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SUBJECT: Addresses concerns of equity investors & suggests alternatives for consideration re proposed sale & leaseback transactions. Also addresses concerns re language in Amends 3 & 6 of License NPF-51 requiring Commission notification.

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July 30, 1986

Edward S. Christenbury, Esq.
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Dear Ed:

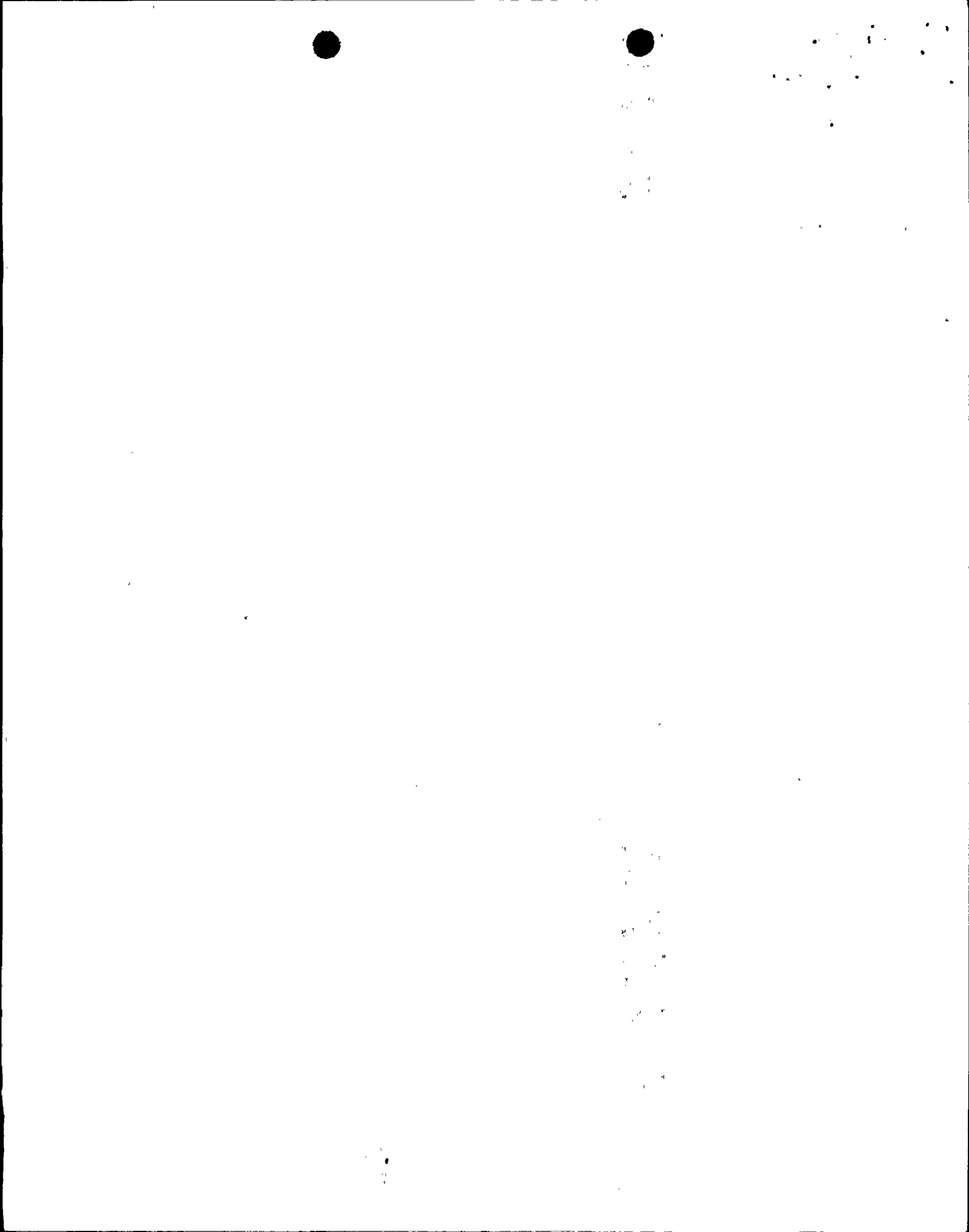
In the Matter of Arizona Public Service Company, et al.
Palo Verde Nuclear Generating Station Unit 2
Docket No. STN 50-529

We are counsel to Public Service Company of New Mexico (PNM), Arizona Public Service Company (APS) and El Paso Electric Company (El Paso) in connection with certain sale and leaseback transactions proposed to be entered into with respect to individual ownership interests in Palo Verde Nuclear Generating Station (PVNGS) Unit 2. The transactions were the subject of separate applications filed on February 14, 1986 by PNM, on May 2, 1986 by APS and on April 15, 1986 by El Paso. Receipt of these applications was noticed in the Federal Register at 51 F.R. 8587 (March 12, 1986), 51 F.R. 20367 (June 4, 1986) and 51 F.R. 20366 (June 4, 1986), respectively.

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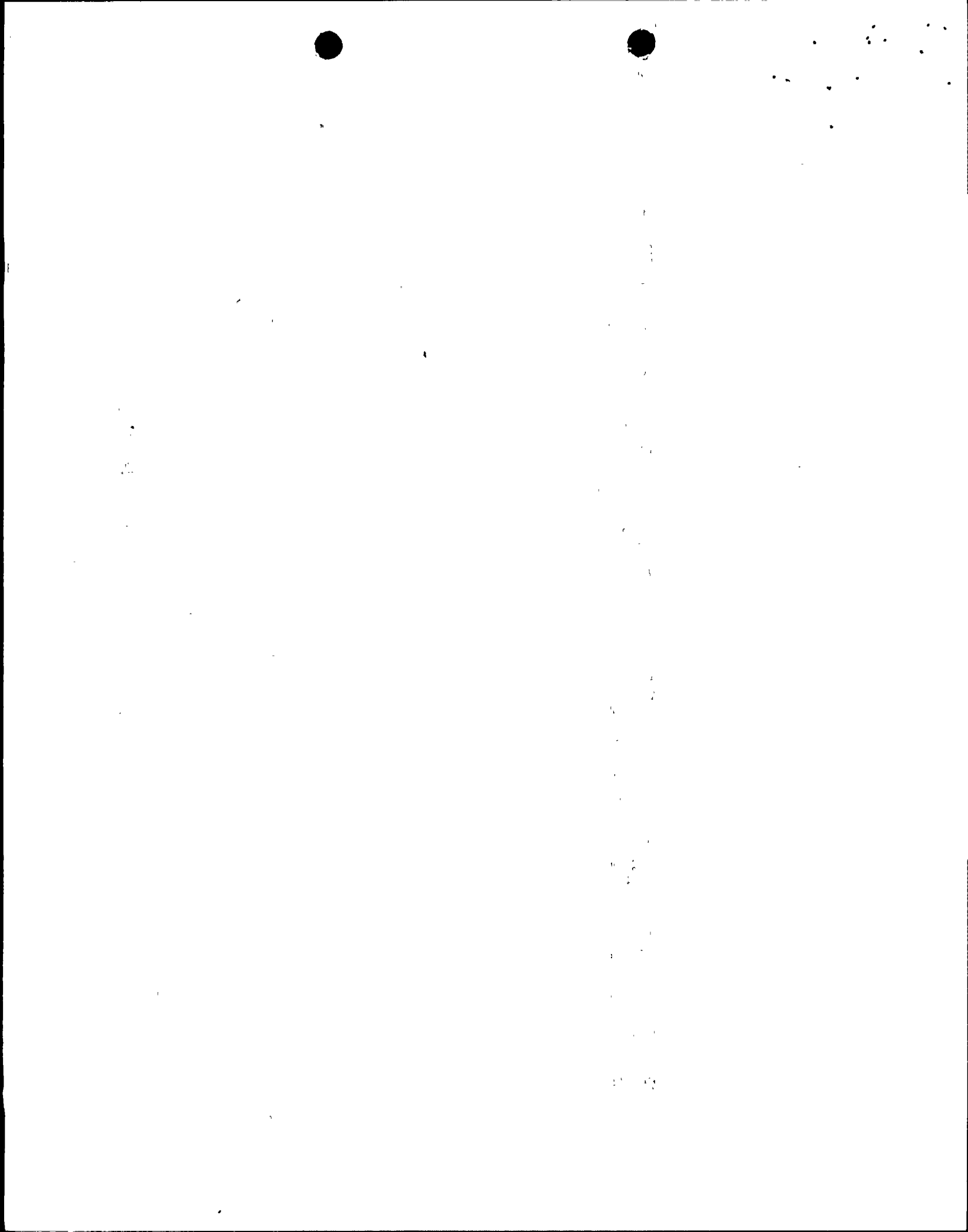
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On behalf of PNM, APS and El Paso, we wish to express our appreciation to you, Mr. Malsch and Ms. Nordlinger for meeting with us and legal counsel to the prospective equity investors on July 24, 1986. At that meeting, we discussed certain questions that have arisen with respect to the wording of License Amendment No. 3 (Amendment 3), dated December 26, 1985, and License Amendment No. 6 (Amendment 6), dated June 2, 1986, to Facility Operating License NPF-41 for PVNGS Unit 1. Substantially similar wording was requested for the amendments to Facility Operating License NPF-51 for PVNGS Unit 2 applied for in the separate applications of PNM, APS and El Paso. In response to your suggestion, this letter will address the concerns of the equity investors and suggest alternatives for you and the Staff to consider. In addition, PNM, APS and El Paso would like separately to address certain matters in connection with language in Amendments 3 and 6 requiring notification to the Commission of changes to existing insurance at PVNGS.

Schedule 1 to this letter provides a status report with respect to potential equity investors for the proposed sale and leaseback transactions. It is currently expected that the basic term of the PNM leases will terminate on January 15, 2016; the basic term of the APS leases will terminate on January 15, 2016; and the basic term of the El Paso leases will terminate on October 1, 2013. The PNM transactions are expected to close on or about August 12, 1986. The APS transactions are expected to close on or about August 14,



1986. The El Paso transactions are expected to close on or about August 16, 1986.

**Issue of Direct or Indirect Control
Over the Licensees**

Currently the applications referred to above include the following language (emphasis supplied):

Specifically, the lessors and anyone else who may acquire an interest under these transactions are prohibited from exercising directly or indirectly any control over the licensees of Palo Verde Unit 2. For purposes of this condition, the limitations in 10 CFR 50.81 "Creditor Regulations" as now in effect and as they may be subsequently amended are fully applicable to the lessors and any successor in interest to such lessors as long as the license for Palo Verde Unit 2 remains in effect.

Similar language is also contained in Amendment No. 3 and Amendment No. 6. As we discussed at our July 24th meeting, prospective equity investors are concerned that the first sentence of the quoted language could conceivably (and, we believe, incorrectly) be construed to preclude covenants and remedies typically found in both lease and secured creditor documents, such as restrictions on merger and the imposition of monetary damages in the event of a default. Schedule 2 hereto shows a comparison between certain provisions of PNM's restated articles of incorporation and first mortgage bond indenture and analogous provisions of the documents relating to the sale and leaseback transactions consummated on December 31, 1985. PNM's restated articles of incorporation and mortgage have been chosen as

an example only; APS's and El Paso's charters and mortgages are not dissimilar in this regard.

Counsel to the equity investors have suggested that the best way to address the concerns of the equity investors would be simply to delete the language underlined above. The effect would be a clearer statement that the provisions of 10 CFR 50.81 apply to equity investors in lease financings, and would not be inconsistent with the December 12, 1985 Order, which in our view used the language more as an explanation of why the approval was being given than as a separate substantive restriction. Alternatively,

(i) the above-language could be rewritten so as to omit the word "licensees" in the first sentence and insert in its place the word "operations" or "license"; or

(ii) the words "the licensees of" could be deleted without further revision; or

(iii) the words "in connection with the operations, maintenance and decommissioning" could be inserted immediately following the word "licensees".

Any one of the foregoing changes would be an acceptable, albeit less desirable, resolution of the concerns of the prospective equity investors, so long as it was combined with adding the language "unless and until they become licensees" at the end of the sentence. We believe that each of the above revisions would adhere to the clear mandate of the Commission, as expressed in its December 12, 1985 Order, that 10 CFR 50.81 "Creditor Regulations" be "fully applicable" to lessors.



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Additional clarity would be provided if the introduction to the second sentence quoted above ("[f]or purposes of this condition") were revised to read "To ensure the foregoing". It has also been suggested that in order to address your concern that the licensees continue to be fully responsible for all aspects of the facility, the words "the licensees shall continue to have sole financial and operational responsibility for the facility and" be added after the word "Specifically" in the first sentence quoted above.

In addition to the foregoing, counsel for prospective equity investors have raised two other ambiguities in the language which could be clarified without undue difficulty. First, the last sentence of paragraph 2.B(7), as set forth in the applications ("[t]hese transactions shall have no effect on the license . . ."), should be omitted, as it states a conclusion, rather than imposing a condition to the license. Second, the wording of the sentence referring to representations and conditions (which was not included in the Order) inadvertently seems to create a condition subsequent rather than a condition precedent. Rather than reading that, "The sale and leaseback transactions are subject to representations . . .", the sentence should say, "The authorization of the sale and leaseback transactions is based upon the representations"

Finally, given the need to close the proposed transactions by mid-August, if you conclude that Commission review of any change in the proposed license amendment language is required, we hope that

you will consider notifying the Commission of such change, rather than seeking the entry of a further Commission order.

Insurance

Art Gehr of Snell & Wilmer has previously discussed with you that portion of Amendments 3 and 6 which requires prior written notice of any change in "the existing insurance for the Palo Verde facility." The breadth and vagueness of the literal requirement causes problems in implementation, and we understand the language goes beyond the concerns of the Commission. For this reason, and in line with Art's discussions with you, we hope that the language of this license condition can be altered to refer only to changes in insurance for the Palo Verde facility if and to the extent such insurance is required by the Commission's regulations, 10 CFR Part 140 and 10 CFR 50.54(w).

Conclusion

We hope the Staff will try to find a way to accommodate the concerns raised by the equity investors. It is not unreasonable that they seek to be treated no worse than secured creditors under the Commission's creditor regulations, 10 CFR 50.81. This is not inconsistent with the conclusion expressed in SECY 85-367, page 9, note 6:

The proposed sale and leaseback is a financing transaction and could be viewed as much like mortgage and lien transactions permitted without specific licensing action by



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section 184 of the Atomic Energy Act and 10 CFR § 50.81. However, it is not technically such a transaction as the security does not automatically revert back to the original owner at the conclusion of the transaction.

The reasons supporting approval of the original PNM application militate for finding a solution to the equity investors' concerns. These reasons are also discussed in SECY 85-367 (see page 4).

Finally, on behalf of PNM, I would like to stress that the fact that these questions have arisen does not reflect any change in the representations made by PNM in connection with, and the assumptions underlying, Amendment 3 and Amendment 6. As was discussed at our meeting, the existence of new potential lessees and equity investors, who do not have the benefit of PNM's previous interaction with the Staff, has been accompanied by a careful reexamination of the language contained in such Amendments. It was this reexamination which resulted in the request for our July 24 meeting and, consequently, this letter. I would also like to emphasize that the PNM Unit 2 transactions are not expected to differ in any respect material to Commission consideration from the PNM Unit 1 transactions. In that regard, as you know, the PNM Unit 1 transaction documents were filed with the Commission by letter dated January 29, 1986, from Keleher & McLeod, P.A., counsel for PNM.

Your attention to the matters addressed in this letter will be greatly appreciated.

Sincerely,

Timothy Toy
Timothy Michael Toy

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Schedule 1 to
Letter of July 30, 1986

PUBLIC SERVICE COMPANY OF NEW MEXICO

UNIT 1 Total Value: \$450,000,000

- \$325,000,000 was sold to three equity investors on December 31, 1985.
- \$50,000,000 to be sold to an owner trust for the benefit of an affiliate of Chase Manhattan Corp. on or about July 31, 1986.
- \$75,000,000 remains uncommitted.

UNIT 2 Total Value: \$450,000,000 (est.)

- \$100,000,000 to be sold to an owner trust for the benefit of an affiliate of Citicorp on or about August 12, 1986.
- \$100,000,000 to be sold to an owner trust for the benefit of an affiliate of Emerson Electric on or about August 12, 1986.
- \$50,000,000 to be sold to an owner trust for the benefit of an affiliate of Mellon Bank Corp. on or about August 12, 1986.
- \$50,000,000 may be sold to an owner trust for the benefit of an affiliate of Beneficial Corp. on or about August 12, 1986.
- \$75,000,000 may be sold to an owner trust for the benefit of an affiliate of Drexel Burnham Lambert on or about August 12, 1986.

-- \$30,000,000 may be sold to an owner trust for the benefit of an affiliate of First Chicago Corp. on or about August 12, 1986.

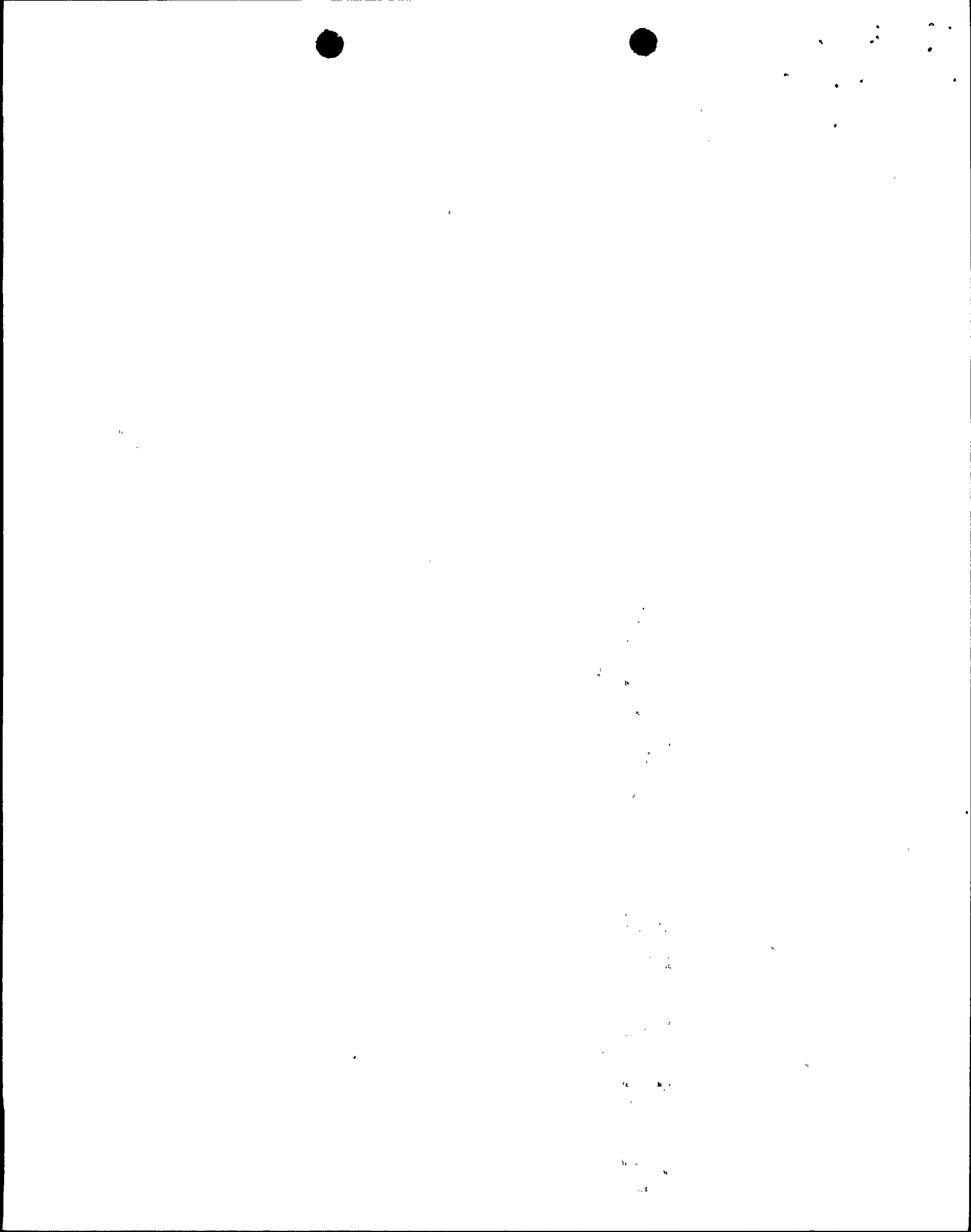
Among the possible candidates for investment in Unit 1 and Unit 2 are: (i) an investment subsidiary of the U.S. subsidiary of a corporation which is up to 100% foreign owned and controlled, (ii) an investment affiliate of a regional telephone utility company and (iii) any prospective equity investor or candidate for equity investment listed for APS or El Paso.

ARIZONA PUBLIC SERVICE COMPANY

UNIT 2 Total Value to be Offered: \$475,000,000 (est.)

- \$130 to 140 million to be sold to an owner trust for the benefit of an affiliate of Security Pacific Corp. on or about August 14, 1986.
- \$100 million to be sold to an owner trust for the benefit of an affiliate of Emerson Electric on or about August 14, 1986.

Among the possible candidates for investment are: (i) an investment subsidiary of the U.S. subsidiary of a corporation which is up to 100% foreign owned and controlled, (ii) investment affiliates of U.S. bank holding corporations and other financial institutions, (iii) investment affiliates of electric utilities with operations both within and outside the Southwest and (iv) any prospective equity investor or candidate for equity investment listed for PNM or El Paso.



EL PASO ELECTRIC COMPANY

UNIT 2 Total Value: \$700,000,000 (est.)

- \$100,000,000 to be sold to an owner trust for the benefit of an affiliate of Drexel Burnham Lambert on or about August 16, 1986.
- \$100,000,000 to be sold to an owner trust for the benefit of an affiliate of Chrysler Financial on or about August 16, 1986.
- \$ 50,000,000 may be sold to an owner trust for the benefit of an insurance subsidiary of HFC International on or about August 16, 1986.
- \$100,000,000 may be sold to an owner trust for the benefit of a joint venture affiliated with HFC on or about August 16, 1986.
- \$50,000,000 (or more) may be sold to an owner trust for the benefit of an investment subsidiary of a Missouri-based electric and gas distribution utility on or about August 16, 1986.
- \$50,000,000 to \$100,000,000 may be sold to an owner trust for the benefit of a subsidiary of water, telephone, and electric utility (with electric operation in, among other states, Arizona) on or about August 16, 1986.
- \$50,000,000 may be sold to an owner trust for the benefit of an investment subsidiary of a savings and loan association on or about August 16, 1986.

Among possible candidates for investment are: any prospective equity investor or candidate for equity investment listed for PNM or APS.

Schedule 2 to
Letter of July 30, 1986

Selected Provisions of
the Restated Articles of Incorporation
and First Mortgage Bond Indenture of
Public Service Company of New Mexico
and
Comparable Provisions of the Sale and Leaseback
Transactions Consummated on December 31, 1985¹

<u>Articles/Mortgage Provision</u>	<u>Sale and Leaseback Provision</u>
1. Limitation on incurrence of certain indebtedness maturing eighteen or more months after issuance thereof (Articles, Article Fourth, E(2)(a)(I)).	(Participation Agreement, Section 10(b)(3)(v)).
2. Limitation on certain common stock dividends (Articles, Article Fourth, F; Mortgage, Seventh Supp., Article IV).	(Participation Agreement, Section 10(b)(3)(ii)).
3. No liens except permitted liens (Mortgage, Section 4.05).	(Facility Lease, Section 7).
4. Covenant to insure (Mortgage, Section 4.06).	(Facility Lease, Section 10(a)).
5. Covenant to maintain and repair (Mortgage, Section 4.07).	(Facility Lease, Section 8(a)).
6. Default and remedies upon default (Mortgage, Article 9).	(Facility Lease, Sections 15 and 16).
7. Merger, consolidation, etc. (Mortgage, Article 12).	(Participation Agreement, Section 10(b)(3)(ii)).

1. This comparison does not purport to be comprehensive, and is included with the July 30, 1986 letter for illustrative purposes only.

