

Director of Technical Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856-5116

Letter of Comment No: 27
File Reference: 1100-163
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July 1, 2002

Ladies and Gentlemen:

Re: File Reference No. 1100-163

We appreciate the opportunity to provide formal comments to the Board and staff with respect to the exposure draft issued May 1, 2002, entitled "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." Given the recent general crisis of confidence in our capital markets and the specific concerns of investors in the merchant energy sector, we believe that now, more than ever, corporate leadership must actively participate in the standard-setting process.

Scope and background

We limit our specific comments and recommendations to the proposed revisions to SFAS 133 as a result of conclusions reached by the FASB staff and cleared for release by the FASB Board in DIG Issues C10, C15 and C16, given the relevancy to our industry. Conceptually, the incorporation of these three DIG Issues into the text of the standard is an improvement, given that it will increase the visibility of the guidance and the authority within the GAAP hierarchy. However, due to the nature of the structure of a Statement of Financial Accounting Standards vis-à-vis the format of a DIG Issue, we believe that relevant insights into the practical application of paragraphs 10(b) and 58(b), as amended, will be lost.

Recommendations

Due to the complexity and broad implications of DIG Issues C10, C15 and C16, we believe that additional information included in the cleared DIG Issues should be incorporated as amendments to SFAS 133. Specifically, we believe the staff should consider the following:

 Amend Appendix B to include the three examples discussed in the response to DIG Issue C10.



Benefit

The inclusion of the examples is useful in helping constituents in diverse industries understand the correct application of the guidance. By demonstrating the correct application of the guidance, the risk of diversity of practice is reduced and the comparability of financial statements is increased.

2. Modify paragraph 58(b)(1)(b) to require that constituents consider the characteristics of a financial option for the purchase or sale of electricity, as well as a capacity contract, in the course of determining if a contract qualifies for the normal purchase or normal sale scope exception.

Benefit

The distinction between a capacity contract and a financial option for the purchase or sale of electricity is difficult to apply in practice. In practice, most 'capacity' contracts include some features of a capacity contract and other features of a financial option. By excluding consideration of the terms of a financial option, less insight is gained by constituents as to where a specific contract lies in the capacity contract-financial option spectrum. Oftentimes, constituents are better-equipped to reach a judgmental decision when black and white are contrasted. Without a comparison or consideration of the characteristics of both contract types, the risk of dissimilar conclusions increases.

3. Include in paragraph 540, the definition of the characteristics which distinguish a financial option for the purchase or sale of electricity.

Benefit

In order to reduce the risk of diversity in practice, the boundaries of the continuum of capacity contracts vs. financial options for the purchase or sale of electricity, should be delineated. With the boundaries established, practitioners are more likely to reach consensus on the accounting treatment for the population of capacity-type contracts.

Conclusion

We strongly support the Board and staff efforts to reduce the sheer volume of interrelated guidance and standards. We believe that the recommendations discussed above will significantly reduce the likelihood of discrepancies in conclusions among practitioners.

In the broader context of SFAS 133, we remain deeply concerned about the appropriateness of using mark-to-model valuation concepts, principally carried over from mature markets in the financial services industry, for certain physically delivered energy contracts where the markets are immature.



The broad mark-to-market principles embodied in SFAS 133 and EITF 98-10 enabled certain companies in the energy sector to manipulate reported revenues. Our company sells electricity in regulated and merchant markets. Often the only transactions available to us in the merchant markets are based on contracts that incorporate many "financial" characteristics. The mark-to-model accounting framework results in nonsensical changes to the income statement. If the model indicates prices improving after the transaction date, our merchant supply of electricity is more valuable, however current guidance requires that we record a loss for previously executed transactions. Investors see the decrease in earnings, but not the improved value of the remaining capacity. If the model indicates that prices have eroded since the transaction, we record a gain in reported earnings, while the inherent value of our remaining capacity is diminished by the eroding prices.

The existing markets for physically delivered energy contracts suffer from inadequate regulation/oversight to ensure uniformity and enforcement, remain under-developed (as indicated by liquidity constraints and little transparency in prices), and are limited by diversity of practice and opinion with respect to legal structures which facilitate trading. Recent events and revelations underscore the cause of our concern—results, as reported to end users, have been neither indicative, nor an accurate representation of certain energy companies' financial position. We strongly encourage the FASB to carefully consider the implications of immature or developing market structures on the guidance found in SFAS 133 and EITF 98-10.

We will continue to support the FASB in the standard-setting process and we hope to identify areas of improvement that will provide clear, concise and accurate information to investors in a timely fashion.

Respectfully,

/s/ Shirley A. Myers

Vice President, Corporate Accounting and Tax TECO Energy, Inc.