

Case 12-1

An Unlikely Alliance?

Meyer Inc. (“Meyer”) and Saban Company (“Saban”) are investors in energy venture Florabama, an independent power producer with one power plant located in the southwestern United States. Meyer owns 60 percent of Florabama, and Saban owns 40 percent of Florabama. Meyer and Saban obtained their ownership in Florabama in February 2011 by contributing cash in a ratio equal to their ownership percentages. The terms of the venture arrangement permit Saban to purchase up to 20 percent of the power produced by Florabama at cost plus. Cost-plus arrangements are those when the buyer agrees to pay the cost of producing the goods plus a certain fee or rate. The fee or rate in this case is not a pertinent fact. The remainder of the power produced by Florabama is sold to third parties at market rates. The Articles of Incorporation of Florabama state the following in terms of governance and management of Florabama:

- The Board of Florabama (the “Board”) comprises ten individuals: six individuals from Meyer and four individuals from Saban.
- All strategic decisions regarding the operations of Florabama, such as establishing operating and capital budgets, determining the pricing of the power produced by Florabama and the appointment of the CEO of Florabama (the “CEO”) must be presented to the Board and are determined by a simple majority vote.
- The CEO is responsible for ensuring that the day-to-day operations of Florabama are executed in a manner consistent with the operating plan approved by the Board.
- The appointed CEO was the COO of Saban before the formation of Florabama and continues to be an employee of Saban after the formation of Florabama and the appointment to the CEO position of Florabama.

The sale, transfer, or disposition of the ownership interest in Florabama by either Meyer or Saban requires the advanced written consent of the other party to the venture. Both Meyer and Saban are willing, independent parties to the arrangement and mutually agreed upon the prior approval terms.

Profits and losses of Florabama are split according to ownership percentage.

Florabama does not meet the conditions specified in ASC 810-10-65-2(aa) to qualify for the deferral from applying the provisions of FASB ASU No. 2009-17, *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*, and formerly FASB Statement 167, *Amendments to FASB Interpretation No. 46(R)*.

Meyer and Saban are not related parties, as defined in ASC 810-10-25-43 (as amended by ASU 2009-17).

All equity investments represent equity at risk. On the basis of the nature of the entity and the level of equity investment at risk, Florabama is deemed to be a variable interest entity

(VIE) pursuant to ASC 810-10-15-14(a) (as amended by ASU 2009-17). In addition, the cost-plus purchase arrangement between Saban and Florabama represents a variable interest, because the cost-plus arrangement is designed such that Saban reimburses Florabama for all of the actual costs incurred to produce the power Saban purchases. Therefore, Saban absorbs variability in Florabama through the cost-plus pricing terms.

Required:

- What is the primary purpose and design of Florabama (including the risks that Florabama was designed to create and pass through to its variable interest holders)?
- Determine whether Meyer, Saban, or both are variable interest holders.
- Who, if anyone, is the primary beneficiary and why?