

100 Constellation Way,
Suite 600C
Baltimore, Maryland 21202 – 6302
410.234.5000
www.constellation.com



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Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

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Dear Board Members and FASB Staff:

Constellation Energy Group, Inc. (“Constellation Energy”) respectfully submits comments on the Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (Proposed Update). Constellation Energy is a leading supplier of energy products and services to wholesale and retail electric and natural gas customers in the United States (U.S.). In addition, we own a diversified fleet of generating units located throughout the U.S. A FORTUNE 500 company headquartered in Baltimore, Maryland, Constellation Energy had revenues of \$15.6 billion in 2009.

We support the Financial Accounting Standards Board’s (FASB) efforts to simplify the accounting for financial instruments and hedge accounting. We use financial instruments and hedging strategies extensively in conducting our business, and thus the Proposed Update will have a significant impact on our company. However, we believe the FASB and the International Accounting Standards Board (IASB) need to reach a converged solution on accounting for financial instruments and hedge accounting as the potential benefits from applying the approach proposed by the FASB will be outweighed by the cost to preparers to implement two approaches and the loss of comparability over a multi year period.

We are providing detailed comments for the following topics related to the Proposed Update:

- Dedicating the hedging relationship
- Identifying the host in multiple product contracts
- Clearly and closely related

While these topics are addressed in a comment letter submitted by the Edison Electric Institute (EEI), with which we concur, we will elaborate below on certain matters related to them. Additionally, we participated in drafting the other comments submitted by EEI as well as the comment letter submitted by the American Gas Association (AGA), and we support the recommendations communicated in those letters. In particular, in addition to the matters we address below, we strongly emphasize the comments regarding the proposed changes in the requirements for hedge effectiveness, the need to provide a substantive method for measuring an entity's own debt at amortized cost, and the need for clarifying the scope of the project. Therefore, we have not repeated EEI's and AGA's comments in our letter.

We present our specific comments below.

Dedesignating the Hedging Relationship

We strongly disagree with the Proposed Update's highly restrictive limitations on dedesignation of hedging relationships. The EEI letter contains extensive discussion regarding these proposed amendments to Accounting Standards Codification Topic 815. We fully support the EEI letter, and we reiterate EEI's recommended modifications that we believe are needed to accommodate common hedging strategies.

Constellation Energy is a competitive provider of energy-related products and services for a variety of customers. The business activities performed by Constellation Energy and other energy companies include:

- develop, own, operate and maintain electric power generating facilities;
- purchases and sales of energy, capacity, and other energy-related products and services with a variety of wholesale and retail customers, including utilities, cooperatives, and commercial, industrial, residential, and governmental customers;
- structured transactions and risk management services (including hedging the output from generating facilities and fuel costs) and trading energy and energy-related commodities;
- risk management and hedging activities for generation fleet assets; and
- natural gas exploration and production activities.

The common element in most of these business activities is that we transact in physical energy and energy-related commodities, mainly power, natural gas, and coal. Since the spot prices of power, gas, and coal can be extremely volatile, we use economic hedges to mitigate this price risk to the company. The products used to hedge the risks associated with future transactions include exchange traded derivatives, financially settling contracts based on changes in the commodity prices, and contracts for physical delivery of the products which meet the accounting definition of a derivative. Most of our economic hedges qualify for cash flow hedge accounting treatment under the provisions of Topic 815.

The Proposed Update would remove (1) the ability to dedesignate a hedging relationship, (2) the ability to modify a hedging relationship by removing a derivative, and (3) the ability to reuse derivatives in future hedging relationships. However, each of these actions is necessary in a volatile commodity price environment which encompasses the management of complex risks across a number of different businesses. By permitting these actions, the existing provisions of

ASC Topic 815 recognize valid hedging relationships that are consistent with the way companies manage their business. In affording cash flow hedge accounting for these relationships as well as changes in them over time through modification and dedesignation of hedges, the entity's financial results more faithfully present the economic effects of the risk management activities undertaken by management. This in turn enables users to assess the performance of the entity and its management compared to its assertions about risk management strategy, activity, and execution.

The EEI letter provides specific examples illustrating common applications of the existing hedge rules for dedesignation and redesignation that are typical in our industry. In order to implement hedge accounting for these transactions, entities may designate combinations of individual hedges as a single, combined hedge in accordance with Topic 815-20-25-45. Further, because of the frequency of changes in factors affecting those relationships, entities may dedesignate the entire hedge, adjust the hedge level through one or more new derivative transactions, and then redesignate the new combined hedge. While the Proposed Update appears to allow limited modification of a hedging relationship, we believe it is unclear whether the Proposed Update would continue to permit such hedging relationships to qualify for cash flow hedge accounting.

We believe that the current framework for cash flow hedge accounting, including dedesignations and redesignations, has worked well and faithfully presents the results of hedging activities consistent with an entity's risk management policy and strategy. As a result, we believe that the limitations placed by the Proposed Update on applying hedge accounting in these situations are unnecessary. Accordingly, we strongly recommend that the FASB not adopt the Proposed Update's limitations on hedge dedesignation and redesignation and instead retain the existing provisions of Topic 815.

Identifying the Host Contract

As noted in the EEI letter, there is diversity in practice in applying the embedded derivative requirements of ASC Topic 815 to certain contracts in the energy industry. While the Proposed Update addresses the accounting for financial instruments that may have an embedded derivative, it does not address the continued application of those requirements when contracts contain both a derivative and a non-derivative element. However, the existing guidance related to these provisions is more easily applicable to financial instruments, and it is unclear how to evaluate contracts for which the nonderivative element is not a financial instrument. This is particularly common in the energy industry. The nature of the physical electricity markets, transmission systems, and distribution networks is such that the production and delivery of energy involves many aspects or products in addition to energy. Those products may include capacity, various ancillary services, emissions allowances, and renewable energy credits. Energy companies often transact using contracts that combine energy with one or more of these other products or services. Many of these multiple product contracts may have components that would meet the definition of a derivative if separated and other components that are not derivatives. Although the guidance in ASC Topic 815 for determining whether bifurcation of certain elements is required would apply if the contract is determined to be a hybrid, it is unclear how to evaluate these contracts when the primary purpose of the contract relates to the derivative component or if the contract contains multiple energy products that may be sold separately.

As a result, we are aware that there is diversity in practice that essentially relates how to identify the proper unit of account for multiple element energy contracts, which in turn affects which portions of the contract are subject to various provisions of the accounting literature. The EEI comment letter describes the following three alternative views which are currently used in practice for evaluating whether and how to apply the bifurcation guidance:

1. Identify the host contract based upon factors such as the business purpose for the transaction and the relative value of the components of the contract. The host contract can be either the derivative or the nonderivative element.
2. If a contract contains both a derivative and a nonderivative element, the ‘host’ contract must always, by default, be the element of the hybrid contract that is subject to accrual accounting treatment, i.e. the nonderivative.
3. Consider whether multiple products with a contract represent separate units of accounting that should undergo an assessment as stand-alone products.

Constellation Energy believes the first and third views are most aligned with the current principles and guidance in Topic 815 as well as other literature that provides guidance in identifying the unit of account. We believe applying this view will result in the accounting for a transaction following the economics and purpose of the transaction and will be less susceptible to structuring. In contrast, we believe the second view is an arbitrary rule which can result in illogical accounting for a number of standard contracts in the energy industry.

In evaluating the proper accounting for contracts with multiple products, we considered the objectives of the accounting for derivatives and nonderivatives. We believe the following excerpts from Topic 815, the basis of conclusion for SFAS 133 (sections that were not codified), and Topic 932 illustrate these objectives:

Reference	Description	Guidance
815-10-55-7c (DIG A6)	Only fair value the derivative component	Only that portion of the requirements contract with a determinable notional amount would be accounted for as a derivative instrument
815-15-30-3 (SFAS 133, para 303)	Separate accounting for derivatives and nonderivatives	The objective is to estimate the fair value of the derivative features separately from the fair value of the nonderivative portions of the contract
SFAS 133, para 293 (not codified)	Should not be able to avoid derivative treatment by embedding	The Board considers it important that an entity not be able to avoid the recognition and measurement requirements of this Statement merely by embedding a derivative instrument in a nonderivative financial instrument or other contract.
SFAS 133, para 299 (not codified)	Should not treat nonderivatives as derivatives	The Board agreed with those respondents and decided that it was inappropriate to treat instruments that include both nonderivative and derivative components entirely as derivative instruments
SFAS 133, para 300 (not codified)	Separate accounting for derivatives and nonderivatives	Accounting for the derivative separately from the host contract also is more consistent with the objective of measuring derivative instruments at fair value and does not result in measuring derivative instruments differently simply because they are combined with other instruments.
932-330-35-1 (EITF 02-03)	Should not treat nonderivatives as derivatives	Mark-to-market accounting is precluded for energy trading contracts that are not derivatives pursuant to Topic 815.

Based on this guidance, we believe an entity's accounting for multiple element contracts (or hybrid contracts) should meet the following objectives:

- Derivatives are recognized in the financial statements at fair value unless they meet stringent requirements for alternative treatment (e.g. normal purchase normal sale),
- Nonderivatives should not be accounted for as derivatives,
- An entity should not be able to avoid fair value accounting by embedding an unrelated derivative instrument in a nonderivative instrument.

We believe that the first and third views summarized above are consistent with these objectives. Accordingly, we believe that practice would be clarified, and potential diversity reduced, if the final standard addresses how to identify the proper unit of account for contracts that contain one or more physical deliverables when some of those meet the definition of a derivative and others do not.

Clearly and Closely Related

As noted in the EEI comment letter, there is diversity in practice interpreting the 'clearly and closely related' concept in the evaluation of whether embedded derivatives must be bifurcated from a hybrid contract, with some constituents applying a qualitative assessment and others believing a mathematical calculation, e.g. a minimum correlation, is required. Constellation Energy supports the view that a qualitative assessment is appropriate for determining whether the underlying of the derivative bears a close economic relationship with the underlying of the remaining components of the bundled contract. A qualitative assessment is in line with the Board's proposal to change the reasonably effective criterion for hedge effectiveness to a qualitative approach as well as the recently enacted requirements for assessing the primary beneficiary of a variable interest entity. Accordingly, we support the EEI recommendation for the FASB to clarify this guidance.

Conclusion

Constellation Energy appreciates the opportunity to provide comments on these important issues. Hedging activities and multiple product contracts are significant to our business and we want to ensure the accounting continues to faithfully represent our risk management policy and strategy as well as the underlying economics of the transactions.

Very truly yours,

/s/ Bryan P. Wright

Vice President, Chief Accounting Officer and Controller for Constellation Energy