October 26, 2004

MEMORANDUM TO: Commissioner Diaz
Commissioner McGaffigan
Commissioner Merrifield

FROM: Luis A. Reyes **/RA Martin J. Virgilio Acting For/**
Executive Director for Operations

SUBJECT: USE OF INSURANCE AS A METHOD TO PROVIDE FINANCIAL ASSURANCE FOR DECOMMISSIONING NUCLEAR POWER REACTORS

The purpose of this memorandum is to inform the Commission of the staff's proposed Standard Review Plan (SRP) criteria for evaluating the insurance method of providing financial assurance for decommissioning nuclear power reactors and provide the status of the staff's ongoing reviews of two insurance proposals.

In a memorandum dated May 20, 2004, from then Executive Director for Operations, Dr. William Travers, the Commission was informed of the staff's receipt of two first-of-a-kind proposals submitted by Marsh USA (Marsh) and Nuclear Electric Insurance Limited (NEIL) to use insurance to provide financial assurance for decommissioning nuclear power reactors pursuant to 10 CFR 50.75(e)(1)(iii). In that memorandum, the staff stated that it would develop SRP criteria to evaluate the use of insurance, commence reviews of the two proposals, and inform the Commission of its progress by October 2004.

The U.S. Nuclear Regulatory Commission (NRC) regulations at 10 CFR 50.75(e) specify that insurance is an acceptable method for a licensee to demonstrate reasonable assurance that sufficient funds will be available for the plant decommissioning process. Specifically, 10 CFR 50.75(e)(1)(iii) requires that certain terms and conditions must be present in the decommissioning insurance policy. These conditions include: automatic renewal, 90-days advance notice by the insurer of intent not to renew the policy, and payment of the full face amount into a trust if the licensee fails to provide an acceptable replacement after receiving notice of the insurer's intent to cancel the policy.

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However, 10 CFR 50.75 contains only limited requirements for use of the insurance method. Similarly, existing guidance provided by NUREG-1577, Rev. 1, “Standard Review Plan on Power Reactor Licensee Financial Qualifications and Decommissioning Funding Assurance” (SRP), and NUREG-1757, Vol. 3, “Consolidated NMSS Decommissioning Guidance: Financial Assurance, Recordkeeping, and Timeliness,” provide only limited information for evaluating the insurance method. As a result, the staff developed a draft supplement to the SRP which provides criteria for evaluating the use of the insurance method. The draft supplement SRP criteria were published for public comment in the *Federal Register* on July 19, 2004 (Attachment 1, 69 FR 43278).

Status of Proposed SRP Criteria

As of August 18, 2004, the end of the comment period on the draft supplement SRP criteria, the staff had received comments from seven industry organizations: the Nuclear Energy Institute (NEI), AIG Environmental (AIG), Morgan Lewis on behalf of Marsh, Tennessee Valley Authority (TVA), Progress Energy, Exelon Nuclear (Exelon), and NEIL. A number of the commenters, including NEIL, Marsh, TVA, and Exelon, endorsed NEI’s comments.

The staff also interacted with a number of State Public Utility Commissions (PUCs) and representatives of the National Association of Regulatory Utility Commissioners (NARUC) regarding the draft supplement SRP criteria, and learned that several PUCs intend to submit comments. The staff recently received comments from the State Public Service Commissions of Wisconsin and Michigan. The submittal of any other PUC comments is uncertain at this time. Nonetheless, based on telephone discussions with the PUCs and NARUC, the staff does not expect that any additional State comments would result in any major changes to the criteria. The staff revised the draft supplement SRP criteria, based on public comments, and developed the proposed final supplement SRP criteria (Attachment 2). The staff considers the proposed final supplement SRP criteria to be adequate, at this time, to be used to complete its review of the two proposals by summer 2005. The staff plans to issue the final supplement SRP criteria in summer 2005.

Key Issues/Staff Positions Regarding the Insurance Method

The comments received on the draft supplement SRP criteria, as provided in Attachment 3, generally support NRC’s issuance of the criteria but raise a number of key issues which are highlighted below for the Commission. Additional details regarding the staff’s resolution of all the comments are provided in Attachment 4.

I. Financial Qualifications of the Insurance Company

State PUC commenters supported the SRP criteria. However, the NEI recommended deletion of the SRP requirements that a captive insurance company obtain (1) a private letter ruling from the IRS as to whether the company qualifies as an insurance company and (2) a financial rating.

NEI recommended that the staff instead evaluate each proposal on a case-by-case basis, with deference to the solvency requirements of the insurance commissioner of the State in which the insurer is licensed. It also recommended deletion of the SRP requirements that the insurer be licensed in the State where the insured plant is located and that the insurer provide the NRC with a statement of approval or no objection to the insurance program from the PUC in the State where the relevant plant is located, if the PUC continues to exercise oversight of decommissioning funds.

Staff Position - The provider of the insurance policy must be financially qualified. This is consistent with the requirement of 10 CFR 140.17(a) with respect to liability insurance that the insurer must demonstrate “a clear ability to meet its obligations.” Although a similar requirement is absent from 10 CFR 50.75, the staff believes that the insurer must demonstrate assurance that, within the coverage limits of the policies, sufficient funds will be available for decommissioning all plants covered by the insurer’s policies.

The staff is concerned about the long-term financial stability of proposed insurance companies, especially new insurance companies that do not have a financial history, and does not agree with the NEI comments to delete the various regulatory approvals. In particular, for a small, captive insurer that is wholly owned by the insureds, “risk pooling” could lead to situations where concurrent payouts of decommissioning costs for multiple plants depletes funds needed for other plants. Reinsurance is also a concern of the staff in that there may be no third party, such as another company that provides reinsurance or a parent company, that will guarantee supplemental funds to the insurance company, if needed.

To address these concerns, the proposed final supplement SRP criteria state that on a plant-specific basis the insurer must do the following:

- If the proposed insurer is a captive, a risk retention group (RRG), or a mutual insurance company, present to the NRC an IRS private letter ruling finding that the insurer is a qualified insurance company thereby permitting certain tax treatment.

- Be licensed by the insurance commission in the States where the plants are located or obtain approval or a statement of no objection for each plant-specific policy from each relevant State insurance commission.

- If the insurer is a captive, an RRG, or a mutual insurance company, possess an acceptable financial strength or safety rating from a nationally recognized insurance rating organization.

- Provide to the NRC a statement from the relevant PUC approving or having no objection to the insurance policy if the licensee is an electric utility or a non-electric utility with access to non-bypassable charges. The staff intends to make it a condition of NRC approval that the PUC accepts or does not object to the proposed policy, since ratepayer funds will be used to purchase the insurance policy and the PUCs generally have oversight of such funds.

II. Claims Management of Decommissioning Costs

The NEI asked that the NRC recognize and allow a claims payment process whereby an insurer can assess a claim prior to reimbursing the licensee for insured costs actually incurred. The commenters stated that it is commercially unreasonable to expect any insurer to pay claims without regard to whether the costs have been incurred and are covered by the policy. They also stated that the absence of the insurer's claims management process could present a significant impediment to obtaining State insurance commissioner approval or the necessary determination from the IRS that the arrangements constitute insurance for tax purposes.

Staff Position -The existing system for the management and payment of decommissioning costs has been effectively used in the decommissioning of nuclear power reactors. To recover decommissioning costs, the licensee submits to the trustee a decommissioning payment request that is in accordance with the NRC-approved license termination plan and/or the provisions of 10 CFR 50.82(a)(8). The trustee verifies that the request is valid and withdraws funds from the trust to pay the licensee. Therefore, both the staff and trustees have a limited role in any licensee's request to withdraw decommissioning funds pursuant to 10 CFR 50.82(a)(8) or an approved license termination plan. Trustees simply verify that the licensee's request is for activities consistent with an NRC-approved plan and/or 10 CFR 50.82. However, the staff can audit the licensee's payment requests to ensure that the licensee is complying with the NRC-approved plan and/or 10 CFR 50.82.

Claims management may be a significant issue for a proposed insurance company whose program relies on a comprehensive claims management process involving substantive review and approval by the insurer of decommissioning activities, vendor selection, and payment of costs. The staff is concerned about any substantive claims management process implemented by an insurer because that process could interfere with NRC's direct regulatory oversight of licensees. The staff believes that such a process has the potential to undermine the system of financial controls established under 10 CFR 50.82 and interfere with the licensee's ability to complete decommissioning in a timely manner in accordance with plans approved by the NRC.

In addition, the staff believes that there are three existing conditions which preclude the need for the insurer to perform claims management: (1) the NRC and a licensee and its decommissioning contractor already provide extensive oversight of costs of decommissioning activities, (2) the trustee of the decommissioning trust certifies the licensee's request for payment to assure that costs are paid only for activities consistent with NRC-approved plans or 10 CFR 50.82, and (3) other approved decommissioning funding methods do not involve any additional claims management process. Further, although claims management is a normal commercial insurance process in other industry contexts, the staff does not believe that it is appropriate in the NRC's reactor decommissioning process, which involves NRC approval of specific decommissioning plans and licensees' adherence to those plans.

Therefore, the proposed final supplement SRP criteria state that a claims management process is unacceptable. The proposed final SRP criteria require the insurance company to pay the trustee of the decommissioning trust or standby trust as necessary to support the trustee's disbursement of funds to cover legitimate decommissioning costs.

III. Amount of Coverage

The NEI asked that the NRC not impose constraints on provisions allowing any increases or reductions in coverage in any limits under a predetermined methodology.

Staff Position - The coverage specified in an insurance policy is the amount of financial assurance to be provided throughout the term of the policy. Some policies may contain variable amounts of insurance coverage contingent on certain events. For example, the amount of coverage for a reactor could increase over the term of the license; it could also be reduced for premature decommissioning. Other policies may contain a specified coverage that does not change over the term of the operating license.

The staff believes that the insurance policy should provide either specified face amounts of coverage or a methodology by which definitive payout amounts can be calculated at any time throughout the period of coverage.

Therefore, the proposed final supplement SRP criteria state that if any proposed insurance policy provides more than a single pay-out amount, the NRC will use only the lowest amount when assessing whether a sufficient amount of coverage has been offered, whether it is in combination with one or more other approved decommissioning funding assurance methods or it is the sole assurance method.

IV. Investment Restrictions

The NEI stated that when NRC decommissioning funds are transferred from prepaid funds or from an external sinking fund to buy insurance, the SRP should require that the standard of care for investments of those funds be either the standard imposed by a PUC or State insurance commissioner or, where no such standard applies, the prudent investor standard.

Staff Position - Restrictions on the investment of decommissioning trust funds of non-electric utilities exist under 10 CFR 50.75(h)(1). Use of the insurance method could involve the transfer of substantial amounts of funds from a licensee's decommissioning funds, currently held in external trusts, to the insurance company. The insurance company could invest those funds in order to build and maintain sufficient reserves to pay for decommissioning. Like any other investment, the invested funds could be subject to market fluctuations. It is important that the insurance company invest and manage the funds in a prudent manner.

Accordingly, for non-electric utilities, the staff believes that to reasonably ensure that funds will be available from the insurance company when needed, the insurance company should be

subject to the restrictions analogous to those in 10 CFR 50.75(h)(1), which obligates a decommissioning trust fund trustee to adhere to applicable State or Federal standards or, in their absence, the prudent investor standard.

Therefore, the proposed final supplement SRP criteria state that, as a condition in the insurance policy, the insurer must invest all NRC decommissioning funds transferred from prepaid funds or an external sinking fund, and all earnings thereon, consistent with applicable state standards, or, where no such standards apply, the prudent investor standard set forth in 18 CFR Part 35 Subpart E.

Under certain plant-specific insurance policies for non-electric utilities, the trustee of an existing nuclear decommissioning trust would use all or substantially all of the trust funds to purchase an insurance policy but maintain the policy as a trust investment. In this case, the trustee would be making essentially a single investment, rather than investing in a diversified portfolio with offsetting risks as would be required, for example, under the prudent investor standard.

Therefore, because 10 CFR 50.75(h)(1) effectively bars non-electric utilities from establishing single-investment decommissioning trusts, certain insurance policies described above may require an exemption to the requirements in this regulation. The single investment restriction is not included in the proposed final supplement SRP criteria, as it will be addressed on a case-specific basis.

Status of Ongoing Reviews of Proposals To Use Insurance

Based on the results of discussions in meetings on May 12 and June 2, 2004, with Marsh and NEIL, respectively, the staff accepted the proposals for review. The staff initiated its reviews of the proposals in May 2004, and is currently on schedule to issue requests for additional information by October/November 2004, based on the attached proposed final supplement SRP criteria and complete the reviews by mid-2005. If the proposed insurance methods are acceptable, the staff plans to review any future applications of the proposed methods on a plant-specific basis.

Status of Decommissioning Reactor Insurance Exemption Request

Additionally, the staff provided SECY-04-0176, dated September 29, 2004, to the Commission denying exemption requests from Maine Yankee, Yankee Rowe, Trojan, and Big Rock Point to reduce the primary insurance coverage required by the Price-Anderson regulation for conditions where removal of all spent fuel has been transferred to an independent spent fuel

storage installation. Upon completion of ongoing spent fuel pool risk studies and pending its resolution of safeguards and security issues regarding these reactors, the staff will revisit the requests for exemptions and any other policy matters pertaining to the level of indemnity insurance coverage for a decommissioning reactor.

Attachments:
1. *Federal Register* Notice: Draft Supplement Standard Review Plan (69 FR 43278; July 19, 2004)
2. Proposed Final Supplement Standard Review Plan: Decommissioning Funding Assurance for Power Reactors
3. Public Comments on Draft Supplement Standard Review Plan
4. Proposed Staff Resolution of Comments on Draft Supplement Standard Review Plan

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