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March 8, 2007



LETTER OF COMMENT NO. 42

Technical Director
Financial Accounting Standards Board
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VIA ELECTRONIC MAIL

File Reference No. 1510-100

**RE: Proposed Statement of Financial Accounting Standards
Disclosures about Derivative Instruments and Hedging Activities,
an amendment of FASB Statement No. 133**

Constellation Energy appreciates the opportunity to comment on the Proposed Statement of Financial Accounting Standards, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*, which amends and expands the disclosure requirements in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. We understand that the expanded disclosures are intended to provide an enhanced understanding of an entity's use of derivative instruments, how derivative instruments are accounted for, and how derivative instruments affect an entity's financial statements.

We support the objective of providing meaningful disclosures for derivative instruments and hedging activities. However, based upon our review of the Exposure Draft to date, we believe that the proposed disclosures about derivatives have such significant limitations and are so extensive that they may not achieve, and may even impede, the document's stated objective to "...help users [of financial statements] better understand why an entity uses derivatives in the context of an entity's risk exposures". We do not believe that simply providing more information is equivalent to providing decision-useful information. Further, we believe that the objective of the Exposure Draft can be achieved by increased qualitative disclosures that explain how the accounting requirements of SFAS No. 133 reflect an entity's use of derivatives. Finally, if the volume of disclosures proposed in the Exposure Draft is retained in the final standard, we believe that the systems and process changes required to implement the standard are so extensive that it would be extremely difficult to implement these disclosures as of the end of 2007, and that a delay in its effective date to fiscal periods beginning after December 15, 2008 is essential.

Our specific comments below address our overall concern with the nature and extent of the document's provisions. Some of our comments relate to specific questions posed as part of the Exposure Draft, while others are additional issues we want to bring to the Board's attention. For comments that relate to questions posed in the Exposure Draft, we have noted that in the comment section heading.

Entity Risk Exposures

The Exposure Draft has an overall objective to relate the use of derivative instruments to an entity's risk exposures. However, for public companies, detailed disclosures that present information about an entity's risk exposures are already required in Management's Discussion & Analysis (MD&A). We believe that MD&A is a better and more appropriate location for market risk exposure disclosures as MD&A allows an entity to discuss how its current risk management activities (i.e., use of derivatives) affect current and future earnings and cash flow.

However, if the final standard includes disclosures about derivative risk exposures in the footnotes consistent with the Exposure Draft's proposals, we recommend a disclosure structure with flexibility similar to that adopted by the Securities and Exchange Commission in FR-61 and Regulation S-K Item 305, *Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations*. FR-61 states: "Information about trading activities, contracts and modeling methodologies, assumptions, variables and inputs, along with explanations of the different outcomes reasonably likely under different circumstances or measurement methods, should be considered for inclusion in management's discussion of how the activities affect reported results for the latest annual period and subsequent interim period and how financial position is affected as of the latest balance sheet date." FR-61 further articulates several acceptable alternative frameworks from which the reporting entity can choose as to how to disclose risk exposures that balance users' perceived need for information while minimizing the disclosure of competitively sensitive data.

We, therefore, recommend that, if the final decision is to include expanded disclosures in the footnotes, the Board provide the principles for disclosure and several acceptable choices from which the reporting entity can choose, similar to those described above under FR-61, in lieu of the voluminous, detailed proposals in the Exposure Draft. We believe that a more focused disclosure framework would provide the best qualitative and quantitative methods to describe entities' use of derivatives in their financial statements.

Notional Amounts

(Issue 5 – Do you agree that this proposed Statement should require the disclosure of notional amounts? Why or why not?)

We do not agree with the proposed disclosure of gross notional amounts (at absolute value). The Basis for Conclusions section of the Exposure Draft, states that "notional amounts provide insight into the overall volume of derivative use and into the magnitude of risks being hedged". While we understand this concept, we believe that disclosure of the absolute value of notional amounts would not meet this objective.

Consider a situation where a reporting entity has a balanced book of transactions, i.e., it has two derivatives with equal notional amounts, one of which is a forward purchase contract and the other of which is a forward sale contract, for the same commodity and delivery period. The net notional would be zero and, as a result, the entity would have no exposure to market price risk. If those derivatives are not exchange-traded, but rather are over-the-counter or bilateral instruments with different counterparties, both instruments would remain outstanding until the contractual settlement date. In the energy industry, it is very common to enter into these types of offsetting positions that will physically deliver instead of settling each position in cash, and even if the instrument provided for cash settlement, it would not be paired off as an exchange-traded contract would be. Thus, disclosing the absolute value of the notional amount would not faithfully present the impact that derivatives have on the reporting entity.

Similarly, for physical commodities where one aspect of the risk is physical delivery location, some entities may enter into a single derivative to manage the all-in price risk to the delivery point, while other entities may use multiple derivatives (for example, an exchange traded contract delivered to a liquid point and a basis swap to manage the location risk from the liquid point to the specific delivery point) that would result in one company reporting notional amounts double that of the other company when each has the exact same commodity price risk profile.

As another example, one entity may employ a “static” risk management approach whereby it enters into a single derivative and holds it until settlement, while another may manage its risk more actively by entering into multiple offsetting derivatives based upon its assessment of changes in risk over time. If those derivatives are not exchange-traded contracts that can be paired off, the second company will show absolute value gross notional amounts significantly in excess of those for the first company, yet its commodity price risk exposure to derivatives at any point in time may be identical.

In sum, we believe that the disclosure of gross absolute value notional amounts would not faithfully represent an entity’s derivatives exposure; it may in fact provide misleading impressions of the extent to which an entity is engaging in derivatives transactions (that some perceive as “risky”); and it likely would not be comparable among different companies based upon their use of alternative risk management practices rather than any fundamental difference in exposure to commodity price risk.

While one potential alternative would be to disclose the “net” notional instead of the absolute value notional amounts, that approach has at least two serious drawbacks. First, the disclosure of net notional amounts disaggregated at the level that appears to be specified in the Exposure Draft would reveal competitively sensitive information about an entity’s risk management positions. Specifically, based on the currently proposed requirement to disclose derivative instruments by primary underlying risk, accounting designation and purpose, this “net” disclosure would indicate an entity’s net position for each specific commodity for each specific purpose. When combined with other available information about the entity’s strategies and business, competitors could readily deduce the entity’s net long or short position by commodity and use that information to the economic disadvantage of the reporting entity.

For example, an entity in the business of generating power using natural gas may disclose that it is using derivatives to hedge its future purchases of natural gas. Disclosure of the net notional amount of such hedges, combined with information regarding the generating capacity of the entity’s facilities, could allow a competitor to determine the extent to which the entity’s fuel requirements were hedged and thus potentially provide an advantage in competing with that generator for future sales of power. The same type of information could be gleaned for many other risk exposures that are managed with derivatives, particularly for entities whose risk management activities are more straightforward. As a result of the potential for significant economic disadvantage that such disclosures could produce, we would not agree with disclosing the net notional amounts.

Second, even if such disclosures were to be required, a net notional disclosure would have further limitations, particularly for physical commodities for which delivery period is a key risk input. A net open position in a commodity for delivery in the current period has a substantially different risk profile than that for delivery several years from now. Additionally, a net open position may reflect long positions in some periods and short positions in others. Those periods may be highly correlated, in which case the underlying risk may be minimal. Alternatively, the net position may be near zero, yet long positions in some periods may not be correlated well with short positions in other periods, and the commodity price risk may be significant. In all of these cases, the presentation of a net notional quantity would not necessarily give an

appropriate view of the net risk exposure of the entity that is consistent and comparable across companies if that exposure is being managed in a sophisticated manner.

Additionally, regardless of whether gross or net notional amounts are presented, each has the potential to overstate an entity's risk exposure to the extent that the entity enters into options transactions. Unless options are deep in-the-money, the notional quantity of an option bears little relationship to the actual exposure to price risk from those derivatives. Even at-the-money options have a roughly equal chance of settling in- or out-of-the-money, and so the risk profile is not properly represented by the notional quantity.

In summary, for all of the reasons set forth above, we believe that the disclosure of notional amounts would not indicate the proper magnitude of derivative risk or the true volume of the use of derivatives. Further, if shown "net", notional amounts may reveal competitively sensitive information as to an entity's overall position for specific commodities or financial instruments. Neither gross or net notional measures are comparable across companies due to differences in risk management strategies and execution that can substantially affect the reported notional quantity. Given these limitations, we believe that disclosures of notional amounts should not be required. We believe that the risk-based disclosures proposed above, which are similar to FR-61 requirements, would be more valuable to a user than requiring disclosure of notional amounts and at the same time would respect the sensitive nature of competitive company information. They would also be more easily implemented and would be more likely to provide information that is comparable across companies.

Gross Fair Value Amounts of Derivatives

The Exposure Draft would require a highly disaggregated disclosure of gross fair value amounts of derivatives (even if they qualify for netting under FIN 39) on the basis that this disclosure would (1) help in better understanding what and how risks are being managed and (2) that *netting this information would lead to misleading information*. In terms of the first objective, we believe that the gross fair value disclosure would be misleading since gross fair value overstates the entity's perceived credit risk exposure by showing large fair value positions when the net credit position could be relatively small. Additionally, gross fair value is not linked to, and does not provide meaningful information about, an entity's market risk from derivatives. Consider a situation in which a reporting entity has several locked-in derivative positions (forward purchase and sale contracts that offset each other) and, therefore, has a net derivative exposure of zero. The amount of gross, or even net, fair value bears no relation to the entity's exposure to derivative price risk, which is instead governed by its net open position, if any.

With regard to the second objective of a gross presentation, we believe that a gross presentation is more misleading than a net presentation. The primary risk that the reported fair value of derivatives reflects is credit risk. For assets, it reflects the extent to which losses would be incurred if the counterparty failed to perform. For liabilities, it reflects the potential demand on the entity's liquidity if it were to settle that position currently. However, presenting such amounts gross would provide a misleading representation of these risks. The gross fair values could be many multiples larger than the actual net credit risk disclosures located elsewhere in the footnotes and MD&A. Presumably FIN 39 permits netting when its requirements are met because it is a desirable, and even preferable, presentation. We do not believe that disaggregated disclosure that has the potential to differ so significantly from the amounts actually presented in the financial statements is useful, and in fact it presents a misleading and overstated measure of credit risk.

Primary Underlying Risk

The Exposure Draft requires disclosure of an entity's objectives and strategies for using derivatives, as well as derivative positions by "primary underlying risk (for example, interest rate, credit, foreign exchange rate, or overall price)". We believe that "overall price risk" was probably intended to mean each individual price risk. However, as currently written, this term can be interpreted to be so broad as to permit aggregation into a single disclosure of all "overall price risk". This could potentially mean that an entity could use one table to disclose all of its price risks or one table for each price risk.

While we believe that the former disclosure (overall price risk) would be substantially less onerous for preparers than disaggregation by each major price risk category, we are concerned that diversity in practice could result based upon the currently proposed provisions of the Exposure Draft. Since energy companies use derivatives to mitigate price risk for several types of commodities (i.e., power, coal, gas, oil, capacity, etc), we believe that the definition of "overall price" in terms of primary underlying risk should be clarified in order to avoid the potential for confusion and diversity in disclosure.

Additionally, if our understanding is correct that each price risk would require a separate table, the disclosures for energy companies potentially would lead to very large tables for each commodity, resulting in extremely voluminous, highly detailed disclosures. We are concerned that this large volume of quantitative disclosures will be overwhelming and, therefore, lose value to the reader. Simply providing volumes of raw notional data and gross fair values for each type of derivative underlying, accounting treatment, and risk management strategy does not provide sufficient context to make that data useful. For example, critical information such as the delta-equivalent quantity of derivatives, long or short positions by period, cross-commodity correlations, positions by region, and relationship to non-derivative risk exposures all would be necessary for a more complete understanding of the risks posed by derivatives. At the same time, mandating the inclusion of some or all of this additional information would have the same drawback as the disclosure of net notional amounts, namely, that it potentially would reveal significant competitive information.

We do not believe that it is the role of the financial statements, including footnotes, to provide this level of disaggregated detail, particularly when fair value amounts presented in the financial statements are deemed to be the most relevant measure for derivatives. Further, for the reasons described above, we do not believe that the proposed disclosures will provide information that is complete, useful, or a faithful representation of derivative risks at the level of detail proposed.

Normal Purchases and Normal Sales Exception

(Issue 10 – The Board considered but decided against requiring additional disclosures as described in paragraphs B55-B63. Those disclosures focused on providing information on an entity's overall risk management profile, methods for assessing hedge effectiveness, and situations in which an entity could have elected the normal purchases and sales exception. Do you agree with the Board's decisions not to require disclosures in those areas? Why or why not?)

We understand that the Board considered requiring disclosures for instances where entities are accounting for derivatives as mark-to-market when the entity could have elected the normal purchase and normal sale (NPNS) exception. The Board rejected this disclosure so as not to single out the NPNS exception when there are other exceptions to the application of Statement 133. We agree with this conclusion.

Timing of Disclosures

The Exposure Draft proposes that these expanded disclosures must be presented for every annual and interim period. We believe that these disclosures should only be required on an annual basis. The additional cost to prepare this disclosure, along with the already-shortened interim reporting due dates, outweighs the benefit of additional quantitative disclosures at every interim period. There are already requirements to update the annual disclosure in interim reports if there are material changes. We believe that these disclosures should be subject to the same standard of financial reporting. This proposal would strike a balance between the costs and benefits of such extensive new quantitative disclosures.

Effective Date and Implementation Considerations

(Issue 11 – Does the effective date provide sufficient time for implementation?)

(Issue 3 – Do you foresee any significant operational concerns or constraints in compiling the information in the format required by this proposed Statement?)

We believe that it would be difficult to meet the effective date proposed in the Exposure Draft in light of the substantial systems and process changes that will have to be implemented and in consideration of other standards that will require significant implementation on or near December 2007. We also believe that it would not be practical to implement such significant changes in disclosure for any periods prior to the actual effective date (i.e., to provide disclosures about calendar-year 2007 income statement information in the 2007 notes to financial statements) because of the need to have systems in place to capture and summarize the required information throughout the entire historical period covered by the disclosures.

The disclosures proposed in this Exposure Draft include information that management presently does not accumulate, review or use to manage the company's risks and performance in the normal course of business. Given the volume of derivatives transactions which we execute, we would have to change systems and process to accumulate this information, which would be difficult to complete by the end of 2007. For other similar market participants, risk management systems may not currently capture information by accounting designation or purpose as defined in the proposal. Further, those systems are geared toward risk management and may not easily disaggregate gross fair values by individual transaction. With regard to other new accounting requirements, SFAS 157, *Fair Value Measurements*, is required to be implemented on January 1, 2008 for calendar year companies and will require significant time and resources to implement. Taken together, these factors render it extremely difficult to meet a December 31, 2007, effective date, even if the final statement were to be issued now, much less at the end of June, 2007, or later.

We note that the Exposure Draft also would have to be implemented as of the end of a calendar year and would require substantial disclosures for income statement data that would have to be accumulated throughout the year of initial implementation. We believe it is not realistic to implement the standard as of the end of a year when it is highly likely that the necessary systems and process revisions will not be complete, tested, and operational as of the beginning of that year. The proposed disclosures will require substantive systems modifications to accumulate the necessary information on a real-time basis during the year. Recreating the necessary information for historical periods would be unduly onerous and difficult to achieve in the year of initial implementation.

Even if a final standard were to be issued as anticipated by the current schedule, we do not believe it would be possible to complete our implementation of SFAS No. 157 and implement

the Exposure Draft's requirements prior to the end of 2007. Accordingly, in order to allow sufficient time to implement these comprehensive requirements completely and accurately and have the necessary changes completed and operational as of the beginning of the first period covered by the disclosures, we believe that an effective date for fiscal periods beginning after December 15, 2008 is the first realistic time in which we could implement the presently proposed requirements of the Exposure Draft.

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We appreciate the opportunity to comment on this Exposure Draft.

Sincerely,

/s/ Reese Feuerman
Vice President & Controller

/s/ Randall Hartman
Assistant Controller – Accounting Policy & Research

/s/ John Collins
Senior Vice President & Chief Risk Officer