October 14, 2011

UNITED STATES OF AMERICA
NUCLEAR REGULATORY COMMISSION

BEFORE THE ATOMIC SAFETY AND LICENSING BOARD

In the Matter of:	)	
	)	
HONEYWELL INTERNATIONAL INC.	)	Docket No. 40-3392
	)	
(Metropolis Works Conversion Facility)	)	

TESTIMONY OF JOHN TUS AND BRUCE DEN UYL

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TESTIMONY OF JOHN TUS AND BRUCE DEN UYL

I. INTRODUCTION

A. John Tus

Q1. Please state your full name.

A1. My name is John Tus ("JT").

Q2. By whom are you employed and what is your position?

A2. (JT) I am currently employed as Vice-President and Treasurer at Honeywell International Inc.

Q3. Please summarize your educational and professional qualifications.

A3. (JT) My professional and educational qualifications are summarized in the curriculum vitae attached to my declaration (Exh. HNY000002). Briefly summarized, I earned a B.S. in Business Administration and Biology from Lebanon Valley College and a M.A. from The George Washington University. I have over 25 years of experience in finance and accounting. Since 2003, I have been Vice President and Treasurer of Honeywell International Inc.

Q4. What is the purpose of your testimony?

A4. (JT) The purpose of my testimony is to provide an overview of Honeywell's financial condition and to explain those aspects of Honeywell's financial data that have been the subject of the license amendment request. In addition, I provide background information on financial terminology and explain the underlying calculations used to generate the data.

Q5. What documents or information have you reviewed to prepare your testimony?

A5. (JT) I have reviewed Honeywell's three requests to use an alternate financial test (Exhs. HNY000004, HNY000005, and HNY000006), including the two supplemental filings providing additional information in response to NRC questions (Exhs. HNY000007 and HNY000008). I have also reviewed the NRC's two decisions granting (Exhs. HNY000009 and HNY000010) and two decisions denying (Exhs. HNY000011 and HNY000012) the license amendment request. In addition, I reviewed financial data for Honeywell that is relevant to the issues involving in this hearing. Exhs. HNY000015-HNY000020 (Honeywell 10Ks for Fiscal Year 2005-2010)

Q6. What has been your role in the license amendment application?

A6. (JT) I have offered guidance and advice in preparing the original submittal requesting use of the alternate test. I have also met with the NRC Staff to explain Honeywell's financial condition and answer any questions regarding general financial issues and Honeywell's specific circumstances (*see* Exh. HNY000013). In addition, in my role as Treasurer I am responsible for overseeing aspects of Honeywell's capital structure, public debt ratings, and financial liquidity. I therefore have participated in the preparation of the SEC filings and am familiar with the financial data that was used in support of the license amendment applications.

B. <u>Bruce Den Uyl</u>

Q7. Please state your full name.

A7. My name is Bruce Den Uyl ("BDU").

Q8. By whom are you employed and what is your position?

A8. (BDU) I am currently employed as a Managing Director and co-head of the Financial Advisory Services practice at AlixPartners.

Q9. Please summarize your educational and professional qualifications.

A9. (BDU) My professional and educational qualifications are summarized in the curriculum vitae attached to my declaration (Exh. HNY000003). Briefly summarized, I earned a B.A. in Economics from Lawrence University, and a M.S. in Resource Economics from the University of Michigan and completed the coursework for the Ph.D. in Resource Economics at the University of Michigan. I have over 25 years experience in valuation, corporate financial and economic consulting. Since 1998, I have been employed as a Managing Director at AlixPartners, LLP. Prior to that, I was employed as a partner at PriceWaterhouse, LLP.

Q10. What is the purpose of your testimony?

A10. (BDU) I have not been involved previously with the amendment request or any other issues related to decommissioning financial assurance for the Metropolis Works facility ("MTW"). I was asked to provide my expert opinion on a number of issues related to corporate financial metrics and Honeywell's financial position in particular.

The purpose of my testimony is therefore to provide an outside expert overview of Honeywell's financial condition and to explain those aspects of Honeywell's corporate financial data that have been the subject of the license amendment request.

Q11. What documents or information have you reviewed to prepare your testimony?

A11. (BDU) I have reviewed Honeywell's three requests to use an alternate financial test (Exhs. HNY000004, HNY000005, and HNY000006), including the two supplemental filings providing additional information in response to NRC questions (Exhs. HNY000007 and HNY000008). I have also reviewed the NRC's two decisions granting (Exhs. HNY000009 and HNY000010) and two decisions denying (Exhs. HNY000011 and HNY000012) the license amendment request. In addition, I reviewed financial data for Honeywell that is relevant to the issues involving in this hearing (Exhs. HNY000015-HNY000020, Honeywell 10Ks for Fiscal Year 2005-2010). I have also reviewed various rating agency reports from Standard & Poor's ("S&P") (Exhs. HNY000027-HNY000032 and HNY000050-HNY000056) and Moody's Investors Service ("Moody's) (Exhs. HNY000021-HNY000026, HNY000048, and HNY000049) and market related data from the CapitalIQ and Bloomberg databases (HNY000044- HNY000047, HNY000057, and HNY000058).

II. <u>OVERVIEW</u>

Q12. What is your understanding of the issues raised by this appeal?

A12. (JT, BDU) As we understand the issues, the NRC is evaluating whether the alternate approach used by Honeywell provides assurances that adequate decommissioning funding for the MTW will be available when needed. Specifically, Honeywell is proposing to use an alternate financial test to demonstrate that a self-guarantee method of decommissioning funding was and continues to be appropriate. The NRC has denied Honeywell's request for the reasons given in a letter to Honeywell, dated April 25, 2011. In part, the NRC asserted that (1) bond ratings were no longer a reliable indicator of a company's ability to pay its decommissioning obligations, (2) free cash flow is unreliable in the event of a bankruptcy, (3) a decrease in tangible net worth is an adequate reason to deny Honeywell's request, (4) an exemption is not in the public interest, and (5) the amendment is inconsistent with the decommissioning planning rule. Honeywell is challenging the NRC's decision, including the adequacy of the bases given for denying the request. Honeywell has provided more than ample information to demonstrate the very low risk of default for Honeywell and strong assurance that decommissioning funds are available. This information warrants issuance of the amendment, which is in the public's interest. The NRC's bases for the denial are not well-founded and do not justify denial of the request given Honeywell's financial condition.

Q13. Please briefly describe the basis for your position and summarize your conclusions.

A13. (JT) The alternate test relies on three factors: Honeywell's long term bond rating, tangible net worth including goodwill, and the book value of U.S. assets. At the end of each calendar year, these factors are re-examined to confirm that Honeywell continues to meet minimum criteria that demonstrate it has the financial capability to meet its future decommissioning obligations. To the extent that is not the case, Honeywell would be required to provide alternate financial assurance within 120 days of such event. Later in this testimony, I will go into more depth as to the adequacy of these three factors as indicators of financial condition and discuss why the reasons given by the NRC in its denial to Honeywell's exemption request are not factually grounded.

(BDU) I have significant experience in assessing the financial wherewithal and value of companies, both troubled and healthy, and am quite familiar with the credit ratings agencies and their ratings process. I also have significant experience in valuing intangible assets and assessing corporate goodwill. In addition to reviewing various documents in this proceeding, I have reviewed and analyzed Honeywell's financials, credit rating reports, and various market indicia of the financial health of Honeywell. Based on Honeywell's size, diversity across products, end users and geographies, cash flow generation and both the rating agencies' and the market's assessment of Honeywell's financial strength, it is apparent that the alternate approach used by Honeywell provides assurance that the MTW decommissioning costs will be adequately covered.

Q14. Why do you disagree with the NRC Staff conclusion that the license amendment application should be denied?

A14. (JT) The alternate test previously approved provides more than ample basis for the NRC to conclude that there is strong assurance that decommissioning funds will be available for the MTW. In addition, there are required mechanisms for regularly revisiting Honeywell's financial condition, including various reporting requirements and corrective actions in the event of an adverse change in financial condition. The NRC agreed to Honeywell's alternate test on two prior occasions, concluding on both occasions that the alternate approach was acceptable. There have been no significant, long-term changes in Honeywell's financial condition that would warrant the drastic change in the NRC's conclusions or its approach to evaluating the request. Bond ratings continue to be reliable indicators of a company's financial condition and ability to pay. And, declining tangible net worth does not, in Honeywell's case at least, reflect declining financial performance or an increased risk of default.

(BDU) The alternate test proposed by Honeywell provides strong assurance that decommissioning funds are available. Bond credit ratings are excellent indicators of the financial strength of a corporate issuer like Honeywell — a conclusion that remains true despite the recent economic challenges — and Honeywell has consistently maintained a high bond credit rating. Further, for highly-rated companies, a negative tangible net worth is not a reflection of financial weakness. Rather, it reflects that the value of a company tends to be much more correlated with its cash flow generation ability than the accounting book value of its assets. Honeywell has consistently produced high levels of free cash flow, which is another indicator of its financial strength and ability to pay decommissioning obligations. There are also NRC regulations requiring licensees to obtain alternate methods of financial assurance in the event of declining performance. Together, all of these factors contribute to my disagreement with the NRC's decision to deny the amendment. To the contrary, Honeywell has provided information that supports issuance of the amendment.

III. DISCUSSION

A. Overview of Honeywell Financial Condition

Q15. Please provide an overview of Honeywell.

A15. (JT) Honeywell International Inc. is a Fortune 75 diversified technology and manufacturing leader, serving customers worldwide with aerospace products and services; control technologies for buildings, homes and industry; automotive products; turbochargers; and specialty materials. Honeywell International Inc. is the ultimate parent company for all Honeywell subsidiaries and affiliates. In 2010, $33.4 billion in sales were distributed among four primary lines of business: automated control solutions (41%), aerospace (32%), specialty materials (14%), and transportation systems (13%). Exh. HNY000013. Under Honeywell's corporate structure, all of these lines of business would be available to provide funds for decommissioning of MTW. Honeywell forecasts 2011 sales between $36.1 billion and $36.7 billion. Honeywell has more than 130,000 employees doing business in more than 100 countries, with a market capitalization of approximately $34 billion as of September 30, 2011.

Q16. What is Honeywell's current decommissioning liability for MTW?

A16. (JT) Honeywell International Inc. owns and operates MTW and is the NRC licensee. The decommissioning obligations relating to MTW rest with Honeywell International Inc. The decommissioning cost estimate at MTW, for NRC purposes, is $186,610,047 based on a site reclamation cost estimate submitted to the NRC on January 8, 2010, and approved in a letter from Marissa G. Bailey, NRC, to Larry

Smith, Plant Manager, Honeywell, dated September 16, 2010 (ADAMS Accession No. ML102170174) (Exh. HNY000014).

Q17. Please provide an overview of Honeywell's current financial condition.

A17. (JT) Honeywell is in a very strong financial position. Our long term bonds are rated "A2" by Moody's and "A" by Standard & Poor's. The company forecasts 2011 free cash flow (excluding any optional U.S. pension payments) in the range of $3.5 to $3.7 billion. Sales in 2011 are expected to grow 12% to 14% when compared to 2010. Honeywell's strong performance allowed the company in 2011 to issue $1.4 billion of long term debt and to renew its $2.8 billion five-year committed revolving credit facility. Unlike most companies, Honeywell's revolver does not contain any financial covenants.

Q18. Describe generally Honeywell's financial condition over the past 5 years.

A18. (JT) During the last 5 years, Honeywell financial condition was very strong in spite of one of the deepest recessions in 80 years. Free cash flow grew from $2.2 billion in 2006 to $3.6 billion in 2010 after making a $600 million voluntary pension contribution. While sales and net income declined by 15% and 23%, respectively, between 2008 and 2009, Honeywell was able to maintain its free cash flow at $3.1 to $3.3 billion. Our credit rating remained at the "A" level due to our superior ability to generate free cash flow in both economic expansions and contractions.

Q19. Has there been any significant adverse change in Honeywell's financial performance that you can observe since 2008?

A19. (JT) No. As stated above, Honeywell's financial position has improved since 2008. While sales declined from a high of $36.6 billion in 2008 to a low of $30.9 billion in

2009, sales are forecast to be in the range of $36.1 to $36.7 billion in 2011. Free cash flow was $3.1 billion in 2008 and is forecast to increase to $3.5 to $3.7 billion in 2011. Net worth similarly grew from $7.1 billion in 2008 to $10.8 billion in 2010. In contrast to many other companies, Honeywell did not experience any limitations on its ability to access the commercial paper markets throughout the financial crisis.

B. Bond Ratings

Q20. Can you please explain the role of ratings agencies?

A20. (JT, BDU) The U.S. bond market has historically been segmentable into at least five sectors – corporates, Treasuries, municipals, investor-owned utilities, and structured finance. The securities issued in these markets have differed in many respects, such as liquidity, price volatility, and the timing of cash flows. Our testimony is focused on corporate bond credit ratings.

Rating agencies assess the general creditworthiness of an issuer and specific debt instruments. Credit ratings are grades given to issuers/bonds on the basis of the creditworthiness of the corporation issuing them and the particular features of the individual debt instruments. The ratings are assigned by independent rating agencies (in the United States the largest are Standard & Poor's and Moody's Investors Service), and they generally run from AAA (highest quality) to D (in default). Bonds with ratings from AAA to BBB from S&P (Aaa to Baa from Moody's) are regarded as "investment grade." A particular letter rating is meant to connote the same general level of creditworthiness for issuers and issues in different sectors and at different times. Rating comparability is maintained by measuring default behavior across different industries and over time, applying common approaches to risk analysis, and using a common set of macroeconomic scenarios associated with different credit ratings.

An important step in analyzing the creditworthiness of a corporate obligor like Honeywell is gauging the resources it has to fulfill its commitments relative to the size and timing of those commitments. Assessing an obligor's resources for fulfilling its financial commitments is primarily a forward-looking exercise. It entails estimating or projecting future income and cash flows, consideration of economic conditions, the regulatory environment, and economic projections and forecasts. For corporate entities, future income and cash flows come primarily from ongoing operations or investments. The assessment of the business considers both the expected level of future income and cash flows and their potential variability. The assessment includes both qualitative and quantitative factors.

The quantitative side of the analysis focuses primarily on financial analysis and includes an evaluation of an obligor's accounting principles and practices. Key financial indicators generally include profitability, leverage, cash flow adequacy, liquidity, and financial flexibility. Off-balance sheet items, such as securitizations, derivative exposures, and leases, trends over time, and peer comparisons are also part of the quantitative analysis. On the qualitative side, the analysis of business entities focuses on various factors, including: country risk, industry characteristics, and entity-specific factors. Industry characteristics typically encompass growth prospects, volatility, and technological change, as well as the degree and nature of competition. Broadly speaking, the lower the industry risk, the higher the potential credit rating for an obligor in that sector. The analysis also considers certain entity-specific factors that can distinguish an individual obligor from its peers. These may include diversification of the obligor's products and services, operational effectiveness, overall competitive position, strategy, governance, financial policies, risk management practices, and risk tolerance.

Since ratings are intended to measure long-term risk, the analytical focus is on fundamental factors that drive each issuer's long-term ability to meet debt payments. As a rule of thumb, rating agencies are looking at the financial strength of a company over a number of years. Because of this, ratings are not intended to ratchet up and down with short term business or supply-demand cycles or to reflect last quarter's earnings report.

Q21. What is Honeywell's bond rating?

A21. (JT) Honeywell has maintained an A2 rating from Moody's and an A rating from Standard & Poor's for the past 17 years. (For consistency and ease of reference, we will refer to Honeywell as having an "A-rating" throughout the testimony, except where otherwise noted.) "A-rated" companies have a strong capacity to meet financial commitments. This demonstrates that Honeywell's financial condition has been stable over the long term.

Q22. Please describe the likelihood of default for "A-rated" companies. How has this changed, if at all, over the years?

A22. (JT, BDU) As the tables below demonstrates, there is a low likelihood of default for A/A2-rated companies, particular within one year of having such a rating.

TABLE 1: Cumulative Average Default Rates by Letter Rating for "A" Rating (S&P) in percent (%)					
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
1981-2005	0.04	0.12	0.23	0.38	0.59
1981-2006*	0.07	0.19	0.32	0.44	0.63
1981-2007*	0.07	0.18	0.30	0.42	0.60
1981-2008	0.08	0.20	0.34	0.52	0.72
1981-2009	0.08	0.21	0.35	0.53	0.72
1981-2010	0.08	0.19	0.33	0.50	0.68

Citation: Exhs. HNY000027-HNY000032

* For these years, S&P did not provide separate data for "A-rated" companies, but rather consolidated A+, A, and A- data into a single "A" category.

TABLE 2: Average Cumulative Issuer-Weighted Global Default Rates for A2 (Moody's) in percent (%)					
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
1983-2005*	0.026	0.082	0.224	0.427	0.612
1983-2006	0.024	0.076	0.206	0.389	0.557
1983-2007	0.024	0.076	0.207	0.392	0.559
1983-2008	0.026	0.092	0.244	0.445	0.639
1983-2009	0.06	0.158	0.325	0.538	0.746
1983-2010	0.065	0.174	0.351	0.578	0.788

Citation: Exhs. HNY000021-HNY000026

* For 1983-2005, the data is for "Average Cumulative Issuer-Weighted Corporate Default Rates." For all other years, the data is "Average Cumulative Issuer-Weighted Global Default Rates."

Q23. Has the default rate for "A-rated" companies during the past few years varied significantly from the default rate during other cyclical events?

A23. (JT, BDU) One of the NRC's stated reasons for denying Honeywell's exemption was that beginning in 2008 and 2009 bond ratings were no longer a reliable indicator of a company's ability to pay its decommissioning obligations. Although this will be discussed in greater detail later in this testimony, the following table demonstrates that corporate default rates during the 2008-2009 recession were not dissimilar from the default rates for the 2001 recession.[1] Significantly, the default rates noted below also include financial institutions, insurance companies and real estate firms — that is, the sectors that were greatly impacted by the 2008-2009 recession.

TABLE 3: Annual Issuer-Weighted Corporate Default Rates for A2 or "A" Rating Category in percent (%)[2]		
	Moody's A2	**S&P "A"**
1999	0.00	0.18
2000	0.00	0.26
2001	0.454	0.35
2002	0.00	0.00
2003	0.00	0.00
2004	0.00	0.08
2005	0.00	0.00
2006	0.00	0.00
2007	0.00	0.00
2008	0.259	0.38
2009	0.00	0.22
2010	0.00	0.00
1983-2010 Mean	.025	N/A
1983-2010 Maximum	.454	N/A
1983-2010 Minimum	0.00	N/A
1981-2010 Mean	N/A	0.08
1981-2010 Maximum	N/A	0.38
1981-2010 Minimum	N/A	0.00

[1] The NRC recognizes the import of historical default rates and their correlation with ratings when it notes: "Standard and Poor's and Moody's have introduced the plus or minus and numerical adjustments to refine their precision of their ratings. . . . Based on the minimal difference in the default rate associated with the qualifiers, the proposed rule would state that all the bonds within a specified rating level meet the regulatory standard." 73 Fed. Reg. 3812, 3826 (Jan. 22, 2008) (Exh. NRC000014).

[2] Exhs. HNY000026 and HNY000032 at Tables 3-4.

Q24. Are bond credit ratings reliable indicators of financial strength?

A24. (JT, BDU) Yes. Bond credit ratings are excellent indicators of the financial strength of a corporate issuer like Honeywell. As previously described in A.20 above, the rating agencies perform a rigorous quantitative and qualitative assessment of the creditworthiness of a corporate issuer. Given the number of variables that the credit rating agencies evaluate, their assessment is more accurate than focusing on one or two financial metrics such as tangible net worth or U.S. assets, as required by the NRC's standard financial test. The rating agencies' track record for corporate issuers has been excellent, as can be observed in Tables 1 and 2 above. Bond ratings take into account numerous financial metrics and qualitative analyses including the assessment of a business's market position, diversification, liquidity, and ability to generate future cash flows, rather than just one static metric.

The Commission has previously recognized that "the bond rating itself — combined with the other reporting requirements — may be a sufficient indicator of financial stability."[3] 58 Fed. Reg. 3515, 3518 (Jan 11, 1993) (Exh. HNY000042); *see also* 58 Fed. Reg. 68726, 68727 (Dec. 29, 1993) (The qualification to use a self-guarantee "is based in large part on a specified bond rating.") (Exh. NRC000013).

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3 Honeywell's bond rating may also be higher than the issuer of a surety bond or a letter of credit (which is one of the other acceptable financial assurance mechanisms), as there is no NRC bond rating requirement for issuances of letters of credit or surety bonds. *See AREVA Enrichment Facilities* (Eagle Rock Enrichment Services, LLC) 74 NRC __, CLI-11-04, slip op. at 10 (July 12, 2010) ("[N] either our rules nor applicable guidance require that the letter of credit issuer demonstrate minimum capitalization requirements, credit rating requirements, or other substantive measures that would demonstrate the issuer's financial soundness); NUREG-1757, Vol. 3, Consolidated NMSS Decommissioning Guidance, "Financial Assurance, Recordkeeping, and Timeliness" (Sept. 2003) (Exh. NRC000049).

C. <u>Tangible Net Worth</u>

Q25. What are intangible assets? What is goodwill?

A25. (JT, BDU) Intangible assets include patents, copyrights, trademarks, trade names, franchise licenses, government licenses, customer lists, goodwill, and other items that lack physical substance but provide long-term benefits to the company. Goodwill is an intangible asset that reflects part of the cash generating potential of acquired businesses. Goodwill is calculated and put on a company's balance sheet at the time of an acquisition or similar transaction using generally accepted accounting principles ("GAAP"). Goodwill is audited annually for impairment.

(JT) Honeywell's business model is such that it often engages in acquisitions or other business combinations that generate significant amounts of goodwill. In almost all business combinations, the consideration paid by the acquiring company exceeds the fair value of the assets acquired and liabilities assumed from the target. The reason for this excess of goodwill is that the acquired company is valued on the basis of its cash flow or net income generating potential, not on the simple fair value of its assets and liabilities. Thus, in the case of an acquisitive company like Honeywell, goodwill may make up a considerable portion of its assets. Since January 1, 2003, Honeywell has acquired approximately 65 companies at a cost of approximately $8.5 billion. The following table lists Honeywell's goodwill as of fiscal year end.

<u>**TABLE 4**</u>	**Goodwill (millions)**
December 31, 2006	$8,403
December 31, 2007	$9,175
December 31, 2008	$10,185
December 31, 2009	$10,494
December 31, 2010	$11,597

Q26. How do companies, such as Honeywell, ensure that goodwill is appropriately valued?

A26. (JT, BDU) Goodwill is assessed using standard accounting practice. The accounting for goodwill subsequent to recognition is provided in Accounting Standards Codification 350: *Intangibles - Goodwill and Other* ("ASC 350") (Exh. HNY000038).[4] Paragraph 35-1 of subtopic 20, section 35 of ASC 350 specifically states that "[g]oodwill shall not be amortized," and "[g]oodwill shall be tested for impairment." This impairment test is performed at least annually and may be performed more frequently if there is an indication of impairment. This testing compares carrying values to fair values and, when appropriate, the carrying value of goodwill is reduced to fair value.

Step 1 (Paragraphs 35-4 through 35-8) is used to identify potential impairment. In step 1, the company compares the fair value of a reporting unit (*e.g.*, the business with recorded goodwill) to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If,

4 Goodwill was previously evaluated using FAS 142, *Goodwill and Other Intangible Assets* (Exh. HNY000033). The Financial Accounting Standards have been replaced by the Accounting Standards Codifications.

however, the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test must be performed to measure the amount of impairment loss, if any. Step 2 (Paragraphs 35-9 through 35-13) measures the amount of impairment loss. In step 2, the company excludes the portion of the goodwill that is not supported by the fair value of the business. After a goodwill impairment loss is recognized, the adjusted carrying amount of goodwill becomes the new accounting basis. Subsequent reversal of a previously recognized goodwill impairment loss <u>is prohibited</u> once the measurement of that loss is completed. Thus, if the value of the business does not support the goodwill, it may not be subsequently re-instated.

Stated simply, <u>each year</u> a company must verify that it "got what it paid for" and that the value of the goodwill is supported by the value of the business that was acquired. This independent test of the "fair value" of goodwill by a company's auditors ensures that there is real value to the credited goodwill. Moreover, by annually testing the fair value of goodwill, potential impairment issues will be identified and addressed in a timely manner.

Q27. Describe the value of intangible assets, including goodwill, and how they reflect a company's financial condition?

A27. (JT, BDU) Intangible assets, like physical assets such as plant, property and equipment, clearly have value as they are an integral part of the business that is generating a company's free cash flow. Intangible assets (including goodwill) are a reflection of the cash generating ability of a business and the corresponding value associated with this cash generation above and beyond the value of a company's aggregated tangible assets. In addition to driving value, cash flow also drives financial strength – the higher the cash flow generating ability of a company, the stronger the company is financially, all things equal. In the modern economy, there are numerous examples of companies that generate significant cash and are highly valued by the marketplace but do not have substantial tangible assets.

In Honeywell's case, as is the case with many modern companies, there are also intangible assets that are not reflected on its balance sheet because booked goodwill only includes the value of those companies that have been acquired, rather than grown organically. The market value of Honeywell is significantly in excess of its book value. The market value of Honeywell reflects the value of all of Honeywell's assets (including those intangibles).

One way of assessing this additional value above and beyond the book value of tangible assets is looking at how stock market participants value a publicly-traded company such as Honeywell. Honeywell trades on the New York Stock Exchange and has a market capitalization, or value of its total equity, of approximately $34 billion as of September 30, 2011. This market value of equity equates to 2.8x the total book value of shareholders equity (including booked goodwill and other intangibles) on Honeywell's latest publicly available balance sheet (June 30, 2011). Exh. HNY000058 (CapitalIQ database). From the beginning of 2008 through the present, the market has valued Honeywell, on average, at approximately 3.5x its total shareholders book equity, including booked intangibles and goodwill. *Id.*

Q28. What is tangible net worth?

A28. (JT) Tangible net worth equals shareholders equity less goodwill and other intangible assets. For Honeywell, shareholders equity was approximately $10.8 billion as of December 31, 2010. Honeywell's tangible net worth in recent years is summarized below.

TABLE 5	**Shareholders Equity (millions)**	**Goodwill (millions)**	**Other Intangible Assets (millions)**	**Tangible Net Worth (millions)**
December 31, 2006	$9,720	$8,403	$1,247	$70
December 31, 2007	$9,222	$9,175	$1,498	($1,451)
December 31, 2008	$7,187	$10,185	$2,267	($5,265)
December 31, 2009	$8,971	$10,494	$2,174	($3,697)
December 31, 2010	$10,787	$11,597	$2,574	($3,384)

Q29. What are tangible assets?

A29. (JT) Tangible assets are assets having a physical existence, such as cash, equipment, inventory and real estate. Accounts receivable are also usually considered tangible assets for accounting purposes. Honeywell's tangible assets in recent years are summarized below.

TABLE 6	**Total Assets (millions)**	**Goodwill and Other Intangible Assets (millions)**	**Tangible Assets (millions)**
December 31, 2006	$30,941	$9,650	$21,291
December 31, 2007	$33,805	$10,673	$23,132
December 31, 2008	$35,490	$12,452	$23,038
December 31, 2009	$36,004	$12,668	$23,336
December 31, 2010	$37,843	$14,171	$23,672

Q30. Please discuss the significance, if any, of tangible net worth in measuring a company's financial condition.

A30. (JT, BDU) Tangible net worth only measures the value of tangible assets less the value of liabilities. It does not reflect the cash generating ability of the business. For instance, a company may have a positive tangible net worth and be cash flow negative. Thus, for a diversified technology and manufacturing company like Honeywell (and a non-electric utility licensee), the tangible net worth test does not necessarily reflect its financial stability or risk of default. Other large companies that are financially strong often have a negative tangible net worth due, in part, to growing via acquisitions. For example, United Technologies Corp. ("UTC") had a negative tangible net worth as of 2010 year-end. Exh. HNY000047. On September 21, 2011, UTC announced the $18.3 billion acquisition of Goodrich Corporation of which $12 billion is expected to be financed with new long-term debt. Long term fixed income investors clearly gave little or no weight to the fact that UTC has a negative tangible net worth, but will instead rely upon UTC's "A" rating as a measure of UTC's ability to repay such debt. Other financially strong "A-rated" (or better) companies, including Danaher, IBM, and Proctor & Gamble, also had negative tangible net worth as of year-end 2010. Exhs. HNY000044-HNY000046.

D. Other Metrics Demonstrating Financial Strength

Q31. What is free cash flow?

A31. (JT) Free cash flow is the cash a company generates from its operations less the cost of maintaining and expanding its asset base for purchases of property, plant and equipment (*i.e.*, capital expenditures). It is essentially the money that the company could return to shareholders if the company was to grow no further. Honeywell's free cash flow in recent years is summarized below.

TABLE 7	Free Cash Flow (millions)
December 31, 2006	$2,200
December 31, 2007	$3,100
December 31, 2008	$3,100
December 31, 2009	$3,300
December 31, 2010	$3,550

Q32. What is net worth?

A32. (JT) Net worth or shareholders equity is equal to the total assets of a company minus its total liabilities. Honeywell's net worth in recent years is summarized below.

TABLE 8	Net worth (millions)
December 31, 2006	$9,720
December 31, 2007	$9,222
December 31, 2008	$7,187
December 31, 2009	$8,971
December 31, 2010	$10,787

Q33. Are there other financial measures that demonstrate financial strength?

A33. (JT, BDU) In addition to bond ratings and the public equity market's value of Honeywell's equity, Honeywell has publicly traded bonds. Honeywell has 14 issues of bonds with maturities ranging from 2011 to 2041. As of September 30, 2011, the yield on these bonds (excluding the issue maturing in November 2011) range from 0.6% to 4.4% with an average yield of 2.7% and had coupons that averaged 5.4%.

These yields are quite low and reflect the bond market's comfort with the financial strength of Honeywell.

E. Overview of Alternate Approach

Q34. Please describe the financial test proposed in the license amendment.

A34. (JT) 10 C.F.R. § 40.36(e) states that a licensee may provide a guarantee of funds for decommissioning costs based on a financial test "if the guarantee and funds are as contained in appendix C to Part 30." Appendix C to Part 30 states that for a self-guarantee a licensee must, among other requirements, have a "[t]angible net worth at least 10 times the total current decommissioning cost estimate for the total of all facilities or parts thereof" to pass the financial test. Because the tangible net worth test — as typically applied — does not accurately reflect its financial strength and stability or its low risk of default, Honeywell proposed an alternate formula that includes the asset of goodwill in the calculation of tangible net worth. Specifically, Honeywell sought to use "goodwill" in addition to tangible net worth in calculating the 10:1 ratio in Appendix C.

The requirements in Appendix C that a licensee maintain: (1) assets located in the United States amounting to at least 90 percent of total assets or at least 10 times the total current decommissioning cost estimate for the total of all facilities or parts thereof; and (2) a current rating for its most recent bond issuance of AAA, AA, or A as issued by Standard and Poor's (S&P), or Aaa, Aa, or A as issued by Moody's, remain unchanged.

Q35. How often is Honeywell required to update the NRC on its financial status or re-perform the financial test?

A35. (JT) Under 10 C.F.R. Part 30, Appendix C, Section II.B, a licensee using a self-guarantee financial assurance mechanism must verify that it meets the financial test allowing it to utilize the self-guarantee within 90 days of the close of each fiscal year (*i.e.*, annually). Honeywell was also required, by License Condition 26, to submit to NRC, for review and approval, the results of the financial test and supporting documentation required by 10 C.F.R. Part 30, Appendix C, Section II.B(3) within 120 days of the close of each fiscal year.

In addition to the annual financial test (Part 30, Appendix C, Section II.B.3), licensees must inform NRC within 90 days of any matters coming to the attention of the company's independent certified public accountant that cause the auditor to believe that the data specified in the financial test should be adjusted and that the company no longer passes the test (Part 30, Appendix C, Section III.E). And, if the licensee no longer meets the requirements of Appendix C, Section II.A, the licensee must send immediate notice to the Commission of its intent to establish alternate financial assurance as specified in the Commission's regulations within 120 days of such notice.

Q36. In your opinion, does the alternate test provide reasonable assurance that adequate funds will be available at the time of decommissioning?

A36. (JT, BDU) Yes. The objective of the NRC's decommissioning funding assurance regulations is to ensure that licensees maintain adequate financial assurance so that timely decommissioning can be carried out following shutdown of a licensed facility. The option of providing a self-guarantee was developed to reduce the licensee's cost burden while maintaining assurance that funds would be available for decommissioning. The financial tests for a self-guarantee in Part 30, Appendix C include specific criteria (*e.g.*, financial test, minimum bond rating, and total asset test) that are intended to reflect the licensee's underlying financial strength and also impose related reporting and oversight requirements. However, not all of the criteria are necessary to ensure a licensee's financial strength in every case. For example, the Commission has previously recognized that since a company's "tangible net worth" is an important factor comprising its bond rating, "the bond rating itself may be a sufficient indicator of financial stability." 58 Fed. Reg. 3515, 3518 (Jan 11, 1993) (Exh. HNY000042); *see also*, 58 Fed. Reg. 68726, 68727 (Dec. 29, 1993) (The qualification to use a self-guarantee "is based in large part on a specified bond rating.") (Exh. NRC000013).

For Honeywell, which has maintained an "A" rating from both Moody's and Standard & Poor's for the past 17 years, the minimum bond rating criteria in the financial test is, by itself, an effective surrogate for financial strength and stability. As explained earlier in the testimony, companies with an A bond rating have a very low risk of default. The risk of an "A-rated" company defaulting in one year is, on average, somewhere between 0.065% and 0.08%. As calculated by Moody's and S&P, the risk of an "A-rated" company defaulting in five years is, on average, between 0.680% and 0.788%. This shows that bond ratings are a reliable indicator of financial health and long-term financial performance. The bond rating companies monitor a company to determine whether the rating should be changed, and downgrade or upgrade the rating as appropriate. Put simply, "A-rated" companies are unlikely to default, and, if they do, there is likely to be a significant time lag (and rating downgrades) prior to actual default. Overall, Honeywell's steady bond rating clearly demonstrates both its financial strength and its financial stability. Honeywell is not requesting any change to the bond rating criterion of the self-guarantee financial test.

In conjunction with minimum bond rating (Part 30, Appendix C, Section II.A.3) and the bond rating downgrade reporting requirement (Part 30, Appendix C, Section III.E), the annual recertification (Part 30, Appendix C, Section II.B.3) and submission of SEC reports (Part 30, Appendix C, Section III.D) ensure that potential problem situations will be identified and addressed in a timely manner or that additional assurance mechanisms can be employed if needed.[5] Because the minimum bond rating and reporting requirements in the self-guarantee financial test will remain unchanged if the requested amendment is granted, there continues to be strong assurance that adequate funds will be available at any point in time to decommission the MTW. Honeywell also generates significant annual free cash flow that is available for decommissioning the MTW when necessary.

Moreover, Honeywell is not proposing to eliminate the "tangible net worth test" in its entirety. Instead, Honeywell proposes an adjustment to the presumptive formula used to calculate tangible net worth (to include goodwill) — the same approach that the NRC approved twice before. The alternate test more accurately reflects the value and financial strength of Honeywell For a diversified technology and manufacturing

5 For example, under Part 30, Appendix C, Section III, a licensee must notify NRC within 20 days if its rating ceases to be in any category of A or above for Moody's and S&P. Such a change triggers a further requirement to seek alternate financial assurance within 120 days.

company like Honeywell (and a non-electric utility licensee), the tangible net worth test does not accurately reflect its financial stability or risk of default because it ignores other assets that are indicative of a company's financial strength and stability.

Accounting Standards Codification 805: *Business Combinations*, ("ASC 805") subtopic 30, section 20, defines goodwill as "[a]n asset representing the future economic benefits arising from other assets acquired in a business combination or an acquisition by a not-for-profit entity that are not individually identified and separately recognized."[6] Exh. HNY000039. ASC 805 generally provides that assets acquired and liabilities assumed be recorded at their fair value. In addition, ASC 805 specifically precludes assigning value to certain "assets" such as an assembled workforce. Since these types of items have a definite value to a company, they are included in the balance of goodwill for accounting purposes.

As noted above, Honeywell's business model is such that it often engages in acquisitions or other business combinations that generate significant amounts of goodwill. This goodwill is an asset and has real value to Honeywell and its shareholders that is not reflected in Honeywell's tangible net worth. While a traditional tangible net worth test may be appropriate and conservative for certain entities (such as electric utilities), it is at best a crude measure of the worth of a diversified company in today's global environment. The low relative weight that should be placed on measuring financial strength via tangible net worth for a global,

[6] ASC 805 replaced FAS 141, *Business Combinations*, paragraph 43, which also defines goodwill as "the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed." Exhs. HNY000034 and HNY000035.

diversified business such as Honeywell is highlighted by the fact that stock market participants currently value Honeywell's equity, on a market capitalization basis, at 2.8x its accounting equity book value.

Q37. Has the NRC reviewed and approved use of the same test in the past?

A37. (JT) Yes, the NRC Staff authorized Honeywell to use the same alternate financial test on two prior occasions.

Q38. Are you familiar with the NRC's decommissioning rulemaking? Does it permit licensees to consider intangible assets?

A38. (JT) I am generally familiar with the NRC's decommissioning rulemaking and, in particular, with the NRC Staff's proposal to include intangible assets in the financial test ratio. As I understand it, the NRC Staff proposed to add language to allow the inclusion of <u>all intangible assets</u> and not just goodwill in the determination of net worth for purposes of the financial test ratio. *See* 73 Fed. Reg. at 3825 ("The staff concluded that permitting the use of intangible assets in conjunction with an investment grade bond rating would not materially increase the risk of a shortfall in decommissioning funding."); 76 Fed. Reg. 35512, 35524 (June 17, 2011) ("[T]his final rule will allow the use of intangible assets, in conjunction with an investment grade bond rating, to meet specified criteria in the financial tests for parent company and self-guarantees.") (Exh. NRC000015). This change would be more lenient than the alternate financial test that the NRC had approved previously for use by Honeywell. The NRC Staff, in denying the amendment, did not address this aspect of the proposed rule, which supports issuance of the amendment but is inconsistent with the NRC reasoning in this proceeding.

Q39. Do you agree with the NRC's rulemaking regarding the role of intangible assets in assuring ability to pay?

A39. (JT) Yes. The NRC, in its rulemaking, has appropriately recognized that intangible assets can be used to demonstrate decommissioning financial assurance (*i.e.*, to demonstrate a licensee's ability to pay). Specifically, the NRC recognized that intangible assets are audited annually using accepted accounting practices and that the use of intangible assets in the financial test ratio calculation would not materially increase the risk of a shortfall in decommissioning funds. 73 Fed. Reg. at 3825 (Exh. NRC000014).

Q40. Do you agree with the NRC's conclusions regarding the minimum tangible net worth in assuring ability to pay, as articulated in the decommissioning rulemaking?

A40. (JT, BDU) No. For highly-rated companies, a negative tangible net worth is not a reflection of financial weakness. Rather, it reflects that the value of a company tends to be much more correlated with its cash flow generation ability than the accounting book value of its tangible assets. One accounting-related result of acquiring cash generating businesses is that the purchaser is required to book either specific intangibles or goodwill to reflect the difference between the value of the purchased tangible assets and the value associated with the ability of the purchased assets to generate cash flow. Further, the 1981 EPA analysis upon which the NRC relied (76 NRC at 35524) is outdated. Overall, we do not believe that a minimum tangible net worth criteria is useful or relevant. Below, we discuss this conclusion in greater detail and suggest that "net worth" would be a more useful measure of a company's financial strength.

F. <u>Evaluation of Alternate Approach</u>

1. Approach Ensures Ability to Pay Under Normal Circumstances

Q41. In your view, does the test proposed by Honeywell (previously accepted by the NRC) ensure Honeywell's ability to pay under normal circumstances?

A41. (JT, BDU) Yes.

Q42. If so, please explain.

A42. (JT, BDU) The licensee's financial ability to pay under normal circumstances is regularly assessed by the bond rating agencies, such as Moody's and Standard and Poor's, through their rating process and ongoing issuer diligence, a rating of "A" or higher indicates a very low probability of default on a company's bonds. The bond rating agency considers environmental obligations, such as radiological decommissioning and environmental remediation, in its rating of the licensee's ability to pay. The bond rating agency also considers the value of goodwill reflected on the licensee's balance sheet. Consequently, the "A" rating held by Honeywell is a reliable indicator that it has the ability to pay for its regulatory obligations under normal circumstances.

The bond rating is also supported by Honeywell's 2010 annual revenues of approximately $33 billion, which generated about $3.5 billion net annual cash flow (as well as the $4.0 billion in cash and short-term investments on its June 30, 2011 balance sheet). In view of the bond rating and Honeywell's cash flow generating capacity, its ability to pay for decommissioning under normal circumstances is more than adequate.

2. Approach Ensures Ability to Pay In Times of Financial Distress

Q43. In your view, does the test proposed by Honeywell (previously accepted by the NRC) ensure Honeywell's ability to pay in times of financial distress?

A43. (JT, BDU) Yes.

Q44. If so, please explain.

A44. (JT, BDU) The likelihood that Honeywell will default due to financial distress during a particular time span can also be assessed with the bond rating. As noted above, there is a very low risk of default of an "A-rated" company over a 5 year time horizon. For the time period from 1983 to 2010, on average, 0.065% of bonds rated "A2" by Moody's defaulted within one year. For the time period from 1981 to 2010 Standard & Poor's calculated that, on average, 0.08% of bonds rated "A" defaulted within one year. The default rate rises only marginally as the time span for default extends beyond one year, and over a five-year time horizon the risk remains very low. Because the financial test to qualify for using the self guarantee is repeated annually, it furthers the low likelihood of default by ensuring that changes in financial conditions are captured quickly (and alternate arrangements made) before a company's ability to pay deteriorates.

An NRC licensee's ability to pay under conditions of financial distress also relates to the ratio of assets to decommissioning liability. Where assets are considered, a 10 to 1 ratio should be adequate to assure that funds will be available if needed in case of financial distress. In the Honeywell case, the ratio of tangible net worth (including goodwill) to decommissioning liabilities is approximately 44:1 as of December 31, 2010. The same ratio was 32:1 as of December 31, 2008 – the most recent data available at the time the request was initially filed. *See* Table 9, below. In view of the "A" bond rating and the high ratio of tangible net worth (including goodwill) to decommissioning obligation, there is a high likelihood that assets will be available for decommissioning in the event of financial distress prior to re-performing the required annual financial test.

For Honeywell, cash balances which are held in normal circumstances could also be used to fund liabilities in times of financial distress. Since December 31, 2005, Honeywell's quarter-end cash balances have been no less than $1.2 billion. Honeywell could also draw upon its $2.8 billion committed revolving credit agreement. In addition, for a diversified company, such as Honeywell, asset sales could be used to pay for decommissioning even in times of financial distress.

Finally, there are a number of mechanisms in place to alert NRC in the event of deteriorating finances. For example, Honeywell must notify NRC within 20 days if its credit rating ceases to be in any category of A or above for Moody's and S&P (Part 30, Appendix C.III.E). This notice triggers a requirement to seek alternate financial assurance within 120 days (Part 30, Appendix C.II.C). Thus, even if Honeywell's finances deteriorated, there would be more than ample time to put in place alternate financial assurance mechanisms.

For all of these reasons, Honeywell has an ability to pay for decommissioning even in times of financial distress.

G. <u>Assessment of NRC Staff Decision Denying Amendment</u>

1. Bond Ratings Are a Reliable Indicator of Financial Strength

Q45. Do you agree with the NRC Staff that bond ratings are not as reliable as previously thought?

A45. (JT, BDU) No. As explained earlier in the testimony, the default rate for "A-rated" companies is very low. The risk of an "A-rated" company defaulting in one year is, on average, somewhere between 0.065% and 0.08%. The risk of an "A-rated" company defaulting in five years is, on average, between 0.680% and 0.788%. This data includes the experience of the recession from 2008-2010. As previously shown in Table 3, the rate of default for "A-rated" companies during this most recent period was about the same or less than during 2001.

This history of low default rates for highly-rated companies shows that bond ratings are a reliable indicator of financial health and long-term performance. Put simply, "A-rated" companies are unlikely to default, and, if they do, there is likely to be a significant time lag and rating downgrades prior to actual default. In fact, the data shows that ratings are very good indicators of cumulative default probability. For example, when you consider companies rated the highest grade of "speculative," or Ba by Moody's, they are 14 to 16 times more likely to default than an "A-rated" company, and companies rated below Ba are even more likely to default.

One of the NRC's stated reasons for denying Honeywell's exemption was that bond ratings beginning in 2008 were no longer a reliable indicator of a company's ability to pay its decommissioning obligations. As outlined in A.23, the Moody's and S&P data clearly demonstrate that corporate default rates during the 2008-2009 recession were not dissimilar from the default rates for the 2001 recession. As described in A.20, a particular letter rating is meant to connote the same general level of creditworthiness for issuers and issues in different sectors and at different times. Rating comparability is maintained by measuring default behavior across different industries and over time. It would be expected that default rates would be higher during a recession but those default rates should not materially alter the long term default averages for that particular rating. That was the case in the most recent recession. Thus, the most recent data on defaults actually supports the reliability of bond ratings for investment grade companies.

Moreover, as noted previously, bond rating companies continually re-evaluate the rating. Any adverse changes in financial condition would trigger a downgrade in rating. NRC regulations require companies to report downgrades and to also provide alternate financial assurance mechanisms. The NRC's regulations also contain a mechanism for re-assessing companies annually (*e.g.*, the annual financial test and certification). Thus, the NRC would have more than ample time to recognize declining performance and require alternative financial assurance. The market and ratings agencies usually see the signs of distress well before a company is on the brink of bankruptcy and will react accordingly. Any meaningful downgrade, driven by a meaningful decline in Honeywell's perceived credit quality, under 10 C.F.R. Part 30, Appendix C, Section II.A, would trigger Honeywell securing another source of financial assurance for the MTW decommissioning costs within 120 days. This serves as another buffer for covering the potential MTW costs since, for the few companies rated "A" by S&P that have eventually defaulted, it was more than 10 years, on average, between when they were rated "A" and when they eventually defaulted. *See* "Standard and Poor's – 2010 Annual Global Corporate Default Study And Rating Transitions" at 19 (Tables 10 and 11) (Exh. HNY000032).

Finally, one of the strengths of Honeywell is its strong and consistent cash flow generation in diversified lines of business.[7] As previously noted, this cash flow serves as a potential source of funds for MTW decommissioning costs. This cash flow generation ability goes hand in hand with credit ratings and other market indicia of the financial strength of Honeywell. As shown previously, it is quite rare for highly-rated companies such as Honeywell to move rapidly from a state of strong financial health to being distressed – it usually takes a significant amount of time. This is especially true of a company as large and diversified as Honeywell.

Q46. How did "A-rated" companies fare in recent years?

A46. (JT, BDU) Since 2005, there have only been defaults for "A-rated" companies (S&P) in 2008 (0.38%) and in 2009 (0.22%). For companies rated A2 by Moody's, there have only been defaults in 2008 (0.259%). *See* Table 3. This demonstrates that, despite a period of significant financial upheaval in the broader markets, "A-rated" companies have not defaulted at unexpectedly large rates.

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7 As noted in A.15 above, under Honeywell's corporate structure, all of these lines of business would be available to provide funds for decommissioning of MTW. The Honeywell corporate structure is not one that insulates the diversified lines of business from Honeywell's decommissioning obligations at MTW.

Q47. What impact has the recent recession had on Honeywell's financial performance?

A47. (JT) While the recent recession has impacted companies, including Honeywell, the recession did not cause a significant deterioration in Honeywell's financial condition. For example, over the past several years, Honeywell has continued to increase its net worth and the value of assets in the United States. Honeywell has also continued to generate increasing amounts of free cash over the same period. In short, despite the considerable turmoil of the past few years, Honeywell has continued to grow and improve its financial condition. The company's credit rating remained at the "A" level throughout the recession.

TABLE 9: Summary of Financial Test Data (2006-2010)

(in millions)	12/31/06	12/31/07	12/31/08	12/31/09	12/31/10
Goodwill	$8,403	$9,175	$10,185	$10,494	$11,597
Tangible Net Worth	$70	($1,451)	($5,265)	($3,697)	($3,384)
Adjusted Net Worth	$8,473	$7,724	$4,920	$6,780	$8,213
Assets in the United States	$20,300	$21,300	$22,500	$22,800	$24,600
Ratio (Traditional)	0.1	(6)	(34)	(24)	(18)
Ratio (Alternate Test)	13	34	32	43	44
Free Cash	$2,200	$3,100	$3,100	$3,300	$3,550
Bond Rating (S&P)	A	A	A	A	A
Bond Rating (Moody's)	A2	A2	A2	A2	A2

Q48. In your view, are credit rating agencies (such as Standard & Poor's and Moody's) reluctant to downgrade because of the impact on the triggers in private financial contracts?

A48. (BDU) No. The credit quality of most issuers and their obligations is not fixed and steady over a period of time, but tends to undergo change. For this reason changes in ratings occur, if necessary, so as to reflect variations in the intrinsic relative position of issuers and their obligations. A change in rating may occur at any time in the case of an individual issue or issuer. A rating change should serve notice that the credit rating agency observes some shift in creditworthiness, or that the previous rating did not fully reflect the quality of the bond as now seen given updated general economic, industry-specific or issuer-specific data. Because of their very nature, changes are to be expected more frequently among bonds of lower ratings than among bonds of higher ratings.

A rating agency cannot realistically be expected to precisely anticipate future changes in macroeconomic conditions. As a consequence, actual, measured default rates by rating category will exhibit pronounced cyclical patterns, rising in recessions and falling in recovery. In general, when an economy shifts into recession, if ratings are unchanged, default rates would likely increase by rating category. To maintain constant default rates by rating category, rapid wholesale rating downgrades would be required in recessions. However, investment-grade issuers generally possess sufficient financial strength to weather a recession. Consequently, for investment grade issuers in particular, ratings do not need to automatically change with business cycles.

According to the 2009 Annual Global Corporate Default Study And Rating Transitions (S&P) (Exh. HNY000031), 2009 was a record year in terms of global corporate default and transition performance. There were 264 defaults globally. Credit degradation among non-defaulting issuers was widespread and pronounced, especially in the first half of 2009, with the percentage of issuers downgraded during the course of the year reaching 18.34%, the highest rate in 29 years. There were 3.85 downgrades for every upgrade. In addition, the average number of notches recorded among downgrades rose in 2009 to 1.76, a pace unmatched since 2002.

According to Moody's, consistent with rapidly weakening credit quality and increasing numbers of defaults, the quarterly downgrade-to-upgrade ratio for corporate issuers began rising sharply in late 2008, reaching a peak of 18.3x in the first quarter of 2009. Exh. HNY000025. During the remainder of 2009, however, the downgrade-to-upgrade ratio declined steeply and reached 1.8x in the fourth quarter, approximately the same level as just prior to the start of the recession in the fourth quarter of 2007.

These two examples (S&P and Moody's) demonstrate that, contrary to the NRC's assertions, ratings agencies are not reluctant to downgrade ratings when conditions warrant, but that they also take into account longer-term trends and expectations of future performance, particularly for highly-rated, diversified companies such as Honeywell. Taking the long-term perspective does have a tendency to stabilize bond ratings, but this is not a measure of any reluctance to appropriately downgrade companies; rather it is consistent with the ratings agencies' focus on long-term risk and the level and predictability of an issuer's future cash generation in relation to its commitments to repay debtholders. Despite this backdrop of relatively higher levels of default, and downgrades, neither S&P nor Moody's downgraded Honeywell, showing that they view Honeywell as having a very low probability of default.

Q49. Does consideration of intangible assets in the financial test ratio, in conjunction with the bond rating requirement, place excess emphasis on intangible assets?

A49. (JT, BDU) No. Ratings agencies consider numerous financial metrics, as well as market position and other qualitative aspects, when conducting their ratings and credit analyses. Their review is not limited to intangible assets. That said, the ratings agencies do consider metrics and factors that focus on the future cash generating ability of the company being rated, as well as how this cash flow measures against the subject company's liabilities. While intangible assets are one means of assessing long-term financial condition because they reflect the cash generating potential of a business, they are not the only means. And, depending on the business strategy, market, and other factors unique to each company, intangible assets may or may not be a significant factor in setting the bond rating for a particular company. On balance and in our opinion, booked intangible assets do not play an oversized role in the credit analyses and subsequent ratings of the agencies. And, with respect to the financial test for Honeywell specifically, booked goodwill and intangibles only make up about one-third of Honeywell's total assets, thus limiting their weighting in the assessment.

2. Negative Tangible Net Worth Does Not Reflect Financial Weakness

Q50. Does negative tangible net worth reflect financial weakness? Please explain.

A50. (JT, BDU) No. For an "A-rated" company such as Honeywell, a negative tangible net worth is not a reflection of financial weakness as implied by the NRC Staff.

Honeywell's negative tangible net worth simply reflects that Honeywell has sought to grow and increase its product and geographic diversification, in part, by acquiring companies. The value of a company tends to be much more correlated with its cash flow generation ability than the accounting book value of its assets. And, companies with diversified businesses have a greater ability to withstand a downturn in any one business.

One accounting-related result of acquiring cash generating businesses is that Honeywell is required to book either specific intangibles or goodwill to reflect the difference between the value of the purchased tangible assets and the value associated with the ability of those purchased assets to generate cash flow. In fact, market indicia, such as the value placed on Honeywell by the public equity market, shows that negative tangible net worth does not reflect financial weakness in a company like Honeywell – the market currently values Honeywell's total net worth or equity (including goodwill and other booked intangibles) at 2.8x its equity book value and has valued Honeywell at approximately 3.5x its book value, on average, from the beginning of 2008 through the present. Exh. HNY000058 (CapitalIQ Database).

While financially weak companies may have a negative tangible net worth, the corollary that all financially strong companies have positive tangible net worth is not true. Likewise, the fact that a company's tangible net worth is declining does not necessarily indicate that its financial condition is weakening. Many financially strong firms that grew by acquisition also have a negative tangible net worth. For example, as of year-end 2010, Honeywell, United Technologies and Danaher, all "A-rated" large multi-industry industrial corporations, had a tangible net worth that was negative. Companies such as IBM and Proctor & Gamble, which have higher credit ratings than Honeywell, also had negative tangible net worth as of year-end 2010.

3. Free Cash Flow Can Be Used to Pay for Decommissioning

Q51. What is the significance of free cash flow?

A51. (JT, BDU) Free cash flow is the essentially the money that a company could use to pay for growth or return to shareholders. The significance of free cash flow is that it is not obligated to another purpose and would therefore be available for use (*e.g.*, in decommissioning). Free cash flow provides the funds that a company could also use in the future to acquire other companies, pay dividends, or buyback stock.

Q52. In normal circumstances, could free cash be used to pay for decommissioning expenses?

A52. (JT, BDU) Yes. For example, Honeywell generated in excess of $3.5 billion in free cash flow in 2010. The total decommissioning liabilities for MTW are approximately 5% of <u>one year's actual free cash flow</u>. Thus, under normal circumstance, this money could be used to pay for decommissioning.

4. Alternate Test Is In Public Interest

Q53. Is there a minimum bond rating requirement for companies that issue surety bonds or letters of credit in NRC regulations or guidance?

A53. (JT) To the best of my knowledge, there is no minimum bond rating requirement in NRC regulations for companies that issue surety bonds or letters of credit. *See* CLI-11-04, slip op. at 10 (July 12, 2010) ("[N]either our rules nor applicable guidance require that the letter of credit issuer demonstrate minimum capitalization requirements, credit rating requirements, or other substantive measures that would demonstrate the issuer's financial soundness); NUREG-1757, Vol. 3, Consolidated NMSS Decommissioning Guidance, "Financial Assurance, Recordkeeping, and Timeliness" (Sept. 2003) (Exh. NRC000049).

Q54. Can you approximate the cost of a surety or letter of credit?

A54. (JT) Yes. Although the costs are not fixed and depend upon the terms of the bond or letter of credit as well as the issuer, a surety or letter of credit has a cost of approximately 100 basis points annually. A surety or letter of credit for MTW would therefore cost Honeywell approximately $1.8 million/year.

Q55. Does a surety or letter of credit provide more financial certainty than a self-guarantee, provided the alternate financial test is satisfied?

A55. (JT, BDU) No. In fact, the issuer of the surety of letter of credit may have a lower bond rating and higher risk of default than Honeywell. A letter of credit or surety burdens shareholders with incremental costs with no corresponding benefit to NRC or to the public. Surety bonds and letters of credit are also an inefficient use of lines of credit, particularly when a company is in strong financial condition. Thus, use of a self-guarantee, which provides an equivalent level of assurance without unnecessary and wasteful expenditures of funds, is in the public interest. *See* Technical Evaluation Report for renewal of the operating license for MTW, dated May 11, 2007 (ADAMS Accession No. ML062640369) (Exh. HNY000009) and Letter to Honeywell from NRC Re: Granting Extension of One-Year Exemption, dated August 22, 2008 (ADAMS Accession No. ML082250707) (Exh. HNY000010) (granting Honeywell's 2007 and 2008 exemption requests and finding that the exemptions were in the public interest).

H. <u>Minimum Tangible Net Worth Test</u>

Q56. Are you familiar with the NRC's decommissioning rulemaking and the minimum tangible net worth test?

A56. (JT, BDU) Yes, as I understand it, the NRC finalized a rule, which is not yet effective, that would require a company to have a minimum tangible net worth of $21 million in order to use a self-guarantee.

Q57. Please explain your views on the significance of a minimum tangible net worth test?

A57. (JT, BDU) The NRC's decommissioning rule published, when effective, will require a minimum "tangible net worth" of $21 million. However, the proposed rule contains no recent analysis to support the use of a minimum tangible net worth. The NRC Staff relied on an EPA analysis that looked at a $10 million minimum net worth requirement. *See* "Financial Assurance Mechanisms Corporate Owners and Operators of Municipal Solid Waste Landfill Facilities and Hazardous Waste Treatment, Storage, and Disposal Facilities; Proposed Rule," 59 Fed. Reg. 51523, 51524 (October 12, 1994) (Exh. HNY000036). In its rulemaking, the EPA was focused on disposal facilities where asset being decommissioned was the primary source of income. "Financial Assurance Mechanisms for Corporate Owners and Operators of Municipal Solid Waste Landfill Facilities; Final Rule," 63 Fed. Reg. 17706, 17715-17 (April 10, 1998) (Exh. HNY000037); *see also id.* (explaining that assets minus liabilities equals net worth and discussing the net worth, not tangible net worth, of various companies). The EPA clearly viewed a minimum net worth test as a surrogate for whether a company was "small" and therefore unlikely to have diversified sources of income and was also looking at the relative net worth of a company relative to its decommissioning obligations.

Q58. Should this test be applied to Honeywell?

A58. (JT, BDU) No. Honeywell is not a small company by any measure and has a diversified income stream. Honeywell has annual revenue in excess of $33 billion and a net worth of more than $10 billion. Honeywell's free cash flow was $3.5 billion in 2010. Honeywell's free cash is forecast to be $3.5 to $3.7 billion in 2011. Honeywell's market capitalization (share price multiplied by the number of shares outstanding) was approximately $34 billion as of September 30, 2011. Thus, there is clearly a substantial financial foundation that provides support for decommissioning funding.

Moreover, as noted above, while financially weak companies may have a negative tangible net worth, the corollary that all financially strong companies have positive tangible net worth is not true. As we have already discussed, many financially strong firms that grew by acquisition also have a negative tangible net worth (*e.g.*, Honeywell, Danaher, United Technologies, IBM and Proctor & Gamble as of each company's most recent year-end). In fact, Proctor and Gamble had a tangible net worth of approximately *negative* $22 billion as its June 30, 2011 year end, generated free cash flow of $10 billion in fiscal 2011, and had an AA-/Aa3 credit rating. Exh. HNY000046 (CapitalIQ for Proctor and Gamble). As this demonstrates, the minimum tangible net worth criteria is not particularly meaningful as applied to large diversified companies like Honeywell.

The proposed test is also inconsistent with the treatment of intangible assets in the decommissioning rule. If intangible assets have value such that they can be used to satisfy the 10:1 financial test ratio, then they should also be considered of value in terms of minimum net worth. As we discuss below, unlike a minimum *tangible net worth* test, a minimum *net worth* test makes more sense and would better reflect the strength of a company's ability to provide decommissioning financial assurance.

Q59. Would your view be different if the test was a net worth (not tangible net worth) test?

A59. (JT, BDU) A minimum net worth test makes more sense than a minimum tangible net worth test. Net worth is the total assets minus total liabilities of an individual or a company. Net worth or shareholder equity is a measure of the residual interest or claim that the shareholders in a company have in the event that a firm was liquidated and all liabilities were extinguished. Thus, it is a rough measure of a company's financial condition. Even a net worth test is conservative because it does not reflect the market value of Honeywell's assets. The market value of Honeywell reflects the value of all of Honeywell's assets (including those intangibles). The value of Honeywell in the marketplace is a multiple of Honeywell's net worth.

Tangible net worth, on the other hand, is simply shareholder equity minus intangible assets. The greater the value of a company's intangible assets, the lower its tangible assets for a given level of shareholder equity. In today's high tech economy, intangible assets are a significant source of value as evidenced by the stock market placing a current market value of 2.8x book value of Honeywell's net worth.

Q60. Is the NRC's use of minimum tangible net worth consistent with its decision to permit intangible assets in the financial test ratio calculation?

A60. (JT, BDU) No. The minimum tangible net worth is inconsistent with the NRC Staff's treatment of intangibles (including goodwill) as an asset. If intangible assets (such as goodwill) are assets that can be used in the financial ratio, intangible assets should also be assets when considering the worth of the company and its ability to pay for decommissioning.

IV. CONCLUSIONS

Q61. What are your conclusions regarding the NRC Staff basis for denying the license amendment?

A61. (JT, BDU) In my opinion, the reasons given by the NRC do not support denial of the license amendment. Bond ratings have been demonstrated to be reliable over long periods of time. And, Honeywell has demonstrated remarkable financial stability – even during the recent financial downturn. Further, Honeywell is in a strong financial position by any objective measure. Honeywell is an A-rated company, which is a reliable indicator of financial strength. And, a minimum tangible net worth bears no relation to the overall financial condition of Honeywell. More than adequate free cash is available to pay for MTW decommissioning under normal circumstances. In addition, there are annual testing requirements and reporting obligations for adverse changes in financial positions that further support Honeywell's ability to pay in times of financial distress.

Overall, the underlying purposes of the three legs of the NRC's self-guarantee financial test are met by: an alternate financial test (alternate net worth to decommissioning liabilities), the bond rating, and the ratio of U.S. assets to decommissioning liabilities. These all support issuance of the amendment to Honeywell.

Finally, there is no significant benefit to requiring a Honeywell to obtain a surety bond or letter of credit given its strong financial position.

Q62. What are your conclusions regarding the alternate test?

A62. (JT, BDU) In our opinion, the alternate test demonstrates that Honeywell would be able to pay for decommissioning if called upon to do so. A bond rating is an effective, time-tested indicator of financial strength. When combined with the other requirements (ratio of assets to decommissioning liabilities), annual reviews, and mandatory reporting requirements for adverse changes in financial condition, there is strong assurance that funds will be available for decommissioning the MTW.

In our opinion, the information provided by Honeywell satisfies NRC criteria governing issuance of the amendment (and the related exemption). The amendment is for a purpose authorized by the Atomic Energy Act, Honeywell is qualified to implement the alternate test in such manner as to protect health and minimize danger to life or property, the MTW equipment, facilities and procedures, which are not impacted by the amendment, remain adequate to protect health and minimize danger to life or property, and issuance of the amendment is not inimical to the common defense and security or to the health and safety of the public. Further, the amendment will not endanger life or property or the common defense and security and is in the public interest.