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NUCLEAR ENERGY INSTITUTE

December 12, 2016

Mr. Anthony Bowers
Chief, Financial Analysis and International Projects Branch
Division of Inspection and Regional Support
Office of Nuclear Reactor Regulation
U.S. Nuclear Regulatory Commission
Washington, DC 20555-0001

Subject: Submittal of NEI 16-11, 10 CFR 50.75(h) Nuclear Decommissioning Trust Investment Restriction Guidelines

Project Number: 689

Dear Mr. Bowers:

NEI is pleased to submit for NRC review and endorsement NEI 16-11, 10 CFR 50.75(h) Nuclear Decommissioning Trust Investment Restriction Guidelines. The purpose of this submittal is to provide clarifying guidance to support the effective implementation of U.S. Nuclear Regulatory Commission (NRC) Nuclear Decommissioning Trust (NDT) investment regulations at "merchant" nuclear power plants (i.e., reactor licensees that are not "electric utilities" subject to traditional cost-of-service rate regulation).

Currently, NRC regulations restrict certain investments made with funds from NDTs held by merchant power plants. With the initial license transfer approvals for nuclear power plants that moved to merchant status, the NRC has imposed license conditions that prohibit investments in any securities of any entities that own one or more nuclear power plants, subject to certain exceptions for "investments tied to market indexes." After imposing these conditions on a case by case basis for several power plants, the NRC codified its NDT investment restrictions in a regulation, 10 CFR 50.75(h)(1), promulgated in 2002. Licensees who continue to qualify as electric utilities are not subject to 10 CFR 50.75(h)(1), but rather must comply with 10 CFR 50.75(h)(2) , which does not impose investment restrictions.

The Statement of Considerations for the rule indicates the NRC intended substantial flexibility in managing investments, provided NDTs were managed consistent with this stated purpose. However, experience to date indicates that the intended scope of this flexibility is potentially subject to varying interpretations. Accordingly, NEI 16-11 provides clarification regarding:

1. Attenuated ownership of nuclear power plants;

2. Active management of “securities tied to market indices”;
3. Investments in Real Estate Investment Trusts (“REITs”); and
4. The 10 percent de minimis investment provision.

We thank NRC for considering NEI 16-11. We would be happy to meet with you to discuss this guidance document and look forward to the possibility of attaining NRC staff endorsement.

Please do not hesitate to contact me if you have any questions. I look forward to meeting with you to discuss this topic further.

Sincerely,

Mark A. Richter

Attachment

From:	McCarthy, Steve
To:	McCarthy, Steve
Subject:	FW: Submittal of NEI 16-11, 10 CFR 50.75(h) Nuclear Decommissioning Trust
Date:	Tuesday, December 13, 2016 11:30:15 AM
Attachments:	12-12-16_NRC_Submittal of NEI 16-11, 10 CFR 50.75(h) Nuclear Decommissio....pdf 12-12-16_NRC_Submittal of NEI 16-11, 10 CFR 50.75(h) Nuclear Decommissio....pdf

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From: RICHTER, Mark [mailto:mar@nei.org]
Sent: Monday, December 12, 2016 4:24 PM
Subject: [External_Sender] Submittal of NEI 16-11, 10 CFR 50.75(h) Nuclear Decommissioning Trust

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NEI 16-11 [Rev 1]

10 CFR 50.75(h) Nuclear Decommissioning Trust Investment Restriction Guidelines

December 2016

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NEI 16-11 [Rev 1]

Nuclear Energy Institute

10 CFR 50.75(h) Nuclear Decommissioning Trust Investment Restriction Guidelines

December 2016

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TABLE OF CONTENTS

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10 CFR 50.75(h) NUCLEAR DECOMMISSIONING TRUST INVESTMENT RESTRICTION GUIDELINES

1 INTRODUCTION

1.1 PURPOSE

The U.S. Nuclear Regulatory Commission ("NRC") restricts certain investments made with funds from Nuclear Decommissioning Trusts ("NDTs") held by "merchant" power plants (*i.e.*, reactor licensees that are not "electric utilities" subject to traditional cost-of-service rate regulation). With the initial license transfer approvals for nuclear power plants that moved to "merchant" status, the NRC has imposed license conditions that prohibit investments in any securities of any entities that own one or more nuclear power plants, subject to certain exceptions for "investments tied to market indexes."[1] After imposing these conditions on a case by case basis for several power plants, the NRC codified its NDT investment restrictions in a regulation, 10 CFR 50.75(h)(1), promulgated in 2002.[2] Licensees who continue to qualify as electric utilities are not subject to 10 CFR 50.75(h)(1), but rather must comply with 10 CFR 50.75(h)(2) , which does not impose investment restrictions.

The Commission explained that the purpose of the restrictions was "to forestall members of the nuclear industry from solely investing their nuclear decommissioning funds in each other's securities."[3] NRC staff indicated that "this requirement is consistent with fund diversification."[4] The Statement of Considerations for the rule indicates the NRC intended substantial flexibility in managing investments, provided NDTs were managed consistent with this stated purpose. However, the scope of this flexibility requires further clarification, *i.e.*, regarding the appropriate interpretation of the existing regulations.

Accordingly, NEI 16-11 provides clarification regarding:

1. attenuated ownership of nuclear power plants;
2. active management of "securities tied to market indices";
3. investments in Real Estate Investment Trusts ("REITs"); and
4. the 10 percent *de minimis* investment provision.

[1] *See, e.g.*, "Order Approving Transfer of License and Conforming Amendment," 64 FR 19202, 19203 (Apr. 19,1999) (TMI-1 License Condition 7(c): "Except for investments tied to market indexes or other non-nuclear sector mutual funds, investments in any entity owning one or more nuclear power plants is prohibited.").

[2] 10 CFR 50.75(h)(1)(i)(A); Decommissioning Trust Provisions, 67 FR 78332, 78336 (Dec. 24, 2002) (codified in 10 CFR Parts 50 and 72) ("Final Rule"). The rule was subsequently corrected and amended in minor form. *See* 68 FR 65386 (Nov. 20, 2003).

[3] 67 FR at 78336.

[4] *Id.*

1.2 NDT INVESTMENT RESTRICTION BACKGROUND

In 1988, the NRC began requiring licensees to provide financial assurance of adequate decommissioning funding.[5] However, the NRC deferred to the Federal Energy Regulatory Commission ("FERC") and state authorities to regulate the funding methodology and investments.[6] FERC adopted a "prudent investor" standard,[7] and imposed a prohibition against investing NDT funds in the securities of the utility holding the NDT:

> Except for investments tied to market indexes or other mutual funds, the Investment Manager shall not invest in any securities of the utility for which it manages the funds or in that utility's subsidiaries, affiliates, or associates or their successors or assigns.[8]

FERC indicated that the allowance for investments in broad market indexes or other mutual funds was appropriate because, otherwise, the investment restriction "would unduly restrict investments in market indexes and other mutual funds, and make such investments inordinately difficult to place and to monitor."[9]

Historically, most nuclear power plants were owned by "electric utilities" with traditional cost-of-service rate recovery. In 1999, in the wake of a significant restructuring of the electric utility industry, some licensees sought license transfers to become "merchant" plants. The NRC Staff determined that additional oversight of merchant plant NDTs was necessary, because FERC and state authority regulation was expected to cease.[10] Accordingly, the NRC began imposing NDT investment-related license conditions on merchant plant license transfers. These conditions placed the FERC "prudent investor" standard and investment restrictions into each plant's license.[11] The NRC expanded the FERC investment restriction to include not only the utility holding the NDT, but also to include all other reactor owners. However, the NRC also adopted an exception for investments tied to market indices.

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[5] Final Rule, "General Requirements for Decommissioning Nuclear Facilities," 53 FR 24018, 24037-38 (June 27, 1988).

[6] In 1995, FERC issued a final rule which set forth detailed guidelines regarding the requirements for forming and organizing NDTs for plants over which it had jurisdiction under the Federal Power Act. Nuclear Plant Decommissioning Trust Fund Guidelines; Final Rule, 60 FR 34109 (June 30, 1995) (codified in 18 CFR 35.32 & 35.33).

[7] 18 CFR 35.32(a)(3).

[8] 18 CFR 35.32(a)(8).

[9] 60 FR at 34117.

[10] 67 FR at 78332.

[11] *See, e.g.*, Three Mile Island, Unit No. 1, "Order Approving Transfer of License and Conforming Amendment," 64 FR 19202, 19203 (April 19, 1999) (providing that, "[e]xcept for investments tied to market indexes or other non-nuclear sector mutual funds, investments in any entity owning one or more nuclear power plants is prohibited").

1.3 RULEMAKING HISTORY OF 10 CFR 50.75(h)

In 2001, the NRC initiated a generic rulemaking to uniformly codify the principles embodied in the merchant plant license conditions.[12] The Final Rule was published December 24, 2002, and, in part, added a new paragraph, 10 CFR 50.75(h), to the agency's NDT regulations.[13] As relevant to NEI 16-11, 10 CFR 50.75 (h)(1)(i)(A) codifies the general rule that the person directing investment of the funds:

> Is prohibited from investing the funds in securities or other obligations of the licensee or any other owner or operator of any nuclear power reactor or their affiliates, subsidiaries, successors or assigns, or in a mutual fund in which at least 50 percent of the fund is invested in the securities of a licensee or parent company whose subsidiary is an owner of a foreign or domestic nuclear power plant…

In responding to comments, the NRC staff indicated that "the NRC believes that this requirement is consistent with fund diversification."

The phrase "securities or other obligations" is used broadly in Section 50.75(h), and covers all forms of investments, including stocks, bonds, and commercial paper. Additionally, 10 CFR 50.75(h)(1)(i)(A) provides two exceptions to the general rule. First, "the funds may be invested in securities tied to market indices." Second, the rule "permit[s] a *de minimis* investment in otherwise prohibited mutual fund investments" of up to 10% of the total value of the trust account.[14]

Finally, the NRC also made clear that the rulemaking did not supersede the investment restrictions that were previously imposed as license conditions.[15] Instead, it gave licensees with such conditions in their licenses the option either to maintain compliance with their existing license conditions, or to amend their licenses to delete the specific conditions and instead comply with the new regulatory requirements.[16] There is significant overlap between the regulations and the specific license conditions, and the more detailed principles articulated in the rulemaking can be viewed as the NRC Staff's interpretation of the license conditions.

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[12] Decommissioning Trust Provisions, 66 FR 29224, 29225 (May 30, 2001) (noting the NRC's intent to "codify existing practice").

[13] Decommissioning Trust Provisions, 67 FR 78332 (Dec. 24, 2002) (codified in 10 CFR Parts 50 and 72) ("Final Rule"). The Commission made minor clarifying changes to the rule in 2003. *See* 68 FR 65386.

[14] 67 FR at 78336. The original rule codified this concept at 10 CFR 50.75(h)(1)(i)(A) with the following language: "that these restrictions do not apply to 10 percent or less of their trust assets in securities of any other entity owning one or more nuclear power plants." In 2003, the language was amended in a Direct Final Rule to read: "that no more than 10 percent of trust assets may be indirectly invested in securities of any entity owning or operating one or more nuclear power plants." 68 FR at 65387. The revision was intended to "clarify" (not change) the meaning of the *de minimis* provision. *Id*.

[15] 10 CFR 50.75(h)(5).

[16] 67 FR 78335.

1.4 NRC GUIDANCE: REGULATORY GUIDE 1.159

In tandem with the rulemaking, the NRC updated Regulatory Guide 1.159, "Assuring the Availability of Funds for Decommissioning Nuclear Reactors."[17] Section 2.2.3.2 of Regulatory Guide 1.159 provides guidance related to the general prohibition in 10 CFR 50.75(h)(1)(i)(A), and defines "affiliate" as follows:

> An affiliate is any company that controls, is controlled by, or is under common control with the licensee or any other owner or operator of the facility.[18]

This guidance is consistent with the commonly understood definition of an affiliate under various rules of the U.S. Securities and Exchange Commission.[19]

The NRC staff stated that the restriction in Section 50.75(h)(1)(i)(A) was necessary to prevent licensees from solely investing in other nuclear companies' securities and to ensure proper fund diversification.[20] However, neither Regulatory Guide 1.159, nor the rule itself, explicitly states:

> (1) whether the term "owner" in 10 CFR 50.75(h)(1)(i)(A) includes either:
> (a) every entity with an equity interest, regardless of attenuation; or
> (b) only direct (full or partial) owners and their parent holding company affiliates;
>
> (2) whether the exception for investments in "securities tied to market indices" is limited to passive investments tied to indices or also applies to investments actively managed by an independent investment manager pursuant to a mandate tied to a widely recognized market index;
>
> (3) whether investment of NDT funds in a security structured as a Real Estate Investment Trust ("REIT") constitutes a prohibited investment, because a licensee or other covered entity might be said to be obligated to the REIT, *e.g.*, pursuant to the terms of a lease for office space or other real estate; or
>
> (4) whether the change to the regulation relating to the 10% *de minimis* exception (or "safe harbor") was intended to impose a 10% "ceiling" on investments involving reactor owners or operators, including investments made under the market index exception that are otherwise permitted.

Thus, NEI 16-11 provides additional guidance in this regard.

[17] *See* 67 FR 78333.

[18] NRC Regulatory Guide 1.159, Rev 2 (October 2011).

[19] *See*, *e.g.*, 17 CFR 230.405.

[20] *See* 67 FR at 78336-37

2 CLARIFICATION OF NDT INVESTMENT RESTRICTIONS

2.1 DEFINITION OF "OWNERS"

In its 2002 rulemaking, the Commission explained that "the NRC considers partial owners of a nuclear power plant to be the same as full owners" for purposes of the investment restriction in 10 CFR 50.75(h)(1)(i)(A).[21] This statement has led some licensees, trustees, and investment managers to question whether the Commission intended the general prohibition in 10 CFR 50.75(h)(1)(i)(A) to apply to investments in any entity possessing an indirect equity interest in the licensed owner or operator of a nuclear power plant, regardless of how attenuated that equity interest may be. However, the record reflects that Commission did not intend such a sweeping definition of "owner."

First, any interpretation of 10 CFR 50.75(h)(1)(i)(A) that would include remote equity interests within the definition of "owner" would yield the absurd result of prohibiting investments in various types of investments or issuances offered by large financial institutions that might happen to be a shareholder of a reactor licensee's parent holding company. Many well-known financial institutions, such as Vanguard, State Street, Franklin, Black Rock, Fidelity, JPMorgan, Citi, and Morgan Stanley, hold attenuated equity interests in publicly traded shares of companies in the energy industry—and many of those energy companies have subsidiaries that own nuclear power plants. But the Commission has never expressed any intent to prohibit investment of NDT funds in these common financial sector securities or other investment vehicles.[22] To the contrary, prohibiting such investments would be antithetical to the purpose of the restriction, because this would limit the ability of NDTs to hold diversified investments.

In fact, the Commission explicitly noted that "a complete list of licensees/owners of nuclear power plants may be found in 'Owners of Nuclear Power Plants,' NUREG/CR-6500, Rev. 2, (March 2002)." Importantly, NUREG/CR-6500 lists only NRC licensees, demonstrating that the Commission did not view attenuated equity interests in licensees to constitute "ownership" for the purposes of NDT investment restrictions. Accordingly, the reference to "partial owners" in the 2002 rulemaking is properly understood as referring to investments in co-owners of a nuclear power plant holding direct, but less than 100%, ownership interests in the plant.

This guidance clarifies that the term "owner or operator" in the investment prohibition in 10 CFR 50.75(h)(1)(i)(A) refers only to direct owners or operators of nuclear power plants and their affiliates, and it does not include entities with indirect, non-controlling equity interests in direct owners or operators of nuclear power plants. If an entity has a controlling interest in the parent holding company of a reactor licensee, then its issuances would be prohibited investments. For example, Berkshire Hathaway has a controlling interest in MidAmerican Energy Company,

[21] 67 FR at 78337.

[22] Indeed, a prohibition on such basic investments would necessitate vast liquidation of securities in NDTs across the industry, resulting in transaction costs and tax liability, with the counterproductive effect of diminishing NDT balances. Furthermore, it would be impractical to track exponentially-attenuated shareholders, significantly reducing the available securities in which NDT funds could be invested, which would frustrate the Commission's stated goal of diversification of investments.

which is a 25% owner licensee for Quad Cities, Units 1 and 2. As such, Berkshire Hathaway qualifies as an "affiliate," and its securities properly are treated as prohibited investments.

In contrast, the Vanguard Group, Inc. (Vanguard) has reported to the Securities and Exchange Commission that it owns approximately 6.2% of the shares of the Southern Company. Vanguard is not considered an "affiliate" of the Southern Company, and as such, it should not be considered an "owner or operator" of a reactor subject to the investment restriction in 10 CFR 50.75(h)(1)(i)(A). Thus, investments in the offerings and issuances of Vanguard are not prohibited investments.

Finally, the investment restriction applies broadly to "affiliates," but is not intended to capture all associated entities and issuances where the owner or operator in question is a governmental entity. For example, the Tennessee Valley Authority (TVA) is an entity related to the United States Government, and while the prohibition should be applied to bonds or other financial instruments issued by TVA, it is not intended to apply to debt or other obligations of the United States Government or other U.S. Government entities. Similarly, while the prohibition is properly applied to investments in the securities and other issuances of a company such as Électricité de France (EDF), it is not intended to prohibit investments in the debt or other obligations of the Government of France, even though the French Government owns a majority of EDF.

2.2 INVESTMENTS ACTIVELY MANAGED TO A MARKET INDEX

The language of Section 50.75(h)(1)(i)(A) provides an exception to the general prohibition for *investments* in "securities tied to market indices." The next section, 50.75(h)(1)(ii), discusses requirements related to licensee *day-to-day management* of investments. It prohibits an NRC licensee from engaging, itself, in active management of a trust fund or being the investment manager for the fund, "except in the case of *passive fund management* of trust funds where management is limited to investments tracking market indices."[23] The reference to "passive fund management" in the context of index funds in Section 50.75(h)(1)(ii) has led some licensees and investment managers to question whether the exception in 50.75(h)(1)(i)(A) for investments in "securities tied to market indices" also may be limited only to funds that are passively managed.

NRC guidance in Regulatory Guide 1.159 does not explicitly address this concern. However, the reference to "passive fund management" in 10 C.F.R. § 50.75(h)(1)(ii) is clearly linked to a licensee being authorized to direct "day-to-day" investments, where the licensee does not hire an investment manager, but passively manages the investments. Furthermore, the conditional phrase, "passive fund management" appears only in this separate and distinct subsection of the regulation.

Accordingly, the exception in 10 CFR 50.75(h)(1)(i)(A) for investments in "securities tied to market indices" is not conditioned upon "passive management" of those investments, and does permit an independent investment manager to actively manage NDT investments pursuant to a mandate to either track or outperform a recognized market index. Furthermore, this is sound public policy. As with non-nuclear sector mutual funds, an independent investment manager

[23] 10 CFR 50.75(h)(1)(ii).

should be free to invest in the full range of securities to achieve the performance desired consistent with the index. This includes separate accounts within a trust fund that are managed by independent investment managers. Each separately managed account, if managed by an independent investment manager, can be viewed as analogous to a mutual fund investment.

2.3 REAL ESTATE INVESTMENT TRUSTS ("REITS")

REITs are investment vehicles, comparable to mutual funds, that are devoted to real estate holdings, and often are traded on major exchanges. REITs pool investments in real estate ventures and commercial properties such as office buildings. NRC regulations at 10 CFR 50.75(h)(1)(i)(A) prohibit investment managers "from investing the funds in securities or other obligations" of covered entities. Licensees and investment managers have questioned whether investment of NDT funds in a REIT constitutes a prohibited investment, because a licensee or other covered entity might be said to be obligated to the REIT, *e.g.*, pursuant to the terms of a lease for office space or other real estate.

A lease for office space that is related to a REIT's portfolio of real estate investment should not be viewed as constituting the type of "obligation" that is the subject of the prohibition. Although lessees have a form of "obligation" pursuant to the terms of the lease instrument, the prohibition should be limited to NDT investments that are directly tied to a lease. REITs are structured to package multiple real estate investments into a single vehicle and should be analyzed by analogy to mutual funds. It would be impracticable to track every square foot of real estate in a REIT portfolio to assure that no leases were made to an affiliate of a utility company that might happen to own an interest in a nuclear plant.

Section 50.75(h)(1)(i)(A) prohibits investments in "mutual fund[s] in which at least 50 percent of the fund is invested in the securities of a licensee" or other covered entity. Thus, if a REIT were heavily invested in utility real estate (more than 50 percent of its assets), then this would be evident, as with a mutual fund, and such an investment in such a REIT is considered a prohibited investment.

The Commission's stated goal with regard to investment restrictions is to prevent licensees from engaging in *quid pro quo* transactions. The Commission explicitly mentioned investments in other nuclear companies' securities as an example. Thus, the investment restriction should apply to investments in REITs where there is a *quid pro quo* element. For example, if a utility with an NDT were to sell property to a REIT and then engage in a leaseback arrangement, investments in such a REIT should be prohibited, if there is any temporal proximity (*e.g.*, within one year) between the leaseback arrangement and investment. Again, it is practical for a utility to be aware of such a transaction and to avoid any such transaction, which could be viewed as an improper *quid pro quo* investment.

Absent a REIT being 50 percent or more invested in utility assets related to a nuclear reactor owner or operator or a REIT investment involving a *quid pro quo* element, investments in REITs are not prohibited by 10 CFR 50.75(h)(1)(i)(A). This approach ensures proper fund diversification by permitting investments in a wide range of REITs. In fact, the Commission's goal of investment diversification is best served by permitting investment in REITs with diversified tenant rosters.

2.4 10% SAFE HARBOR PROVISION

10 CFR 50.75(h)(1)(i)(A) provides a *de minimis* exception to the general rule that NDT funds may not be invested "in a mutual fund in which at least 50 percent of the fund is invested in the securities of a licensee" or other covered entity. The original rule language from the 2002 rulemaking explained that the general prohibition "do[es] not apply to 10 percent or less of their trust assets in securities of any other entity owning one or more nuclear power plants." In 2003, the language was revised to state "that no more than 10 percent of trust assets may be indirectly invested in securities of any entity owning or operating one or more nuclear power plants."[24]

In the original rule, the Commission explained that the provision was intended to "permit a *de minimis* investment in otherwise prohibited mutual fund investments" of up to 10 percent of the total value of the trust account.[25] This "safe harbor" provision was not meant to be an exception or limitation to investments in mutual or similar type funds in which *less* than 50 percent of the funds are invested in the securities of a licensee or other covered entity. The 10 percent "safe harbor" provision permits this *de minimis* investment in "otherwise prohibited" mutual or similar type funds. Licensees and their investment managers should not be required to police their entire portfolio of investments tied to market indices and somehow assure that the NDT does not directly or indirectly hold more than 10% of its assets in otherwise prohibited investments.

As noted in the subsequent Statement of Considerations, the 2003 revision was intended to "clarify," not alter, the original meaning of the *de minimis* provision. Thus, as before, the 10 percent "safe harbor" provision is not a limitation on investments in mutual funds in which *less* than 50 percent of the funds are invested in the securities of a licensee or other covered entity.

In addition, in cases where NRC imposed specific license conditions, it never addressed the 10% "safe harbor" included in the rule. Given that the premise of the rule is that investments that fall within the 10% safe harbor are *de minimis* and not of concern to NRC, the same safe harbor applies in cases where licensees are subject to specific license conditions that are otherwise silent regarding the subject of a 10% safe harbor.

[24] *See* "Minor Changes to Decommissioning Trust Fund Provisions," Direct Final Rule 68 FR 65386 (Nov. 20, 2003).

[25] *See* 67 FR at 78336.

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