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

DEC 04 1985

MEMORANDUM FOR: Frank J. Miraglia, Jr., Director
Division of PWR Licensing - B
Office of Nuclear Reactor Regulation

FROM: Jerome Saltzman, Assistant Director
State and Licensee Relations
Office of State Programs

SUBJECT: PALO VERDE 1 -- PROPOSED SALE/LEASEBACK OF PUBLIC SERVICE COMPANY OF NEW MEXICO INTEREST

Enclosed is a financial review of the proposed sale and leaseback transaction involving Public Service Company of New Mexico's interest in Palo Verde Unit No. 1. Since construction is complete and the unit is operational, emphasis is placed on the licensees' assurances that operating and decommissioning costs will continue to be fully funded after the transaction.

Please contact James Petersen of this office on 492-9883 if there are any questions.

Jerome Saltzman, Assistant Director
State and Licensee Relations
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Enclosure: As stated

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Financial Review - Proposed Sale and Leaseback Financing Transaction By Public Service Company of New Mexico Palo Verde Unit No. 1 Docket No. STN-50-528

Introduction

On October 18, 1985 Arizona Public Service Company (APS), lead licensee and operator of Palo Verde Unit No. 1 (PV 1), and its associated utility participants applied to the NRC for approval for co-owner Public Service Company of New Mexico (PNM) to sell and lease back all or a portion of PNM's 10.2 percent ownership interest in the unit and all or a proportionate share of one-third of PNM's 10.2 percent ownership interest in the Palo Verde common facilities. In addition to information provided in the application, the licensees provided on November 21, 1985 additional financial information to the staff. The proposed new owners/lessors are institutional investors and are not utilities. Accordingly, this financial review analyzes the anticipated method for refinancing all or a portion of PNM's existing capital investment in PV 1. Since the unit is already completed and is operational, the staff is primarily concerned about arrangements under the proposed new ownership for assuring that all ongoing operating costs, decommissioning costs, as well as any increases in these costs are fully covered. It is noted that a financial qualifications finding is not required in a power reactor case where all of the licensees are utilities. This is in accordance with 10 CFR 50.33(f).

Proposed Capital Refinancing

The licensees propose that PNM sell (and simultaneously lease back) all or a portion of its 10.2 percent interest in PV 1 and common facilities valued at

$446 million. As of November 21, 1985 the following investors are participating for a total of $300 million. Their estimated sources of funds from debt sales and equity are presented below.

	(dollars in millions)		
	Debt	Equity	Total
Total Estimated Asset Value	$343	$103	$446
Burnham Leasing Corp.	78	22	100
Chrysler Capital Corp.	114	36	150
Mellon Financial Services Corp.	38	12	50
Uncommitted (as of 11-21-85)	113	33	146

The licensees indicate that additional commitments may be received for the uncommitted portion noted above and that NRC will be so notified. The licensees also state in their application that the asset sales price will result in no gain or loss to PNM.

It is anticipated that the investors' equity funds will be derived from general corporate resources in each case. The investors' debt financing indicated above is expected to cover 70 percent to 80 percent of the purchase price of the interest in PV 1. The investors plan to issue debt instruments for sale to the public. The debt, which must be issued on terms acceptable to PNM, will be payable from the rentals due from PNM under the lease. The debt will be structured to have principal and interest payments that correspond to the receipt of rental payments under the lease.

Financial Effects of Sale/Leaseback

The owners/lessors (investors) in the proposed transaction will be able to recapitalize PV 1 with greater debt leverage than PNM is able to do and, therefore, utilize greater interest expense deductions for tax purposes. In addition, the investors are expected to be able to take greater advantage than PNM of depreciation on the unit for tax purposes. Thus, the licensees explain that the net capital cost of the investment in the unit will be reduced and that the savings will at least partially be passed on to PNM's customers.

PNM expects to use the sale proceeds to retire some outstanding debt capitalization, to reduce its level of short-term debt, and to defer future financings. The company anticipates that these actions will lead to greater future financing flexibility and should provide enhanced access to the financial markets. PNM provided a pro forma balance sheet and income statement to show these effects resulting from the sale/leaseback.

Operating and Decommissioning Costs

The licensees submitted estimated annual operating costs (including PNM's share of such costs) for each of the first five full years of PV 1 operation. Total costs during the period range from approximately $105 million to $134 million per year. PNM's share ranges from approximately $11 million to $14 million per year. The licensees' most recent (1982) estimate of PV 1 decommissioning costs assumes the DECON alternative and is $79 million (1982 dollars), according to a study by the S. M. Stoller Corporation.

Under the terms of the proposed leases and pursuant to a proposed amendment to the Arizona Nuclear Power Project (ANPP) Participation Agreement with the other utility owners, PNM would continue throughout the term of the lease to be a utility participant in PV 1, entitled to a 10.2 percent share of the power and energy generated by PV 1, entitled to its full pro-rata vote with the other utilities on all PV 1 business, and obligated to pay 10.2 percent of the costs of operating, maintaining and decommissioning the unit.

The licensees indicate in their application that the source of funds for operating and decommissioning costs will be the same as for other normal utility operations; i.e., revenues derived from sale of utility service to customers. The New Mexico Public Service Commission (NMPSC) has already approved PNM's recovery of PV 1 operating expenses from customers. PNM expects to file by January 1, 1986 for approval to recover funding for decommissioning in current rates. Since PNM will continue as a participant in PV 1, entitled to its pro rata share of the electrical output, the NMPSC will continue to have jurisdiction over determination of revenue requirements to cover PNM's costs related to PV 1. The NMPSC has approval authority over the proposed sale/leaseback transaction. Such approval was granted on November 27, 1985. It is reasonable to assume that such approval would be followed by rational ratemaking treatment of the PV 1 costs. This would include allowing PNM the opportunity to recover prudent PV 1 costs from customers. Thus, the licensees indicate that there will be no change from the present in the source of the 10.2 percent share of PV 1 costs under the proposed refinancing arrangement.

Under the ANPP Participation Agreement, if PNM should default on its obligations to provide operating and decommissioning costs, then the non-defaulting utility participants are required to pay their pro rata shares of such defaulted amounts to assure that such costs will be paid. This default provision, common to nuclear power plant participation agreements, provides an additional level of assurance that all PV 1 costs will be fully funded on a current basis.

Conclusion

We conclude that the licensees have provided reasonable assurance that PNM's share of PV 1 operating and decommissioning costs will be funded after the sale/leaseback transaction. The licensees indicate that there will be no change in the source of such funds from before the transaction. Approval has been granted to PNM to recover PV 1 operating costs from customers. PNM expects to file in the near future for approval to collect decommissioning funds from customers.

We also conclude that the licensees have presented a reasonable plan for refinancing PNM's interest in PV 1. The sale and leaseback method will apparently reduce the net capital cost of the investment primarily due to increased tax benefits. This will be caused by (1) greater debt leverage used by the investors (than by PNM) resulting in increased interest expense and (2) the investors' ability to more fully utilize (than PNM) tax depreciation deductions on the unit. The licensees indicate that this will also reduce the net cost of the investment to PNM's customers. The proposed sale/leaseback transaction is a capital refinancing method aimed at reducing PNM's and its

customers' capital costs and at providing an investment with tax benefits to the investors.