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LETTER OF COMMENT NO. 1

October 22, 2007

Mr. Russ Golden, Director
Financial Accounting Standards Board
401 Merritt 7; P.O. Box 5116 Norwalk,
Connecticut 06856-5116

Re: Phase 2 of Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment to FASB Statement No. 115*

Dear Mr. Golden:

Sequent Energy Management (Sequent), a wholly owned subsidiary of AGL Resources Inc. (AGLR), welcomes the opportunity to provide input on Phase 2 of the Fair Value Option project which will consider permitting the fair value option for certain nonfinancial assets and nonfinancial liabilities. As background, AGLR is a publicly traded energy services holding company with subsidiaries focused on Distribution Operations (natural gas LDCs), Retail Energy Operations (SouthStar), Wholesale Services (Sequent) and other energy investments and currently has a market capitalization of approximately \$3 billion. Sequent is involved in asset management and optimization, storage, transportation, producer and peaking services and wholesale marketing. Per our correspondence with Holly Barker, Project Manager:

"The Board is seeking input on what nonfinancial instruments should be included in the scope of Phase 2. Please provide details of those nonfinancial instruments and why they should be eligible for the fair value option. How would applying the fair value option to those nonfinancial instruments (a) improve financial reporting, (b) mitigate problems for reported earnings caused by the mixed-attribute model, and (c) enable an entity to simplify its accounting methods? Is fair value information readily available for those nonfinancial instruments?"

We believe offering the fair value option for certain nonfinancial instruments would result in significant benefits in, and simplification of, financial reporting.



Sequent Energy Management

The most significant advantage of this change would be the alignment of the externally reported results with the economic results that are used internally to manage the business. We manage our operations by utilizing a “daily position report” (DPR) which values financial instruments, physical inventories, and other contracts within the portfolio at fair value. Some of these transactions meet the definition of a derivative under FASB Statement No. 133, as amended, and are reflected at fair value in the external financial statements. However, other positions within the portfolio do not meet the definition of a derivative, but are managed on a fair value basis although they are externally reported on an accrual basis. For example, when we enter into a position by physically injecting natural gas into storage we lock-in the economic margin by using a NYMEX hedge consistent with the withdrawal period. Although the economic margin will remain unchanged during the period of the transaction, changes in the fair value of the hedging instrument are required to be reported in the financial statements, while the other component of the transaction (physical inventory) remains unchanged (unless a lower-of-cost-or-market (LOCOM) adjustment is required). This creates volatility in our reported results even though the economics remain unchanged. The DPR reports daily, monthly and year-to-date results on an “economic” basis and an “accounting” basis, which follows GAAP. The difference in the results demonstrates the disconnect between the accounting treatment and the actual economics of the portfolio and creates a reconciliation challenge internally, as well as difficulty in providing external transparency to the operations of the business.

We believe that the availability of a fair value option for certain nonfinancial instruments would have measurable benefits. The following are our responses to the items listed above:

What nonfinancial instruments should be included in the scope of Phase 2?

From our perspective, we would seek the inclusion of physical natural gas inventory, pipeline transportation capacity and storage capacity. The rationale for each of these items is the same; we hedge the majority of our positions with financial instruments that qualify as derivatives. The derivative instruments allow us to mitigate a particular risk and lock-in economic value, however as we are required to report the changes in the fair value of the derivatives in the financial statements without reporting changes in the underlying hedged item, the financial results show only one side of the change in fair value. This results in earnings volatility when there has actually been no change in the overall value of a given position.

How would applying the fair value option to those nonfinancial instruments improve financial reporting?

We believe that financial reporting would be improved as the reported results would be more reflective of business performance. The current

requirements introduce significant earnings volatility. We note that some entities, including Sequent, have attempted to address this issue by including additional details in their quarterly and annual SEC filings and press releases. We have included a “reconciliation” of operating margin in order to isolate the impacts of storage and transportation hedge movements, as well as LOCOM adjustments. The process attempts to isolate actual commercial activity for the period so that the reader has the ability to compare our results to prior periods without the temporary impacts of hedge movements and LOCOM. We feel that this practice is necessary to improve the reader's understanding of the results and superior to simply reporting GAAP results. However, we also believe that this procedure has the potential to undermine the integrity of the financial reporting process, and is inconsistent with the need for financial statements to be relevant, reliable and comparable.

How would applying the fair value option to those nonfinancial instruments mitigate problems for reported earnings caused by the mixed-attribute mode?

It is our position, as mentioned above, that problems with reported earnings caused by the mixed-attribute model would be mitigated. The current accounting alternatives to address the mixed-attribute model include hedge accounting and scope exceptions (e.g. normal purchases and normal sales), both provided within FASB Statement No. 133, as amended. The use of these alternatives may be either difficult or impossible to apply in certain situations. For example, physical natural gas inventory can be readily valued; however implementing an accounting hedging process is costly and introduces additional reporting risk, while at the same time may impact the ability to commercially optimize, or subsequently alter, the economics of the position as market circumstances change. Separately, the use of the normal purchases and normal sales scope exception is usually inconsistent with the energy commodity-trading business.

How would applying the fair value option to those nonfinancial instruments enable an entity to simplify its accounting methods?

We believe that accounting methods would be simplified, with a reduction in administrative workload and associated costs. As we discussed above, Sequent is internally monitored, controlled and managed on a fair value basis. To publish our GAAP results, a parallel process is employed to remove those items that do not qualify for fair value treatment. These efforts require additional resources in the back and mid offices in order to complete the accounting close, analytical reviews, and financial reporting processes.

Is fair value information readily available for those nonfinancial instruments?

As our business is focused on natural gas, we know that fair value information is readily available for the nonfinancial instruments in question, as it is used daily for calculating margin, managing the business and monitoring risk. We note that current accounting for similar financial instruments is typically done on a fair value basis. We also believe that calculating fair value for certain nonfinancial instruments would be consistent with the Fair Value Measurement initiative.

We believe that in a commodity-trading business context, a fair value option would likely be utilized continuously. However, a business in a different industry that is entering into similar instruments may choose not to elect the option, because this type of business may not be managed or reported on a fair value basis. It is possible that for a different type of business, the cost of implementing fair value reporting may exceed the associated benefits. In addition, establishing criteria that would require or preclude fair value accounting creates a responsibility for all entities involved to apply those criteria appropriately.

In summary, we fully support the inclusion of certain nonfinancial instruments within the scope of a fair value option. We appreciate the opportunity to comment on this topic and would welcome the opportunity to provide any additional details in the future.

Sincerely,

R. Todd Rimmer
Senior Vice President and Controller, Sequent Energy Management