PDR

UNITED STATES
NUCLEAR REGULATORY COMMISSION
WASHINGTON, D. C. 20555

CHAIRMAN

January 24, 1986

The Honorable Edward J. Markey, Chairman
Subcommittee on Energy Conservation and Power
Committee on Energy and Commerce
United States House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This is in reply to your letter of November 27, 1985 regarding the issue of financial qualifications of nuclear utilities as it relates to safety of operating nuclear power plants.

The most important question as we understand it is how the Commission assures and enforces safe operation of nuclear plants. NRC regulation of commercial nuclear power activities is based on the premise that licensees are responsible for the safe and properly-managed operation and construction of their nuclear facilities. We establish rules and standards to provide guidance for licensees; we carefully monitor licensed activities; and we take enforcement steps to obtain corrective action by licensees when poorly-operated or poorly-constructed facilities create safety concerns. Typical NRC enforcement steps include civil penalties, and, in the most serious instances, plant shutdowns.

As to your inquiry on the technical basis for assuring that safety comes first and will not be undercut by financial pressures, the answer is that the exercise of the Commission's regulatory authority over plant operation forms the basis for this assurance. The July 22, 1985 memorandum from William J. Dircks, which you cited, and followup actions by the Commission staff are directly relevant in showing how this is done.

The Commission recognized that Middle South Utilities and its subsidiaries, Arkansas Power and Light and Mississippi Power and Light, were experiencing financial stress related to the costs of Grand Gulf and their inability to obtain approval from the State PUC's to recover such costs. While no safety issues had been identified in the operation of these utilities' nuclear plants related to the financial stress, Mr. Dircks informed these utilities by letter of September 10, 1985 that. . ."We recognize that financial austerity measures are sometimes necessary and are a matter between you and appropriate State bodies. However, you should thoroughly evaluate your plans in this regard to assure that they do not contain elements which could affect the continued safe operation of your licensed

nuclear facility or delay the fulfillment of your commitments to the NRC. Please provide me with the results of your evaluation no later than September 30, 1985."

These evaluations were performed as required and reviewed by appropriate Regional and Headquarters staff. By memorandum of November 14, 1985, Harold R. Denton, Director, Office of Nuclear Reactor Regulation, informed Mr. Dircks that the staff concluded in both cases there had been no adverse safety impact from the cost curtailment program. Additionally, the staff considered the impact of cost constraints at Arkansas Nuclear One during its scheduled maintenance program survey in November. The survey was completed on November 8, 1985 and there was no evidence that the cost curtailment program had any adverse safety impacts.

The Commission has taken a similar approach with the issue of incentive regulation by the State PUC's. We recognize, as stated in SECY-85-260, that some of these plans present potential safety issues. Our response was to develop a tracking system, now in place, to identify these plans as they are being established, and to evaluate the possible effects of these plans on plant safety. If safety concerns are raised from the evaluation, an action will be initiated.

NRC responses to incentive plans where safety was potentially of concern include the following:

-- On October 28, 1983, Mr. Denton wrote to Mr. Leonard Grimes, President of the California Public Utilities Commission:

> "On balance, we believe the productivity incentive program for San Onofre Unit 2 is consistent with reactor safety. Nonetheless, we shall remain alert to symptoms of adverse influences on safety."

-- The Colorado Public Utilities Commission has proposed an incentive plan for Fort St. Vrain owned by Public Service Company of Colorado. Mr. Denton, by memorandum of November 1, 1984 to Robert D. Martin, Regional Administrator for Region IV, stated:

> "While the imposition of such 'incentive' plans by a Public Utility Commission on a licensee concerning operation of a facility may be unusual, it is not clear that they constitute a clear and present threat to public health and safety. It is still the licensee's responsibility to comply with the Commission's Rules, Regulations, Orders and all Conditions of its License with respect to the conduct of operations at the Fort St. Vrain Nuclear

Generating Station. Violations of those Rules, Regulations, Orders and License conditions, especially those done deliberately in the wake of economic 'incentives' which may compromise the public health and safety, are subject to the strictest enforcement action including revocation of the Facility License for Fort St. Vrain, and may also be subject to criminal investigation and prosecution."

-- The staff reviewed the incentive plan of the Arizona Corporation Commission for Arizona Public Service as related to Palo Verde, Unit 1. On April 9, 1985, Mr. Denton wrote to Mr. Wayne E. Ruhter, Director of the Utilities Division of Arizona Corporation Commission:

"The effect of the incentive plan on plant safety ultimately hinges on utility management's reaction to the plan; that is, the nature of the operational plans, operating instructions and other measures that may be taken to further safety objectives in the context of the incentive plan's provisions. Since Palo Verde Unit 1 has just started the post-construction testing program in January 1985, we have not yet seen how the utility will implement those elements of the incentive plan that deal with plant operation. During the four month period covering fuel load and low power testing, the NRC staff has planned an enhanced inspection effort for the plant, in part because of the incentive plan. This enhanced inspection effort is intended to provide added assurance that the utility is operating the plant in accordance with NRC requirements and to determine whether any adverse safety implications are evolving due to the incentive plan."

Region V has performed this enhanced inspection and concluded that there was no evidence of adverse safety implications resulting from the incentive plan. As you can see, the Commission is ready to take necessary action to enforce safety. While we have no control, nor seek any over State PUC's, we do inform them of our concerns where their actions raise potential safety concerns.

The Commission's new financial qualification rule, 49 Fed. Reg. 35747, does not preclude the Commission from consideration of safety problems which are caused by or related to financial problems. Nor does the new rule in any way alter or lessen the degree of financial monitoring that the Commission may carry out in determining the intensity of safety inspections appropriate at a particular facility. At the licensing stage where no safety problem has been presented and where all the Commission's

technical and safety requirements have been met, the new rule does allow the Commission to grant an operating license to a regulated utility without further consideration of solely financial issues. The basis for this rule is that, for such utilities, the rate regulatory process provides reasonable assurance that all prudent operating costs, including all costs of meeting NRC safety requirements, will be recovered. This level of assurance has always been sufficient to allow the granting of an operating license, both before and after the new rule.

The Commission believes there is an appropriate level of financial qualification at licensing. It should be kept in mind that a financial qualification licensing requirement represents a basis on which an otherwise qualified applicant may be denied a license solely for financial reasons. The Commission has in effect determined that such a denial is reasonable only if the applicant cannot demonstrate a reasonable assurance of obtaining the funds necessary to carry out the licensed activities safely. To go beyond this and deny a license to an otherwise fully qualified applicant on the grounds that sometime in the future financial pressures might provide incentive for misconduct could be seen as an unfair and unjustified prejudgment. An applicant who has demonstrated the competence and integrity requisite for a license might reasonably object to being denied a license purely because of speculation about future misbehavior.

The financial qualification rule takes note of the fact that, as a generic matter, electric utilities do have a reasonably assured source of income adequate to meet power reactor operation expenses and concludes that such applicants should therefore not be denied a license solely on financial grounds. For such applicants the rule in effect shifts NRC resources away from further speculation about financial pressures and back to matters that bear directly on an applicant's fitness, e.g., technical and managerial competence and integrity.

But this rule leaves the Commission free to increase the intensity of its safety reviews, either before or after licensing, because of perceptions about the licensee's financial situation.

The Davis-Besse incident is relevant here. Our letter of July 17, to the Subcommittee stated, "There are some indications that the Company's financial involvement in other nuclear projects necessitated budget restraints at Davis-Besse." It should be noted that a financial qualification review was done for the Davis-Besse operating license in accordance with the former rule. The utility was found at that time to be financially qualified to operate Davis-Besse under that rule. The question involved here is not whether the State PUC would provide sufficient funds for safe operation (the issue addressed by the Commission's earlier financial review) but whether the licensee will utilize the funds available to operate its plants

safely. This raises an issue of management judgment and prudence rather than financial qualification.

In response to your inquiry, we consider the current authority of the Commission in dealing with financial difficulties of licensees to be sufficient so that further rulemaking is unnecessary. It should be emphasized that only the pre-operating license case-by-case reviews were eliminated. Financial qualification reviews are still required for construction permit applicants. In addition, the Commission retained its residual authority under Section 182.a. of the Atomic Energy Act of 1954, as amended, to require such additional information in individual cases as may be necessary for the Commission to determine whether an application for an operating license should be granted or denied or whether an operating license should be modified or revoked. An exception to or waiver from the rule precluding consideration of financial qualifications in an operating license proceeding will be made if, pursuant to 10 CFR 2.758, special circumstances are shown.

On your final point, the NRC has not precluded adjudication of financial qualifications issues in appropriate cases. In addition to the waiver provisions mentioned above, the Commission's regulations in 10 CFR 2.206 allow any person to file a request to institute a proceeding. If a proceeding is instituted, interested persons may petition to intervene.

Commissioner Asselstine adds:

> I believe that the effort of the NRC staff to assess the impact of financial stress and incentive programs on operating plants is a step in the right direction. However, more is necessary.
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> The Commission should have a program in place so that it can ensure that future problems like those at Davis-Besse do not occur at other plants. The Commission should establish an augmented inspection program which would try to identify licensees who might be inclined to take shortcuts or defer resolution of problems for financial reasons. The staff can then factor that determination into their inspections in an attempt to identify problem utilities before serious events, like Davis-Besse, occur. The inspection program, as well as our incident response program, should also be geared toward identifying the possible connection between financial considerations and identified plant safety weaknesses. The NRC staff has been doing some of this on a case-by-case, informal basis. However, these efforts should be made a formal part of the inspection process, and should be exparded to include all plants.

I also believe that the Commission should not have virtually eliminated consideration of financial qualifications from the review and adjudication of operating license applications. I did not agree with the Commission's financial qualifications rulemaking. Rather than repeating here my reasons for disagreeing with the Commission I will just say that I did not, and do not, find the Commission's reasons for eliminating consideration of financial qualifications to be persuasive and will refer you to my separate views on the rulemaking for more detail. A copy of my views is enclosed.

We hope this response will assist you in your consideration of these issues.

Sincerely,

Nunzio J. Palladino

Enclosure:
As Stated

cc: Rep. Carlos Moorhead

(REVISED)

ADDITIONAL VIEWS OF COMMISSIONER ASSELSTINE

A majority of the Commission has concluded that in its consideration of an application for an operating license for a nuclear power plant, no review whatsoever of the utility applicant's financial qualifications to operate the facility is required and, other than in exceptional cases, no case-by-case litigation of the financial qualification of the applicant is warranted. The majority's conclusion appears to be based upon the judgment that the record of this rulemaking demonstrates generically that the rate process assures that funds needed for safe plant operation will be made available to regulated electric utilities.

Although the NRC should not return to performing the same types of financial qualification reviews required by the old rule, the majority has gone too far in excluding virtually all consideration of the utility applicant's financial qualification in nuclear power plant operating license proceedings. Such a sweeping exclusion is contrary to the requirements of the Atomic Energy Act, is unsupported by the facts and is unjustified on the basis of this rulemaking record.

Section 182 a. of the Atomic Energy Act of 1954 requires that each application for an operating license for a nuclear power plant "specifically state such information as the Commission, by rule or regulation, may determine to be necessary to decide such of the technical and financial qualifications of the applicant...as the Commission may deem

appropriate for the license." The plain language of the statute appears to require consideration of the financial qualification of the applicant as part of the Commission's decision on whether to issue an operating license for a nuclear power plant. Thus, at least absent clear and convincing evidence that the financial qualification of a regulated utility is wholly irrelevant to safe plant operation in all cases (evidence that is not to be found in this rulemaking record), the Commission is required to perform some type of financial qualification review and to consider financial qualification issues as part of the licensing proceeding for a nuclear power plant.

The majority points to a survey conducted by the National Association of Regulatory Utility Commissioners (NARUC) which shows that public utility commissions and publicly-owned utilities have the authority to set rates in such a way that sufficient revenues to meet NRC safety requirements are assured. However, the fact that regulated electric utilities can generally expect to be compensated for the cost of safety requirements does not provide a basis for eliminating all consideration of financial qualification issues in operating license proceedings.

As the NARUC study itself confirms, public utility commissions typically do not specify that funds to cover safety requirements must be spent on nuclear plant operations. Nor are nuclear plant operating costs the only element considered by public utility commissions in deciding on the amount of revenues to be provided to the utility. As some commenters

noted, utility rate commission decisions can include elements such as rate base phase-ins or disallowances that affect the overall rate level allowed for the utility. Such factors, together with the cost of ongoing construction programs that frequently are not included in the rate base, inevitably require the utility to make choices regarding the allocation of rate returns among such competing priorities as nuclear and non-nuclear plant operating costs, plant improvements aimed at increasing plant capacity factors, increasingly costly construction programs and providing an adequate rate of return to investors. The difficult financial choices faced by some utilities, particularly smaller utilities with larger ongoing construction programs, are widely documented. There is simply no basis in this rulemaking record for concluding that in all instances a utility will resolve the conflicting financial priorities in favor of allocating full funding to nuclear plant operation. In the absence of such evidence, the fact that utility commissions typically provide rate relief sufficient to cover the cost of safety requirements does not, by itself, justify the total exclusion of all financial qualification issues and the elimination of all financial qualification reviews.

The majority also argues its conclusion is supported by the agency's long experience in regulating utilities, and that present inspection and enforcement efforts are a sufficient means for identifying and correcting financially motivated safety problems. The majority, although professing not to rely on this point, further attempts to bolster its position by asserting that there is some support for the

proposition that there is no link between financial qualification reviews and safety. In support of this assertion, the majority points to a study by the National Economic Research Associates, Inc. (NERA), which finds that the financial risks to the utility associated with the consequences of a nuclear accident outweigh any financial gains that might be achieved by cutting corners on safety.

Although these arguments are superficially attractive, they are not supported by the facts. Unfortunately, financial considerations can and do lead to safety weaknesses in some instances. There have been instances, some recently, in which regulated utility licensees with operating power reactors have emphasized maximizing electricity generation over safety, have been unwilling to build a strong, technically capable nuclear plant operations organization, or have failed to move aggressively to satisfy new NRC safety requirements. In many instances, financial considerations appear to be a significant contributor to these utility decisions. Some of these safety weaknesses have been of continuing duration, and not all have been identified or corrected by our inspection and enforcement program. These examples would appear to indicate clearly that financial considerations can and do affect safety in some instances. Given this experience, I see no basis for the majority's conclusion that the NRC need not examine a utility's financial capability to operate the plant or consider financial qualification issues in our licensing proceedings. Nor does the Commission's reliance on 10 CFR section 2.758 provide an effective means for identifying and

correcting safety weaknesses caused by financial considerations. As it would apply here, 10 CFR section 2.758 would require that a member of the public first identify the financial qualification issue, bring it to the Commission's attention and demonstrate that special circumstances exist in the case before any consideration of the issue will be permitted. This very restricted opportunity to raise the issue imposes a heavy burden on the party seeking to raise the issue, and the Commission's new rule, for all practical purposes, can be expected to eliminate virtually all consideration of financial qualification issues by the NRC staff and in operating license hearings. Finally, the majority argues that the elimination of the Commission's existing financial qualification reviews is justified on the ground that those reviews fail to consider how a utility actually spends the revenues provided by public utility commissions. However, if present financial qualification reviews are ineffective, that is an argument for restructuring, rather than eliminating, them.

Rather than seeking to eliminate virtually all consideration of financial qualification issues, the Commission should be restructuring its rules and regulatory programs to ensure that its financial qualification reviews identify any financial considerations that can affect the safety of plant operations. Such a restructured program could focus on five elements. The first element would be a required certification by the relevant public utility commission or commissions to the effect that revenues necessary to support the plant's prudent operation will be forthcoming. Such a certification would satisfy the purpose served by

the Commission's previous financial qualification reviews. At the same time, unwillingness on the part of a utility commission to provide such a certification would indicate a potential financial qualification problem requiring further NRC review.

The second element would be to restore the opportunity for participants in NRC licensing proceedings to raise and litigate financial qualification issues, including questions regarding the utility's ability or unwillingness to apply the funds needed for safe plant operation, and questions involving regulatory or contractual commitments that could lead to unsafe operation. The third element would be to permit members of the public to raise financial qualification issues regarding operating plants and to have those issues considered pursuant to 10 CFR section 2.206.

The fourth element would consist of an augmented NRC inspection program to consider the possible connection between financial considerations and identified plant safety weaknesses. The final element would consist of a required showing by the utility of how it intends to assure the availability of funds to pay the cost of plant decommissioning. This final element may best be considered as part of the Commission's decommissioning rule, but the Commission could commit to requiring such a showing now. It is worth noting that the majority was unwilling even to indicate at this time a commitment to address the financial qualification issue for decommissioning in a subsequent decommissioning rule. Taken together, these elements of a restructured

program would reflect the role and knowledge of the public utility commissions and would eliminate unnecessary duplication of effort. At the same time, this program would recognize the link between financial considerations and safety, and would provide for more effective consideration of financial qualification issues. Such an approach would demonstrate the Commission's desire to deal effectively with safety issues. Unfortunately, the Commission seems more inclined simply to avoid them.