of Canada and is headquartered in Toronto, Ontario, our securities are traded on the New York Stock Exchange (in addition to the Toronto Stock Exchange), we follow accounting principles generally accepted in the United States of America, and are considered a U.S. domestic filer, and therefore file Annual and Quarterly Reports on Forms 10-K and 10-Q with the Securities and Exchange Commission. We have historically used hedge accounting to account for both fair value and cash flow hedges, and expect to continue our application of hedge accounting.

The body of this letter includes our general comments and observations on the Exposure Draft. Appendix A to this letter includes our responses to the specific issues raised.

Risk Management

We agree with many of the alternative views expressed in pars. A52 – A54 in the proposed Statement. The principal impact to Nortel of the proposed Statement is in accounting for risk management activities related to interest rate risk. If the Board continues to support a general abandonment of the "bifurcation-by-risk" approach, we support the exception to allow designation of only interest rate risk for an entity's own debt and urge the Board to reconsider making the exception available throughout the life of the debt instrument as well. For many of the reasons cited by dissenting Board members in A57, we believe that allowing this exception only at inception of the debt will force preparers to choose between accepting volatility in reported results (either in the form of an undesignated interest rate swap or unmatched changes in fair value of the debt

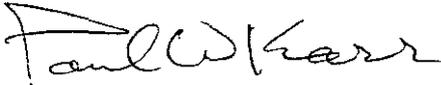
stemming from our own credit risk), incurring additional costs to hedge our own credit risk, or departing from economically proper risk management strategies.

By limiting the interest rate only exception to inception of the related debt, the proposed standard provides very different accounting results for very similar risk management strategies based only on the timing of those strategies. Consider the example of an interest rate swap entered into at inception of the related debt agreement that converts the debt from fixed to floating. Whether we desire to enter into such a swap (and the magnitude of debt we wish to convert from fixed to floating rate) is determined based on a comprehensive review of entity-level interest rate risk. This is true whether we execute the strategy directly (by issuing debt with the desired interest rate risk profile) or indirectly (by issuance of debt and an interest rate swap).

Based on discussion in paragraph A19, the Board supports hedge accounting for risk management strategies targeting only interest rate risk in cases where the strategy results in synthetic alteration of the related debt instrument or a portion of the debt instrument, for its entire term. We believe this instrument-level view of the hedging activity is inconsistent with how we use interest rates swaps to manage risk. Our overall risk management process is performed at an entity level, relying on analytical techniques to monitor volatility in the P&L resulting primarily from fluctuations in interest rates. We believe that many companies manage interest rate risk in the same way, as a practice that continually reacts to changes in certain factors, and not through an approach that seeks to synthetically alter a financial instrument.

We appreciate the opportunity to comment on the proposed Exposure Draft. If you would like to further discuss any of our comments, please do not hesitate to contact me at (905) 863-3653 or pkarr@nortel.com.

Sincerely,



Paul W. Karr
Controller

C: Paviter S. Binning, Executive Vice President and Chief Financial Officer

APPENDIX A

Hedged Risk

Issue 1: For the reasons stated in paragraph A16 of this proposed Statement, the Board decided to eliminate (with two exceptions) the ability of an entity to designate individual risks as the hedged risk in a fair value or cash flow hedge. As a result of that change, the financial statements would reflect information about the risks in the hedged item or transaction that an entity both chooses to manage and not to manage as part of a particular hedging relationship.

Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the ability of an entity to designate individual risks and requiring the reporting of the risks inherent in the hedged item or transaction?

We believe that the elimination of the ability to designate individual risks as the hedged risks in a fair value or cash flow hedge would impair the usefulness of the financial statements. The changes limit the usefulness of legitimate risk management techniques by requiring the reporting of non-hedged risks, ultimately requiring companies to make a decision to either commit more resources to acquiring additional hedging instruments that are not part of the original risk management goal, or to accept greater volatility in the P&L. As an example, Nortel attempts to manage some interest rate risk by maintaining a balanced floating rate asset and floating rate liability portfolio using interest rate swaps, and applying hedge accounting to reduce the P&L volatility created through mark-to-market changes in the interest rate swaps. The overall portfolio is maintained on an ongoing basis, and the interest rate swaps may not always be entered into at inception of the hedged item. Under the proposed Statement, we would be required to designate the overall changes in fair value of the hedged item (usually debt), as opposed to just the individual interest rate risk, if the hedge was not established at inception of the debt. As the overall fair value of the debt is affected by more than just changes in interest rate, Nortel would have to either enter into additional derivatives (i.e. a credit derivative) or accept a greater amount of ineffectiveness run through earnings each reporting period. The results in either case are not palatable, as the ineffectiveness from the credit risk can create greater P&L volatility than leaving the original hedging instrument undesignated; and adding a credit default swap would result in cash inflows or outflows resulting from the desire to protect the accounting. Whichever decision an entity makes, it seems that its risk management decisions would be driven by accounting rules instead of by the original goal of minimization of selected risk.

Part of the basis for eliminating the individual risks was that it is "directionally consistent with the goal of measuring all financial instruments at fair value." Under the proposed Statement only those instruments designated as hedged items would have their carrying value adjusted, and even then the carrying amounts would not necessarily be equivalent to fair value, for example on late hedges (as discussed in par A25). We believe it would be more appropriate to develop any fair value guidance in a separate project and that this proposed Statement should deal only with the goal of simplifying hedge accounting and resolving practice issues.

Issue 2: For the reasons stated in paragraphs A18–A20, the Board decided to continue to permit an entity the ability to designate the following individual risks as the hedged risk in a fair value or cash flow hedge: (a) interest rate risk related to its own issued debt (that is, its liability for funds borrowed), if hedged at inception, and (b) foreign currency exchange risk. For those two exceptions, the financial statements would not reflect information about the risks that an entity chooses not to manage as part of a particular hedging relationship.

Do you believe the Board should continue to permit an entity to designate those individual risks as a hedged risk?

Yes. Please see response to Issue 1.

Hedge Effectiveness

Issue 3: *This proposed Statement would eliminate the shortcut method and critical terms matching. Therefore, an entity would no longer have the ability upon compliance with strict criteria to assume a hedging relationship is highly effective and recognize no ineffectiveness in earnings during the term of the hedge. As a result, when accounting for the hedging relationship, an entity would be required, in all cases, to independently determine the changes in fair value of the hedged item for fair value hedges and the present value of the cumulative change in expected future cash flows on the hedged transaction.*

Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for fair value hedging relationships and cash flow hedging relationships?

Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the shortcut method and critical terms matching, which would eliminate the ability of an entity to assume a hedging relationship is highly effective and to recognize no ineffectiveness in earnings?

Our main operational concerns are the additional system or outsourcing costs required to value additional items. We currently outsource our hedge valuations and increased usage of the outsourcing providers will lead to increased costs. We also foresee some challenges in defining an acceptable hypothetical derivative, especially in circumstances where the hedge is meant to offset the FX risk in a series of related transactions.

We do not believe the proposed Statement would impair the usefulness of financial statements by eliminating the shortcut method and critical terms matching. However, we do not believe that the financial statements would be appreciably improved either. Many entities will continue to use hedging instruments that historically would have met the shortcut and critical terms matching criteria, but would now be required to expend additional resources to measure and record what may be an insignificant amount of ineffectiveness.

Issue 4: *This proposed Statement would modify the effectiveness threshold necessary for applying hedge accounting from highly effective to reasonably effective at offsetting changes in fair value or variability in cash flows.*

Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

For situations in which interest rate risk is currently designated as the hedged risk for financial instruments but would no longer be permitted under this proposed Statement (except for an entity's own issued debt at inception), do you believe you would continue to qualify for hedge accounting utilizing your current hedging strategy? If not, would you (a) modify your hedging strategy to incorporate other derivative instruments, (b) stop applying hedge accounting, (c) elect the fair value option for those financial instruments, or (d) adopt some other strategy for managing risk?

Under the changes in the proposed Statement, we believe modifying the effectiveness threshold from highly effective to reasonably effective is appropriate, as it may allow an entity to continue using current risk management techniques (i.e. hedging of interest rate risk only) and still maintain hedge accounting. As discussed in Issue 1, we believe that the changes in the proposed Statement could require an entity to make a decision between increased use of derivatives and increased P&L volatility, but the modification of the effectiveness threshold at least leaves the decision up to the entity.

In our current business environment, we believe that there is a reasonable possibility that we would not qualify for hedge accounting using our current strategy, due mainly to fluctuations in Nortel's credit spread. Given that the changes in overall value under the fair value option are just as affected by changes in credit spread and the associated cost of adding additional hedging instruments, we would most likely attempt to adopt some other strategy for managing risk or, failing that, stop applying hedge accounting.

Issue 5: This proposed Statement always would require an effectiveness evaluation at inception of the hedging relationship. After inception of the hedging relationship, an effectiveness evaluation would be required if circumstances suggest that the hedging relationship may no longer be reasonably effective.

Do you foresee any significant operational concerns in creating processes that will determine when circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness each reporting period?

Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? If so, why?

We are confident we could build processes to identify circumstances where we believe the hedge relationship may no longer be reasonably effective. However, any such process will require the application of significant professional judgment and we are wary that auditors or regulators will second-guess our judgments and, over time, require specific one-size-fits all processes that are frequently cumbersome.

Issue 6: The Board considered but decided against eliminating any assessment of effectiveness after the inception of the hedging relationship. The Board believes that eliminating such an assessment of effectiveness could result in the continuation of hedge accounting even when situations suggest that the hedge relationship may no longer be reasonably effective. Some observe that an implication of the decision to not eliminate any assessment after the inception of the hedging relationship could be that hedge accounting results would be reflected in some reporting periods and not in other reporting periods throughout the life of the relationship. Also, in a hedge accounting model that generally does not permit hedging of individual risks, changes in the relationship between the individual risks being managed and those not being managed could increase the likelihood that the hedging relationship would no longer be reasonably effective. That would result in hedge accounting no longer being permitted for a portion of an expected hedge term. That "in and out" of hedge accounting would make it more difficult for users to interpret financial statements.

Do you agree with the Board's decision to continue to require that hedge accounting be discontinued if a hedge becomes ineffective? Alternatively, should an effectiveness evaluation not be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term?

We agree with the Board's decision to require that hedge accounting be discontinued when a hedge becomes ineffective to ensure that there is a reasonable connection between the hedged item and hedging instrument and to simplify interpretation of the financials for users.

Presentation of Hedging Gains and Losses

Issue 7: In the statement of operations, Statement 133 does not prescribe the presentation of gains and losses associated with hedging instruments, including the effective portion, the ineffective portion, and any amounts excluded from the evaluation of effectiveness, such as forward points. Some have suggested that such a prescription would improve financial reporting by creating consistency in the presentation of these amounts across all entities. Others observe that FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, requires disclosure about that information, and they question whether a prescriptive approach is appropriate given the diverse hedge accounting strategies employed by entities.

Do you believe that Statement 133 should be amended to prescribe the presentation of these amounts? For example, the Statement could require that the effective portion of derivatives

hedging the interest rate risk in issued debt be classified within interest expense and that the ineffective portion and any amounts excluded from the evaluation of effectiveness be presented within other income or loss.

We believe that the issuance of FASB Statement No. 161 provides enough information about the location of derivatives and related gains and losses, that no additional presentation requirements are necessary.

Effective Date and Transition

Issue 8: *The Board's goal is to issue a final Statement by December 31, 2008. The proposed Statement would require application of the amended hedging requirements for financial statements issued for fiscal years beginning after June 15, 2009, and interim periods within those fiscal years.*

Do you believe that the proposed effective date would provide enough time for entities to adopt the proposed Statement? Why or why not?

As a calendar-year fiscal company, we believe the proposed effective date would provide enough time for Nortel to adopt the proposed Statement.

Issue 9: *The Board did not prescribe any specific transition disclosures upon the adoption of this Statement.*

Do you believe that there are specific disclosures that should be required during transition? If so, what? Please be specific as to how any suggested disclosures would be used.

At this time we don't believe any specific transition disclosures should be required.

Issue 10: *The Board decided to permit an entity a one-time fair value option election under FASB Statements No. 156, Accounting for Servicing of Financial Assets, and No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, for (a) servicing assets and servicing liabilities designated as a hedged item on the date immediately preceding initial application and (b) eligible financial instruments designated as a hedged item on the date immediately preceding initial application of this proposed Statement.*

Do you agree with the Board's decision to allow a one-time fair value option at the initial adoption of this proposed Statement? Do you agree with the Board's decision to limit the option to assets and liabilities that are currently designated as hedged items under Statement 133?

We do not have an opinion on this matter as we would most likely not take advantage of the offer.

Benefit-Cost Considerations

Issue 11: *The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. The benefit-cost considerations considered by the Board are provided in paragraphs A43–A50 in Appendix B of this proposed Statement.*

Do you believe the Board identified the appropriate benefits and costs related to this proposed Statement? If not, what additional benefits or costs should the Board consider?

While we believe the Board identified most benefits and cost appropriately, additional costs the Board should consider include:

- The elimination of individual risk designations may cause some entities to choose use of multiple hedging instruments in cases where only one instrument was previously required, and drive higher risk management costs, as noted in response to Issue 1.
- Elimination of dedesignation at the option of the entity may cause increased calculation and accounting costs as entities are required to use the more complicated accounting model in DIG H15 rather than dedesignate at the occurrence of the forecasted transaction. A possible solution would be to allow dedesignation only at a time identified in the hedge documentation at inception.
- The Board has labeled the calculation of overall changes in fair value and development of hypothetical derivatives as one time costs. However, we believe these costs are more appropriately identified as recurring since fair value would need to be calculated for every reporting period and a hypothetical derivative created for every new hedge.