UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

BEFORE THE ATOMIC SAFETY & LICENSING BOARD

In the Matter of	)	
	)	
BOSTON EDISON COMPANY, et al	)	Docket No. 50-471
	)	
(Pilgrim Nuclear Generating Station, Unit 2)	)	

APPLICANT'S DIRECT TESTIMONY
ON FINANCIAL QUALIFICATIONS

APPLICANT'S DIRECT TESTIMONY ON FINANCIAL QUALIFICATIONS*

PANELISTS: Ralph M. Kelmon, Treasurer, Boston Edison Company

Thomas J. May, Assistant Treasurer, Boston Edison Company

2314 085

* Intervenor Commonwealth of Massachusetts Contention 5

Applicant's Direct Testimony

On

Financial Qualifications

Q. Mr. Kelmon, would you please state your name and business address for the record?

A. My name is Ralph M. Kelmon. My business address is 800 Boylston Street, Boston, Massachusetts.

Q. By whom are you employed?

A. Boston Edison Company.

Q. What is your position at Boston Edison Company?

A. I am Treasurer of the Boston Edison Company.

Q. Will you briefly describe your educational and professional background?

A. I received a Bachelor of Science degree in Business Administration from the University of Florida in 1941 and an M.B.A. degree from the Harvard Graduate School of Business Administration in 1943. Prior to joining Boston Edison Company in 1951, I was employed as a work controller with Allegheny Ludlum Steel Corporation; as an assistant professor of accounting at the University of Florida; and a staff member with Lybrand, Ross Bros. & Montgomery, Accountants and Auditors. I am a member of

2314 086

the American Institute of Certified Public Accountants; the American Accounting Association; the National Association of Accountants; the American Economic Association; and the American Management Association, and I am a Director of the Reading Cooperative Bank.

I was chairman of the Accounting Division Executive Committee of the Edison Electric Institute in 1970-1971. I previously was chairman of the EEI Application of Accounting Principles Committee.

Q. Please describe your duties at Boston Edison Company.

A. As Treasurer of Boston Edison Company, I supervise the four departments whose primary functions are the forecasting of company earnings and financing requirements, financial management, review and analysis of the financial aspects of company operations, determination of revenue requirements, taxes, preparation of reports and pension cost administration.

Q. Mr. Kelmon, would you please state what your role was with respect to the information appearing in the Applicant's license Application (NRC Docket 50-471) relating to the financial qualifications of Boston Edison Company?

A. All of such material relating to the financial qualifications of Boston Edison Company has been prepared under my general supervision and has been reviewed and approved by me.

2314 087

Q. Mr. May, would you please state your name and business address for the record?

A. My name is Thomas J. May. My business address is 800 Boylston Street, Boston, Massachusetts.

Q. By whom are you employed?

A. Boston Edison Company.

Q. What is your position at Boston Edison Company?

A. I am Assistant Treasurer and head of the Financial Management Department.

Q. Will you briefly describe your educational and professional background?

A. I received a Bachelor of Science degree in Business Administration from Stonehill College in 1969. Prior to joining Boston Edison Company, I was employed as a General Practice Manager with Coopers and Lybrand, an international firm of Certified Public Accountants. I am a member of the American Institute of Certified Public Accountants, the Massachusetts Society of Certified Public Accountants, and the Financial Executives Institute.

Q. Please describe your duties at Boston Edison Company.

A. My duties largely involve the review and preparation of financial plans and the review and analysis of financial aspects of Company operations.

Q. Mr. May, would you please state what your role was with respect to the information appearing in the Applicants'

License Application (NRC Docket 50-471) relating to the financial qualifications of Boston Edison Company?

A. Since June 28, 1976, the information relating to the financial qualifications has either been prepared by me or under my direct supervision. This includes Amendments to the License Application Numbers 5, 6, 7, 8 and 9, filed 7/25/77, 11/10/77, 12/20/77, 5/5/78 and 9/27/78 respectively. Also prepared under my supervision and direction has been information forwarded to NRC Staff by letters dated 5/28/78, 6/2/78, 6/23/78, 6/30/78, 9/1/78, 9/15/78, 10/16/78, 11/3/78, 11/7/78, 11/15/78, 1/29/79, and 4/17/79.

Q. Please provide the estimated construction costs for the Pilgrim 2 Unit.

A. Excluding allowance for funds used during construction the costs for the unit, per Amendment 9, were estimated to be $1,319,000,000. The breakdown of this cost is as follows (millions of dollars):

Nuclear Plant	$1,210
Site and Common Facilities	26
Initial Core of Nuclear Fuel	64
Transmission & Switching Facilities	19
	$1,319

Subsequent to the filing of mendment 9, an updated estimate was prepared. The current estimate of costs, dated January 31, 1979, resulted in a $9 million expected

2314 089

increase in nuclear plant cost, raising the estimate from $1,210 million to $1,219 million. The cost estimates for site and common facilities, initial core of nuclear fuel, and transmission and switching facilities remain the same at $26 million, $64 million, and $19 million respectively.

Since the cost changed by such a small margin and since the cost estimation process includes a potential contingency that recognizes that costs could vary within a range, we believe the $1,319 million cost is still a reasonable cost estimate and the recent change does not require an amendment to the license application.

Q. How much has already been spent on the Pilgrim 2 project?

A. Approximately $226,000,000 has been expended to December 31, 1978.

Q. Has a more current financial forecast been prepared since the date of Amendment 8, May 5, 1978?

A. Yes, an updated forecast dated March 7, 1979 has been prepared.

Q. What effect does this forecast have upon Boston Edison's financial plan as filed in Amendment 8 of the license application?

A. This new forecast, in effect, paints the same financial picture that existed as of May 5, 1978, the date of Amendment 8. Key comparisons of the May 1978 forecast and the March 7, 1979 forecast for the seven year period 1979 to 1985 are as follows:

	May 1978 Forecast	March 1979 Forecast
Average annual kWh sales growth rate	3.1%	3.0%
Increases in base rates during Pilgrim 2 construction	$62.5 million	$51 million
Internal cash flow percentage	37%	36%
Average return on common equity	12.3%	12.1%
Average interest coverage-SEC method	2.7X	2.6X
Construction expenditures	$1,431 million	$1,367 million
External financing	$1,096 million	$1,009 million

As can be seen, the new 10 year forecast is substantially the same as the forecast implicit in the financial plan as amended May 5, 1978. Therefore, the filed financial plan properly reflects the current financial forecast for the construction period.

Q. Would you briefly explain Boston Edison Company's general financial plan for financing its 59.026% share of the cost of Pilgrim 2?

A. A detailed Sources of Funds statement indicating forecasted cash requirements, assumptions made in developing the forecast and a plan for financing is presented in Amendment 8 to Section VI, pages VI-a-1 to VI-a-11 of the License Application. In general Boston Edison will be relying upon a combination of internally generated funds and the sale of debt and equity securities to finance the construction of Pilgrim 2. It is

2314 091

estimated that approximately 39% of the construction funds necessary will be generated from operations for the eight year period 1978 - 1985. The funds statement indicates that the major sources of cash will be retained earnings adjusted for the following non cash income and expense items: AFUDC, deferred taxes, and depreciation. The remaining 61% of funds will be financed externally.

Q. What sources of funds will the participants be relying upon to meet the obligations of the 40.974% of the plant not owned by Boston Edison?

A. Schedules for each of the other participants showing the various sources of funds for each company are included in the License Application section VI. As indicated in these schedules, each owner will be relying upon a combination of internally generated funds and external funds in the form of debt and/or equity securities.

Q. Mr. Kelmon and Mr. May, in your opinions, is there reasonable assurance that Boston Edison can obtain the funds necessary to finance its portion of Pilgrim 2?

A. Yes. First, the construction expenditures for the 1978 to 1985 period of construction, while of considerable magnitude, are not as major on a relative basis as the construction expenditures undertaken in the past 8 years. In the period 1970 to 1977, construction expenditures were $878 million. $617 million, net, in outside financing

2314 092

was raised by the company. In this 8-year period, total assets of the company grew from $652 million at 12/31/69 to $1,468 million at 12/31/77. This represents an increase in company assets by a factor of 2.25. Total capitalization during this same period grew from $516 million to $1,123 million, an increase of 2.18 times.

During the period 1978 to 1985 construction expenditures of $1,584 million and net external financing of $961 million are projected. From 12/31/77 to 12/31/85, total assets are forecasted to increase to $2,991 million and total capitalization is expected to increase to $2,335 million. These figures represent increases by factors of 2.04 and 2.08 respectively. Therefore, on a relative basis, the growth in assets and in capitalization during the period 1978 to 1985 will not be as great as that previously experienced by the company from 1970 - 1977.

Secondly, a marked improvement in internal funds as a source of cash for construction is expected in the 1978 to 1985 period of Pilgrim 2 construction. During the 8-year period ending December 31, 1977, internal funds averaged 29% of the company's total construction expenditures. The 8-year forecast for the construction period of Pilgrim 2 indicates that internal funds will average approximately 39% of the company's total construction budget. This means that reliance on external funds will

2314 093

be less in the 1978 to 1985 period than it had been in the 1970 to 1977 period. This improved cash flow percentage is due mainly to income tax normalization practices, which began in 1974 with DPU order 17795, and increased depreciation expense providing an increased source of internal cash generation.

Finally, based upon forecasted earnings, return on equity, capital structure, and coverage ratios, a market for the company's stocks and bonds should be maintained which will enable the company to raise sufficient external funds to finance construction. A major determinant of the company's ability to finance centers around the ratings of securities as established by Moody's and Standard and Poors. The criteria for the determination of ratings are difficult to state with precision. No fixed mathematical formula automatically produces any particular rating. Many subjective factors play an important role. However, both organizations place special emphasis on such ratios as interest coverages, return on equity, and debt-equity ratios. In fact, it is necessary for a company's financial ratios to fall within specific bands to even be considered for a particular rating. Based upon statistics for the twelve months ended September 30, 1978, the range in interest coverage, return on equity, and debt-equity ratios for single A* utilities

*Bonds which are rated A are considered "upper medium grade obligations" by Moody's.

2314 094

was as follows:

	Range	Median
Interest coverage (pre-tax)	2.0X to 4.3X	3.0X
Return on Equity	7.4% to 15.7%	12.1%
Long Term Debt	45% to 55%	51%
Preferred Stock	5% to 18%	13%
Common Stock	31% to 43%	36%

In comparison, Boston Edison's forecast indicates that interest coverage, return on equity, and debt-equity ratios for the construction period 1979 to 1985 are expected to fall within the following range:

Interest Coverage (pre-tax)	2.5X to 3.0X
Return on Equity	11.9% to 12.9%
Long Term Debt	51% to 53%
Preferred Stock	12% to 14%
Common Stock	33% to 36%

Boston Edison's projected performance compares favorably with that of the single A rated utilities. For this reason we believe that the company will have the financial strength to undertake the Pilgrim 2 construction program.

Q. Much of the forecasted internal cash position, earnings, rate of return on common equity, and coverage ratios depends upon receiving adequate and timely rate relief from the DPU. Do you believe that the rate relief necessary to actually earn a 10% to 13% return on common equity will be granted by the appropriate regulatory authority?

A. Clearly, an important assumption that underlies the financing plan is one of obtaining adequate rate relief. It is Boston Edison's opinion that forecasted rate increases, both retail and wholesale, will be shown to be necessary and reasonable and will be granted by the appropriate regulatory authority. With a DPU allowed rate of return on common equity of 13% it certainly is not unreasonable to assume an actual return in the range of 10 to 13%. We believe that regulatory authorities will act responsibily and will provide adequate and timely rate relief and that the company will be able to obtain the capital funds necessary to complete the project.

2314 096