

June 28, 2017

Technical Director
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Financial Accounting Standards Board
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**Comments by the Edison Electric Institute and the American Gas Association
Regarding the Accounting for Land Easements and the Application of
Topics 350 and 842**

Dear Ms. Cosper:

The Edison Electric Institute (“EEI”) and the American Gas Association (“AGA”) support the goals of Topic 842 to reflect right-of-use assets and lease liabilities on the balance sheet. We respectfully offer these comments to assist the Financial Accounting Standards Board (“FASB” or “the Board”) with its outreach concerning the appropriate accounting for land easements and the applicability of Topics 350 and 842.

The Edison Electric Institute (EEI) is the association that represents all U.S. investor-owned electric companies. Our members provide electricity for 220 million Americans, and operate in all 50 states and the District of Columbia. As a whole, the electric power industry supports more than 7 million jobs in communities across the United States. In addition to our U.S. members, EEI has more than 60 international electric companies as International Members, and hundreds of industry suppliers and related organizations as Associate Members. Organized in 1933, EEI provides public policy leadership, strategic business intelligence, and essential conferences and forums.

The 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.

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Executive Summary

EEI and AGA appreciate the Board considering issues related to land easements. Land easements take different contractual forms and the execution of these contractual arrangements may often date back several decades. As a result for utilities, there has been diversity in practice and utilities have historically accounted for land easements in a variety of ways based upon reasonable judgments in applying the existing accounting literature. This diversity in practice includes accounting for such agreements as PP&E, intangible assets, executory contracts and, less frequently, leases.

There are two important considerations our comments will focus upon; clarification of the “unit of account” for which to consider ASC 842’s model of control and a need to consider the historical transaction volume and existing diversity in practice when applying the standard’s transition guidance. Land easement agreements executed by utility companies frequently provide joint or shared rights to use the underlying land, but some provide exclusive rights. Thus, as part of implementing ASC 842, it is important to apply its requirements for these agreements in a way that is consistent with the underlying rights that the easement agreements convey.

Utilities believe that ASC 842 should be applied by evaluating the rights of the parties as they relate to the parcel of land identified in the land easement agreement. Consistent with ASC 842, agreements that provide rights to exclusive use of a property likely would be considered leases, while agreements that provide joint or shared use by both parties to the agreement likely would not be considered leases.

Utilities typically have tens of thousands of land easement agreements. As a result of the volume and age of land easement agreements in our industry (and potentially others), we believe that transition relief is essential for companies that do not elect the practical expedients if the board ultimately determines that the implementation of ASC 842 should result in a change in the accounting for land easements. Ideally, such relief would grandfather easement agreements in existence at the date of implementation of ASC 842 and apply its provisions only to all new agreements executed after that date. Where companies elect the practical expedients, the accounting for existing easements in implementing ASC 842 will remain unchanged.

Background

For purposes of this discussion, we define the property owner as the “grantor” and the entity acquiring the land easement as the “grantee”.

Land easements encompass many types of arrangements. In the electric and natural gas utilities industry, these arrangements are necessary for various purposes including:

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- Securing the right to construct and access electric transmission and distribution lines and gas pipelines which pass through, over, or under the grantor's property;
- Securing the right to construct and access gas storage or gas production gathering facilities which are placed on or under the grantor's property;
- Securing the right to construct and access wind generation assets (turbines and wires) on and under the grantor's land; and,
- Securing the right to construct and access other operating assets, such as an electric substation, communication towers, or solar generation assets, on the grantor's land.

Land easements typically allow the grantee to use a parcel of land (or a portion of a parcel of land) for a very specific and limited purpose. The rights obtained through a land easement are defined in the easement agreement and restrict the rights of the grantee to certain defined activities, typically including construction and ongoing access as described above. Continued access is typically necessary to maintain and ultimately remove the assets.

The grantor continues to own the land and often can continue to use or provide other third parties the right to use the same land for other purposes that do not interfere with the limited rights of the grantee. The grantor or other third parties often continue to obtain economic benefits from the land through activities such as farming, raising livestock, mining, and other commercial business operations. In many cases, the grantee's assets occupy a relatively small physical portion of the overall property; in some cases (such as electric transmission lines), the assets may not contact the property subject to certain easements at all.

Easement arrangements usually do not but may specify the exact location where the grantee's assets may be located on an overall larger piece of property. Accordingly, arrangements may relate to a larger parcel of land, without providing for the exact location where assets may be placed by the grantee (although this may be implicitly specified following the inception of the easement when the asset is installed on the property). Once the assets have been installed, the grantor will likely not have the unilateral right to move the grantee's assets, or, if the grantor has the right to move the assets, the cost of moving the assets may be prohibitive.

Easement terms can vary from a specified period to perpetual rights. Payment terms for these arrangements are also varied. Certain easements are granted at no cost, others require a one-time upfront payment, and still others require periodic payments.

Easements are typically acquired by utilities to construct assets which require the utility to acquire access to land, either by acquisition or easements, for the desired location of the facilities. For example, in order to construct an electric transmission or distribution line, the utility is required to acquire the land and easements for the desired path or corridor

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where the line will be located. Typically, the land and easements are acquired before construction of the line in order to assure that the entire path or corridor for the line is viable.

Present Accounting Treatment by Utilities

Upfront Payments

When the acquisition of a land easement requires an upfront payment, the majority of utilities capitalize the payment as a part of the cost to construct the related utility asset, with the costs included as part of the overall property, plant, and equipment (“PP&E”). Since these land easements are acquired to construct specific PP&E, the costs to acquire the easements are incurred to bring the asset to the condition and location necessary for its intended use and therefore, are capitalized in accordance with ASC 360, *Property, Plant, and Equipment*. However, we have also identified instances where some utilities recognize an intangible asset for the upfront payment for land easements in reliance on ASC 350, *Intangibles - Goodwill and Other*.

Periodic Payments

When a land easement requires periodic payments, most utilities consider the agreement to be an executory contract and record the cost of the easement as an operating expense in each period. To a lesser extent, some utilities either account for these land easements as an operating lease with amounts expensed on a straight-line basis or follow a similar recognition pattern by analogy. However, prior to the effective date of ASC 842, *Leases*, this distinction between executory contract accounting and operating lease treatment was not critically important since both treatments result in the recognition of the cost of the land easement as an operating expense in the period incurred, and no amounts are recorded in the balance sheet.

Discussion of ASC 842, Leases

Summary of Conclusions

To qualify as a lease, a contract must convey the right to control the use of an identified asset for a period of time. Unless the grantor has substantive substitution rights, we believe land easement contracts will typically contain an identified asset. In most cases, the identified asset will be the entire land parcel identified by the contract, portions of which the grantee will use to construct and access its assets.

Therefore, the determination of whether or not the contract contains a lease will generally depend on whether the contract conveys the right to obtain substantially all of the

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economic benefits of the identified asset to the grantee during the period of use. While all facts and circumstances must be considered, in general, a land easement or other arrangement that conveys exclusive use of the identified asset during the term of the arrangement will be a lease under ASC 842. Conversely, when the grantor continues to have the right to use the identified asset along with the grantee during the period of use, the arrangement will likely not be a lease for the reasons discussed below.

Identified Asset

We believe that the proper identification of the unit of account is critical to the lease evaluation for land easements. Since each easement agreement identifies the parcel of land to which the grantee obtains certain rights, we believe the land easement agreement defines the unit of account as the entire land parcel for which the easement is granted.

As described in the background section above, land easements encompass many types of arrangements. By looking to the easement agreement to define the unit of account, the requirements of ASC 842 can be consistently applied to land easement agreements at the time the easement agreements are executed. We also believe this approach is consistent with ASC 842-10-15-9 which states that an asset typically is identified by being explicitly specified in a contract.

Furthermore, because ASC 842-10-15-2 requires that an assessment of whether or not an agreement is or contains a lease be made at inception of the agreement, we believe the identified asset will be the entire parcel of land identified in the easement agreement. In some cases, the agreement will specify the entire land parcel and give the grantee the ability to place assets on the parcel, but not specify exact locations. In other cases, the contract may specify where the grantee's assets will be placed (e.g., where a transmission tower or wind turbine will be placed), or require that the specific location of the assets be identified before the period of use begins.

Even when the location of the assets to be placed is identified in the agreement (granting exclusive use of these discrete areas), these specified areas are generally small in relation to the entire parcel of land. In most land easement arrangements, the grantee has access to the entire parcel of land for purposes of constructing and maintaining the assets, access to common areas such as roads, and the ability to place other assets, such as electric conduit, above or below the ground.

However, the grantor generally retains the right to use substantially the entire parcel of land subject to such easements. The grantee's rights to access the entire property, are specific and limited, exercised jointly with the continuing rights of the grantor to continue to use the property. As such, we do not believe that the grantee's right to place assets such

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as utility poles or wind turbines on small portions of the larger parcel changes the overall substance of the agreement, which is to share the use of the land.

As a result, we believe that land easement agreements can be classified into two categories:

1. Easements that provide the grantee exclusive use of the land
2. Easements that provide for joint use of the land by the grantee and the grantor

Easements Granting Exclusive Use of an Identified Asset

Per ASC 842-10-15-3 a contract contains a lease if the contract conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. To determine if the grantee controls the use of the identified asset, in accordance with ASC 842-10-15-4, the grantee must obtain substantially all the economic benefits from the use of the identified asset, and the grantee must have the right to direct how and for what purpose the identified asset is used. As such, for an arrangement to contain a lease it must possess these three characteristics: 1) identified asset 2) the grantee must obtain substantially all the economic benefits from the use of the identified asset and 3) the grantee must have the right to direct how and for what purpose the identified asset is used.

In the case of land easements whereby the grantee is given exclusive use of an identified parcel of land, we believe the contract will be a lease. As an example, a utility may obtain an easement for a specified land parcel on which it will build a substation as part of its electric delivery system. Due to the nature of the operations, the utility will typically construct a locked fence around the substation equipment and restrict access. The utility will have exclusive use of this property or portion of property and will therefore obtain substantially all the economic benefits from its use during the term of the arrangement. Finally, the grantee in this case has the right to direct how and for what purpose the identified asset is used. While, in the case of the substation, the purpose for which the land will be used may be predetermined (i.e., specified in the easement), the grantee directs how the asset is used by controlling access to the property and how the land will be used (placement of the substation equipment and supporting plant).

Easements Granting Joint Use of an Identified Asset

There is diversity in the accounting for joint use land easements in the industry. When land easements are executed via a one-time upfront payment, these arrangements are predominantly accounted for as part of the cost of the property, plant and equipment being constructed on the land (similar to permits). In some instances, as noted earlier, companies may account for joint use easements as executory contracts, intangible assets, or operating leases (straight-line expense pattern). Under today's accounting standards there is little difference in accounting for executory contracts, easement intangible assets and operating

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land leases, so the distinction has been less important. Under ASC 842, lessee accounting for operating land leases for lessees will require a right of use asset and lease obligation to be recorded, so correctly identifying lease contracts becomes more important.

Many land easements granting utility companies the right to place and access transmission and distribution lines on the grantor's property, with the grantor retaining the right to use the land in ways that do not interfere with the power lines, are perpetual in nature and require a one-time upfront payment or no payment at all. We believe land easements of this nature, whether joint use or exclusive use, are not leases since they do not meet the core definition of a lease. ASC 842-10-15-3 states that "a contract is or contains a lease if the contract conveys the right to control the use of identified property, plant or equipment (an identified asset) for a period of time in exchange for consideration. " For these perpetual land easements, the agreement does not state a term for the right to use the land (no period of time) and, in some cases, no consideration is exchanged. Accordingly, these types of easements will not meet the definition of a lease.

Other joint-use easements must be evaluated further. As noted above, ASC 842-10-15-3 indicates that a contract contains a lease if the contract conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. To determine if the customer controls the use of the identified asset, in accordance with ASC 842-10-15-4, the customer must obtain substantially all the economic benefits from the use of the identified asset, and the customer must have the right to direct how and for what purpose the identified asset is used.

ASC 842-10-15-17 states that to control the use of an identified asset a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). The economic benefits from the use of an asset include its primary output and by-products (including potential cash flows derived from these items) and other economic benefits from using the asset that could be realized from a commercial transaction with a third party (including, for example, a sublease).

A unique characteristic of joint use land easements is that they do not provide the grantee exclusive use of the land. The grantor of an easement typically may continue to use the land for other purposes. The arrangement may restrict both the grantee and grantor's rights to use the land such that one party's use does not interfere with the other party's use of the land.

Unless the grantor's rights are very limited, this shared use of the land indicates the customer is not obtaining substantially all the economic benefits of the asset. Grantors (or other third parties who contract with the grantor) often continue to use the land for livestock grazing, farming, mining, and other commercial business operations. The grantor

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has a contractual right to continue to obtain benefits from the land, and therefore the grantee does not have a right to substantially all the economic benefits of the asset.

It should also be noted that in certain instances the grantee may receive a land easement right, but elect not to construct on the land. For example, a utility may acquire a land easement to potentially construct wind generation assets but decides to not build those assets for a variety of reasons. In such an instance, the grantor continues to obtain all the economic benefits of the asset, which further demonstrates the grantee does not have the exclusive right to control the land for a period of time under these arrangements.

ASC 842-10-55-41 through 55-130 provide 10 separate examples that assist with identifying a lease. In eight of these examples, ASC 842 concluded the arrangement contained a lease, and in each of those eight examples, the customer had exclusive use of the identified asset (see examples 1, 3, 4, 5, 6, 7, 9, and 10). The lessee's exclusive use of the identified asset indicated the lessee obtained substantially all the economic benefits from the asset. Land easements often differ from these examples, as the grantee typically does not have exclusive use of the land.

To provide further clarification regarding economic benefits BC38 (a) states:

The lessee's right of use permits the lessee to obtain substantially all the benefits from use of the asset during the lease term and to control others' access to the identified underlying asset through its right to control the use of the underlying asset throughout the lease term. Once the underlying asset is delivered (that is, the right of use is conveyed) to the lessee, neither the lessor nor any other party is able to have access to the underlying asset without the consent of the lessee (or breach of contract). Despite being the legal owner of the underlying asset, the lessor is unable to retrieve or otherwise use the underlying asset during the lease term without breaching the contract with the lessee.

The rights granted with a joint use land easement are not typically consistent with the discussion in BC38. The grantee obtains certain limited rights relating to a land easement, but does not control others' access to the land, and typically the grantor is able to access and use the land without the grantee's consent. The grantee does not typically have exclusive use of the overall land parcel as the grantor continues to have access rights and may derive other economic benefits from using the land. So long as the grantee's right to traverse the land or place equipment on a portion of the land does not restrict the grantor's ability to access and use the land, then that right does not provide the grantee with substantially all the economic benefits from the land. In contrast with BC38, if the grantee entered a sublease arrangement for use of the property, it would typically be in breach of the land easement contract, as its rights with respect to the property are too limited to permit such activity.

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Further, we believe the key consideration in this evaluation is that the grantor retains *the contractual right* to use the land in ways that do not interfere with the grantee's use. We do not believe it is required that the grantor is currently using the land or that the easement contract can determine how the grantor might use the land. At the inception of the easement, the parties only need to determine whether the grantor retains the contractual right to share the use of the land to obtain economic benefits and that the grantor's contractual rights are not insignificant in order to evaluate whether the arrangement is a lease. Accordingly, the evaluation of whether or not the grantee enjoys substantially all the economic benefits of the identified asset should be based on the contractual provisions of the agreement.

Per ASC 842-10-15-20, a lessee must have the right to direct how and for what purpose an asset is used through the period of use, unless those decisions are predetermined. Land easements relate to the right to utilize and access space that may be above, below, or on land. As should typically be the case per the standard, and particularly given the importance of access rights which permit construction, maintenance and ultimately removal of the grantee's asset from the grantor's property, the evaluation of directing how and for what purpose an asset is used should be performed at the level of the land parcel identified in the contract.

In general, the grantee under an land easement does not make decisions regarding how and for what purpose the land parcel identified in the contract is used, and the grantor will continue to make decisions on how the land parcel identified in the contract will be used (such as whether the land should be grazed or farmed). Thus, the grantee does not direct how and for what purpose the identified asset is used. Similar to economic benefits, the structure of the arrangement may require additional assessment to clearly understand the rights of both the grantee and the grantor to direct how and for what purpose the land is used.

Transition Guidance

Utilities are committed to working diligently to implement ASC 842 effectively and accurately. However, as discussed above, there has been diversity in practice in the accounting for land easements by utilities based on judgements made by utilities on how to apply generally accepted accounting principles ("GAAP") prior to the issuance of ASC 842. The cost of many land easements paid upfront has been recorded in PP&E based on the guidance contained in ASC 360. However, some companies classified these costs as intangible assets based on the guidance of ASC 350. Typically, the cost of land easements requiring periodic payments has been charged to operating expense. We believe that these were reasonable judgements by utilities based on the existing guidance.

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Typically, each utility has thousands of land easements which have been recognized in accordance with that company's accounting policies prior to the issuance of ASC 842. Utilities may have a significant volume of these transactions; however, the transactions do not tend to have a significant monetary value in relation to the utility's financial statements. Thus, implementing ASC 842 will require a significant effort on the part of utilities that do not elect the practical expedients to identify easement agreements and, if necessary, apply the ASC 842 framework. For companies that elect the practical expedients, the accounting for the existing land easements will remain unchanged.

To the extent the outcome of the Board's deliberations result in a change in current practice in the accounting for land easements, we believe that the Board should consider providing transition guidance for companies that do not elect the practical expedients regarding the accounting for land easements in implementing ASC 842 to mitigate the burden of evaluating such a large number of agreements which are not expected to result in a material change to utility financial statements. For example, the Board could consider only requiring application of the requirements of ASC 842 prospectively for land easements executed after the adoption of the standard. This would mitigate concerns related to the evaluation of such a large volume of land easement agreements in connection with the implementation of ASC 842 and possible negative impacts on the ability to successfully meet the required implementation date. Without such transition guidance for companies that do not elect the practical expedients, the volume of land leases will impact their ability to effectively adopt ASC 842.

Conclusion

EEI and AGA appreciate the opportunity to provide our input regarding the accounting for land easements and the application of ASC 842. We would be pleased to discuss our comments and to provide any additional information that you may find helpful, including attending the workshop planned for July 12, 2017.

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Very truly yours,

/s/ Richard F. McMahon, Jr.

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