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November 3, 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)	)	

REBUTTAL TESTIMONY OF JOHN TUS AND BRUCE DEN UYL

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TESTIMONY OF JOHN TUS AND BRUCE DEN UYL

I. INTRODUCTION

Q1. Please state your full name.

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

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

Q2. Have you previously presented testimony in this proceeding?

A2. (JT, BDU) Yes. We provided testimony to support Honeywell's position on October 14, 2011. Specifically, we sponsored those statements that were marked with our initials. In addition, our professional qualifications were included in that filing.

Q3. Have you reviewed the NRC Staff's statement of position and testimony?

A3. (JT, BDU) Yes, we have reviewed the NRC Staff's testimony and exhibits that were filed on October 14th.

Q4. Please describe the purpose of your Rebuttal Testimony.

A4. (JT, BDU) The purpose of our Rebuttal Testimony is to respond to statements made in Exh. NRC000001, entitled "NRC Staff's Testimony Regarding Honeywell's 2009

Exemption Request," dated October 14, 2011, and the "NRC Staff's Initial Statement of Position," dated October 14, 2011.

Q5. Please summarize the conclusions in your initial testimony regarding Honeywell's application for an amendment/exemption.

A5. (JT, BDU) Our initial testimony 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 (financial test, 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).

In contrast, the reasons given by the NRC Staff do not justify denial of the license amendment. As we discuss in our testimony, the NRC Staff has not provided support for its decision because:

- Bond ratings have been demonstrated to be reliable over long periods of time, especially for diversified "A-rated" companies like Honeywell;
- Honeywell has demonstrated remarkable financial stability — even during the recent financial downturn — and is in a strong financial position by objective measures, including its "A" bond credit rating;
- A minimum tangible net worth test bears no relation to the overall financial condition of Honeywell;

- More than adequate free cash flow is available to pay for MTW decommissioning under normal circumstances;

- 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; and

- There is no significant benefit to requiring that Honeywell obtain a costly surety bond or letter of credit given its strong financial position.

Overall, the underlying purposes of the NRC's self-guarantee financial test are met by: an alternate financial test (alternate net worth to decommissioning liabilities), the bond rating, the ratio of U.S. assets to decommissioning liabilities, and the reporting/alternate arrangements requirements. Together, these requirements support issuance of the exemption to Honeywell.

II. OVERVIEW

Q6. Have you reviewed the NRC Staff Testimony and the exhibits cited in that testimony?

A6. (JT, BDU) Yes, we have reviewed the NRC Staff testimony and the exhibits.

Q7. What is your general reaction to the NRC Staff Testimony?

A7. (JT, BDU) We strongly disagree with the inferences and conclusions that the NRC Staff witnesses draw from the information that they present. The information put forward by the NRC Staff does not address the data presented in Honeywell's application (and supplemental filings) or Honeywell's particular financial

circumstances, nor is it appropriately focused on factors and financial conditions applicable to diversified, multi-industry, "A-rated" companies such as Honeywell.

The NRC Staff's testimony also over-generalizes some of the lessons from the recent financial downturn and inappropriately extends them to Honeywell's circumstances. On balance, the reasons given by NRC Staff for denying Honeywell's request are not supported by the testimony or exhibits.

III. DISCUSSION

Q8. In ¶¶24 and 27 of its testimony, the NRC Staff highlights a number of specific companies that defaulted or nearly defaulted during the recent recession. Do you think these companies are relevant comparables for Honeywell?

A8. (BDU) No.

Q9. Why not?

A9. (BDU) The companies that the NRC Staff selected for comparison are not diversified companies, but instead are focused on specific industries. For example, Lyondell is exclusively a chemical company and General Motors' only business is related to the automotive industry. Honeywell is a very well diversified company with numerous customers and end markets for its goods and services. In 2010, Honeywell's $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%).[1] This serves as a natural buffer to the issues that the NRC-selected companies faced. Furthermore, many of the NRC-identified companies were financial companies that experienced difficulties starting with the

[1] Honeywell Presentation, dated March 14, 2011 (Exh. HNY000013).

subprime mortgage crisis. Honeywell is not a financial company. Financial companies are quite different from other industries and face unique challenges and dynamics. Finally, the non-financial companies that the NRC cited were speculative, or junk, rated companies well before they defaulted on their debts.[2]

Company	Moody's 12/31/07	Moody's 12/31/08	S&P 12/31/07	S&P 12/31/08
Chrysler	B3	Ca	B	CC
XM Satellite Radio	Caa3	C	CCC+	CCC+
General Motors	Caa1	WR*	B	CC
Lyondell Chemical	B3	WR*	B+	CC
Level 3 Communications	Caa2	Caa2	B-	SD**
Clear Channel	Baa3	Caa1	B+	B
Nortel Networks	B3	Caa2	-	-
Energy Future Holdings	B3	B3	B-	B-
Ford Motor Company	Caa1	Ca	B	CCC+

* Withdrawn Rating (WR)
** Entered Selective Default (SD) status on December 29, 2008

As a result, the examples cited by the NRC Staff are not useful indicators of the risk of default for diversified, "A-rated" companies such as Honeywell.

Q10. In ¶24 of its Submission, the NRC Staff cites Standard & Poor's (actually an article from the Economist, which cites Standard & Poor's) discussing its prediction of a significant rise in corporate defaults in 2009. Is this relevant to Honeywell?

A10. (BDU) No.

[2] *See* Compilation of Bond Credit Rating Histories (Exh. HNY000062).

Q11. Why not?

A11. (BDU). When discussing its default forecast for 2009, Standard & Poor's ("S&P") was not referring to investment-grade borrowers such as Honeywell. The two underlying S&P reports that the Economist takes its information from were describing only speculative-grade, or "junk" rated, companies.[3] Honeywell was and is rated "A," an "investment-grade" rating. As described in ¶¶22 and 44 of Honeywell's initial testimony, companies rated "A" by S&P default at an extremely low rate, or a one-year default rate of 0.08% for the period 1981-2010. Companies that were rated Ba (the highest non-investment-grade rating) by Moody's defaulted at 14 to 16 times this rate.[4] Thus, this article is irrelevant and does not support the NRC Staff's decision.

Q12. The NRC Staff also cited an article listing defaults during the first half of 2009. Is this relevant to Honeywell?

A12. (BDU) No. The NRC Staff highlights a number of articles describing defaults during 2008 and 2009. However, as noted above, these defaults have limited relevance to Honeywell's particular circumstances. For example, Exh. NRC000039 lists more than 90 defaults from 2009. However, only two of those examples had "A" bond credit ratings and both were credit unions. The vast majority of the defaults were "C-rated" companies. As discussed in our direct testimony, default rates are expected to

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[3] Standard & Poor's, "Global Credit Portal, Ratings Direct, Global Corporate Default Update (June 5-June 11, 2009)," dated June 12, 2009 (Exh. HNY000063); Standard & Poor's, "Global Credit Portal, Ratings Direct, U.S. Corporate Default Rate Forecasted To Reach All-Time High Of 13.9% In 2009," dated January 23, 2009 (Exh. HNY000064).

[4] Tus/Den Uyl Testimony at ¶45.

be higher for companies with lower credit ratings.[5] The data in the credit ratings agency reports also indicate that, for companies rated A or better, there is a very low risk of default within one year.[6] For example, in 2009, the year with the highest number of defaults, there were only three defaults out of the 1,396 companies with an A rating at the beginning of the year.[7] There were no defaults for companies rated AA or AAA.[8] In 2010, there were no defaults for any companies rated A, AA, or AAA at the beginning of the year.[9] And, 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.[10]

In short, the mere fact that there were more defaults in 2008 and 2009 is unsurprising given the financial circumstances at that time, but there is no objective evidence indicating anything other than a very low risk of default for a diversified "A-rated" company such as Honeywell.

Q13. In ¶34, the NRC Staff expresses a concern that intangible assets and goodwill, in particular, are relatively illiquid. Would you please comment on this concern?

A13. (BDU) Tangible assets include items such as cash, accounts receivable, inventory and hard assets like equipment and machinery. Other than cash or near-cash equivalents,

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5 Tus/Den Uyl Testimony at ¶48.

6 *Id*. at ¶¶22-23.

7 *See* S&P 2009 Global Default Study at 22 (Table 14) (Exh. HNY000031).

8 *Id*.

9 *See* S&P 2010 Global Default Study at 21 (Table 14) (Exh. HNY000032).

10 *See* Tus/Den Uyl Testimony at ¶45 *citing* S&P 2010 Annual Global Corporate Default Study and Ratings Transitions at 19 (Tables 10 and 11) (Exh. HNY000032).

most of these assets are relatively illiquid. For example, tangible assets, like a piece of equipment or machinery, tend to be somewhat industry- or task-specific and it often takes a considerable period of time to market the asset and secure a purchaser. In addition, it is quite uncommon for a business to sell a tangible asset that is in good working condition unless the company is exiting that business line or is facing some sort of extraordinary liquidity need.

Intangible assets, and in particular the goodwill that was utilized in the financial test proposed by Honeywell (and accepted by the NRC in May 2007 and August 2008), are usually included in the sale of an entire ongoing business or business unit. While corporate mergers and acquisitions activity ebbs and flows, there is a relatively liquid market for business units.[11] In fact, in addition to corporate strategic buyers which purchase these businesses, there is a significant amount of capital committed to private equity firms in the United States and globally. Many of these private equity firms focus on purchasing individual business units from diversified conglomerates such as Honeywell. Furthermore, Honeywell's own history of purchasing whole, ongoing businesses (not tangible assets) that was discussed in Honeywell's testimony at ¶25 highlights that such a market exists for businesses and their associated goodwill.

Finally, in the very unlikely event that Honeywell was forced to sell assets in a distressed sale to pay for decommissioning, the causes of the distress also would have

[11] Indeed, it is often more difficult to sell a piece of equipment or other tangible asset than an entire business unit.

caused deterioration in Honeywell's bond credit rating[12] or other financial metrics that would be captured by the NRC's reporting requirements and alternate financial assurance mechanisms. Thus, in my opinion, the NRC's concern regarding relative illiquidity is unfounded and, in any event, unpersuasive.

Q14. How can the NRC have assurance that Honeywell has sufficient assets to promptly pay any decommissioning costs?

A14. (BDU) As I previously testified, although I believe that intangible assets, including goodwill, can often be converted into cash as quickly as tangible assets, Honeywell nevertheless has significant tangible assets that could be relied upon. Honeywell's tangible assets have increased from approximately $21 billion at the end of 2006 to approximately $24 billion at the end of 2010.[13] These tangible assets far exceed the decommissioning cost estimate for MTW ($187 million).

The availability of sufficient assets can be confirmed by examining Honeywell's net worth. Net worth is the total assets minus total liabilities of a company. Honeywell's net worth grew from $7.1 billion in 2008 to $10.8 billion in 2010.[14] 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 $34

12 Bond ratings agency reviews are not limited to "snapshots" in time. Rather, the ratings agencies may re-evaluate a company's rating any time new information becomes available, including the release of quarterly financial statements. Bond ratings are therefore responsive to changing conditions, and an adverse ratings change would trigger a notification to the NRC.

13 Tus/Den Uyl Testimony at ¶29 (Table 6).

14 *Id.* at ¶19.

billion, which is a multiple of Honeywell's net worth.[15] This demonstrates that Honeywell has assets that could be used to pay for decommissioning funding if necessary.

Also, as noted in Honeywell's direct testimony (at ¶17), Honeywell has a $2.8 billion five-year committed revolving credit facility that could be drawn upon immediately in the event that decommission funds were needed for MTW. Unlike most companies, Honeywell's revolver does not contain any financial covenants.

Q15. The NRC Staff cites, in ¶ 28 of its testimony, a statement from Honeywell's 2008 annual report noting that industry and economic conditions could adversely impact the market and operating conditions of its customers which would, in turn, impact Honeywell. Is there any significance to these statements being included in the 2008 report?

A15. (JT) These statements reflect the simple fact that Honeywell's business, operating results, cash flows, and financial condition are subject to various risks and uncertainties, including, without limitation, those set forth in the annual report, any one of which could cause actual results to vary materially from recent results or from our anticipated future results. Importantly, however, the explanation of these risk factors was not new in 2008. Honeywell included similar statements in its 2005, 2006, and 2007 annual report (see Exhs. HNY000015, HNY000016, and HNY000017). Thus, no particular significance should attach to the identification and inclusion of these risk factors in the 2008 report.

[15] *Id*. at ¶¶58-59.

Q16. In ¶39, the NRC Staff expresses concern that there could be "impairment" of Honeywell's goodwill. Would you please comment on this concern?

A16. (JT) Honeywell performs its goodwill impairment test annually as of March 31st. Based on a review of annual reports dating back to the 2006 annual report (encompassing the period from March 31, 2005, to March 31, 2011), there were no impairments of goodwill. Thus, the NRC Staff's concern, as applied to Honeywell, does not have merit.

Moreover, even in 2008, when the NRC expressed concern that Honeywell needed to apply 67% of its goodwill to the financial test, Honeywell would have to write down more than 30% of its goodwill before it no longer met the financial test. Given that Honeywell had not taken any impairment charges since at least 2005, an impairment charge of this magnitude would be very unlikely.

Q17. Even if Honeywell had reduced the amount of goodwill, would that have increased the risk of a shortfall in decommissioning funding?

A17. (JT) No. As the NRC Staff witnesses noted, goodwill is tested for impairment annually, or whenever there might be a change of circumstances potentially affecting its value.[16] This annual test for impairment aligns with the NRC's annual financial test. If the results of the test indicated that goodwill was impaired and that, as a result, Honeywell no longer met the 10:1 test permitted under the exemption, then Honeywell would be required to put in place alternate financial assurance.

In addition, the reporting requirements in 10 C.F.R. Part 30, Appendix C, Section II.B.2, require notice to the NRC of any adjustments in financial data used in the

[16] *See* NRC Staff Testimony at ¶39 (citing HNY000033 at 14-15).

financial test and would also trigger the requirement to obtain alternate financial assurance. These mechanisms, which are in place to capture declining financial performance, continue to apply under the exemption. Thus, in the event that goodwill was impaired such that Honeywell no longer met the test, the NRC would have notice of that fact and there would be a self-executing requirement for Honeywell to obtain alternate financial assurance (such as a surety bond or a letter of credit). There is no reason to treat impairment of goodwill differently than any other change in financial condition that is used as an input parameter in the self-guarantee test.

Q18. The NRC cited one example of an NRC licensee that took a goodwill impairment charge of $6 billion at the end of 2008. Is this relevant to Honeywell?

A18. (JT) No. As the NRC Staff witnesses noted in ¶39, the parent company for Western Nuclear, Freeport-McMoRan took a goodwill impairment charge of $6 billion at the end of 2008. However, Freeport-McMoRan is not an A-rated company like Honeywell. Because Western Nuclear was relying on a parent company guarantee, rather than a self-guarantee, to provide decommissioning financial assurance, under 10 C.F.R. Part 30, Appendix A, the minimum bond rating is only BBB (S&P) or Baa (Moody's) and the required financial test ratio is only 6:1.[17] Freeport-McMoRan had a BBB- bond credit rating in 2008. Moreover, the impairment charge was based on significant declines in copper and molybdenum prices. Unlike mining companies that have a relatively narrow set of assets and are susceptible to large changes in

17 The NRC rules for parent guarantees are more lenient than those for self-guarantees, which require a 10:1 ratio and an "A" rating. *Compare* 10 C.F.R. Part 30, Appendix A *and* Appendix C.

commodity prices, Honeywell is a globally diversified company with products and customers spanning several industries and several geographic regions.

This example tends, if anything, to support the use of goodwill. The cited example demonstrates that companies are required to annually test goodwill for impairment and reflect any charges on their balance sheets, and that the testing is effective. This conclusion is consistent with an article cited by the NRC Staff (Exh. NRC000040), which suggests that U.S. companies are more aggressive than European companies at taking goodwill impairment charges based, in part, on regulatory pressure from the U.S. Securities Exchange Commission.

Q19. In ¶40, the NRC indicates that the percentage of goodwill used to cover the 10:1 test increased over time, is this a meaningful analysis?

A19. (BDU) No. The more relevant analysis is that, when including goodwill under the revised test, Honeywell far exceeds the 10:1 test. As presented in Table 9 of the Honeywell testimony (at ¶47), the ratio under the alternate test was 34:1 at December 31, 2007, 32:1 at December 31, 2008, 43:1 at December 31, 2009; 44:1 at December 31, 2010. The alternate test calculation also does not include other identified intangible assets on the balance sheet. If these were included in the calculation, the ratio would be significantly higher.

The NRC Staff witnesses also neglect to calculate the same ratio for 2009 and 2010, which demonstrate that Honeywell would need to rely on less goodwill than in 2008. This further undercuts the NRC Staff's rationale for denying the exemption.

Q20. In ¶31, the NRC Staff argues that free cash flow is not "committed" to the NRC and therefore cannot support the exemption. Can you comment on this statement?

A20. (BDU) The fact that free cash flow is not "committed" to the NRC should not preclude its consideration in assessing ability to pay. For example, neither tangible nor intangible assets are "committed" to the NRC when a company is relying on a parent or self guarantee.

Q21. In ¶44, the NRC Staff states that Honeywell has environmental liabilities of $946 million at the end of 2008. What is the significance of this in terms of the financial test?

A21. (JT) The NRC Staff appears to be conflating "environmental liabilities" with decommissioning costs. The Part 30, Appendix C, financial test only requires Honeywell to include the "amount of decommissioning funds being assured by a self-guarantee, for all decommissioning activities for which the company is responsible as a self-guaranteeing licensee and as parent-guarantor." The environmental liabilities remark in the annual report is not specific to decommissioning costs; rather, it includes environmental liabilities such as property damage claims and site remediation. Thus, the NRC Staff testimony and legal arguments (*see* NRC Staff Statement of Position at 38 n.130) on this point are irrelevant.

IV. CONCLUSIONS

Q22. What are your conclusions regarding the NRC Staff testimony?

A22. (JT, BDU) We conclude that most of the statements and information presented in the NRC Staff testimony and supporting exhibits are similar to those in the NRC Staff's denial letter, which we accounted for in our initial testimony.

There are some new arguments in the NRC Staff Testimony, but these do not change our conclusion that the reasons given by the NRC do not support denial of the license amendment. For example, we disagree that the number of defaults in 2008 and 2009 calls into question the reliability of bond ratings, particularly for diversified investment-grade companies. We also disagree that intangible assets, including goodwill, are relatively illiquid. In contrast with the NRC Staff, we believe that taking goodwill impairment charges reflects a functioning financial accounting system.

The NRC Staff testimony also does not affect our conclusion 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. In our view, the NRC Staff ignores or understates the role of the other self guarantee criteria (*e.g.*, reporting requirements and requirement to obtain alternate financial assurance) that are important to the overall assurance finding. When combined with the other financial requirements (financial test, ratio of assets to decommissioning liabilities), annual reviews, mandatory reporting requirements for adverse changes in financial condition, and requirements to make alternate arrangements, there is strong assurance that funds will be available for decommissioning the MTW.

Q23. What are your overall conclusions regarding the amendment and exemption?

A23. (JT, BDU) We conclude that the amendment and exemption should be granted. Overall, bond credit ratings have been demonstrated to be reliable over long periods of time. Further, Honeywell is in a strong financial position by objective measures, including its bond rating, while a minimum tangible net worth bears no relation to the

overall financial condition of Honeywell. 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. While Honeywell has the ability to pay for a financial assurance instrument to comply with NRC regulations, this cost plainly reflects an unnecessary regulatory burden.