

SAFETY EVALUATION BY THE OFFICE OF NUCLEAR REACTOR REGULATION

DIRECT TRANSFER OF FACILITY OPERATING LICENSES

FOR

DIABLO CANYON POWER PLANT, UNITS 1 AND 2

DOCKET NOS. 50-275 AND 50-323

1.0 INTRODUCTION

Pursuant to Section 184 of the Atomic Energy Act of 1954, as amended (AEA), and Section 50.80 of Title 10 of the *Code of Federal Regulations* (10 CFR 50.80), Pacific Gas and Electric Company (PG&E), by application dated November 30, 2001, requested that the Nuclear Regulatory Commission (NRC) consent to a direct transfer of ownership interest in Facility Operating Licenses DPR-80 and DPR-82, Diablo Canyon Power Plant, Units 1 and 2, (DCPP) respectively. The application requests approval of conforming license amendments to reflect the proposed direct transfers as detailed later in this safety evaluation. This amendment is being made in support of a comprehensive reorganization and restructuring of the businesses and operations of PG&E, including its nuclear and non-nuclear generation, transmission, and electricity distribution businesses. PG&E proposes to spin off new entities such that the licenses will be held by a non-utility, with no corporate connection to the remaining subsidiaries and affiliates of PG&E Corporation.

2.0 BACKGROUND

On April 6, 2001, PG&E filed a petition for relief under Chapter 11 of the United States Bankruptcy Code. As stated by PG&E, the goal of the bankruptcy was to halt the deterioration of its financial position, restore the company to financial health, and continue supplying electricity and gas in the normal course of business. On September 20, 2001, PG&E and its parent corporation, PG&E Corporation, filed with the Bankruptcy Court a comprehensive Plan of Reorganization (Plan) for PG&E. Under the Plan, operating authority for DCPP will be transferred to a new limited liability company named Electric Generation LLC (Gen) and ownership of the two-unit generating asset will be assigned to a wholly-owned subsidiary of Gen named Diablo Canyon LLC (Nuclear).

According to the November 2001 application, the current businesses of PG&E will be disaggregated and restructured. PG&E will divide its operations and the assets of its business lines among four separate operating companies. The majority of the assets and liabilities associated with the current electric transmission business of PG&E will be transferred to

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ETrans LLC (ETrans); the majority of PG&E's gas transmission assets and liabilities will be transferred to GTrans LLC (GTrans); and the majority of the assets and liabilities associated with the current generation business, including DCP, will be transferred to Gen or its subsidiaries. In addition, PG&E has created a separate corporation called Newco Energy Corporation (Newco) to hold the membership interests of each of ETrans, GTrans and Gen. PG&E is the sole shareholder of Newco. After the assets are transferred to the newly-formed entities, PG&E will declare and pay a dividend of the outstanding common stock of Newco to PG&E Corporation, and each of ETrans, GTrans and Gen will thereafter be an indirectly wholly-owned subsidiary of PG&E Corporation. PG&E Corporation will also change its name in the near future.

PG&E has also created subsidiaries of Gen to hold specific assets and project-specific liabilities related to Gen's line of business. Nuclear is a subsidiary of Gen created to hold the ownership of DCP. Gen will also have multiple subsidiaries formed to hold its hydroelectric assets.

Nuclear will hold the ownership interest in DCP under the new corporate restructure initiated in the current bankruptcy plan. Nuclear will lease DCP to Gen under lease terms that assign to Gen the entitlement to the output and capacity of DCP and that make Gen responsible for all costs of plant operation. (A copy of the facility lease for DCP between Nuclear and Gen is provided as Enclosure 3 of the application.) Gen will operate DCP and will become the operating licensee.

3.0 FINANCIAL QUALIFICATIONS ANALYSIS

Pursuant to 10 CFR 50.33(f), an electric utility as defined in 10 CFR 50.2 is not required to demonstrate its financial qualifications. Section 50.2 of 10 CFR states that an electric utility is "any entity that generates or distributes electricity and which recovers the cost of this electricity, either directly or indirectly, through rates established by the entity itself or by a separate regulatory authority." The application states that "Nuclear will not be a rate-regulated utility" and that "DCP's output will be sold to the reorganized PG&E pursuant to a bilateral contract" (see Enclosure 7). Therefore, the staff finds that Nuclear will not meet the definition of an electric utility, as stated in the application. The staff has also concluded that Gen will not be an "electric utility."

As both newly formed entities and a non-electric utilities applying to own nuclear power plants, Gen and Nuclear are subject to a more detailed financial qualifications review by the NRC than established electric utilities. Specifically, Nuclear and Gen must meet the requirements of 10 CFR 50.33(f) by providing information which shows the following:

- (1) As a non-electric utility applicant for ownership interest in operating licenses, it possesses or has reasonable assurance of obtaining the funds necessary to cover estimated operating costs for the period of the licenses. It must submit estimates for total annual operating costs for the first five years of facility operations and indicate the source of funds to cover these costs.
- (2) As a newly formed entity organized primarily for the purpose of operating nuclear power plants, it must show: (a) the legal and financial

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relationships it has or proposes to have with its stockholders or owners; (b) its financial ability to meet any contractual obligation to the entity which they have incurred or propose to incur; and (c) any information considered necessary by the NRC to enable it to determine the applicant's financial qualification.

In addition, 10 CFR 50.33(k)(1) requires that Gen and Nuclear must provide information described in 10 CFR 50.75 indicating reasonable assurance that funds will be available to decommission the facilities. Nuclear's and Gen's proposals for decommissioning funding assurances are discussed in Section 4.0 of this evaluation.

Neither licensee, Nuclear as the owner or Gen as the operator, will be a regulated electric utility, selling to traditional retail ratepayers with cost-of-service rates. Nuclear will lease DCPD to Gen under a lease agreement that will require Gen to cover all of the operating and capital costs of DCPD. Gen will operate as an electric generation company that controls various generation assets, including DCPD and hydroelectric generating stations. Pursuant to the plan, Gen and the reorganized PG&E will enter into a long-term bilateral power sales agreement whereby Gen's output and the power produced under its power purchase agreements will be sold at wholesale to reorganized PG&E. According to the application, these sales will be in accordance with a rate approved by the Federal Energy Regulatory Commission (FERC).

Under the bilateral contract (Enclosure 7 of the application), reorganized PG&E will be entitled to purchase substantially all of the output of Gen's facilities and Gen's power purchase agreements, but electricity from DCPD will be purchased on a must-take basis. As currently contemplated, the contract will have a term of twelve years.

As a condition to the licence amendment, Gen and Nuclear shall notify the NRC of any material differences in the bilateral contract between reorganized PG&E and Gen from that submitted in the application. If material differences exist, the revised bilateral contract is subject to NRC review and acceptance.

The application delineates the two major assumptions for revenue - price per Megawatt hour and Nuclear Capacity Factor. According to the application those factors are as follows:

Gen
Major Revenue Assumptions

<u>Fiscal Year</u>	<u>Year 1</u> 2002	<u>Year 2</u> 2003	<u>Year 3</u> 2004	<u>Year 4</u> 2005	<u>Year 5</u> 2006
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\$/Mwh

Capacity Factor

Following the proposed restructuring and license transfers, the financing and financial reporting relevant to the generation businesses will occur at the Gen level of the organization. As

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indicated in the projected income statements, below. Gen should be a financially sound entity due to its diversified generation portfolio and power sales contract with reorganized PG&E. The projected revenues from sales of electricity and capacity, the capitalization, and the extent and diversity of Gen's assets together indicate that Gen, as the operator, will meet its financial obligations under the lease with Nuclear, as the owner.

Gen
Projected Income Statement
(In millions \$)

<u>Fiscal Year</u>	<u>Year 1</u> <u>2003</u>	<u>Year 2</u> <u>2004</u>	<u>Year 3</u> <u>2005</u>	<u>Year 4</u> <u>2006</u>	<u>Year 5</u> <u>2007</u>
Revenue:					
Nuclear					
Other Generation					
Total					
Total Operating Expenses					
Operating Income					
Other Non-Operating Deductions					
Income Taxes					
Net Income (Loss)					

With respect to the financial qualifications of Nuclear, the staff analyzed the following information under 10 CFR 50.33(f)(2) and (f)(3). As stated earlier, Nuclear shall be a wholly-owned subsidiary of Gen. Under the lease agreement between Gen and Nuclear, Gen will be solely responsible for all costs associated with the facility (except for costs to be paid out of the decommissioning trusts which will be transferred to Nuclear, as discussed in the staff's decommissioning funding analysis, below). In other words, Nuclear will have no "estimated operation costs." See 10 CFR 50.33(f)(2). On the other hand, under the lease agreement, Nuclear will receive rent from Gen for the facility in the amount of \$ per year. Accordingly, under the terms and conditions proposed in the application, including but not limited to the terms in the lease agreement, the staff finds that Nuclear will be financially qualified to own the facility and lease it to Gen, provided the following is made a condition of approval of the transfer and a conforming license condition:

Notwithstanding the fact that the title to the DCPD will be held by Nuclear, Gen and Nuclear shall at all times following the transfer of the DCPD licenses to Gen and Nuclear, be fully responsible for all costs associated with the operation, maintenance, and decommissioning of DCPD.

DIABLO CANYON NUCLEAR OPERATIONS
Projected Income Statement
(In millions \$)

<u>Fiscal Year</u>	<u>Year 1</u> <u>2003</u>	<u>Year 2</u> <u>2004</u>	<u>Year 3</u> <u>2005</u>	<u>Year 4</u> <u>2006</u>	<u>Year 5</u> <u>2007</u>
Revenue:					
Total Operating Expenses					
Operating Income					
Income Taxes					
Net Income (Loss)					

Staff has concluded that no further sensitivity analyses are required for this application based on the fact that the applicant has shown that there is a Master Power Purchase & Sale Agreement that will be in force for twelve contract years from the effective date, thus alleviating the possibilities of volatile pricing during the five year Projected Income Statement. In addition, the staff notes that the projected capacity factor of about 89% is the same as the historical capacity factor for the last six years (1995 to 2000) at DCP. The staff also concludes that projected total operating expenses are reasonable.

The staff notes the concerns of various interveners that have filed petitions with the NRC. It is the staff's opinion that the interveners have not provided any new financial information that is not already included in the application. Therefore, the staff's opinion is that the license amendment application contains the necessary information to fulfill the requirements of 10 CFR 50.33(f). The NRC conducts financial qualification analysis to determine if the applicant has reasonable financial resources to operate a commercial nuclear reactor safely.

However, in view of the NRC's concern that restructuring can lead to a diminution of assets necessary for the safe operation and decommissioning of a licensee's nuclear power plants, the NRC has sought to obtain commitments from its licensees that initiate restructuring actions not to transfer significant assets from the licensee without notifying the NRC. Thus, the NRC proposes the following commitment or equivalent be made a condition for the units licenses or of the order granting the proposed restructuring:

Gen and Nuclear agree to provide the Director, Office of Nuclear Reactor Regulation a copy of any application, at the time it is filed, to transfer (excluding grants of security interests or liens) from Gen and Nuclear to the proposed parent, or to any other affiliated company, facilities for the production, transmission, or distribution of electric energy having a depreciated book value exceeding ten percent (10%) of such licensee's

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consolidated net utility plant, as recorded on Gen or Nuclear's books of accounts.

The business of Gen will be conducted under the direction of a two person board of control (a limited liability company's equivalent to a corporation's board of directors). The members of the board of control are provided in the application. Nuclear will not have a board of control. The business of Nuclear will be conducted under the direction of its sole member, Gen. All members of the board of control and officers are citizens of the United States.

Based on the above information, the NRC staff finds that there will be no change in the amount of revenue, the sources of funds, or Gen and Nuclear's ability to obtain funds necessary to operate and decommission their units as a direct result of the proposed restructuring. The NRC staff finds that the application has fulfilled the regulatory requirements of 10 CFR 50.33(f), subject to the conditions as noted.

4.0 DECOMMISSIONING FUNDING

The NRC has determined that the requirements to provide assurance of adequate decommissioning funding is necessary to ensure the adequate protection of public health and safety. Section 50.33(k) of 10 CFR requires that an application for an operating license for a utilization facility contain information indicating how reasonable assurance will be provided that funds will be available to decommission the facility. Decommissioning funding assurance for DCPD is presently provided by an external Nuclear Decommissioning Trust as authorized by 10 CFR 50.75(e)(1)(ii). PG&E will transfer to Nuclear the interest in the Nuclear Decommissioning Trust associated with DCPD. The funds associated with the interest will be segregated from the new licensee's assets and outside its administrative control. The trustee will continue to manage investment of the funds in accordance with a master trust agreement and applicable NRC requirements and license conditions. The funds will be used only in a manner consistent with the terms of the trust agreements.

As stated in the Diablo Canyon Facility Lease by and Between Diablo Canyon LLC, (Nuclear), as Lessor, And Electric Generation LLC, (Gen), as Lessee, the following condition is included:

"Lessee shall be solely responsible for the decommissioning of the Diablo Canyon Power Plant in accordance with NRC requirements and any other legal requirements. Lessee's responsibilities shall include all necessary planning, engineering, permitting, reporting and carrying out or overseeing of such decommissioning. Notwithstanding Section 3.02(j) of the contract, Lessor shall reimburse Lessee for the cost of all Decommissioning Activities to the extent that such costs are payable out of the Diablo Canyon Decommissioning Master Trust Agreements. Lessee shall be solely responsible for all costs of Decommissioning costs of Decommissioning Activities not paid out of the Diablo Canyon Nuclear Decommissioning Trust."

The Nuclear Decommissioning Trust includes a California Public Utilities Commission (CPUC) jurisdictional qualified and a Federal Energy Regulatory Commission (FERC) jurisdictional qualified trust. The liquidation value of the DCPD Nuclear Decommissioning Trust as of September 30, 2001, was approximately \$473.5 million for DCPD Unit 1, and \$627.5 million for DCPD Unit 2. Pursuant to 10 CFR 50.75(c), Diablo Canyon, Unit 1, must provide

decommissioning assurance in the amount of \$309.9 million and Diablo Canyon, Unit 2, must provide decommissioning assurance in the amount of \$309.9 million. Based on the conformation, the staff has determined that the current fund balances exceed the minimum Decommissioning Trust amounts specified in 10 CFR 50.75, even without taking a 2% credit for future interest growth. The transfer to Nuclear of PG&E's interest in the Decommissioning Trust is subject to the approval of the Bankruptcy Court as part of the confirmation of the Plan. The transfer of the Trust is also subject to the approval of FERC and, accordingly, PG&E will seek in its application for approvals associated with the transaction under Section 203 of the Federal Power Act.

PG&E also expects to seek a private letter ruling from the Internal Revenue Service (IRS) to assure that the beneficial interest in the qualified decommissioning funds can be transferred to Nuclear on a tax-free basis.

In addition, the application states that the Gen and Nuclear Decommissioning Trust Fund Agreement will be in a form that is acceptable to the NRC and will provide, in addition to other required clauses, that:

1. Investments in the securities or other obligations of reorganized PG&E, its affiliates, or its successors or assigns will be prohibited, except for investments in funds tied to market indices or other non-nuclear sector collective, commingled or mutual funds.
2. Investments in any entity owning one or more nuclear power plants shall be prohibited, except for investments in funds tied to market indices or non-nuclear sector collective, commingled or mutual funds.
3. Investments made in the trust shall adhere to the standards for such investments.
4. Except for routine taxes and administrative costs, no disbursements or payments from the trust shall be made by the trustee unless the trustee has first provided thirty (30) days prior written notice of such disbursement or payment to the Director, Office of Nuclear Reactor Regulation, and the trustee has not received prior written notice of an objection from the Director, Office of Nuclear Reactor Regulation by letter of (1) the date that is thirty (30) days after the giving of such notice, or (2) the date of the disbursement.
5. The Director, Office of Nuclear Reactor Regulation, shall be given thirty (30) days prior written notice of any material modification to the trust agreement.
6. The entire amounts stated in the Decommission Trust, \$473.5 million for Diablo Canyon, Unit 1, and \$627.5 million for Diablo Canyon, Unit 2, shall be transferred to Nuclear to be used exclusively for the purposes of decommissioning.

As stated in the application, Gen, Nuclear and reorganized PG&E will take all necessary steps to ensure that the decommissioning trust is maintained in accordance with the above conditions.

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Based on the above information, the NRC staff finds that Gen and Nuclear will provide reasonable assurance of decommissioning funding assurance for DCPD.

5.0 ANTITRUST REVIEW

The Atomic Energy Act does not require or authorize antitrust reviews of post-operating license transfer applications. Kansas Gas and Electric Co., et al. (Wolf Creek Generating Station, Unit 1), CAI-99-19, 49 NRC 441, 468 (1999). Therefore, since the transfer application postdates the issuance of the DCPD, Units 1 and 2 operating licenses, no antitrust review is required or authorized. However, this decision left open the disposition of existing antitrust license conditions.

Certain parties have responded to the Commission's notice of consideration of approval of transfer of facility operating licenses and conforming amendments and opportunity for a hearing, dated January 10, 2002, with respect to the applicability of existing license condition to the proposed new licensees. At this time, the staff makes no finding with respect to its antitrust review, pending the outcome of the Commission's Memorandum and Order, CLI-01-12, dated April 12, 2002.

The application proposed that the Plan would call for a restructuring that would split generation assets from the transmission and distribution businesses. The antitrust conditions currently included in Appendix C of the DCPD licenses would not apply directly to Gen or Nuclear. The conditions also would not apply solely to reorganized PG&E. With respect to the existing antitrust license conditions, PG&E proposes to retain those conditions. In order to preserve the current antitrust obligations, PG&E proposes to retain reorganized PG&E on the license with respect to antitrust conditions and to add ETrans as a licensee for those conditions, as PG&E's successor, with respect to the transmission system. PG&E and ETrans would be licensees for the limited purpose of the antitrust license conditions. Along with Gen, reorganized PG&E and ETrans would be jointly and severally responsible for those conditions. This arrangement is reflected in the proposed license mark-ups provided in Enclosures 4 and 5 of the application. The Commission is currently considering whether it has the authority to effectuate applicant's proposal. Until such time as the commission decides this issue, the staff has deferred its antitrust analysis.

6.0 FOREIGN OWNERSHIP, DOMINATION OR CONTROL

Reorganized PG&E will be a publicly traded company whose securities will be traded on the New York Stock Exchange and widely held. Gen and Nuclear will be indirectly owned and controlled by reorganized PG&E. Reorganized PG&E is not currently owned, controlled, or dominated by any alien, foreign corporation, or foreign government. Based upon filings with the Securities and Exchange Commission, PG&E states that it is not aware of any alien, foreign corporation, or foreign government that holds more than 5.0% of the securities of PG&E.

Therefore, the staff finds that there is no reason to believe that Gen or Nuclear will be owned, controlled, or dominated by any alien, foreign corporation, or foreign government. The staff further notes that all of the directors and officers of reorganized PG&E, Gen and Nuclear, and the intermediate companies controlling Gen and Nuclear will be United States citizens. Thus,

Gen and Nuclear will not be under foreign ownership, domination, or control within the meaning of the Atomic Energy Act of 1954, as amended.

7.0 MANAGEMENT OF OPERATIONS AND TECHNICAL QUALIFICATIONS

The staff finds that there will be no physical change to DCPD and no changes in the day-to-day operations of DCPD in connection with the transfer of ownership interest from PG&E to Gen. The application states that Nuclear will at all times remain the licensed operator of the facility. Thus, the staff concludes that Gen is technically qualified to operate DCPD.

8.0 NUCLEAR INSURANCE

The provisions of the Price-Anderson Act (Section 170 of the AEA) and the Commission's regulations at 10 CFR Part 140 require that Gen and Nuclear be added to the current indemnity agreement for DCPD. In accordance with the Price-Anderson Act, Gen and Nuclear will also be required to provide primary insurance and participate in the secondary retrospective insurance pool. These requirements can be met by purchasing insurance policies from American Nuclear Insurers. Gen will also be required to maintain property insurance as specified in 10 CFR 50.54(w). The information provided in the application concerning financial qualifications demonstrates that Gen will be able to pay the \$10 million per unit potential annual retrospective premium in accordance with 10 CFR 140.21(e)-(f).

Consistent with NRC practice, the NRC staff will require Gen to provide satisfactory documentary evidence that Gen has obtained the appropriate amount of insurance required of licensees under 10 CFR Part 140 of the Commission's regulations, prior to the issuance of the amended licenses reflecting Gen as the licensee. Because the issuance of the amended licenses is directly tied to the proposed transfers, the order approving the transfer of the licenses for DCPD will be conditioned as follows:

Gen and Nuclear shall, prior to the completion of the transfers, provide the Director, Office of Nuclear Reactor Regulation satisfactory documentary evidence that Gen and Nuclear have obtained the appropriate amount of insurance required of licensees under 10 CFR Part 140 of the Commission's regulations.

9.0 CONCLUSION

In view of the foregoing, the NRC staff finds that Gen and Nuclear are qualified to be the holder of the facility operating licenses for DCPD, and that the transfer of the licenses is otherwise consistent with applicable provisions of law, regulations, and orders issued by the Commission pursuant thereto, subject to all of the conditions addressed in this safety evaluation.

The staff further finds that the establishment of intermediate parent companies would not effect the financial qualifications of Gen and Nuclear, and would not effect the qualifications of Gen and Nuclear as the holders of the licenses, and that the indirect transfer of the licenses, to the extent effected by the foregoing transactions, is otherwise consistent with applicable provisions of law, regulations and orders issued by the Commission pursuant thereto.

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