March 12, 2012

Technical Director
File Reference: 2011-230
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Ms. Cosper:

File Reference: 2011-230 - Revenue Recognition (Topic 605) Revenue from Contracts with Customers

The Edison Electric Institute (EEI) respectfully submits our comments on the Financial Accounting Standards Board (FASB or the Board) Proposed Accounting Standards Update—Revenue Recognition (Topic 605) Revenue from Contracts with Customers (the ED). EEI is the association of United States shareholder-owned electric companies. Our members provide service to 95 percent of the ultimate customers in the shareholder-owned segment of the industry, and represent approximately 70 percent of the United States electric power industry.

EEI appreciates the FASB and International Accounting Standards Board (collectively the Boards) considering our comment letter dated October 22, 2010 on the initial exposure draft, and we note that the ED addressed certain of our concerns, such as the classification of credit risk and the retention of the guidance for alternative revenue programs currently included in ASC 980 - Regulated Operations. As we support the changes related to credit risk and alternative revenue programs, we have no further comments on those areas. Therefore, we have limited our comments and responses to questions for which we have specific concerns and items for which we either request clarification, make recommendations, or wish to convey our support.

EEI appreciates the Boards seeking to develop a converged standard on revenue recognition related to contracts with customers. We noted that this ED would supersede most current revenue recognition guidance; thereby also eliminating the guidance related to revenue-generating transactions that do not involve a contract with a customer. Therefore, we recommend the Boards clarify their intent with respect to what literature will govern revenue recognition for transactions without a contract.

While the questions and concerns discussed below include specific comments from our industry’s perspective, the underlying issues will be applicable broadly to many other industries, such as those that continuously deliver the same product over forward delivery periods, have month-to-month services that can be cancelled at any time by the customer, and/or have pricing based on a forward market price. Examples of industries that we believe are likely to be affected
include the telecommunication, gas, coal, steel, metal and agriculture industries. We appreciate your consideration of our comments in response to the underlying issues that have a significant impact across industries.

Executive Summary

Highlights of our comments are summarized as follows:

- We seek clarification on the identification of a ‘distinct’ performance obligation, transaction price allocation, measurement of revenue, contract modifications, contracts with multiple products (i.e., a single contract that incorporates bundled products), and identification of a contract.
- We support the practical expedient provision of the ED to account for two or more goods or services as a single performance obligation if they have the same pattern of transfer to the customer. We believe that contracts for the sale of most energy commodities exhibit this characteristic due to repetitive deliveries of the same product (e.g., electricity or power). We strongly believe that the resulting use of the contract price for recognizing revenue is most consistent with the ED’s core principle and is supported by application of the practical expedient.
- We disagree with the proposals related to onerous performance obligations.
- We believe the proposed disclosures of the remaining and expected timing of satisfaction of performance obligations could be misleading, misinterpreted by users, and potentially create confusion with other financial information provided to investors.

We provide our detailed comments below.

Identification and Satisfaction of Performance Obligations (Question 1 in the ED)

As background, long term physical energy contracts often involve the obligation to continuously deliver a fungible, homogeneous product (electricity or power) to customers over multiple forward delivery periods. These delivery periods are commonly defined in terms of months for forward pricing, contractual terms, and billing purposes. In many cases, the obligation to physically deliver power is accompanied by the obligation to provide additional products such as ancillary services, capacity, and in the case of renewable energy arrangements, renewable energy certificates (RECs). Many of these items can typically be bought and sold separately in North American power markets and are usually provided to the customer simultaneously with the delivery of power. Therefore, one may analyze the various performance obligations in a long-term physical energy contract under both a “vertical” view (i.e., obligations to deliver the various products each delivery period) and a “horizontal” view (provide the separate products such as energy, capacity, RECs, etc. over multiple delivery periods).

Given this background, particularly the ready availability to buy or sell the above items separately in their related markets, we believe that the obligations to deliver power and each related product in each forward delivery period (month) represent separate and distinct performance obligations in accordance with paragraph 28 of the ED. While there is an ability to
obtain extremely granular data on certain commodities (e.g., each kWh delivered in 15-minute intervals), the cost and effort of accounting for these products at this level does not provide any incremental benefit and does not, in our view, change the pattern of revenue recognition. Therefore, we suggest adding practical expedient clarifications to indicate that conventional market pricing and billing practices may also be considered in identifying performance obligations on a forward-looking basis.

We also believe that the individual increments of energy-related commodities delivered to the customer meet the criteria in paragraph 37 of the ED for satisfaction of the performance obligations as of a point in time. This is demonstrated by the fact that utility meters track each individual kWh delivered to the customer at each point in time. For example, when a business operates a manufacturing assembly line, power is instantly transferred to, and immediately consumed by, the customer in the production of their goods. Along with electric energy, other products such as capacity and ancillaries are also delivered to, and consumed by, the customer. Title to, and physical possession of, these commodities are transferred to the customer upon receipt. The provider of these energy-related commodities has a present right to receive payment for these products upon delivery to the customer independent of any future deliveries, and all of these products are included on the customer’s bill. Finally, because the customer immediately consumes the power upon delivery, the customer has inherently accepted the asset and assumed the risks and rewards of ownership. The delivery of energy commodities (e.g., power, gas, capacity, etc.) does not create or enhance an asset over time and it creates an asset with an alternative use to the seller because power could be sold in the spot market to another customer; thus, the sale of energy commodities do not appear to meet the criteria in paragraph 35 of a single performance obligation satisfied over time. As the examples of identification and satisfaction of performance obligations currently in the ED relate to the delivery of different products, we request that the Boards provide an example related to the continuous delivery of the same product over multiple forward delivery periods in order to confirm our interpretation and ensure consistency in financial reporting. For instance, we would appreciate an example that clarifies that an annual contract to deliver electricity has several distinct performance obligations satisfied at various points in time, rather than one performance obligation that is satisfied continuously over time.

Given our view that energy commodities are transferred at points in time, we strongly support the ability to apply the practical expedient included in paragraph 30 of the ED that permits an entity to account for products together (even if they are not considered a single performance obligation) if they have the same pattern of transfer to the customer. For example, two services could be accounted for as a single performance obligation if applying one method of measuring progress would faithfully depict the pattern of transfer of the two services to the customer. In particular, this provision will simplify the accounting for many types of energy contracts while maintaining transparent financial reporting. The objective when measuring progress, as stated in paragraph 38, is to “depict the transfer of control of goods...to the customer – that is, to depict an entity’s performance.” This objective is clearly met as each delivery of the commodity occurs. Paragraph 41 indicates that an output method of measuring progress may be the “most faithful depiction of the entity’s performance,” and we believe this is also true for deliveries of commodities. Paragraph 42 goes on to indicate, with a similar example, that “if an entity has a
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right to invoice a customer in an amount that corresponds directly with the value to the customer of the entity’s performance completed to date ...[which the paragraph appears to indicate could be] a fixed amount for each hour of service [or goods] provided, the entity shall recognize revenue in the amount to which the entity has a right to invoice.” This is also true for our industry’s contracts. The existence of specific damages or nonperformance clauses reinforces that this is the expectation of both buyer and seller in many of our contracts – when such clauses provide a formula for calculating damages, it generally measures them by reference to the contract price, strongly indicating that both parties assigned the contract price to each unit to be delivered as the measure of its value. The forward curve in effect at the inception of the contract has no bearing on the calculation of damages in a default scenario. Rather, the calculation of the amount that either party is entitled to seek when the other defaults makes reference to the contract price (not the inception forward curve) because the contract price is the value that each party assigned to each unit to be delivered under the contract.

While output (units delivered) is most indicative of performance in our contracts, even the concepts in the input methods paragraphs of the ED support our view. As we discuss more fully below, we often hedge our margins (revenue less power or fuel purchase costs). Thus, the economics of our business and how we operate are measured on and designed to lock in the relationship between cost and revenue. Consistent with the input methods of measuring progress, this characteristic of our industry further supports the use of the contract price as the measure of revenue for performance under our contracts.

In addition, we believe that the core principle of the ED articulated in paragraphs 3 and 70 should take precedent in interpreting and applying some of the more detailed aspects of the ED, including the concept of “the value to the customer” as noted in paragraph 42 related to the output method. We found it helpful that the staff clarified that value to the customer is not intended to mean fair value or standalone selling price during the FASB and IASB joint webcast addressing frequently asked questions about the ED on February 29, 2012. We agree that the concept of value to the customer should not be interpreted to require an assessment of the potential for changes in the standalone selling price of the product in the future. Virtually every product is subject to pricing changes over time, and a key part of the value proposition to a customer from a fixed price contract is to eliminate the risk of those changes. Thus, even for a long-term contract, the buyer has determined that it is willing to accept the possibility that it may pay a price higher than it would otherwise pay if prices were lower in the future in order to assure that it won’t pay a higher price if prices increase. Subsequent changes in prices of the good or service may result in a positive or negative fair value of the contract, but they do not affect the value of the contracted good or service. The ED governs revenue recognition for the sale of products and should not juxtapose a fair value concept in evaluating the value of the good or service. The fact that the customer has locked in a historical price is a key portion of the value of the product or service being delivered. Accordingly, we believe it is important for the final standard to clarify that the core principle would take priority in the interpretation of these provisions and that the value to the customer of the goods or services is not the same as the fair value of the contract.
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Transaction Price Allocation

Consistent with the ED’s core principle, paragraph 50 of the ED states that the transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services (i.e., performance obligations) to a customer (emphasis added). Further, paragraph 70 states that an entity shall allocate the transaction price to each separate performance obligation in a similar manner (i.e., in an amount that depicts the amount of consideration to which the entity expects to be entitled for each separate performance obligation, emphasis added). Paragraphs 71 and 72 state that entities shall allocate consideration to each separate performance obligation based on the relative standalone selling price of each underlying good or service and that contractually stated prices may, but shall not be presumed to, represent the standalone selling prices.

We believe that for contracts with multiple performance obligations for the same product delivered separately over time (hereinafter referred to as “delivery months”), revenue recognition based on the contract price is consistent with the core principle and the defined transaction price in the ED (also consistent with current GAAP). Allocating a standalone selling price based on something other than the contract price to each such obligation will not represent the amount to which the entity expects to be entitled to receive for that specific contract and will be inconsistent with the economic substance of the underlying transaction. As discussed further below, we also believe that recognizing revenue based on the forward curve at contract inception will: 1) distort operating margins, 2) not be useful to investors, 3) reduce comparability between similar market participants, 4) result in unduly burdensome operational requirements, 5) reflect revenues that are not consistent with the economics of our contracts, and 6) in certain cases lead to entirely different revenue patterns depending on the use of alternative accounting elections. Therefore, in order to help assure that the core principle is applied to energy contracts in a consistent and representationally faithful fashion, we recommend that the Boards clarify and/or provide an example to indicate that the contract price for a contract with multiple deliveries of the same product over future periods reflects the standalone selling price to be allocated to each of those deliveries.

Before elaborating on specific supporting views, it may be helpful to provide background information on how commodities are generally priced. Pricing for energy contracts (and commodity contracts in general) is primarily determined by reference to the company specific forward market prices for the commodity at the date of execution. It is important to note that there is not always an observable market for a given commodity instrument or “contract”, unlike traditional financial products which are quoted or priced at the instrument level (e.g., one contract to sell a commodity monthly for 12 months would be priced at the average of the monthly forward curve prices for the year, which is not the same price that 12 different contracts to sell the same commodity one month at a time over the next year would receive). Instead, the market for commodity contracts references the underlying commodity (asset or good) itself. While influenced by many factors, a given commodity’s price is typically referenced to a specific delivery location or region and varies by forward delivery period (typically monthly in the forward markets) in reflection of its seasonal supply and demand characteristics. For these reasons, a commodity’s market price for future delivery periods, in absence of a long-term contract, is also typically referred to as the “forward curve” for that commodity. In near term
forward periods with sufficient liquidity, the curve is quoted as granularly as monthly as supply and demand needs are more visible. As the time horizon increases and liquidity diminishes, quotes will be limited to longer periods of quarters, seasons (summer or winter strips), and finally in calendar (12 month) strips.

Fixed (Strip) Priced Commodity Contracts
Energy companies frequently provide customers with fixed pricing for their energy commodity needs over their respective forward contract term to benefit from certainty in cash flows. Such fixed pricing is based on the forward curve at the date of execution as discussed above. The curve, multiplied by the stated or estimated volumes in each respective forward delivery period, is then divided by total contract volumes in order to derive the fixed price for each unit. Therefore, the amount of total consideration to which the entity is expected to be entitled under the contract is the price curve of the underlying commodity times total expected volumes in each delivery month (i.e., the standalone selling price of the entire contract, were it to be priced as a traditional financial instrument). Further, the amount of consideration the entity is expected to be entitled to receive is clearly the legally fixed contract price. For example, in the event of a contract termination, we are only entitled to receive payment based on the contract price and have no exposure for the difference compared to the forward curve. However, on a delivery month basis, the fixed contract price will almost never be equivalent to the forward curve of each such forward obligation. We offer the following observations in support of our views as mentioned above:

Impact on Margins & the Investor’s View
We are concerned about the impact that allocating pricing based on the forward curve will have on our operating margins. Our investors are most interested in the gross margins that a given contract and related cash flows will provide (e.g., total cash received less hedges and other costs) and are not concerned about the shape of the forward curve. As mentioned above, differing strategies are commonly used to fulfill or economically hedge energy sales contracts, whether by supplying from owned generation, inventory (in the case of gas and storable commodities), offsetting forward market purchases, or otherwise. However, what is common to each strategy is that economically, our margins have been locked in under the contractual arrangements. This aligns our revenue, margins, and cash flows and results in reporting results that are consistent with the economics of our businesses and operations.

Given that electricity cannot be stored, the most prevalent economic hedging strategies are to serve the contracts either from generation or from an offsetting market purchase. In the latter case, an entity enters into contracts for both the sale and purchase of the electricity (as well as other commodities) which we believe should be accounted for consistently whether an entity is the buyer or seller. Once an entity has fixed the price of its sales contract it will concurrently execute an offsetting forward market purchase in the wholesale market for roughly (if not exactly) equivalent volumes. The periodic expense of the offsetting fixed price purchase (also based on the forward curve at execution) will be recognized at the fixed price. Therefore, to recognize the individual monthly revenues from the sales contract(s) based on the forward curve price at execution will not only provide asymmetrical margins that are not reflective of either the contractually locked-in margin or the combined strategy’s economics, but in periods where the curve price is below the fixed (average) sales price this may actually result in negative margins.
as well as volatile margins on a quarterly basis due to the seasonal nature of our business. We do not believe the earnings asymmetry that will result from applying the forward curve allocation model is appropriate given the fixed margin and cash flows that the contract will ultimately produce. This same principle will hold true for electricity sales served from generation, where the cost to generate electricity is fixed based primarily on a combination of the plant’s fixed heat-rate (an efficiency measure expressed in units of fuel required to produce one unit of electricity) plus a contracted fuel commodity purchase cost. In addition, it will result in asymmetric accounting by the seller versus the buyer if the seller recognizes revenue allocated based on a forward curve while the buyer recognizes costs based upon the contract price. While not determinative, we believe this is an additional consideration that calls into question the relevance and representational faithfulness of using something other than the contract price to record revenue.

**Lack of Comparability & Operational Concerns**

As noted above, the market price for a given commodity is directly tied to its respective location and delivery period, among other related factors. However, the forward curve for a given commodity is likely to vary among market participants. While the commodities markets (particularly energy) have indeed developed over time and, in general, increased in liquidity, there is often still a high degree of judgment involved in developing an estimate of the forward curve for a given product and location. Different locations are traded more actively than others (influenced mostly by availability of supply and demand), as are particular commodities and grades thereof. Power pricing is also influenced by and sold in peak and off-peak products. For most commodities, liquidity tends to decline further out on the time horizon. Therefore, beyond a given tenor for even the most commonly traded wholesale locations, and assuming at least fundamental similarities in curve seasonality or “shape”, different market participants’ estimate of the same forward price curve will tend to diverge as the time horizon increases and modeled values therefore replace the availability of external quotes. As an example, the availability of price quotes for most actively traded power hubs in North America tends to decline 1.5 to 3 years out on the curve, although it is common for many of our members to lock in energy sales for periods of 5 to 7 years (or even up to 30 years in the case of structured products or generation offtake agreements). In addition, many of the physical sales contracts have been assessed under ASC 815 - *Derivatives and Hedging* and do not meet the requirements to be considered a derivative due to an illiquid market; therefore, it does not seem appropriate to recognize revenue based on a forward market curve. We believe there is a fundamental difference between a fixed contract price for a commodity under a long-term contract and the forward curve projected market price for the commodity. In our view, the former represents the “stand-alone selling price” for the commodity for the given quantity and given term of the contract, while the latter represents the estimated market price for the commodity in absence of a long-term contract. Interjecting the forward curve price for a commodity into the allocation of the transaction price in a long-term commodity contract would result in undue complexity and earnings asymmetry as discussed above.

Further, a given utility may have hundreds or even thousands of individual sales contracts at numerous locations. In addition, a contract may contain several different products, such as electricity, gas, RECs, ancillary services, etc. When one considers the various contract tenors a given utility typically offers, it is quite possible that a single enterprise could (under a forward
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price allocation and recognition construct) be required to allocate and track the prices and related revenue recognition of millions of individual performance obligations. Such a requirement would necessitate substantial process and systems enhancements in an environment where no such solution currently exists. We do not believe that the potential benefits to financial statement users (as discussed in the preceding section) justify the cost of recognizing revenue based on a forward curve. When we compound these operational constraints by the number of publicly traded utilities and their individually constructed commodity curves, and the potential for comparability to suffer is dramatically increased.

We believe that recording revenue based on the contract price is appropriate even if it results in a different pattern of revenue recognition for a single contract as compared to separate contracts for that same period (for example, a single contract with a two year term versus two, one-year contracts for the same quantity and time period). In other words, we believe that there are fundamental reasons why the pattern of revenue recognized should, in fact, differ depending on the specific and unique characteristics of each contract. This is consistent with, and supported by the portion of paragraph 72 indicating that the best evidence of the standalone selling price is the observable price of a good that the entity sells “separately in similar circumstances to similar customers.” The term, delivery periods, and quantities of term contracts versus single delivery or spot contracts are unique and different circumstances that result in a different price. A key consideration is that the risk profile on a two-year contract can be quite different than that of two one-year contracts. For example, if contracts are structured separately, a counterparty can default on one contract and not the other. The liquidated damages provisions would reference the contract price to determine the settlement amount which is different for each deal. Also, assuming the transactions are hedged, there would be constant margins in both deal structures (i.e., one two-year deal or two one-year deals) which provide transparency and comparability for investors. If transactions are executed at different times, the contract prices would appropriately reflect the view of market prices at the various times of execution. Also, one may structure a transaction as two separate contracts in order to reflect that one portion represents a hedge of an existing position whereas the other contract may be more speculative in nature. The ability to account for these separately allows entities to provide the most transparent view of the intent of the transaction. Absent indicators that a transaction was specifically structured to achieve a certain accounting result, we believe that revenue should be recognized at the contract price in order to clearly reflect the fundamental characteristics unique to the specific contract. Consistent with paragraph 72, we believe that a fixed contract price for a term contract represents the standalone selling price for those specific circumstances, and we recommend that the final standard provide examples of what constitutes “similar circumstances” and what would not be considered similar for purposes of identifying the standalone selling price, particularly if a forward curve exists for some period of time.

_Differing Accounting for the Same Contract_

Many of our members avail themselves of accounting elections afforded under derivative accounting guidance, which often apply to forward commodity contracts (assuming they are not scoped in to higher authoritative literature such as lease or consolidation guidance). For example, many entities make the normal purchase normal sale (“NPNS”) and/or hedge accounting elections in order to better match their accounting results to the economics of the combined sale and service strategy. For sales contracts elected as NPNS, the ED would apply. Alternatively,
the same physical sales contract could be accounted for as a derivative and marked to market monthly. In the former case, assuming a revenue construct that mandates use of the forward curve at contract inception to allocate pricing to each forward delivery month, the revenue pattern would follow the shape of the curve under the ED. In the latter case, the revenue recognized upon delivery of the commodity would be dictated by the fixed contract price under the derivative framework. In addition, if one were to elect cash flow hedge accounting for the same physical sales contract, revenue would likewise be recognized based on the contract price, not the forward curve price. The combination of the reclassification of the accumulated other comprehensive income to earnings on the hedge and the realization of the underlying forecasted transaction would result in revenue being recognized at the contract price. Therefore, the allocation of contractually fixed contract pricing to individual monthly delivery obligations based on the inception forward curve provides an opportunity to structure and create different accounting results for the same contract, which we think should be avoided. It also would require different accounting for economically identical contracts solely based upon whether they were accounted for as accrual contracts versus cash flow hedges, despite identical cash flows and economics. Please see the attached appendix for an example of the different accounting treatments that could result.

Variable (Index) Priced Commodity Contracts
For long-term energy sales whose pricing is tied to market (index) rates, the final selling price will (in almost all cases) by definition be equivalent to the standalone selling price at delivery. See further discussion regarding Variable Consideration under Measurement of Revenue section below.

Measurement of Revenue

Variable Consideration (Question 3 in the ED)
We believe that the ED’s provisions on variable consideration need to be revised and clarified for energy and other contracts for which deliveries are priced at spot market prices at the time of delivery. Absent such modifications, we believe that these provisions could be unnecessarily burdensome to implement and could be misinterpreted to require recognition of revenue in amounts that do not faithfully represent the promised consideration for each delivery (i.e., the market price at the time of each delivery). We illustrate our concern below.

Energy companies frequently enter into contracts to sell energy commodities (e.g., power, gas, etc.) at prices that reflect the spot market price for that commodity at the time of delivery (i.e., a “market-based contract”). That is, in these contracts the spot market price at the time of delivery represents the “cash selling price” for the commodity delivered. Since the actual spot market prices are unknown until the future deliveries take place, the amount of consideration is variable and would have to be estimated at contract inception in accordance with paragraph 54 of the ED which states, “If the promised amount of consideration in a contract is variable, an entity shall estimate the total amount to which the entity will be entitled in exchange for transferring the promised goods or services to a customer. An entity shall update the estimated transaction price at each reporting date to represent faithfully the circumstances present at the reporting date and the changes in circumstances during the reporting period.” Further, paragraphs 77 through 80 of
the ED indicate that such changes in the estimated transaction price should be allocated to the separate performance obligations under the contract, but are subject to the following constraints:

- An entity shall allocate to the separate performance obligations any subsequent changes in the transaction price on the same basis as at contract inception;
- However, an entity shall not reallocate the transaction price to reflect changes in standalone selling prices after contract inception.

We are concerned that a strict application of these variable consideration allocation provisions might result in an outcome that is not consistent with the economic substance of the underlying transaction. For instance, we believe that the amount of revenue that a power supplier should recognize for the delivery of power under a market-based contract should be equal to the quantity of power delivered in each increment (e.g., typically an hour) multiplied by the spot market price of power for the hour of delivery. This is the amount to which the provider is entitled and for which the provider will bill its customer. We believe this meets the spirit of the guidance in paragraph 70 of the ED which states that revenue should depict “the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation.”

Conversely, we believe that a strict application of the criteria outlined above could result in a less representative outcome when applied to market-based commodity contracts. For example, if the entity supplying power to a customer is not permitted to adjust the final transaction price for power delivered in a specific hour to the spot market price for that hour due to the second constraint above (that is, the entity shall not reallocate the transaction price to reflect changes in standalone selling prices after contract inception), then the amount of revenue recognized for that hour will be different than the amount of cash collected from the customer based on the spot market price for power delivered during that hour (i.e., the amount is not “reasonably assured” as required by paragraph 81 of the ED).

Accordingly, we request the Boards to modify or clarify in the final standard the following items with respect to the allocation of variable consideration:

1. For variable priced contracts where the contract price is equal to market at the time of delivery for all points in time (i.e., market-based contracts), the final standard should not require the estimation and allocation of variable consideration. This process is neither necessary nor relevant for such contracts, and it should be clear from the final standard that it is not required. Further, the same indicators cited in paragraph 82 for use in determining when an entity’s experience may not be predictive of the amount of consideration the entity is entitled to collect are also relevant in the case of variable priced contracts. In other words, we would not be able to reliably estimate the amount of revenue we expect to receive for market priced contracts due to factors outside of the entity’s control.

2. If such an allocation requirement for market-based contracts is retained in the final standard, an entity should be permitted to update the estimated transaction price at least as frequently as at each reporting date and upon delivery.


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Time Value of Money  
Another area of concern we wanted to highlight relates to the application of the time value of money provisions to fixed-price energy commodity contracts. As noted under the Transaction Price Allocation section above, companies in the energy industry frequently enter into contracts to sell power to customers at a fixed price in small increments (e.g., hourly) for a stated future term. While the fixed contract price is the same for each kilowatt-hour delivered to the customer throughout the entire term, the expected future market price (i.e., evidence of cash selling price) for each future delivery period will vary from the fixed price that is stated in the contract.

The time value of money provisions in paragraph 58 of the ED indicate that a contract has a financing component “if the promised amount of consideration differs from the cash selling price of the promised goods or services.” Further, paragraph BC144 of the ED also states, “A contract has a financing component if the promised amount of consideration differs from the cash-selling price of the promised goods or services. In that case, the transaction price would be calculated as the nominal amount of customer consideration adjusted for the effects of the time value of money. The transaction price would be allocated to the performance obligations in the contract and, when a performance obligation is satisfied, the amount of revenue recognized would be the amount of the transaction price adjusted for the financing – in effect, the ‘cash selling price’ of the underlying good or service at the time the good or service is transferred.”

Some may interpret these fixed price forward contracts to contain a financing component because, based on alternative views on price allocation above, the amount of consideration allocated to each performance obligation in the contract (i.e., the fixed strip price) differs from the cash selling prices that the supplier would be willing to separately and individually sell the power for at each forward delivery period during the term of the contract (i.e., if it were making spot market sales or sales under market-based contracts). As discussed in detail above, we believe that the contract price in these circumstances is equivalent to the cash or standalone selling price and that this concern is not applicable. However, even if one were to adopt the alternative interpretation, we strongly believe that, as long as the total transaction consideration under the contract does not differ substantially from the sum of the cash selling prices throughout the contract term, such fixed price forward power contracts do not inherently contain a financing element because: (1) there is usually no significant time lag between the delivery of the power and the cash payment for the power (typical payment terms are 30 days), and (2) the assessment of the transaction consideration for a fixed price contract should be made at the aggregate level for the entire contract and not at the individual performance obligation level.

Viewing these fixed price forward contracts as containing a financing component would introduce undue complexity and would produce an outcome that we believe is inconsistent with the intended objectives of the ED. Accordingly, to prevent misinterpretations of such fixed price forward contracts as containing financing components, we request the Boards to clarify in the final standard the following item with respect to applying the time value of money provisions:

• For a long term contract with multiple deliverables, if the fixed prices in the contract are based on the view of future prices at contract inception (e.g., current forward curve) and there is no significant time lag between delivery of each performance obligation and
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payment for those performance obligations, by definition, that contract would not contain a financing element.

Also, the following would likewise be a clarification which would result in an appropriate accounting conclusion:

- The application of the time lag practical expedient in paragraph 60 of the ED (e.g., assessing the time lag between delivery of power and cash payment for the power) should be made at the individual performance obligation delivery level rather than for the entire contract as a whole. For example, assume a customer enters into a three year power contract which is billed monthly based on the power volumes delivered in the prior month. If power is delivered in September and payment is due in October, this arrangement would not be viewed as containing a financing element since the goods are delivered and cash is collected for the delivered goods within 30 days. In assessing whether or not a financing exists in a contract with multiple performance obligations, it is not relevant that all goods are not delivered until the end of the three year period. Rather, the assessment would be made based on the delivery of each individual performance obligation as compared to the cash payment for the delivery of that performance obligation.

Onerous Performance Obligations (Question 4 in the ED)

We believe that the clarifications provided by the Boards in defining a contractual performance obligation and the implementation guidance provided to assist in determining whether the performance obligations are satisfied over time or as of a point in time preclude the application of the onerous test to typical energy commodity contracts. For typical energy commodity contracts, each of the performance obligations within the contract are distinct and are delivered to, and consumed by, the customer in small increments at various points in time. Accordingly, we believe that such energy commodity arrangements, even if accounted for as a single performance obligation under the practical expedient in paragraph 30 of the ED, would not be subject to the onerous performance obligation requirements. However, due to the reasons discussed in the paragraph below and in our previous comment letter dated October 22, 2010, we continue to suggest that the Boards remove the onerous performance obligation provision in its entirety.

We previously disagreed with and expressed significant concerns with the onerous performance obligation requirements and we appreciate the modifications made in response to our original comment letter. We indicated that the requirement to record an onerous performance obligation for potentially temporary market price movements of energy-related commodities could result in volatile and asymmetrical income statement fluctuations. In our industry, the costs to serve energy commodity contracts fluctuate with market prices and it would be misleading to recognize an onerous performance obligation for a portion of a contract based on a temporary change in market prices only to ultimately realize a profit on the overall contract. We also noted that for those entities that manage their business on a portfolio basis, the costs and effort involved in disaggregating and allocating costs associated with specific performance obligations
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to determine if onerous performance obligations exist would be overly burdensome and would not provide the transparency the ED sought to provide.

**Contract Modifications**

We appreciate the Boards’ efforts to address our concerns around contract modifications by developing specific criteria for distinguishing if a contract modification should be treated as a separate contract or as part of an existing contract. However, we respectfully request that the Boards provide further clarification on what they consider to be an ‘appropriate adjustment’ to an entity’s standalone selling price for a good or a service, as discussed in paragraph 21(b), as different interpretations of this term could result in inconsistent accounting treatment for the same contract modification.

In order to illustrate this point, we have considered the revised guidance for contract modifications contained within the ED, including paragraphs IG 61 and BC 55 through BC 61, and its application to the example below. This example relates to a ‘blend-and-extend’ modification which is a common type of contract modification in the energy industry. Blend-and-extend arrangements typically involve extending the existing term of a power purchase agreement (PPA) and blending the current contract price with the market price of the extended term. The rate for the extension term is based on the market price for such term; however the fixed price per unit of product (megawatt hour or MWh) for the quantities to be sold during the term of the modified contract blends the rate of the remaining term under the original contract with the market rate for the extended term. Consider the following example:

The Seller enters a PPA in 2000 to sell energy to the Buyer through 2023 at a price of $39/MWh (considered a market price at the time the original contract was entered). In 2012, both parties to the contract wish to extend the contract for another 5 years through 2028. Additionally, the parties want to change the contract price for the remaining term through 2028. A fixed market price for the extension period would be $75/MWh at the date of modification. No cash will be exchanged upon restructuring. The modified pricing for the term 2012 through 2028 is a fixed price of $44/MWh, representing a blend of $39/MWh and the $75/MWh. The net present value of the extended contract at $39/MWh through 2023 and $75/MWh for the period 2024-2028 is not significantly different from the extended contract at a flat rate of $44/MWh. Such pricing is the economic equivalent of pricing the new volumes at market while retaining the original price for the remaining volumes under the original contract; blending the price is simply a convention to provide the customer with an overall fixed price for the remaining term.

In our evaluation of the accounting treatment for this example, and as discussed in the section above, we have assumed that the supply of energy consists of multiple performance obligations satisfied at points in time (e.g., on a MWh basis).

The Boards have suggested that an entity should only account for a contract modification as a separate new contract if it does not affect the amount or timing of revenue recognition for the existing contract. In order to determine this, the Boards proposed that a contract modification must meet the two criteria in paragraph 21 in order to be accounted for as a separate contract.
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In applying these two criteria to the example above, we concluded the following:

a) As the supply of energy is considered to be multiple performance obligations satisfied at points in time, the additional energy to be delivered under the terms of the contract modification would therefore be considered ‘distinct’, as defined by paragraphs 28 and 29.

b) The contract modification price of $44/MWh represents a blend of the standalone selling price of the additional energy to be delivered under the contract modification ($75/MWh) which has then been adjusted to reflect the contract price of the pre-modification remaining deliverables ($39/MWh). We consider this adjustment to the standalone selling price to be ‘appropriate’ as it is necessary in order to reflect the economics governing ‘blend-and-extend’ contract modifications.

Based upon the above analysis, the contract modification would be accounted for as a separate new contract and the Seller would account for the effects of the contract modification on a prospective basis. This would faithfully depict the economics of the contract modification as the change in contract price is negotiated after the original contract and it is based upon new facts and circumstances and the future delivery of energy.

If the adjustment to the standalone selling price is not considered ‘appropriate’, the contract modification would not meet the criterion stipulated by paragraph 21 (b) and the Boards propose that we must next consider paragraph 22.

As the remaining deliverables at the point of the contract modification are considered to be ‘distinct’ from the Seller’s performance to date, the guidance in the ED tells us to account for the contract modification as an effective termination of the old contract and the creation of a new contract. While this treatment would result in the appropriate recognition of the blended rate on a prospective basis, accounting for the old contract as a contract termination could affect the accounting treatment of other items. If it is the intent of the Boards for the original contract to be accounted for as effectively being terminated, we respectfully ask the Boards to clarify the accounting treatment for items that would typically be recognized in earnings as a separate line item upon termination of a contract (e.g., cash payments made in relation to a contract modification, mark-to-market related to net settled contracts for which the normal purchases normal sales exception has been elected, and assets or liabilities recognized as a result of contracts acquired under business combinations related to a modified contract).

The analysis above illustrates how different interpretations of what is considered to be an ‘appropriate adjustment’ to standalone selling price could potentially result in different accounting treatments for the same contract modification. We respectively request that the Boards provide further clarification on the definition of an ‘appropriate adjustment’ to standalone selling price and its application to contract modifications together with implementation guidance and an example of how the guidance should be applied to a contract involving continuous delivery of the same product in order to clarify this issue and ensure consistent application of the ED.
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Identification of a Contract

We request clarification on the applicability of the ED to an arrangement between two parties that is governed by a third party and that can be terminated by the customer at any time. For example, our utility companies provide electricity to residential customers based on a regulated tariff. The customer determines the amount of electricity consumed on a real-time basis and can terminate the service at any time (e.g., relocation, switch to an alternative provider, etc.). However, typically the utility company can cancel only under certain circumstances (e.g., past due bills) due to state regulation. Revenue recognition is currently based primarily on the billing price, as established by the regulated tariff, multiplied by the amount of actual energy consumed on a monthly basis. We believe that revenue recognition under current GAAP is consistent with the ED’s core principle to recognize revenue “in an amount that reflects the consideration to which the entity expects to be entitled”.

Paragraph 13 of the ED provides that “contracts can be written, oral, or implied by an entity’s customary business practices.” In addition, paragraph 15 states that “a contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party.” There are divergent interpretations in our industry regarding the applicability of these provisions to the delivery of electricity to a residential customer, who pays tariff rates and decides at the point of sale how much, if any, electricity he wants to purchase. We would like clarification on whether this type of arrangement is a contract as defined in the ED. If a contract exists, clarification of the term of the contract when no term is specified would also be helpful as it could be interpreted to refer to a month-to-month contract or to a contract with an estimated term based on customary business practices. The latter may result in a change to current accounting.

The determination of whether the delivery of electricity to residential customers under tariff arrangements is within the scope of this ED may impact our accounting and disclosures. If the ED applies (i.e., a contract exists), potential implications may include additional disclosure requirements, the allocation of the transaction price based on the standalone selling price (in which case, we would have the same concerns as discussed in the Transaction Price Allocation section above), assessment of the time value of money for payment plans with delinquent customers for past electricity consumption, and assessment of the contract modifications guidance for changes in pricing due to billing programs. A clarification or example would assist us in determining whether the delivery of electricity to certain residential customers is within the scope of this ED and, if so, whether the current revenue recognition treatment would still apply.

Multiple Product Contracts (Bundled Contracts)

While paragraph 11 of the ED provides guidance with respect to how to apply the revenue recognition guidance when a contract is partially within the scope of the proposed ED, we believe further clarification is necessary with respect to how to identify and account for the separable units of account as we discussed in our previous comment letter dated October 22, 2010. We believe that there is diversity in practice with respect to defining a hybrid instrument as defined in ASC 815, Derivatives and Hedging. For instance, if a physical commodity contract contains one element that meets the definition of a derivative and another element which does
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not, we believe there are alternative views on how to account for this contract. In other words, some may view the entire contract as a hybrid simply because one of the elements meets the definition of a derivative while others may account for the derivative portion under ASC 815 and account for the non-derivative portion under the revenue recognition guidance. One potential solution would be to look to the revenue recognition guidance to define the unit of account and then look to other relevant guidance to the extent the element is not within the scope of the proposed ED. We would appreciate clarification on this topic.

Disclosures (Question 5 in the ED)

We support the proposed new disclosure requirements, with the exception of the proposal to disclose the aggregate amount of the transaction price allocated to remaining performance obligations and the expected timing of when an entity expects to recognize that amount as revenue as we do not believe that the potential benefits, if any, to financial statement users justify the cost to prepare this disclosure.

We are concerned because the disclosure would not contain reliable or complete amounts of future revenues expected in each period for existing contracts. The disclosed amount of future revenues related to existing performance obligations would be an estimate as preparers may need to make significant judgments about contingent revenue (e.g., estimates in pricing for index-priced contracts and estimates in volumes that will be required to be provided) and timing of the satisfaction of future performance obligations several years into the future. Therefore, the data presented may change significantly from period to period. In addition, the revenue information disclosed would be incomplete as much of our revenue is generated through contracts that are accounted for as leases or derivatives and therefore are not included within the scope of this ED. Since the actual amount of revenues earned in a future period would not equal the amount disclosed, we do not believe this disclosure would be meaningful to financial statement users.

Similarly, we are concerned that some users may interpret the amounts disclosed as the total revenues expected in future years, as opposed to expected revenues for existing contracts. The amount of expected revenues for contracts that currently exist is often a small piece of the total revenue expected to be earned in a future year (i.e., a contract does not yet exist for most of the projected future revenue); thereby, further supporting our position that this disclosure would not be meaningful to financial statement users. Management develops long-term revenue and earnings forecasts for the company that are based on expected revenues under existing and future contracts, and as such, the forecast information which is often provided to investors will not be based on the same revenues as the disclosure. This difference may lead to confusion among our investors and other financial statement users. Also, this type of forward-looking information would typically be included in Management's Discussion and Analysis as it is expressly covered by the safe harbor rule for projections under Rule 175 of the Securities Act of 1933; therefore, the inclusion of forward-looking information in the footnotes, which are not covered by the safe harbor rule, will increase potential litigation risk to companies.

Although the ED indicates that this information may be disclosed quantitatively or qualitatively, we are not certain how the aggregate amount of the transaction price allocated to remaining performance obligations and the expected timing of when an entity expects to recognize that
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amount as revenue could be presented using qualitative information in a way that is useful to investors. Therefore, if this disclosure requirement remains in the final guidance, we request that the Boards provide an example of a qualitative disclosure.

Financial statement preparers may need to gather and maintain a significant amount of data solely to comply with this disclosure requirement. The amount of information required for the disclosure is more extensive than what is needed to understand the accounting under the proposed guidance.

As we believe that the cost to prepare the information required to comply with this disclosure may be burdensome and the resulting information may be easily misunderstood and not beneficial to financial statement users, we suggest eliminating the proposed requirement to disclose the transaction price allocated to remaining performance obligations and the expected timing of their recognition as revenue.

Effective Date

The ED indicates that it will not be effective sooner than for annual reporting periods beginning on or after January 1, 2015. If we will be required to allocate the standalone selling price to each performance obligation based on the forward curve, rather than the contract price, as discussed in Transaction Price Allocation section above, we recommend the Boards establish an effective date no sooner than January 1, 2016. In order to comply with retrospective application, we anticipate the need to keep two sets of GAAP books, in addition to our books for tax and regulatory reporting purposes. Recognizing revenue based on a forward curve would take a significant amount of time and resources to educate and train impacted functions within our organization; review and analyze a large volume of transactions; design and implement the necessary process and systems changes; reassess and update the relevant financial controls and Sarbanes Oxley documentation; and educate and socialize the changes with external stakeholders. Therefore, it would be challenging to complete these items prior to January 1, 2013 for retrospective application considering that the ED is not yet finalized.

Conclusion

We appreciate your consideration of this topic and our related comments. The proposed changes to revenue recognition will have a significant effect on all industries, and 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 these important issues.

Very truly yours,

[Signature]

Richard F. McMahon, Jr.
Appendix

The following example illustrates the different accounting results that could occur for virtually identical, fixed-price contracts that are governed by different accounting guidance (e.g., Revenue Recognition ED or ASC 815 Derivatives and Hedging) with the same or similar fact patterns as discussed on page 7.

Background & Assumptions:
- Forecasted transaction – Sale of 100 units of commodity X at market price for Periods 1 and 2
- Risk management objective – the seller desires to enter into a fixed price contract to lock in its selling price (and thus its margin) for two years
  - For simplicity, purchased power and fuel costs have not been included because they would be the same for each revenue scenario
- Two different but virtually identical contract types could be executed to achieve this objective:
  - A physical forward sale of 100 units of commodity X at $40/unit for Periods 1 and 2 (average of forward market prices for Periods 1 and 2)
  - A fixed-price financial derivative at $40/unit for Periods 1 and 2 which settles based on the difference between contract and market
- Assume that the forward prices at inception and ultimate settlement prices are the same ($30 in Period 1 and $50 in Period 2) – in other words (for simplicity to illustrate the effect on revenue), assume no changes in fair value during the contract term and no ineffectiveness
- Market and contract prices are as follows:

<table>
<thead>
<tr>
<th>Market Price/Forward Curve</th>
<th>Period 1</th>
<th>Period 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract Price</td>
<td>40</td>
<td>40</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Example of Different Accounting Results – ASC 815 versus interpretation of this ED:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Period 1:</td>
</tr>
<tr>
<td></td>
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<tr>
<td></td>
</tr>
<tr>
<td>Revenue from Physical Sale</td>
</tr>
<tr>
<td>Revenue from Financial Derivative</td>
</tr>
<tr>
<td>Total Revenue</td>
</tr>
</tbody>
</table>

| Period 2:                                     |
|                                              |
|                                    | Physical Hedge (ASC 815) | NPNS or Accrual Contract - ED | Financial Hedge (ASC 815) |
| Revenue from Physical Sale                   | $4,000               | $5,000                     | $5,000               |
| Revenue from Financial Derivative            | -                    | -                          | ($1,000)             |
| Total Revenue                                | $4,000               | $5,000                     | $4,000               |
Appendix (cont’d.)

Key Observations:
- The revenue recognized under both the physical and financial hedges equals the contract price multiplied by the quantity delivered as provided by the derivative accounting guidance in ASC 815, the same as under existing revenue recognition guidance.
- An entity could elect the NPNS scope exception for the exact same physical supply contract which would then be subject to the provisions of the proposed ED and revenue would be recognized based on the forward prices as opposed to the contract price.

Key Concerns:
As stated in the body of our letter, we believe that the fixed per-unit sales price represents the standalone selling price for multiple deliveries (performance obligations) of the same commodity under a fixed-price contract. We believe that an alternative interpretation allocating the transaction price to individual deliveries based on the forward curve as of inception, rather than the contract price, is not consistent with the core principle of the ED and would:
- Introduce substantial diversity in practice for identical contracts used to achieve the same business objectives.
- Introduce an unnecessarily high level of subjectivity in determining revenue
  o Because of lack of visibility of the forward curve
  o By reducing comparability between entities due to different views of the shape of the forward curve for identical contracts
  o That is neither required nor representationally faithful when a fixed, objective contract price is known
- Result in asymmetric accounting
  o By the same entity for revenue and the costs incurred to produce that revenue, thereby distorting margins and decoupling revenue and margins from the cash flows and economics of the business
  o By sellers versus buyers for actual deliveries under the same contract
- Introduce the potential to elect different accounting for the same contract solely for the purpose of altering earnings timing