

Letter of Comment No: 26
File Reference: 1201-100
Date Received: 9-7-04

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From: Morris, Ben [mailto:Benjamin.Morris@Williams.com]
Sent: Tuesday, September 07, 2004 10:40 AM
To: Director - FASB
Subject: Comment Letter - File Reference No. 1201 - 100

September 7, 2004

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

File No. 1201-100 - Proposed Statement of Financial Accounting Standards - Fair Value Measurements

We appreciate the opportunity to provide the Financial Accounting Standards Board (the "Board") with our views on its Exposure Draft of a Proposed Statement of Financial Accounting Standards, *Fair Value Measurements* (the "ED"). The following letter focuses on key issues we identified in the ED, which we believe are worthy of further consideration or clarification.

Fair Value Hierarchy

Paragraph 15 states that quoted prices used for Level 1 estimates shall not be adjusted. Also, paragraph 19 mentions adjustments for appropriate differences for Level 2 estimates of fair value. We request that the Board clarify whether Level 1 and 2 estimates should be adjusted for the effects of discounting and credit standing. For example, a quoted price for a forward physical commodity purchase or sale contract (non-exchange traded) may be available from active broker/dealer markets to which an entity has immediate access and would appear to meet the definition of a Level 1 estimate. The quoted price, however, is indicative of the expected future settlement price and in order to appropriately estimate the current value at which the derivative contract could be settled or transferred, a present value technique must be applied. Further, the transaction may be one that was matched through a broker to a specified counterparty, and the credit standing of the counterparty would impact the fair value of the contract. In our interpretation, this type of contract meets the definition of a Level 1 estimate, but we believe the estimate of fair value should be adjusted for the effects of discounting and credit standing. However, we acknowledge that certain types of contracts (e.g. exchange traded futures), which meet the definition of Level 1 estimates, may not require application of present value techniques or consideration of credit standing.

Present Value in the Measurement of Liabilities

Note 4 to paragraph 5 states that for a liability, the estimate of fair value should consider the effect of the entity's credit standing, and this concept is further discussed in the context of present value techniques in paragraphs A23 - A27. We suggest that the Board clarify whether an entity should consider its own credit standing only for estimates involving the application of present value techniques or whether such consideration should be applied to all types of estimates in which credit risk is a consideration. Therefore, we request guidance as to whether or not an estimate's placement within the Fair Value Hierarchy (Level 1, 2, or 3) has any bearing on whether an entity's own credit standing should be considered.

Finally, we understand that for certain transactions the basis for factoring one's own credit rating into the fair value estimate of one's liability is consistent with how a counterparty estimates the price at which they are willing to hold the liability. However, we believe that for certain contracts there are important differences between asset and liability positions, specifically as they relate to the presumption that any future transfers of the liability will be made to an entity of comparable credit standing. The practical application of this principle could result in significant reductions to fair value estimates of an entity's derivative liabilities in a period of declining credit standing which will not likely be realized when considering the fact that a subsequent transfer of such liabilities through a sale of an entity's portfolio may well be made to an entity of higher credit standing. This scenario has been amply illustrated during the decline of the energy marketing and trading industry through which many who have received credit downgrades and have attempted to sell their portfolios have found potential buyers not to be those with similar credit standings but rather those with much stronger credit standings. Thus, we believe for certain types of instruments, such as derivative contracts, financial statement readers would be better served by a standard which incorporates the premise that an entity will fulfill its obligations under the derivative contract over the contract's contractual term and therefore present the contract at fair value without the effect of an entity's own credit standing.

Using Bid and Ask Prices

Paragraph 17 states that mid-market prices should be used for the matched portion of offsetting positions, whereas bid and asked prices should be used for net open positions, as appropriate. Footnote 8 to this paragraph states that other pronouncements specify whether and, if so, when such offsetting is appropriate. FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts (An Interpretation of APB Opinion No. 10 and FASB Statement No. 105)* ("FIN 39") specifies when offsetting is appropriate. FIN 39 limits such offsetting to two or more contracts between an entity and a single counterparty. This limitation is in contrast to netting of offsetting positions between the entity and multiple counterparties within an entire portfolio.

We believe the Board should clarify whether the netting of positions for purposes of estimating fair value using mid-market prices is limited to contracts between an entity

and the same counterparty as required by FIN 39 or whether it is appropriate to net offsetting positions between the entity and two or more unrelated counterparties within a portfolio of similar positions. We believe the latter better reflects the risk position and estimated fair value of the contracts because the entity has locked in its cash flows from all offsetting contracts within the portfolio. Credit risk would, however, continue to be appropriately reflected on an individual counterparty basis. Also, an entity could potentially sell the matched position to an unrelated buyer without incurring the bid-ask spread.

Additionally, we would request that the Board consider providing additional guidance in the appropriate forum related to the application of guidance in paragraph 17 to derivatives designated as hedges under SFAS 133. Specifically, if bid and asked prices are to be used as appropriate for a net open position which has been designated as, for example, a cash flow hedge, what price should be used for estimating the fair value of the hedged item to assess the effectiveness of the hedging relationship? For example, if a company enters into forward physical sales transactions (a short position) to hedge expected future sales of its own gas production (in effect a long position) and elects to apply cash flow hedge accounting, for purposes of assessing effectiveness and recording ineffectiveness, should the expected cash flows from the hedged long position (the expected gas production) be estimated using bid prices? If so, we believe that artificial ineffectiveness will be created. We would suggest that in such case the hedged item be valued using the same price as the hedging derivative, or alternatively both the hedging derivative and the hedged item be valued at mid-market.

Long and Short Positions

Throughout the ED (e.g. paragraph 18), the Board refers to long positions as assets and short positions as liabilities. These classifications differ from our view of what is considered an asset and a liability in the context of derivative transactions. In practice, we reflect long and short derivative contracts as assets and liabilities on our balance sheet based on the relative position of the contract price to market price. For example, a long position with a contract price above market (an “out-of-the-money contract”) would be reported as a liability and a short position with a contract price below market (an “in-the-money contract”) would be reported as an asset. These classifications correspond to the manner in which derivative contracts are expected to be net settled. An out-of-the-money contract represents a future obligation of the entity upon net settlement and an in-the-money contract represents future economic benefit to the entity upon net settlement.

We request the Board consider whether references to long and short positions as assets and liabilities, respectively, is meaningful relative to derivative contracts and to more accurately define long and short positions for purposes of estimating fair value using bid and ask prices.

If you have questions about our comments or wish further to discuss any of the matters addressed herein, please contact me at (918) 573-2832.

Sincerely,

Gary R. Belitz
Controller