Edison Electric Institute
Power by Association

AGA American Gas Association

November 30, 2015

Ms. Elizabeth M. Murphy
Secretary
File Reference: S7-20-15
Securities and Exchange Commission
100 F Street NE.
Washington, DC 20549-1090

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Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant

Dear Ms. Murphy:

The Edison Electric Institute (EEI) and the American Gas Association (AGA) appreciate the opportunity to comment on the Securities and Exchange Commission's (SEC or Commission) request for comment on the effectiveness of financial disclosures about entities other than the registrant (hereafter the "Request for Comment").

EEI is the association that represents all U.S. investor-owned electric companies. EEI members provide electricity for 220 million Americans, operate in all 50 states, and directly employ more than a 500,000 workers. With more than $90 billion in annual capital expenditures, the electric power industry is responsible for millions of additional jobs. EEI has 70 international electric companies as Affiliate Members and 250 industry suppliers and related organizations as associate Members. Organized in 1933, EEI provides public policy leadership, strategic business intelligence, and essential conferences and forums.

AGA, founded in 1918, represents 202 local energy companies that deliver clean natural gas throughout the United States. There are more than 70 million residential, commercial and industrial natural gas customers in the U.S., of which almost 93 percent – more than 65 million customers – receive their gas from AGA members. AGA is an advocate for natural gas utility companies and their customers and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international gas companies and industry associates. Today, natural gas meets almost one-fourth of the United States' energy needs.

EEI and AGA regularly work together on projects of mutual interest and impact to the energy utility sector broadly, and the comments expressed herein represent the majority view of each organization's member companies and respond only to certain questions that are most relevant to our members.

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We support the Commission's Disclosure Effectiveness Initiative. Transparent and robust disclosures are a critical element of the capital markets necessary to allow investors the ability to better evaluate the financial condition and performance of companies and make informed investing decisions. However, more disclosure is not always better. As former Commissioner Troy Paredes has remarked, too much disclosure can become counterproductive, particularly when it is too complex, resulting in investors being overwhelmed, distracted, or misplacing their focus on information that is only marginally useful.[1]

In this context, and considering the Commission's primary goal to improve effectiveness and not necessarily to reduce or increase the amount of disclosure, we request the Commission to consider the recommendations that follow. We believe there is opportunity to modify the requirements of Rule 3-05 of Regulation S-X (the Rule) in order to limit information not used or relied upon by investors, reduce cost to preparers, and improve the effectiveness of financial information provided by eliminating some of the redundancies or inconsistencies – all of which will benefit investors and preparers alike.

We provide our comments on certain specific questions as they relate to Rule 3-05 in the Request for Comment below.

Question 2: Are there changes to these requirements we should consider to further facilitate the disclosure of useful information to investors? For example, is there different or additional information that investors need about acquired businesses or about how the combined entities might perform following the acquisition? If so, what information is needed and are there challenges that registrants would face in preparing and providing it?

The degree to which historical financial information of an acquired business is useful to an investor can vary greatly depending on the specific circumstances. In many instances, historical financial information of an acquired business may not be indicative of the future expected results of the acquired business as a result of operational changes expected to be made subsequent to the transaction (e.g., synergies expected from planned workforce reductions, consolidation of headquarters, closing of facilities, etc. which often motivates the acquisition in the first place).

Therefore in cases where audited historical financial statements are not readily available, the significant additional costs that a registrant incurs to obtain and present such information are often not commensurate with the limited value to the investor. In other instances, historical financial statements may not be representative of the assets and liabilities expected to be

[1] Remarks at The SEC Speaks in 2013 by Commissioner Troy A. Paredes, U.S. Securities and Exchange Commission (2013)

recognized in the acquirer's financial statements subsequent to consummation of the transaction. For example, transactions accounted for as equity method investments or investments in joint ventures may meet the definition of a business as defined in Rule 11–01(d) of Regulation S-X, and therefore require disclosure of historical financial statements of the equity investee. However, only the acquirer's share of the underlying net assets of the equity investee will be presented on the acquirer's financial statements as a single investment. The current requirements of the Rule do not distinguish between these situations or allow a registrant to tailor the required disclosures accordingly.

Therefore we recommend making the following changes to Rule 3-05:

- Limit the requirement to disclose historical financial information to two years at most, subject to the other recommendations outlined below. – *While historical financial information can be useful to investors in some situations, we do not believe providing an incremental third year provides significant additional value to investors sufficient to justify the added cost, particularly when many acquisitions contemplate changes in the acquired entity after closing.*

- Permit disclosure of audited statements of revenues and direct expenses and assets acquired and liabilities assumed, in lieu of full or carve-out financial statements of the acquired business when historical audited financial statements are not readily available. – *In situations where historical audited financial statements are not readily available, it can reasonably be assumed that management is not using or relying on such information and therefore it would also have limited value to investors.*

- Allow a practical expedient to present financial statements of acquired entities prepared under accounting standards for nonpublic entities when the available financial statements of the acquiree are prepared on that basis. – *While we acknowledge that the current rules provide an exception for disclosures not required by FASB standards for nonpublic entities (e.g., segment information, earnings per share), there is not an explicit exception for differences in accounting between public and nonpublic entities that arise from nonpublic entities applying accounting alternatives allowed under FASB standards. We believe the notes to the financial statements prepared under accounting standards for nonpublic entities along with additional narrative disclosure from registrants should be sufficient to provide an investor with the appropriate context to understand differences versus public company accounting standards, without incurring significant additional cost.*

- Limit the required disclosures for transactions in which the acquiree will be accounted for as an equity method investment to pro forma financial statements only – *Limiting the required disclosures would improve the effectiveness of such disclosure by enabling an investor to focus on the effect the investment will have on the registrant's financial statements subsequent to consummation of the transaction and eliminate any confusion that may arise from an investor attempting to reconcile the pro forma financial statements to the historical financial statements of the equity investee.*

Question 3: Are there challenges that registrants face in preparing and providing the required disclosures? If so, what are the challenges? Are there changes to these requirements we should consider to address those challenges? If so, what changes and how would those changes affect investors' ability to make informed decisions?

There are numerous challenges that registrants face in preparing and providing the required disclosures that often result in additional cost and effort including:

- Audited financial statements may not be available for the business being acquired.
- Audited financial statements may not be compliant with Regulation S-X (e.g., financial statements prepared under accounting standards for nonpublic companies).
- Preparation of carve-out financial statements, including the carve-out tax provision, can be complicated and often highly subjective and potentially prolong the consummation of transactions.

Please refer to our responses to specific questions within this letter for our recommended changes to address these challenges. We believe that the proposed changes outlined in this letter will help improve the overall effectiveness of the information provided to investors and will not adversely affect investors' ability to make informed decisions.

Question 4: Are there requirements that result in disclosures that investors do not consider useful? If so, what changes to these requirements would make them useful or should we consider eliminating or replacing all or part of those requirements?

In addition to those identified in our response to Questions 2, another area of opportunity for improving effectiveness is the application of the rule to businesses under common control. In recent years, our industry has seen an increase in the use of alternative financing structures, such as YieldCos, Master Limited Partnerships, and Real Estate Investment Trusts. These new structures often involve the ongoing, regular acquisition of new assets, which in turn can trigger disclosure requirements under Rule 3-05. In some cases, this includes recasting previously filed financial information which, in turn, can cause confusion to investors without much added benefit. In addition, due to the complexity of applying the current rules, registrants are often required to consult with legal counsel, auditors, and the Commission.

In order to reduce this confusion but retain the intent of the disclosure requirements, we recommend the following changes to Rule 3-05:

- Permit registrants to disclose information in a footnote to the financial statements or Form 8-K rather than requiring companies to recast previously reported amounts.
- Remove the requirement to provide separate audited financial statements for individually insignificant acquisitions when those acquisitions are determined to be significant in the aggregate, as defined by Rule 3-05. Instead, a registrant should be allowed to provide pro forma information supplemented with audited financial statements, if available.

Question 5: How could we improve the usefulness of the Pro Forma Information? Could we do so by changing the extent of information required and/or the methodologies used to prepare it? For example, should we add a requirement for comparative pro forma income statements of the prior year and/or modify the restrictions on pro forma adjustments? If so, what changes should be made and should auditors have any level of involvement with the information? Are there disclosures we should consider adding to the Pro Forma Information that are currently found only in the Rule 3-05 Financial Statements?

Pro forma information can be of significant value to investors, particularly as it relates to understanding the expected future results of the acquired business. However, current rules for presentation of such information are restrictive and do not allow for certain adjustments to reflect actions that registrants frequently take (e.g., workforce reductions, facility closings), which we believe investors would find useful.

We recommend modifying the pro forma requirements to allow registrants to include such pro forma adjustments, with appropriate disclosures, for significant changes planned by management. Permitting registrants to do so can improve the effectiveness of these disclosures by better enabling investors to view the acquired business through the eyes of management of the company and eliminate discrepancies between information related to the business acquisition in SEC filings and information provided to investors through other means (e.g., earnings calls, investor presentations).

Registrants should also be allowed to omit pro forma adjustments for items expected to have a continuing impact if the calculation or determination of such adjustments results in undue burden or costs on the registrant and are believed to have limited value to investors. Any such items would instead be disclosed in the pro forma footnote disclosures.

We also recommend aligning the pro forma adjustments required for the income statement and balance sheet. Pro forma income statement adjustments are required to have a continuing impact on the registrant, but pro forma balance sheet adjustments are not. This results in nonrecurring charges and credits resulting directly from the transaction being excluded from the pro forma income statements but being included in the pro forma balance sheet. This difference in treatment can result in added confusion to investors.

Current pro forma rules require registrants to reflect a tax provision calculated using the separate return method for the most recent year and interim period. This requirement can result in the pro forma financial statements not accurately reflecting the actual expected tax effects subsequent to the consummation of the transaction since in many cases the acquired business will not file a separate return on a stand-alone basis, but rather will be included in the consolidated entity's return. Therefore, we recommend modifying the pro forma requirements to allow for a practical expedient to disclose in narrative format the expected tax implications of a transaction rather than require a comprehensive calculation of a tax provision using the separate return method that is not representative of the future consolidated tax provision.

We do not believe adding a requirement to present comparative pro forma income statements would improve the usefulness of the information for investors. By nature, pro forma results are adjustments of the historical information to model a projected future state. Preparing such amounts using periods other than the most recent historical period would not add additional relevant information but could substantively increase the cost of making required filings.

Consistent with the current pro forma rules, we do not believe an auditor's report on pro forma financial information should be required.

Question 6: If we make changes to improve the usefulness of the Pro Forma Information, should we modify the requirement to provide Rule 3-05 Financial Statements? If so, how? If not, why?

We recommend that the Commission change the requirement to provide Rule 3-05 Financial Statements for transactions accounted for as equity method investments as described in our response to Question 2.

Question 7: Should we modify the amount of time that registrants have to provide disclosures about acquired businesses to investors? If so, under what circumstances and how? If not, why?

In order for financial information of an acquisition to be useful, the information must be made available to investors in a timely fashion. Therefore, in conjunction with the proposed recommendations outlined above, we believe the current rule allows sufficient time for registrants to comply with the disclosure requirements.

Question 9: Are significance tests the appropriate means to determine the nature, timing, and extent of disclosure under Rule 3-05 and the related requirements?

While the quantitative significance tests generally yield reasonable results, we believe investors and preparers could both benefit from certain changes. These recommendations are further described in our responses to Questions 10 – 12. We recommend that any changes made to the significance tests be applied consistently across all aspects of Regulation S-X (e.g., Rule 3-09) and other SEC regulations that require measuring financial significance (e.g., Form 8-K requirements).

Question 10: Are there changes or alternatives to the tests that we should consider to further facilitate the disclosure of useful information to investors? If so, what changes and are there challenges that registrants would face as a result?

Please refer to our response to Question 12.

Question 11: Are there changes to the tests we should consider to address challenges registrants face in preparing and providing the required disclosures? If so, what changes and how would those changes affect investors' ability to make informed decisions?

Please refer to our response to Question 12.

Question 12: Should we revise the financial measures used to determine significance or change the percentage thresholds? For example, should we consider limiting the use of the income test and/or devise new tests such as purchase price compared to a registrant's market capitalization?

We recommend the following revisions to simplify the application of the rules (subject to all other recommendations outlined in this letter):

- Revise the threshold for an acquired business to be considered significant to 25%.

- Revise the threshold to provide financial statements for the most recent year and latest required interim period to acquisitions that exceed 25% up to 50%

- Revise the threshold to provide financial statements for the two most recent fiscal years and the latest required interim period and corresponding interim period of the preceding year to acquisitions that exceed 50%.

Adopting these recommendations would effectively limit the number of annual periods required to two years at most (consistent with our recommendation in Question 2) and remove the 80% threshold currently used to distinguish an acquisition of "major significance". We believe these revisions will improve the usefulness of the information for investors and not diminish their ability to make informed decisions.

Question 13: Should we allow registrants to apply more judgment in determining what is considered a significant acquisition? If so, why and how? What concerns might arise from allowing registrants to apply more judgment and, if allowed, should registrants disclose the rationale for the judgments?

We do not believe that allowing registrants to apply more judgment in determining what is considered a significant acquisition would be helpful, as this would increase the complexity of applying the requirements of Rule 3-05 and may result in greater diversity among registrants. Furthermore the current rules allow registrants to request interpretation from the Division of Corporate Finance's Office of Chief Accountant in unusual situations or relief where strict application of the rules and guidelines results in a requirement that is unreasonable under the circumstances.

Question 17. Should we align the definition of a business in Rule 11-01(d) with the definitions in the applicable accounting standards? Why or why not?

We believe the definition of a business in Rule 11–01(d) of Regulation S-X and Accounting Standards Codification 805 should be aligned in order to simplify reporting for registrants and usefulness for financial statement users. Having a consistent definition would eliminate the need to perform separate analyses under GAAP and SEC reporting requirements. However, we believe that the definition of a business under FASB standards is currently applied overly broadly in practice and may result in transactions that investors believe represent the acquisition of an asset or group of assets being treated as the acquisition of a business. The additional disclosure required in such an instance would provide limited value to the investor and would be contrary to the stated goal of the Commission's initiative. We recommend the Commission work with the Financial Accounting Standards Board to modify the GAAP definition of a business to align with the current SEC definition.

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EEI and AGA appreciate the opportunity to provide our input on this Request for Comment. We would be pleased to discuss our comments and to provide any additional information that you may find helpful.

Very truly yours,

/s/ Richard F. McMahon, Jr.

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Vice President, Edison Electric Institute

/s/ William R. Ford

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