



December 9, 2010

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via email:

**Re: Proposed Accounting Standards Update Leases (Topic 840)  
File Reference No. 1850-100**

### **The National Rural Electric Cooperative Association**

Formed in 1942, NRECA is the national service organization for more than 900 not-for-profit rural electric utilities and public power districts that provide electric energy to approximately 42 million consumers in 47 states or 12 percent of the nation's population. Kilowatt-hour sales by rural electric cooperatives account for approximately 11 percent of all electric energy sold in the United States. NRECA members generate approximately 50 percent of the electric energy they sell and purchase the remaining 50 percent from non-NRECA members. The vast majority of NRECA members are not-for-profit, consumer-owned cooperatives which distribute electricity to consumers. NRECA's members also include approximately 66 generation and transmission ("G&T") cooperatives, which generate and transmit power to 668 of the 846 distribution cooperatives. The G&T cooperatives are owned by the distribution cooperatives they serve. Remaining distribution cooperatives receive power directly from other generation sources within the electric utility sector. Both distribution and G&T cooperatives were formed to provide reliable electric service to their member-owners at the lowest reasonable cost. All these cooperatives work together pursuant to their common public service mandate from their members, often without the type of contracts that exist between for-profit entities. Rather, many cooperatives deal with each other "all requirements contracts" which set forth the terms of service/energy sales, but not necessarily the price for such service/energy sales. For example, as between a G&T cooperative and its distribution cooperative member-owners, the price is often determined based on a "cost of service" rate, with no market price component.

Electric cooperatives own approximately 43% of the distribution lines in the U.S., reaching some of the country's most sparsely populated areas, from Alaskan fishing villages to remote dairy farms in Vermont. In an electric cooperative, unlike most electric utilities, its owners -- called "members" of the cooperative -- are also customers, who are able to vote on policy decisions, directors and stand for election to the board of directors. Because its members are customers of the cooperative, all the costs of the cooperative are directly borne by its members.

***Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?***

In our industry, we typically use long-term bilateral contracts for the purchase and sale of electricity. These contracts may have terms up to 50 years but all are long-term in nature. These contracts include take and pay contracts that obligate a distribution cooperative to purchase all of the power it needs to supply its retail patrons from a generation and transmission (G&T) cooperative or other utility. The contracts obligate the G&T to supply all the power needed by the distribution cooperative through the use of its own generating plants and/or through wholesale purchased power contracts with other utilities which may be used to supplement a G&T's own generation or when the G&T loses a generating unit due to an unexpected outage. Additionally, we have some G&Ts which do not own any generating assets but instead enter into wholesale purchased power contracts to buy power from other utilities on behalf of their distribution cooperative members.

Most of our long-term bilateral contracts do not contain prices for the sales of power, but may refer to tariffs or rate schedules which establish the price per kilowatt hour for electricity. However, these costs cannot be considered fixed since the G&T must increase or lower its rates in response to changes in the components which make up the cost of service rate it charges the distribution cooperative.

We recently became aware that these long-term bilateral contracts may be considered leases based on the Exposure Draft. We do not believe that such contracts, which do not specify any particular asset and whose term is not associated with any particular asset should constitute leases. The most obvious solution to this situation is to exclude from the scope of any new leasing standard long-term bilateral contracts for the sale of electricity (excepting unit power sales). Since the Exposure Draft contains other exclusions for certain industries, having the FASB and IASB agree to exclude such contracts for the sale of electricity would not set a new precedent.

Alternatively, we believe that the definition of a lease as contained in the Exposure Draft is too broad and should not include contracts such as the our long-term bilateral contracts for the following reasons:

- While we understand the ED suggests that assets may be implied in their use under a contract, our long-term bilateral contracts do not specify any asset or group of assets. Our G&Ts may use any mixture of their generating assets to serve the distribution cooperatives load or may supplement the use of their own assets with power purchases from other utilities.
- The criteria contained in Appendix A, B4: (e) "The entity will obtain all but an insignificant amount of the output or other utility of the asset during the term of the lease, and the price that the entity will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output. If the price that the entity will pay is contractually fixed per unit of output

or at the current market price as of the time of delivery of the output, then the entity is paying for a product or service rather than paying for the right to use the underlying asset. “As we recall, this is the identical criteria contained in EITF 01-08.

In our case, most bilateral contracts are contracts in which the price per unit of power is not embedded in the contract but is contained in a rate schedule or tariff. Additionally, the price per unit of output under these long-term bilateral contracts can vary since the formulaic rate mechanism may include variable components of costs such as fuel which are passed through to the distribution cooperative. Since these costs vary considerably, even from month – to – month, we don’t believe that the costs per unit of output can be considered to be “fixed”.

We would propose a solution to this situation by having the FASB and IASB amend the definition of a lease to exclude those contracts in which the price per unit of output is determined by reference to a rate schedule or tariff, which may not be embedded in the contract itself. Also, it would be most helpful if the term “fixed” could be understood to include a rate schedule or tariff which contained costs which were passed through in the contract as well as costs which were variable in nature such as variable operations and maintenance expense. We believe that it is not unreasonable to assume that such costs may be considered to be contractually “fixed” at the time of delivery of the output, even though such costs may contain variable components which may cause the actual cost per kilowatt hour to change from month-to-month.

### ***The Difficulty in Determining the Aggregate Cash Flows under Long-term Bilateral Contracts***

One major difficulty that electric cooperatives will encounter if forced to adopt the Exposure Draft as proposed is that in order to determine the asset for the right of use, a cooperative would have to forecast what electric sales or purchases would be over the term of the long-term bilateral contracts which could extend to 50 years. Considering the extreme variability in such key components of electric power and energy such as natural gas, coal and wholesale electric power in the “Day 2” regional transmission organization markets, and considering that a long-term forecast in our industry is considered to be 10 years, attempting to determine what the price of power will be 50 years from now is a hopeless exercise which would ensure that virtually all of our members would have different assumptions which would render their financial statements essentially unusable and all comparability would vanish. Even if one were to consider that the only costs that needed to be forecast were capital costs (as opposed to all costs), we would still be faced with attempting to forecast the cost of new generating units which may be required over the term of the contract-something which is very difficult to do. Additionally, since the term of our contacts are not associated with any specific asset, more complications could be introduced into the discounting process-for example, should we assume that the term of a contract that extends beyond the longest life of any of our generating units establishes the appropriate discount period? We do not believe that this is the result intended by the FASB or the IASB.

***The Costs Associated With the Implementation of the Exposure Draft Would Outweigh the Benefits***

Electric cooperatives would incur substantial costs to update accounting systems and train personnel to implement the Exposure Draft if it is adopted as proposed. Additionally, we currently have no systems to run the calculations required for the complex valuations and subsequent re-valuations for changes identified in later periods. Finally, for users of our financial statements which have viewed us for over 70 years as electric utilities, the dramatic change in format and disclosure information would be undoubtedly disconcerting. We believe that any new standard which would impose such dramatic change on our reported financial results would lead to significant confusion and would make our financial statements less relevant and useful to our lenders and other regulators. We believe that such radical change would undermine the efforts of the FASB and IASB to promote GAAP since, as mentioned below; we are concerned that the implementation of a new standard based on the Exposure Draft would seriously cause many, if not most, of our members to abandon GAAP to some extent.

***The Likely Result of Electric Cooperatives Having to Implement the Exposure Draft***

Unfortunately, we would not expect many of our members to agree to so drastically change their accounting. Instead, they would probably adopt a “regulatory” set of books which would be based on GAAP as it existed before the implementation date of a new standard based on the ED, or simply take a GAAP exception for lease accounting. Such an outcome would be most unfortunate, in our view.

***Conclusion***

Essentially all of our assets are debt financed. Over the past 70 years, electric cooperatives have borrowed hundreds of billions of dollars and our lenders have never asked us to determine the net present value of the stream of payments under the long-term bilateral contracts. In speaking with one lender about this issue, I was told that they would view such an accounting requirement as an impediment to their ability to determine cash flows and believe that it would significantly reduce comparability between electric cooperative financial statements. Additionally, having been in the electric business for so many years, it would be most disconcerting to find ourselves in the leasing business by virtue of an accounting pronouncement, particularly when our long-term bilateral contracts had never been considered to be leases in the past.

If you have any questions or if I may be of further assistance, please don't hesitate to call.

Kind regards

/s/Russ Wasson  
Director of Tax, Finance and Accounting Policy