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Mr. Russell G. Golden
Director of Technical Application
Financial Accounting Standards Board
401 Merritt 7
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LETTER OF COMMENT NO. 87

Re: File Reference No. 1590-100

Dear Mr. Golden:

FirstEnergy Corp. appreciates the opportunity to respond to the Proposed Statement of Financial Accounting Standards "Accounting for Hedging Activities, an amendment of FASB Statement No. 133."

FirstEnergy is a diversified energy company with approximately \$34 billion in assets and annual revenues of over \$12 billion. Our electric utility operating companies comprise the nation's fifth largest investor-owned electric system, serving 4.5 million customers within 36,100 square miles of Ohio, Pennsylvania and New Jersey. Its generation subsidiaries control more than 14,000 megawatts of capacity.

FirstEnergy supports the Financial Accounting Standards Board's (FASB) recommendations discussed in the proposed Statement in that the accounting will be easier to apply and understand. However, we disagree with the provisions that prohibit dedesignating a hedging relationship without terminating the hedge instrument, and believe that hedge accounting should not be limited to hedged interest rate risk on an issuer's own debt only if entered into at issuance of the debt.

We believe that the ability to dedesignate hedges is critical to a risk management strategy. Many hedge instruments that are not commonly traded on exchanges cannot be easily terminated; entering into other positions to offset the hedge will not result in an effective termination of the hedge in the financial statements. There are also instances where a hedge instrument can be dedesignated and used to economically hedge a risk that cannot be designated as a hedged item. Under portfolio hedging, which is currently allowed under Statement 133, the hedged item changes over time as the portfolio moves. The ability to dedesignate and designate anew as the needs of the portfolio change is critical to the portfolio strategy.

We request that the exception to allow designation of only interest rate risk for an entity's own debt be made available throughout the life of the debt instrument rather than only at inception. This proposed at-inception limitation will result in an entity having to inconsistently account for transactions designed to achieve the same risk management strategy based only on the timing of the transactions. Additional comments regarding this limitation are included in our responses to the issues raised by the Board below.

Issue 1: For the reasons stated in paragraph A16 of this proposed Statement, the Board decided to eliminate (with two exceptions) the ability of an entity to designate individual risks as the hedged risk in a fair value or cash flow hedge. As a result of that change, the financial statements would reflect information about the risks in the hedged item or transaction that an entity both chooses to manage and not to manage as part of a particular hedging relationship.

Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the ability of an entity to designate individual risks and requiring the reporting of the risks inherent in the hedged item or transaction?

We believe that together with the revised hedge effectiveness requirements and the exceptions noted by the Board, elimination of the ability to designate individual risks will improve the usefulness of financial statements. The elimination of the ability to designate individual risks is reasonable and will help to simplify hedge accounting. However the expectation of effectively offsetting all risks associated with a hedged transaction would be unreasonable without modification of the effectiveness threshold from "highly effective" to "reasonably effective." The Board appropriately proposes an exception for hedging component risk and permits the use of interest rate swaps to hedge an entity's own debt. However, the Board allows designation of interest rate risk as the hedged risk only when a hedge is established at the inception of the debt. As explained under Issue 2, we believe that hedge accounting should be permitted for hedged interest rate risk after inception of the debt.

Issue 2: For the reasons stated in paragraphs A18-A20, the Board decided to continue to permit an entity the ability to designate the following individual risks as the hedged risk in a fair value or cash flow hedge: (a) interest rate risk related to its own issued debt (that is, its liability for funds borrowed), if hedged at inception, and (b) foreign currency exchange risk. For those two exceptions, the financial statements would not reflect information about the risks that an entity chooses not to manage as part of a particular hedging relationship.

Do you believe the Board should continue to permit an entity to designate those individual risks as a hedged risk?

Yes, we believe that interest rate risk, in particular, related to an entity's own issued debt should continue to be permitted as a designated risk to be hedged. However, hedge accounting should not be limited to hedges designated at inception of the debt. FirstEnergy routinely hedges its own issued debt before, after and on the date of issuance and would be required to account for the risk differently. The inability to use hedge accounting for transactions entered into before or after the debt is issued would result in an entity having to value its hedged debt every reporting period and would introduce additional value fluctuations to the financial statements related to changes other than interest rate risk. This adds additional and unnecessary complexity to hedge accounting without adding any beneficial information.

Moving to a model where individual risks cannot be hedged results in "creditor influenced ineffectiveness" presented in the company's financial statements. Introducing the entity's own valuation based on its own assumptions regarding the creditor's analysis clouds the information available rather than clarifying it. In the current market, there are no cost-effective alternative methods to hedge non-interest-rate risk related to our debt. For pre-issuance hedging, the company's credit spread and any new-issue premium would be required to be hedged under the proposed method. As the company measures the changes in the fair value of the expected debt, it must make assumptions regarding creditors' expectations and risk appetite. Creditors will then alter their expectations based on the changes in the financial statements.

Issue 3: This proposed Statement would eliminate the shortcut method and critical terms matching. Therefore, an entity would no longer have the ability upon compliance with strict criteria to assume a hedging relationship is highly effective and recognize no

ineffectiveness in earnings during the term of the hedge. As a result, when accounting for the hedging relationship, an entity would be required, in all cases, to independently determine the changes in fair value of the hedged item for fair value hedges and the present value of the cumulative change in expected future cash flows on the hedged transaction.

Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for fair value hedging relationships and cash flow hedging relationships? Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the shortcut method and critical terms matching, which would eliminate the ability of an entity to assume a hedging relationship is highly effective and to recognize no ineffectiveness in earnings?

Both the shortcut method and the critical terms matching approach were designed to simplify hedge accounting. In this proposal, the FASB has stated that its goal is to further simplify the accounting for hedging activities, but it is not entirely clear how eliminating two of the most heavily relied upon methodologies accomplishes this goal.

We do not anticipate significant changes or costs resulting from the elimination of critical terms matching or the shortcut method. Calculating the effectiveness of overall changes in the fair value of debt (as opposed to interest rate risk only) will likely be more complex, result in additional ineffectiveness and subject the company's earnings to additional volatility. Ineffectiveness associated with hedging interest rate risk is expected to be immaterial and will neither impair nor improve usefulness of financial statements. Some entities with varying credit spreads may not be permitted to use hedge accounting as changes in the fair value of an interest rate swap may not be reasonably effective at hedging the changes in the fair value of its debt. Some users of financial statements associate derivatives that do not qualify for hedge accounting as discretionary risks.

Issue 4: This proposed Statement would modify the effectiveness threshold necessary for applying hedge accounting from highly effective to reasonably effective at offsetting changes in fair value or variability in cash flows.

Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

For situations in which interest rate risk is currently designated as the hedged risk for financial instruments but would no longer be permitted under this proposed Statement (except for an entity's own issued debt at inception), do you believe you would continue to qualify for hedge accounting utilizing your current hedging strategy? If not, would you (a) modify your hedging strategy to incorporate other derivative instruments, (b) stop applying hedge accounting, (c) elect the fair value option for those financial instruments, or (d) adopt some other strategy for managing risk?

Yes, we strongly support the modification of the effectiveness threshold necessary for applying hedge accounting. Under the current standard, which in practice has been widely interpreted to be a bright line between 80% and 125%, many highly economic hedges do not qualify for hedge accounting. As a result, they are forgone to avoid mark-to-market impacts to the company's earnings. We believe that the revised effectiveness standard will allow entities to apply the appropriate accounting model (hedge accounting in the case of highly economic hedges) while communicating the imperfect nature of hedging effectively via ineffectiveness testing and disclosures.

We anticipate that our current hedges, for which we designate the interest rate risk as the hedged risk, will continue to qualify for hedge accounting based on the "reasonably effective" standard. However, we expect significantly more ineffectiveness to be recognized in earnings. As a result, we may reduce the amount of hedging related to our debt or adopt other risk mitigation strategies. We do not believe that electing the fair value option is a realistic alternative to hedge accounting. One of the benefits of using hedge accounting is the relative ease and low cost of entering into an

interest rate swap transaction, and, if necessary, the ease in terminating the transaction. Under the irrevocable fair value option, an entity is required to continue fair value accounting for the debt as long as the debt remains in place. The cost and process required to offer new debt precludes ending the "hybrid hedge accounting" with the same efficiency and results in higher risk overall.

When hedging primarily extrinsic risks (such as forecasted purchases of commodities), the proposed model requiring that the hedge reasonably offset the hedged item or transaction in its entirety is appropriate. When the hedged risk is significantly impacted by the financial and operational performance of the company, such as with its own debt, the model fails to produce beneficial information. The Board appears to recognize this shortcoming in its recommendation to permit hedging only interest rate risk at inception of debt. This should also be addressed for hedges of previously issued debt and forecasted interest payments related to future debt.

Issue 5: This proposed Statement always would require an effectiveness evaluation at inception of the hedging relationship. After inception of the hedging relationship, an effectiveness evaluation would be required if circumstances suggest that the hedging relationship may no longer be reasonably effective.

Do you foresee any significant operational concerns in creating processes that will determine when circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness each reporting period?

Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? If so, why?

No, we do not anticipate operational concerns in monitoring hedges to determine if hedge effectiveness should be reassessed. Nor do we believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued. Most discontinued hedging relationships result from significant changes in circumstances changing the effectiveness of the hedge relationship. Significant circumstantial changes will be evident before a regular effectiveness evaluation for each period would be required.

Issue 6: The Board considered but decided against eliminating any assessment of effectiveness after the inception of the hedging relationship. The Board believes that eliminating such an assessment of effectiveness could result in the continuation of hedge accounting even when situations suggest that the hedge relationship may no longer be reasonably effective. Some observe that an implication of the decision to not eliminate any assessment after the inception of the hedging relationship could be that hedge accounting results would be reflected in some reporting periods and not in other reporting periods throughout the life of the relationship. Also, in a hedge accounting model that generally does not permit hedging of individual risks, changes in the relationship between the individual risks being managed and those not being managed could increase the likelihood that the hedging relationship would no longer be reasonably effective. That would result in hedge accounting no longer being permitted for a portion of an expected hedge term. That "in and out" of hedge accounting would make it more difficult for users to interpret financial statements.

Do you agree with the Board's decision to continue to require that hedge accounting be discontinued if a hedge becomes ineffective? Alternatively, should an effectiveness evaluation not be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term?

Discontinuing hedge accounting due to the expectation that the hedge relationship will no longer be reasonably effective appears to contradict the proposed Statement's requirement disallowing dedesignation of hedge accounting unless the hedge instrument is terminated; however, if a thorough hedge analysis is performed, there should be few situations requiring a reassessment of effectiveness.

Issue 7: In the statement of operations, Statement 133 does not prescribe the presentation of gains and losses associated with hedging instruments, including the effective portion, the ineffective portion, and any amounts excluded from the evaluation of effectiveness, such as forward points. Some have suggested that such a prescription would improve financial reporting by creating consistency in the presentation of these amounts across all entities. Others observe that FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities, requires disclosure about that information, and they question whether a prescriptive approach is appropriate given the diverse hedge accounting strategies employed by entities.

Do you believe that Statement 133 should be amended to prescribe the presentation of these amounts? For example, the Statement could require that the effective portion of derivatives hedging the interest rate risk in issued debt be classified within interest expense and that the ineffective portion and any amounts excluded from the evaluation of effectiveness be presented within other income or loss.

No, we do not believe there should be a prescribed presentation of hedge gains and losses. Companies should continue to be allowed to report gains and losses on hedging transactions based on, and reflecting, the risk management strategies and techniques used. The disclosures requirement in Statement 161 will provide adequate information and the desired comparability.

Issue 8: The Board's goal is to issue a final Statement by December 31, 2008. The proposed Statement would require application of the amended hedging requirements for financial statements issued for fiscal years beginning after June 15, 2009, and interim periods within those fiscal years.

Do you believe that the proposed effective date would provide enough time for entities to adopt the proposed Statement? Why or why not?

Yes, we believe there will be sufficient time to adopt the proposed Statement. We would expect that most entities will not require significant additional processes or systems in order to implement the changes.

Issue 9: The Board did not prescribe any specific transition disclosures upon the adoption of this Statement.

Do you believe that there are specific disclosures that should be required during transition? If so, what? Please be specific as to how any suggested disclosures would be used.

An entity must dedesignate most hedging relationships prior to adoption of the proposed Statement as part of the transition. The current disclosures required by Statement 133 (as amended) provide sufficient information for financial Statement users to understand the transition. No additional transition disclosures should be required.

Issue 10: The Board decided to permit an entity a one-time fair value option election under FASB Statements No. 156, Accounting for Servicing of Financial Assets, and No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, for (a) servicing assets and servicing liabilities designated as a hedged item on the date immediately preceding initial application and (b) eligible financial instruments designated as a hedged item on the date immediately preceding initial application of this proposed Statement.

Do you agree with the Board's decision to allow a one-time fair value option at the initial adoption of this proposed Statement? Do you agree with the Board's decision to

limit the option to assets and liabilities that are currently designated as hedged items under Statement 133?

We do not agree with the decision to permit an entity a one-time fair value option since it would reduce the comparability of financial statements. The fair value option not only permits different accounting models between companies, but also differing accounting models for similar assets and liabilities within a company's balance sheet. We also believe the irrevocable nature of the fair value option is not a viable alternative to hedge accounting.

Issue 11: The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. The benefit-cost considerations considered by the Board are provided in paragraphs A43–A50 in Appendix B of this proposed Statement.

Do you believe the Board identified the appropriate benefits and costs related to this proposed Statement? If not, what additional benefits or costs should the Board consider?

For most hedging relationships, the Board's proposed accounting for the hedge instruments properly reflects the economics of hedged transactions. Comparability between entities will be improved due to the simplified ineffectiveness measurements. We believe that the added transparency of risks not being managed or transformed by the hedging instrument does not necessarily produce better information for users of financial statements. Financial statement users are being made fully aware of the risks that hedge instruments are not offsetting, however they are not informed about risks that are not being managed at all. The best example of this is with hedges of an entity's own debt. With the provisions of the proposed Statement, the most effective method to remove debt related volatility reported in the financial statements is not to hedge at all. Conversely, the most effective and economic hedge of risk is to hedge interest rate risk only. Designating a hedge for all changes in the fair value of an entity's debt will result in ineffectiveness, and thus volatility, reported in the financial statements. As proposed, this Statement discourages companies from using the most effective and efficient risk management tools for hedging their debt. The Board should reconsider permitting the designation of interest rate as the hedged risk before and after the inception of debt.

FirstEnergy looks forward to continuing participation in this important hedging project. We believe the end result should be a manageable accounting model that improves financial reporting by providing useful and understandable information about entities' hedging activities to all users of financial statements.

Sincerely,