September 25, 2012

Technical Director
File Reference No. 2012-200
Financial Accounting Standards Board
401 Merritt 7
Post Office Box 5116
Norwalk, CT 06856-5116

File Reference: 2012-200 Financial Instruments (Topic 825), Disclosures about Liquidity Risk and Interest Rate Risk

Dear Ms. Cosper:

The Edison Electric Institute (EEI) appreciates the opportunity to comment on the Financial Accounting Standards Board’s (FASB) Proposed Accounting Standards Update – Financial Instruments (Topic 825), Disclosures about Liquidity Risk and Interest Rate Risk. EEI is the association of United States shareholder-owned electric companies. Our members provide service to 98 percent of the ultimate customers in the shareholder-owned segment of the industry and represent approximately two-thirds of the United States electric power industry. Because our members are not financial institutions, we have limited our comments and recommendations to the proposed changes regarding liquidity risk disclosures for non-financial institutions.

We support the Board’s goal of providing users of financial statements with more decision-useful information about entity-level exposures to liquidity risk. However, we believe that the proposed ASU, as it is currently written, will not achieve this objective. Our fundamental concern is that the proposed requirements will result in duplicative and/or overlapping disclosures for public companies, which we believe detract from the clarity and transparency of financial disclosures, thereby reducing their relevance and usefulness to readers of public company financial reports.

The substantial overlap with existing liquidity disclosures indicates to us that most of the important information included in the proposal is already being included substantively in public entities’ financial reports. At the same time, virtually duplicating the volume of existing disclosures in two different sections of those reports while requiring them to be prepared under different sets of requirements impairs the usefulness and credibility of each. In our view, the minimal incremental information and perceived benefits of adding such disclosures to the footnotes decreases the usefulness of public company financial reporting. Accordingly, we do
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not believe that the proposed liquidity disclosures should be adopted for public entities that are not financial institutions.

However, if the Board decides to proceed with the issuance of an ASU, we believe a number of changes are required because the scope of the proposed disclosures is not clear and the presentation requirements could misrepresent how our members manage liquidity risk. The proposed ASU also does not sufficiently define the terms “expected financial cash flow obligations,” “expected cash flow obligations” or “off-balance-sheet obligations” that would need to be disclosed.

We note from the Basis for Conclusions that the outreach conducted in preparing the proposed ASU was limited to eight non-financial institution preparers. We do not believe this is sufficient outreach to identify the breadth of potential issues impacting non-financial entities, and in addition to the reasons we discuss below, we believe further consideration of the impacts on non-financial entities, including EEI member companies and users of their financial statements, is required before a final ASU is issued.

Our detailed comments below address certain of the proposed ASU’s questions, beginning with our most pressing concerns about duplicative and/or overlapping disclosures.

**Duplicative/Overlapping Disclosures**

**Question 22:**

Do you believe that any of the amendments in this proposed Update provide information that overlaps with the SEC’s current disclosure requirements for public companies without providing incremental information? If yes, please identify which proposed amendments you believe overlap and discuss whether you believe that the costs in implementing the potentially overlapping amendments outweigh their benefits? Please explain why.

**Response:**

We believe that there is significant overlap between the proposed liquidity disclosures and current SEC disclosure requirements and disclosures required under GAAP. We believe that the adoption of new duplicative, but not identical (and in some cases inconsistent) disclosures would decrease, rather than increase, the usefulness of financial information for users of public company financial reports.

The recent Invitation to Comment on Disclosure Framework indicates that the Board recognizes the need to improve the effectiveness of disclosures, with an additional benefit that entities may be able to reduce the volume of disclosures, particularly less meaningful ones. The proposed ASU is in conflict with this vision; it mandates consistency and comparability but, in our view,
would not improve decision-making as a result of the significant overlap with existing disclosures and the other shortcomings we discuss.

It is within Management’s Discussion and Analysis (MD&A) and the Risk Factors section of SEC filings where, using significant management judgment, all significant factors are evaluated together for their impact on liquidity risk. These factors may include, for example, projected cash from operations, increases in collateral required for non-derivative contracts with credit-contingent features, pending changes in credit facilities, the need to cover unhedged energy positions, the presumed liquidity risk of counterparties, sensitivities concerning contingent payments and capital expenditures. These relevant factors are not contemplated by the proposed ASU.

Furthermore, although the proposed disclosures are intended to provide information about the risks and uncertainties that a reporting entity might encounter in meeting its financial obligations, we believe the proposed disclosures would result in an unbalanced and potentially misleading assessment of liquidity risk, especially when an entity relies on future cash from operations to meet its future obligations. The proposed disclosure framework can be likened to the presumption that an entity effectively faces a liquidity crisis as of the balance sheet date, because probable future cash inflows are excluded from the disclosures. We do not believe that comparing expected cash outflows with existing liquidity resources results in a fair presentation of Management’s expectations regarding future cash flows. Furthermore, we believe that it would be difficult, if not impossible, to audit the disclosures satisfactorily.

Overlap with SEC Requirements
In the Basis for Conclusions, the Board noted that the identified areas of overlap relate to the qualitative disclosures about an entity’s exposures to liquidity risk and how they manage it, the information about available liquid funds, and certain information in the maturity table. We agree with that assessment and strongly believe that the liquidity risk disclosures should remain solely within the MD&A. Specifically, the proposed standard overlaps with MD&A’s required disclosures for off-balance sheet arrangements, tabular disclosure of contractual obligations and short term liquidity.

Overlap with GAAP Requirements
The proposed disclosures also overlap with other financial statement disclosure requirements; entities disclose future cash obligations for debt, leases, purchase obligations, commitments, and increases in collateral requirements for derivatives if credit-contingent features are triggered, among others, in their Notes to Financial Statements.
Results of Overlapping Disclosures
Overlapping disclosure requirements are likely to lead to:
- fragmented and inconsistent presentation of information;
- use of disparate terminology;
- additional reconciling disclosures;
- increased costs, efforts, and loss of clarity to users who need to interpret the differences between overlapping disclosures; and
- increased time, effort and cost for preparers with little or no incremental benefits to users.

Summary
Given the concerns we identified, we recommend that the FASB not adopt any new liquidity disclosure requirements for non-financial public companies. We believe that existing liquidity risk disclosure requirements for public non-financial entities are appropriate and should remain solely in the MD&A until the FASB has: 1) conducted comprehensive outreach with non-financial institutions’ preparers and users of financial statements; 2) considered the objectives of, or completed, its Disclosure Framework project and 3) worked with the SEC staff to address and minimize the potential for duplicative disclosures.

While we recommend that the FASB not adopt new liquidity disclosure requirements for public entities that are not financial institutions, we offer additional comments regarding specific aspects of the proposed ASU in the event the FASB decides to proceed with applying the proposed requirements to non-financial public companies.

Expected Maturities

Question 2:

For an entity that is not a financial institution, the proposed amendments would require a cash flow obligations table that includes the expected maturities of an entity’s obligations. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

Response:

We believe that the definition of “expected cash flow obligations” is not sufficiently clear and would create significant operational concerns, if broadly defined. We are also concerned that the proposal would restrict the disclosures to only cash flow obligations for our energy commodity positions without reflecting cash inflows associated with the management of those positions.

Definition of Expected Cash Flow Obligations
The Basis for Conclusion states FASB “believes that another important aspect of the liquidity disclosures is the requirement to present expected maturities of financial assets and financial liabilities in the maturity table.” Proposed ASU 825-10-55-5D provides an example of financial
liabilities for non-financial institutions, but it is not meant to represent all the financial liabilities that might be included. Proposed ASU 825-10-55-5D and proposed ASU 825-10-50-23M both state that the table would include “expected financial cash flow obligations” and that the table would include “off-balance-sheet obligations,” but the proposal does not sufficiently define what types of obligations should be included in the table.

Generally, we believe that there may be significant subjectivity in determining “expected cash flow obligations,” which will result in a lack of consistency among entities and increased audit difficulty. To improve the consistency in reporting, we request that the FASB provide additional guidance about the types of cash flow obligations that it would expect entities to disclose, because we have identified significant categories that may or may not be considered expected cash flow obligations. Items that could potentially be in the scope of the disclosures under the proposed definition for our members could be regulatory liabilities, contingent liabilities (either on- or off-balance sheet), committed capital expenditures, planned maintenance expenses, accrued liabilities or accounts payable, forecasted pension/OPEB payments, as well as potential environmental or guaranty obligations under which the probability of a loss is remote.

Furthermore, it is uncertain whether liabilities that may not be probable should be included in the disclosures. Entities might not include some types of contingent obligation in their internal liquidity management processes because the probability of having to make a payment is low. If these obligations with low probabilities of payment are to be included, we believe that it would be very difficult to prepare and audit such disclosures satisfactorily.

Portrayal of Energy Commodity Positions
The Basis for Conclusions states that entities that are not financial institutions generally do not have a strategic imperative to manage the maturities of assets and liabilities and often settle the liabilities with funds generated from operations. However, while we are not financial institutions, EEI member companies that have marketing operations (that is, they actively seek new customers, either wholesale or retail, and meet the customers’ energy needs with their generation and/or forward or spot wholesale purchases) manage their energy derivative portfolios using a similar asset-liability management approach that financial institutions use for their portfolios.

Additionally, these companies use both physical and financial derivatives within their energy portfolio. Although the economic effect is identical, there would be significant reporting differences under the proposed guidance. We provide two examples\(^1\) below that demonstrate our concerns.

Example 1:
Assume that a power sales contract was entered into at $50 per megawatt hour (MWh). To fulfill the sales contract, a physical fuel or power purchase derivative contract is executed at $45/MWh,

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\(^1\) For simplicity purposes, we have assumed that no margining is required for these examples. If margining was required, it would increase the complexity of application of the proposed guidance.
which locks in a gross margin of $5/MWh. If forward prices move to $52/MWh, the sales contract is a liability of $2/MWh, and the purchase derivative contract is an asset of $7/MWh.

If market prices remain unchanged at delivery, the company will receive the contractual price of $50/MWh and pay $45/MWh to buy the power under the second contract. The change in market prices had no impact on this balanced position.

- The company manages its net position; therefore, to include only the cash flows related to the purchase obligation of $45/MWh in the liquidity disclosure presents misleading data.
- If an actual liquidity crisis existed, the company would consider
  - holding both contracts until delivery,
  - settling or transferring the contracts to other entities, thereby monetizing the $5/MWh gross margin earlier (ignoring discounting issues), or
  - settling or transferring the purchase contract to another entity, thereby receiving $7/MWh earlier. Upon delivery, the entity would receive $50 from the sales contract and pay $52 in the spot market. This third alternative would accelerate cash inflows and delay cash outflows for as long as possible.
- In all cases, the company’s liquidity is improved, not reduced, because of its risk management activities.

Example 2:
Assume that a power sales contract was entered into at $50/MWh. The physical fuel or power to fulfill the sales contract will be purchased in the spot market, but the company executes a financial swap for fuel or power that locks in an effective purchase price of $45/MWh, resulting in a gross margin of $5/MWh.

Again, if forward prices move to $52/MWh, the sales contract is a liability of $2/MWh, and the financial swap is an asset of $7/MWh. If market prices remain unchanged at delivery, the company will receive $50/MWh, pay $52/MWh to buy the power in the spot market, and receive $7/MWh to settle the financial swap, thereby achieving the $5/MWh gross margin.

- Under the proposed disclosures, the liability from the physical sales contract will not be included in the cash flows obligations table, because it requires no cash outflow.
- The asset from the financial swap is not included in the proposed disclosures, because the company does not have, as of the balance sheet date, a contractual obligation to purchase power, despite the need for a future purchase to avoid default.
- However, if the company considers the net position of its cash flow obligations, it would include the expected spot purchase in assessing its cash obligations, resulting in the same alternatives discussed in Example 1.

In contrast to the proposed ASU, in MD&A, physical purchase obligations that meet the definition of a derivative are reported at their contractual cash outflows. As noted, it is likely that entities have offsetting sales positions that effectively lock in a gross margin. This net increase in cash from operations is incorporated into the overall discussion of liquidity risk within the MD&A but, as the examples demonstrate, is not contemplated in the proposed ASU’s disclosures and would be a significant difference from the liquidity risk discussion in the
MD&A. Furthermore, the entity that has not yet covered a short physical position appears to be less risky than an entity that has covered its position, when in fact the opposite may be more accurate.

These proposed requirements also are not consistent with the principles underlying the right of setoff permitted in the balance sheet under GAAP. This guidance recognizes the legal ability to net cash payments under certain circumstances. ASU 210-10-45 provides criteria for offsetting amounts related to certain contracts when a right of setoff exists. Also, ASU 210-20-45 gives entities the right to offset fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from derivative instrument(s) recognized at fair value executed with the same counterparty under a master netting arrangement. In an actual distressed liquidity situation, these rights are likely to come into play and be exercised, if necessary.

To be consistent with the existing balance sheet guidance and to facilitate comparability of disclosures, we strongly recommend that the table of expected cash obligations should be presented using the following parameters:

- Contractual payment obligations associated with commodity contracts should include both asset and liability derivatives if the company uses an asset-liability management approach to managing liquidity risk.
- Contractual payment obligations should be presented net of cash flows and collateral associated with transactions executed under master agreements. Such arrangements are executed precisely to manage cash flow risk that flows directly from credit and market risk management and should be included in the table.
- Contractual payment obligations associated with derivative contracts should be based on the fair value of cash flows rather than the notional cash flows (i.e., consistent with the balance sheet valuation for derivative contracts), which will incorporate net cash flows as well as future spot market transactions that are necessary to avoid default (see Example 2, above).

These parameters would lessen, but not eliminate, the exclusion of projected cash from operations from any inferred liquidity gaps.

**Question 3:**

The proposed amendments would require information about expected maturities for financial assets and financial liabilities to highlight liquidity risk. *Expected maturity* is the expected settlement of the instrument resulting from contractual terms (for example, call dates, put dates, maturity dates, and prepayment expectations) rather than an entity’s expected timing of the sale or transfer of the instrument. Do you agree that the term *expected maturity* is more meaningful than the term *contractual maturity* in the context of the proposed liquidity risk disclosures? If not, please explain the reasons to suggest an alternative approach.
Response:

We do not agree that the term *expected maturity* is more meaningful than the term *contractual maturity* in the context of the proposed liquidity risk disclosures, without additional clarification and definition. In addition, if not clearly defined otherwise, we are concerned that requiring disclosure of expected maturities could result in requiring disclosure of proprietary and potentially harmful information. For example, if an entity intended to repurchase certain of its debt, disclosure of such expected repurchase could negatively affect the opportunity to execute the repurchase.

Accordingly, we believe that any final standard needs additional clarity, and we suggest consideration of the following:

- Earliest:
  - Only certain acceleration of contractual payments should be included. In a liquidity crisis, it is likely that a contractual maturity date may be accelerated through the rights of the counterparty, but it is not likely that it would be accelerated by a company facing a liquidity crisis. Thus, written puts and calls that can be expected to accelerate cash flows would be shown at the earliest possible date.
  - Prepayment expectations that would accelerate the timing of the contractual cash flows only if the prepayment was announced; otherwise, a company in a liquidity crisis would be unlikely to accelerate payments for which later timing is permitted by contract.

- Contractually required:
  - The energy industry is expected to incur billions of dollars in capital expenditures over the next five years to replace aging transmission and distribution infrastructure, comply with environmental regulations, and replace retiring generating stations. Some of the expenditures involve contractual arrangements already in place, some are explicitly mandated by regulators, and others are necessary to maintain ongoing operational performance and effectiveness but are not required by regulators.
  - These planned costs are currently included in projected capital expenditures within the MD&A; however, the proposed ASU limits the disclosures to those cash outflows from contractual obligations but does not include regulatory commitments. We believe that regulatory commitments that have not been formalized through the execution of contractual obligations would not be included in the cash flow obligations table.
  - Similarly, only legally required contributions to pension plans would be included in the cash flow obligation table, which may differ from other disclosures that reflect an entity’s current financial condition.
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- Unconditional:
  - The proposed ASU states that the term *expected maturity* refers to the expected settlement of the instrument resulting from contractual terms (for example, call dates, put dates, maturity dates, and prepayment expectations); this definition implies an acceleration of the timing of cash flows, not a change in the cash flows. However, it is unclear whether the Board intended to define “expected” cash flows as changes in amounts paid as well as changes in the timing.
  - The energy industry has several examples of contingent transactions. The payments are non-discretionary but the amounts are unknown.
    - For example, a contract to purchase all the output of a wind farm (a power generating plant involving multiple individual wind-blown turbines) for a fixed price per actual MWh generated has a contractual minimum of zero, because the wind may not blow.
    - Similarly, a contract to purchase all the gas needed to run a plant also has a contractual minimum of zero because the plant may not operate.
    - Although projected cash flows may be inconsistent with other disclosures, “expected” cash flows could include the projected minimum cash flows, rather than zero.

We recommend that Board expand the guidance for “expected” cash flows to address the acceleration of cash flows only if the decision rests with the counterparty, whether contractual terms includes commitments to regulatory agencies and the preferred approach for contingent, non-discretionary payments.

High Quality Liquid Assets

Question 4:

The proposed amendments would require a quantitative disclosure of an entity’s available liquid funds, as discussed in paragraphs 825-10-50-23S through 50-23V. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

Response:

We believe that it is important for the final guidance to include a clear, operational definition of “high quality liquid assets” in order to ensure consistency across reporting entities to the greatest extent possible. We question the exclusion of cash flow from operations as a source of liquid funds as it is typically included as part of the assessment of liquidity risk as it relates to obligations that only require settlement in the future.

We note the description of “high-quality liquid assets” as being “free from restrictions and readily convertible to cash” (per Proposed ASU 825-10-50-23T). In addition, “high quality
generally refers to the level of nonperformance risk associated with fixed income financial instruments” (per Proposed ASU 825-10-50-23V). It is possible that certain assets presented as noncurrent could be included with appropriate footnote clarification of the application where such assets could become current and highly liquid.

In addition, the guidance should specifically discuss the inclusion or exclusion of financially or physically settled commodity derivatives. On the one hand, the fair value of derivatives can fluctuate rather quickly and dramatically with fluctuations in the price of the underlying (including changing from an asset to a liability); as such, it is possible that an asset at the close of a quarter could be a liability by the time the financial statements are filed, or vice versa. On the other hand, if only liabilities are measured as of quarter close (see our response to Question 2), the definition of “high-quality liquid assets” should include current and non-current derivative assets, which could be sold to increase cash.

We further believe it would be helpful for the final ASU to include examples of common types or categories of assets that the FASB believes should or should not be considered highly liquid for purposes of this disclosure. For example, following are common items that we believe it would be helpful to clarify, our assessment of whether or not they should be included or excluded from high quality liquid funds, and the reason:

<table>
<thead>
<tr>
<th>Asset</th>
<th>Included?</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets not included in the Current Asset section of the balance sheet</td>
<td>Yes, for any “high quality liquid” financial instrument that qualifies as if it were a current asset.</td>
<td>Since the table of financial obligations includes obligations which are not current, then financial instruments which are non-current should be included. In addition, as long as the financial instrument is readily convertible to cash and unencumbered, it would qualify.</td>
</tr>
<tr>
<td>Available for sale and trading securities</td>
<td>Yes</td>
<td>Consistent with the measurement of such securities at fair value</td>
</tr>
<tr>
<td>Held to maturity securities</td>
<td>Yes</td>
<td>In a liquidity crisis, liquid securities would be used to help an entity survive, regardless of accounting consequences</td>
</tr>
<tr>
<td>Collateral posted to satisfy credit requirements</td>
<td>Yes, to the extent that the host contract is included in the table of contractual obligations.</td>
<td>Reflect net liquidity claim or availability. <em>Note:</em> Our recommendation, however, is that the table of contractual obligations reflect liabilities, net of collateral posted</td>
</tr>
</tbody>
</table>
We also recommend that restricted available funds be included in available liquid funds to the extent that they are restricted to cover the cash flows of obligations in the cash flow obligation table. This would ensure that the liquid funds table is portraying the relevant availability of funds to offset related obligations. Footnotes to the table can be used to clarify potential tax, etc. implications of using those funds for other than their designated purpose.

Understanding of Liquidity Risk

Question 6:

As a preparer, do you feel that the proposed amendments would provide sufficient information for users of your financial statements to develop an understanding of your entity’s exposure to liquidity risk? If not, what other information would better achieve this objective?

Response:

For the reasons discussed in this letter, we do not believe the proposed amendments provide additional insights into an entity’s exposure to liquidity risk and in fact may cause confusion by increasing the volume of disclosures with overlapping, but different, metrics. Again, we urge the FASB to conduct comprehensive outreach with preparers and users of financial statements of non-financial institutions and to work with the SEC staff to address and minimize the potential for duplicative disclosures.
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Beside the other concerns discussed in this letter, we call your attention to two other issues:

*Timing of derivative cash flows*

Proposed ASU 825-10-55-5A(e) states: “For derivatives, expected maturity does not necessarily relate to the timing of expected cash flows. For example, the fair value of a five-year interest rate swap should not be allocated across the five years that cash flows are expected to be paid or received. However, the fair value of the swap should be shown in the time interval that corresponds with the financial instrument’s contractual maturity.” This statement seems to indicate that all periodic cash flows required throughout the life of a derivative be aggregated and shown at the final maturity date.

This approach does not accurately reflect the timing of actual cash flows, which is important to presenting liquidity requirements accurately. In the energy industry, it is common to have multi-year contracts that effectively represent a series of monthly contracts with monthly cash settlements. We believe that the proposed presentation will distort liquidity risk. We request that the Board modify the requirements for presentation of a derivative’s expected maturity in the table of expected cash flow obligations to reflect the actual contractual timing of the cash flows that would be required.

*Disconnect between expected cash flow obligations and available liquid funds*

Liquidity risk must be managed in addition to market, credit and other risks. Because of its tendency to compound other risks, it can be misleading to attempt to isolate liquidity risk. However, the proposed disclosures do just that by guiding readers to evaluate an entity’s expected cash flow obligations for five or more years against the entity’s available liquid funds as of the date of the financial statements. Entities that have reduced or eliminated market risk and balanced their portfolios would appear riskier than others that remain exposed to market risk. Furthermore, in later time periods, the exclusion of projected cash from operations and other probable cash inflows (such as replacing maturing debt with a new issuance) exacerbates the disconnect between expected cash flow obligations and currently available liquid funds.

We recommend that, for nonfinancial institutions, the disclosures be required only for the next 24 months beyond the balance sheet date. We believe that liquidity risk during this time frame is most relevant, since liquidity risk by nature reflects the entity’s ability to meet obligations within a specified, near-term time constraint; beyond that time frame, the implied liquidity risk is not necessarily accurate and instead reflects a potential lack of comparability of currently available liquid funds versus all future obligations. We also believe that annual, instead of quarterly, obligations is appropriate and sufficient. Omitting quarterly amounts would reduce costs and deemphasize short-term, micro analysis.
Implementation Date

Question 21:

Although the proposed amendments do not have an effective date, the Board intends to address the needs of users of financial statements for more information about liquidity risk and interest rate risk. Therefore, the Board will strive to make these proposed amendments effective on a timely basis. How much time do you think stakeholders would require to prepare for and implement the amendments in this proposed Update? Should nonpublic entities be provided with a delayed effective date? If so, how long of a delay should be permitted and why? Are there specific amendments that would require more time to implement than others? If so, please identify which ones and explain why.

Response:

While the information needed for most of the disclosures may be generally available in planning or other records, if such proposed disclosures are required in the notes to the financial statements, we recommend that the Board provide at least a one-year implementation time frame to allow companies to develop new processes, identify and document new controls, update systems as needed, create new XBRL tags and provide time for auditing.

Conclusion

For the reasons discussed above, we believe users (as well as preparers, auditors and others) would be best served by including this project (as it applies to non-financial institutions that are public companies) in the FASB’s disclosure framework project and coordinating with the SEC consolidated disclosures around liquidity risk. We also believe such disclosures are best suited for MD&A where appropriate management discussion can be provided.

We appreciate your consideration of this topic and our comments. We would be pleased to discuss the impact on our industry with you and to provide any additional information that you may find helpful in addressing this issue.

Very truly yours,

Richard F. McMahon, Jr.