UNITED STATES OF AMERICA
NUCLEAR REGULATORY COMMISSION

In the Matter of	)	
	)	
UNION ELECTRIC COMPANY	)	Docket No. STN 50-483-OL
	)	
(Callaway Plant, Unit 1)	)	

SUPPLEMENTAL CONTENTION OF JOINT INTERVENORS

Joint Intervenors hereby respectfully submit the following Supplemental Contention:

> The applicant is not financially qualified to construct and operate the plant to which it is committed by this application. The applicant cannot show that it has the funds necessary, or has reasonable assurance of obtaining the funds necessary, to operate the Callaway nuclear plant with safety.

In support of this contention, Joint Intervenors submit the following:

1. The Financial Qualifications Rule

Pursuant to 10 C.F.R. § 2.104(c)(4), the scope of issues that can be raised in an operating license hearing includes:

> Whether the applicant is technically and financially qualified to engage in the activities to be authorized by the operating license in accordance with the regulations of this chapter . . .

See also 10 C.F.R. §§ 50.40(b), 50.57(a)(4). To obtain an operating license, an applicant must submit to the NRC "information sufficient to demonstrate to the Commission the financial qualifications of the applicant" to carry out the activities for

which the license is sought. 10 C.F.R. § 50.33(f). This information includes a demonstration

> that the applicant possesses the funds necessary to cover the estimated operating costs or that the applicant has reasonable assurance of obtaining the necessary funds, or a combination of the two.

Id. More specifically, the operating license applicant must show that it

> possesses or has reasonable assurance of obtaining the funds necessary to cover the estimated costs of operation for the period of the license or for 5 years, whichever is greater, plus the estimated costs of permanently shutting the facility down and maintaining it in a safe condition.

Id. Ordinarily, it is sufficient to show that an applicant can obtain the necessary funds to operate the plant for the first five years of operation, plus the estimated costs of permanent shutdown. 10 C.F.R. Part 50, Appendix C, § I.

The establishment of adequate financial qualifications by a utility is essential to a finding that a nuclear plant can and will be operated safely during its life. As the Licensing Board recognized in **Cleveland Electric Illuminating Co.** (Perry Nuclear Power Plant, Units 1 & 2), LBP-81-24, 14 NRC 175, 196 (1981):

> The current rule has an important purpose. It is possible for an applicant to scrape by financially during the construction stage. That is, due to unanticipated cost increases and backfit requirements, it might barely manage to complete construction. If it does just scrape by, then the company's financial straits could interfere with its sound judgment in safety matters. Safety measures that might be taken by a financially healthy company might not be taken.

Thus, the financial health of a utility is integrally related to its ability to operate a plant safely.

2. The Applicant Is Facing Serious Cash Flow Problems Which Could Prevent the Applicant From Spending For Necessary Or Desirable Safety Features, And Could Interfere With Its Judgment In Safety Matters. Safety Measures That Would Be Taken By A Financially Healthy Company Could Not Be Taken By the Applicant, For Lack of Funds.

Union Electric is a very, very sick company, entirely dependent upon lenders and investors to supply the cash needed to operate the company, pay interest on outstanding debt, and pay dividends on the stock. The erosion of investor confidence which is reflected in, and accelerated by, the recent publications and ratings of investment advisers, will push the company closer to the brink of disaster each day. Under such circumstances, neither this Commission nor the public can have confidence that management will be able to exercise sound judgment with respect to the making of expenditures for safety features.

A. Union Electric is entirely dependent upon the investment community (lenders of money and purchasers of stock) to provide the cash to operate its plant, pay interest on outstanding debt from day to day, and pay dividends. **E. F. Hutton's** review of 96 major electrical utilities, February, 1984, shows that AFUDC (a fictitious revenue receipt) constituted 105% of Union Electric's total earnings, according to what was then the latest available income statement from the company. This was the sixth highest of all the utilities studied. As **E. F. Hutton** states, "since AFUDC is a non-cash item, in those instances where it represents a large portion of reported earnings, it can be construed as symptomatic of poor earnings quality and can indicate a cash

flow problem." If the entire earnings of the company (and more) are represented by a fictitious revenue entry, it is clear that the company is borrowing money (or selling stock, diluting equity) just to stay afloat. As nearly as Joint Intervenors can determine, the company has been dependent upon the investment community to produce the cash needed to pay dividends for at least two years, and perhaps three or four years. The company acknowledged in its stock prospectus of November 15, 1983 that substantially all of its earnings in 1983 and 1984 will be provided by AFUDC (p. 6).

The company will continue to be dependent upon external sources of funds for at least all of 1984, and probably 1985 and 1986. Even if (an unlikely hypothesis) Union Electric should move ahead swiftly and steadily to bring Callaway on line in early 1985, it is by no means clear that all of the cost of Callaway would then go into the rate base, and start generating real dollar revenues. Much of the cost could be excluded, because of the horrendous cost over-runs. Much of it could be excluded on the ground that Callaway provides a great deal of excess capacity.

Further, the company has itself proposed that its requested 70% rate increase be phased in over a period of five years, thus delaying recovery of allowable costs, and further aggravating the cash flow problem.

In short, Union Electric is going to be heavily dependent upon external sources of funds for at least a year or two, and

probably more. The company acknowledged in its stock prospectus of November 15, 1983 that, until Callaway is included in the rate base (apparently in its entirety), all of the company's cash requirements for construction and payments on long-term debt and preferred stock would have to be obtained from external sources, and that "no assurance can be given that such required funds can be obtained" (page 6). The 1983 Annual Report (February 24, 1984) indicates that this situation has not improved.

B. Those external sources of funds may not be readily available, for several reasons.

First, the company has acknowledged in its Form 10-K for the fiscal year ended December 31, 1982 that it is subject to financing restrictions which may restrict the issuance of bonds in 1984:

> **Financing Restrictions.** Under the most restrictive earnings test contained in the Company's Indenture of Mortgage and Deed of Trust ("Mortgage") relating to its First Mortgage Bonds ("Bonds"), no Bonds may be issued (except in certain refunding operations) unless the Company's net earnings available for interest after depreciation (the amount of AFC and other net non-operating income which may be included in such net earnings being limited to an amount not in excess of 10% of the portion of such net earnings which does not constitute net non-operating income) for 12 consecutive months within the 15 months preceding such issuance are at least two times annual interest charges on all Bonds then outstanding and to be issued (all calculated as provided in the Mortgage). Such ratio for the 12 months ended December 31, 1982 was 2.26, which would permit the Company to issue an additional $126 million of Bonds (13 1/2% annual interest rate assumed). The earnings test referred to above may restrict the issuance of Bonds in 1984 unless sufficient rate relief is received. See "Rates" for discussions of rate increase requests pending in Missouri and Illinois. The Company's Articles of Incorporation restrict the Company from selling Preferred Stock

> unless its net earnings for a period of 12 consecutive months within 15 months preceding such sale are at least two and one-half times the annual dividend requirements on its Preferred Stock then outstanding and to be issued. Such ratio for the 12 months ended December 31, 1982 was 4.69, which would permit the Company to issue an additional $288 million stated value of Preferred Stock (12 1/2% annual dividend rate assumed). Certain other financing arrangements require the Company to obtain prior consents to various actions by the Company and its subsidiaries, including any future borrowings by the Company and its subsidiaries, except for permitted financings such as unsecured short-term borrowings (subject to certain conditions) and the issuance of additional Bonds.

Second, creditors and investors may be slow to put any more money into this company. The investment community has belatedly recognized that Union Electric is not a sound investment. For example **Standard & Poor**, in its March 28, 1984 Outlook, put Union Electric in the lowest tier of electric utilities, in terms of soundness of investment, classifying it as a utility "with nuclear exposure and problems." **Standard & Poor** did not recommend the purchase of Union Electric stock. **Public Utilities Fortnightly** in its January 19, 1984 issue warned that even in 1983 those utilities with heavy nuclear construction had lost the confidence of the investing community, and their stock price had plunged 27% relative to the price of the electric utilities with no nuclear construction, since the beginning of 1983. **Value Line** of January 27, 1984 noted that prospects for payout increases are below average, and that only the "more venturesome might find the stock of interest at the recent price."

A survey of 75 utilities by Salomon Brothers, printed in the December 5, 1983 issue of **Forbes**, rated Union Electric as

one of the only five with an earnings quality grade as low as D.

The **E. F. Hutton** study of 96 electric utilities referred to above, in February, 1984, reported that Union Electric's ratio of stock price to book value per share was .78, down from .87 at the end of 1982 (see Union Electric Annual Report for 1982), and thirteenth lowest in the 96 utilities studied. Of those thirteen, three have cancelled nuclear power plant construction projects late in the construction cycle recently (Cincinnati Gas & Electric, Dayton Power & Light, and Public Service Company of Indiana); one is General Public Utilities, proud owner of Three Mile Island; five others are generally conceded to be in substantial trouble, with the probability that commercial operation of their nuclear plants under construction is unlikely (Consumers Power Co., Long Island Lighting Co., Public Service Company of New Hampshire, United Illuminating Co., and Middle South Utilities); and two others (Toledo Edison and Portland General Electric) were denied full recovery of the cancellation costs of cancelled nuclear plants. The only other company reported to have a lower ratio of price-to-book value is Rochester Gas & Electric, which is a substantial participant in the Nine Mile Point nuclear plant (on which Lilco has already defaulted), and which has had considerable difficulty with its nuclear operations. In short, the investment advisors are reporting that the investors have already recognized that Union Electric is one of the thirteen worst investments in the electric utility industry.

By the middle of April, 1984, the ratio of stock price to book value had slid all the way down to .73, as the precipitous decline continues. **St. Louis Business Journal**, April 16-22, 1984, p. 19.

As a result, the company is in a precarious situation. Unless everything works out exactly right for the company, the company will face insolvency. The company's continued survival depends upon all of the following:

1. Commercial operation of Callaway I in 1985.

2. Favorable rulings by the Missouri Public Service Commission that all or nearly all of the money spent to build Callaway was prudently spent, and is allowable as a part of the rate base.

3. Favorable decisions by the Missouri Public Service Commission that the entire plant is needed, and no part of it is to be excluded from the rate base as representing excess capacity.

4. Decisions by the Missouri Public Service Commission granting a very high rate of return, sufficiently high to enable such a weak company to continue to attract investors, notwithstanding the fact that electric utilities generally are not granted such high rates of return.

5. Avoidance of any serious operating problems at the plant, or lengthy outages.

6. Maintenance of an upward trend in annual kilowatt hour sales, notwithstanding the tendency of consumers to restrict consumption when hit with a 70% rate hike.

If the date of commercial operation is delayed, AFUDC will continue to represent all or most of the earnings until the plant does go into the rate base, and extensive borrowing will continue to be required; total construction costs (including financing costs) of the plant will continue to escalate; and investor confidence will be further eroded.

If all or a substantial portion of Callaway is determined to constitute excess capacity, the Public Service Commission will presumably not allow the company to earn a return on that portion. Inasmuch as financing costs continue, and must be paid from some source, there will be continued pressure to obtain money from external sources.

It is highly doubtful that the company will obtain the rate relief needed to meet the cash flow needs. The company itself has asked that its rate increase be phased in over five years. If any operating problems should develop in that period, the later portions of the phased-in rate increase would be jeopardized. Further, **Value Line** of January 27, 1984, predicts: "The authorities will likely scale down the request."

Serious problems have befallen many other nuclear power plants, such as the need to replace steam generators, or to conduct retrofitting required by the NRC. Such a development at Callaway would place a strain upon the company which its financial resources could not withstand. Even a shutdown for a substantial period requires the purchase of replacement power, and the expense of that replacement power would not be recovered

from the consumers if it is found by the Public Service Commission to result from fault of the utility.

Any reduction in kilowatt hour sales would have a serious impact upon the cash flow at Union Electric. In the last ten years Union Electric's annual sales increases have fallen from an average of 6.7% per annum (1964 to '73) to 0.9% (1978-82). A 70% increase in rates, even spread over five years, is likely to have a significant impact upon demand, thus restricting the cash available to the utility.

As the investing public becomes more and more sensitive to the company's precarious financial condition, the company will have increasing difficulty in generating the external cash needed. This precarious financial situation will put increasing pressure on company executives to put the plant on line as early as possible, regardless of safety. Sadly, we have seen this scenario before.

> Questions have already been raised about whether General Public Utilities and its subsidiary Metropolitan Edison Co., which operates the Three Mile Island complex, ended the testing phase on unit 2 prematurely. Because the reactor went into commercial operation on Dec. 30, the utility was apparently eligible for certain tax breaks and rate increases that might not have been available if the facility had started up this year. **Wall Street Journal**, April 9, 1979, page 25.

All indications are that Callaway is another Three Mile Island, begging for an opportunity to happen.

In the interest of the safety of the public, this Commission should not permit a nuclear power plant to be brought into commercial operation by a company which lacks the financial resources to assure that every possible measure will be taken to protect the public. The operating license should be denied.

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing were served on April 18, 1984 by deposit in the United States mail first class, postage prepaid, addressed to the persons listed below.

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