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Director of Research and Technical Activities File Reference 194-B Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116

Dear Sir:

Texaco Inc. wishes to offer the following comments on the Exposure Draft on "Consolidated Financial Statements: Purpose and Policy."

We agree with the Board's decision to limit the scope of this ED to the criteria for determining which entities should be consolidated by an enterprise. This determination can require considerable judgment in some cases. The instances are increasing where economic ownership percentage and voting interest percentage in an entity differ. Also, there is an increasing use of structures other than the corporate structure to form new enterprises.

In general, Texaco agrees that consolidation should be based on control of an entity rather than economic ownership interest held. However, we believe that the ED is over-reaching in its presumptions of control in certain instances. Except for instances of voting control in paragraph 18a (without also a paragraph 18c situation involving another investor) control should not be presumed, because an examination of facts and circumstances is required to conclude whether effective control exists when there is no direct voting control. In particular, we disagree with paragraphs 18b, 18c and 21 that control shall be presumed in those cases absent evidence to the contrary. While we agree that control may be present in the paragraph 18b and 18c cases, we do not find the evidence compelling that it should be presumed. In the case of paragraph 21, we question whether the ED's definition of control is in fact met with respect to enabling the general partner to "increase its benefits and limit its losses" as required in the paragraph 6a definition of control. If control is presumed in these three cases, we believe that in practice it will be difficult to convince independent auditors that non-consolidation is ever appropriate in these situations, despite any evidence presented. Auditors will be averse to taking audit risk in these cases. Therefore, paragraphs 18b, 18c, and 21 should be stated as conditions which may indicate control, but without a presumption of control.

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Paragraph 18b provides that control is presumed based on an entity's holding a large minority voting interest, and no other party or group has a significant voting interest. The term large minority voting interest is interpreted in the ED to mean more than 50 percent of actual votes cast in elections for directors. While this qualification makes the application somewhat less arbitrary, the criterion still does not take into account all facts and circumstances. We believe that determining control in this case should depend upon factors such as the investor's ability to select the management of the entity, ability to affect management policies, the significance of any investor-investee transactions in relation to either the investor or the investee's overall business activities, whether the investor was significantly involved in forming the investee, and whether the investor guarantees all or part of the investee's debt. Applying the test based on 50 percent of votes cast for election of directors could result in alternating years of consolidation and deconsolidation even though there was no change in other facts and circumstances. We do not think this yields logical results. However, we also do not favor a test based merely on a specified percentage large minority interest.

Paragraph 18c provides that control is presumed based on a unilateral ability to (1)obtain a majority voting interest or (2) obtain a right to appoint a majority of the governing body through ownership of convertible securities or other rights such as warrants, when conversion or exercise is deemed to result in an overall net benefit to the investor. In this case, we believe that a presumption of control is equally unwarranted as in paragraph 18b. If the investor entity has taken no action nor given intent to take action to achieve majority voting power, there is no effective control absent other evidence. Determining whether the "expected benefit from converting those securities or exercising that right exceeds its expected cost" is affected by the period of time for the outlook. The effect could be beneficial over the long-term yet marginal at the present time. Are we to say in that case that there is control today if there is no expiration date for exercise of the rights? The investor's decision necessarily involves forward-looking information unless the intent is not to retain the additional shares, in which case control would be temporary and there is no issue. Forward projections are by nature subjective and have the potential for significant variability over time due to changing economic conditions. We question whether this is an objective basis upon which to base a consolidation judgment. Also, an investor's ability to exercise his rights may be affected by liquidity concerns, which could preclude his exercise of these rights at a given point in time. Accordingly, we do not accept a presumption of control based upon an assessment of whether it is beneficial to exercise rights to acquire a majority voting interest. The factors we cited above for factors to be evaluated in a paragraph 18b control test should also apply to paragraph 18c in testing for control.

Texaco supports the general concept that control for consolidation purposes should be based on control of the entity rather than control over the entity's assets. Specifically, control of the entity is obtained through the ability to direct the management and policies of the entity, which results in benefits to the investor through the entity's, not the investor's, use of the entity's assets. This is an important distinction. In order to have the ability to direct the management and policies of an entity, the investor must either possess an ownership interest in the entity or be a party to the formation or governance document of the entity which provides the investor specific rights. The ability to obtain benefits from the use of the entity's assets outside the entity, such as from a lease agreement, does not indicate control of an entity. For example, a lessee may be entitled to

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share in the excess proceeds upon the sale of a leased asset under the terms of a single or multiple asset lease agreement. The lessor may have multiple assets under lease or only a single asset under lease. The control conclusion should not be influenced in this case by rights given by the lease agreement, because the excess proceeds right is not unique to leases involving a single asset lessor.

Previously, EITF Issues 90-15 and 96-21 required consolidation by lessees of special purpose entity lessors under certain conditions. The ED should address whether these criteria are now to be superseded or modified. In particular, those EITF rules provide that consolidation is required by lessees for certain lessors unless the lessor has at least 3% in equity capital. If the 3% equity rule is to be retained, clarification is also needed as to how this is applied for lessors which are trusts, which do not issue equity in the usual context of a corporation or partnership.

The ED lists corporations, partnerships, trusts, and unincorporated associations as examples of entities subject to the consolidation rules. However, we find no reference to the limited liability company (LLC in the U.S.) or the limited life company (LLC outside the U.S.). We believe that both of these structures should be viewed in the same manner as corporations for purposes of the ED. Therefore, we suggest that the "Corporations" section comprising paragraphs 18 and 19 be expanded to include LLCs.

In paragraph 21, the ED provides that control of a partnership is presumed if the investor is the only general partner in a limited partnership, and no other partners have the ability to remove the general partner by dissolution or otherwise. We believe that this provision was inserted primarily to relate to publicly offered limited partnerships having numerous unorganized small investors as limited partners. In these cases, there is a single general partner as operating manager who also shares in the profit or loss based on his economic interest. It is clear in this case that the general partner controls the management, since it is the management under the partnership agreement. However, it is unclear how this control enables the general partner to "increase its benefits and limit its losses from that other entity's activities" under the paragraph 6a definition of control. The general partner has a fiduciary-type duty to the limited partners and is not free to take actions to benefit itself without agreement of the limited partners. Clearly this is not the intent of paragraph 6a. As such, we question whether based upon facts and circumstances, the ability of the general partner to increase its benefits and limit its losses can be demonstrated.

We further believe that the provisions of paragraphs 20 and 21 should not apply in the case of current specialized industry accounting practices for minority interests held in nonpublic partnerships, where undivided interest accounting (proportionate consolidation) is currently used by the general partner to account for its interest, such as in the oil and gas industry. In the case of oil and gas, the limited partnership structure with a single general partner is an alternative to the commonly used direct joint ownership of assets, in which one of the joint owners is designated as operator/manager of the assets. The operator entity operates the assets in the joint ownership of assets as does the general partner in a limited partnership. In the case of direct joint ownership, there is no consolidation of the total assets by any party, because there is no separate entity, association or trust which owns the total assets. Accordingly, the ED would not

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apply to that situation. In direct joint ownership of oil and gas assets, the operator entity accounts for its interest on the undivided interest basis. We do not see why the use of a partnership entity to own the assets instead should result in different consolidation accounting for a minority interest holder than does a joint ownership of assets structure. The transactions have the same economic substance, and the reasons for using a partnership entity are not for the purpose of having control.

The opportunity to comment has been appreciated.

George J. Batavick

Very truly yours,

DEH