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Ms. Suzanne Bielstein Director - Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Subject: File Reference No. 1201-100

Dear Ms. Bielstein:

The Edison Electric Institute (EEI) appreciates the opportunity to comment on the Financial Accounting Standards Board's (FASB or the Board) Exposure Draft (ED) of proposed Statement of Financial Accounting Standards, "Fair Value Measurements."

EEI is the association of the United States investor owned electric utilities and industry affiliates and associates worldwide. Its U.S. members serve over 90 percent of all customers served by the investor-owned segment of the industry. They generate approximately three-quarters of all the electricity generated by electric utilities in the country and serve approximately 70 percent of all ultimate customers in the nation. EEI members own a majority of the transmission and generation facilities in the nation.

Valuation Techniques

Issue 2: This proposed Statement would clarify and incorporate the guidance in FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements, for using present value techniques to estimate fair value. Is that guidance sufficient? If not, what additional guidance is needed?

The ED discusses present value techniques for estimating fair value in Appendix A. Paragraphs A2 (f) and A23 through A27 indicate that estimates of the fair value of a liability must include the effect of an entity's creditworthiness. While this approach has been included in Concepts Statement 7, for practical reasons certain liabilities recorded at fair value may not currently reflect the effect of an entity's creditworthiness. For example, such an adjustment may not be incorporated in the measurement of either (a) Level 3 derivative liabilities whose value can fluctuate from asset to liability from period to period and for which the probability of default is relatively low or (b) liabilities of entities which do not issue debt publicly and for which the determination of a credit adjustment may be relatively subjective.

If the provisions of the ED are adopted, the final standard for the first time would explicitly incorporate into Level 1 GAAP the requirement to include the effect of an entity's creditworthiness in estimates of the fair value of all liabilities. Because entities may not be applying such a factor currently, the final standard should provide that initial effect of incorporating an entity's creditworthiness in the valuation of liabilities should be reported as the cumulative effect of a change in accounting principle, similar to the proposed transition provisions for the effect of using bid and asked prices for valuations in dealer markets.

Pricing in Active Dealer Markets

Issue 7: This proposed Statement would require that the fair value of financial instruments traded in active dealer markets where bid and asked prices are more readily and regularly available than closing prices be estimated using bid prices for long positions (assets) and asked prices for short positions (liabilities), except as otherwise specified for offsetting positions. Do you agree? If not, what alternative approaches should the Board consider?

Paragraph 17 of the ED indicates that, in active dealer markets, offsetting positions should be valued at mid-market prices, and net open positions should be valued at either the bid or the ask price, as appropriate. Note 8 to that paragraph states that "other pronouncements specify whether and, if so, when such offsetting is appropriate."

EEI member companies are not aware of other pronouncements that address when it is appropriate to offset risk positions for purposes of applying this paragraph of the ED. Further, for purposes of determining offsetting positions eligible for pricing at mid-market EEI believes that it would not be appropriate to apply the netting requirements of FASB Interpretation 39 (FIN 39), which relates

to balance sheet netting of amounts due to and from two parties. Rather, midmarket pricing should be applied to offsetting risk positions based upon the existence of offsetting long and short positions for the same underlying and the same settlement period and should not be governed by credit netting provisions.

In the energy commodity markets, many transactions are executed in brokered, over-the-counter or bilateral markets. Among market participants, certain counterparties (such as generators of power) are more consistently sellers of energy, while other counterparties (such as distribution companies) are more consistently buyers of power. As a result, unlike financial instruments such as exchange-listed futures contracts, it is common for contracts for the purchase and sale of energy to be executed with different counterparties and not to be eligible for balance sheet netting under FIN 39. However, if such purchases and sales are for the same underlying and settlement period, the effect of pricing offsetting transactions at the bid and ask price would introduce an artificial "reserve" equal to the bid-ask spread that would only be reversed into earnings upon settlement of the contracts.

EEI believes that it would be inappropriate to apply bid-ask pricing to offsetting risk positions as described above because it would create artificial reserves on the balance sheet and result in deferral of the recognition of earnings until the settlement of contracts. In order to avoid doubt as to the intent of paragraph 17 of the ED, we recommend that any requirement in the final standard to use bid-ask pricing specifically provide that offsetting positions should be determined on a risk basis and not on the basis provided for credit netting on the balance sheet under FIN 39.

Level 3 Estimates

Issue 9: This proposed Statement would require that in the absence of quoted prices for identical or similar assets or liabilities in active markets, fair value be estimated using multiple valuation techniques consistent with the market approach, income approach, and cost approach whenever the information necessary to apply those techniques is available without undue cost and effort. Appendix B provides general guidance for applying multiple valuation techniques. Is that guidance sufficient? If not, what additional guidance is needed?

Paragraph 21 of the ED requires the use of multiple valuation techniques to determine Level 3 estimates of fair value whenever the information necessary to apply those techniques is available without undue cost and effort. Thus, these provisions of the ED appear to place the burden of demonstrating "undue cost and effort" on the preparer for each situation in which fair value is applied, and it is possible that some could interpret these provisions to require a quantitative analysis.

However, example 6 in Appendix B appears to apply this requirement somewhat qualitatively, excluding the income approach on the basis that the necessary adjustments would be subjective, that other relevant market inputs are available, and that the income approach would not provide significant additional information. Similarly, example 7 excludes the market approach due to lack of publicly available information. The application of the ED's provisions in these examples appears to be more consistent with Paragraph 22 of the ED, which notes that if information to apply multiple valuation techniques is not available, the valuation technique that best approximates what an exchange price would be in the circumstances shall be used.

EEI believes that, for Level 3 estimates, the final standard should require the application of valuation technique(s) that best approximate what an exchange price would be in the circumstances. In our view, the use of multiple valuation techniques should not be required when one technique is common, generally accepted, or most representative of the methods used by market participants to determine exchange prices. As presently written, the ED appears to require an affirmative demonstration that applying all three valuation techniques would entail undue cost and effort for each Level 3 estimate prepared. We believe that this would create unnecessarily burdensome documentation requirements, and we believe our proposal is more consistent with a principles-based approach for determining fair value rather than a rebuttable requirement to apply three valuation methods in all circumstances.

Alternatively, if the Level 3 requirements are retained as drafted in the ED, EEI believes that the final standard should clarify that a demonstration of "undue cost and effort" is not necessarily a quantitative exercise. While we concur with the judgment-based approach illustrated in the examples provided in Appendix B, we are concerned that in practice some may interpret the phrase "undue cost and effort" to require a mathematical calculation or other objective determination that in itself may be burdensome. However, as clearly illustrated in the two examples in Appendix B, it is our understanding that judgment may

be applied in satisfying the Level 3 valuation provisions. If these provisions are retained, we recommend that the final standard be clarified accordingly.

Fair Value Disclosures

Issue 11: This proposed Statement would require expanded disclosures about the use of fair value to remeasure assets and liabilities recognized in the statement of financial position. Appendix B illustrates those disclosures. This proposed Statement also would encourage disclosures about other similar remeasurements that, like fair value, represent current amounts. The Board concluded that those disclosures would improve the quality of information provided to users of financial statements. Do you agree? If not, why not?

The ED specifies certain disclosures about fair value in paragraph 25 and illustrates those disclosures in paragraph B22. EEI has several concerns about these proposed disclosures as described below.

First, EEI observes that the proposed disclosure table is similar to disclosures required by SEC release FR-61 governing trading activities. This raises the potential for duplicative disclosures for public companies with trading activities. Further, the definition of fair value and the three levels of the fair value hierarchy in the ED differ in some respects from the three categories of valuation methodology required under the FR-61 disclosures. As a result, there is the potential for conflict between two similar disclosures that could lead to confusion for financial statement users. While we recognize that the focus and specific provisions of SEC and FASB pronouncements may differ, we request the FASB to coordinate any potentially overlapping disclosure requirements such as this with the SEC in order to minimize the potential for conflicting disclosures and resulting confusion for the financial statement reader.

Second, we believe that the final standard should explicitly recognize that the classification of the fair value of assets and liabilities between the various levels in the hierarchy should be presented in accordance with the entity's valuation and risk management practices with appropriate disclosure of the basis of presentation. We are aware of at least two potential bases of presentation that could occur, and we believe that either should be permitted:

By Settlement Period – Under this methodology, the fair value of individual contracts is segregated between each of the levels in the fair value hierarchy based upon the availability of market information for each settlement period within each contract. For example, a five-year natural gas

purchase contract may be valued using exchange-quoted prices for two years, over the counter bid-ask quotes for two years, and management extrapolation of prior period data for the last year. For that contract, the first two years would be classified as level one, the second two years as level two, and the final year as level three. We believe that this approach is most consistent with the objective of reporting the components of fair value among each of the levels in the valuation hierarchy, namely, identifying the relative subjectivity exercised in determining the fair value of an entity's assets and liabilities. Reporting the determination of fair value by settlement period across contracts provides the financial statement user with a detailed view of the basis underlying the determination of fair value and is especially important in industries such as the energy industry where many contracts span periods that require the use of more than one level of the hierarchy to determine fair value.

By Contract – Some entities may not have the systems and procedures required to readily identify by settlement period the components of fair value between each of the hierarchy levels and may even obtain fair value amounts by requesting quotations from third parties on a periodic basis for financial reporting purposes. In such situations, an alternative presentation would be to classify the fair value of an entire contract based upon the lowest level in the hierarchy used to determine fair value. Thus, for the same five-year gas contract described above, because the fair value of the entire contract is not observable in either an identical or similar market where the differences are objectively determinable, the fair value of the entire contract would be classified as level three.

The determination of fair value inherently is a matter of judgment, particularly in industries where non-financial commodity contracts must be classified as derivatives and recorded at fair value. Those derivatives may require the use of multiple elements of the valuation hierarchy to determine fair value for a single contract. We recommend that the final standard explicitly permit entities to make the required disclosures about how fair value is determined on a basis consistent with how they manage their business and their risk positions, including either of the two bases described above. We believe that it would be appropriate to require each entity to disclose the basis upon which it presents these disclosures.

Third, the proposed requirement to disclose unrealized gains and losses relating only to assets and liabilities held at the end of the period would be

administratively difficult to fulfill and would inappropriately exclude changes in fair value for assets and liabilities disposed prior to the end of the period. Conceptually, for assets and liabilities that are measured at fair value at any time during a reporting period, unrealized changes in value are more reflective of the effect on earnings or comprehensive income than realized transactions, which merely represent the exchange of one financial instrument for another or for cash. From a practical perspective, many companies account for all unrealized changes in fair value in the aggregate, and it would not be practical or cost-effective to segregate such amounts between assets and liabilities held at period end versus those disposed of during the period. This is particularly true for entities that engage in a substantial amount of hedging or trading activities.

We believe that the apparent purpose of the disclosure requirement for unrealized gains and losses is to identify for the financial statement user the effect on earnings and comprehensive income of unrealized changes in assets and liabilities that are recorded at fair value during the period. Therefore, we believe that this disclosure should apply to the entire unrealized change in fair value of all such assets and liabilities held during the period, not just those held at period end.

Other Issues - Issue 13

Issue 13: This proposed Statement represents the completion of the initial phase of this project. In subsequent phases, the Board expects to address other issues, including issues relating to the relevance and reliability of fair value measurements and the unit of account that should be used for those measurements. What, if any other issues should the Board Address? How should the Board prioritize those issues?

The ED indicates that the Board will consider issues relating to the relevance and reliability of fair value measurements in the next phase of this project. EEI believes that this is a critical phase of the project, and we encourage the Board to ground financial accounting standards in conceptually supportable and consistently applied concepts. EEI believes that this is especially important with regard to the use of fair value for financial accounting purposes.

The use of fair value as a measurement basis has proliferated on a standard-by-standard basis. While we acknowledge that there are instances in which fair value is the most relevant measurement basis, EEI believes that there are many other instances in which the application of fair value is less relevant,

overly complicated, highly subjective, and obscures the transparency of the underlying economics of certain transactions. EEI believes that theoretical analyses supporting the increasingly broad application of fair value accounting must be tempered by practical considerations regarding the relevance, reliability, and usefulness to financial statement readers of fair value measurements, and by the potential for a loss of comparability as a result of different methodologies, different inputs, etc., in the determination of the fair value of instruments for which observable market data does not exist.

In EEI's view, it is critical for the Board to reassess the applicability and relevance of fair value accounting. Applying fair value measurement to transactions and contracts for which another attribute is more relevant produces one of two undesirable results: either fair value accounting standards must be complicated to provide exceptions that are necessary in order to provide practical accounting results that are useful to investors; or, if such exceptions are not provided or specific transactions do not qualify for the exceptions, financial statement preparers must make added disclosures (for example, in quarterly earnings presentations) in an attempt to provide investors the information they need to adjust fair value reporting to a basis that they find more useful.

EEI appreciates the opportunity to respond to the proposed Statement. We hope that our comments will be helpful and look forward to working with the Board in the future.

Sincerely,

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David K. Owens Executive Vice President Business Operations

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