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Mr Mitchell Rogovin, Director
NRC/TMI Special Inquiry Group
Nuclear Regulatory Commission
Washington, D C 20555

Dear Mitch:

We have reviewed the draft you gave me and offer our comments on the financial portions only.

This draft generally offers a compelling argument followed to logical conclusions; certain of the subsequent recommendations, however, rely on questionable assumptions. My detailed comments follow, each referenced to the applicable portion of the draft.

Section II:

(9) ✓
Page 11 The premise is advanced that shareholders assume additional risk after a unit is declared in commercial operation, because any further material expenditures incurred after that date could not be recovered. I would characterize this premise as narrow and unfair. Depending upon the nature of the expenditure, a regulatory commission usually will permit the utility to either capitalize the cost as part of the plant cost, or include it in the next rate application as an operating expense. Utilities make capital additions to facilities throughout their depreciable lives, long after the cessation of allowance for funds (AFDC) at the date of commercial operation. ✓

(9) ✓
Page 12 Referring to AFDC as a "safe harbor" simply imparts an erroneous flavor. AFDC is a proper but often misunderstood accounting procedure with some lack of credence in the community of investors. It represents a "safe harbor" only regarding earnings, and the financial community often discounts earnings of which a material portion is due to AFDC.



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(19) ✓
Page 12 The terms fair value and original cost are not interchangeable in the electric utility industry. Reduction of allowed AFDC will certainly reduce the original cost of a plant but, depending upon the jurisdiction, may or may not reduce its fair value.

(19) ✓
Page 22-26 On page 26, the draft summarizes that GPU received about \$165 million in rate relief in 1979, reflecting "to a large extent the addition of TMI-2 to the companies' rate bases and associated regulatory treatment." This should be quantified: What constitutes "a large extent"? Our calculations from data provided would suggest a maximum of \$103 million relates to Unit 2 of Three Mile Island Nuclear Station (TMI).
I think that's large.
and they have paid w/o TMI-2?

(19) X
Page 26 The idea that "only a small percentage" of rate increases accrues to the shareholders of a utility ignores the role of the shareholder as the risk-bearing party receiving only the residual after the company meets all other requirements. While only a small portion of the \$165 million of rate increases may have been allocated to the shareholders, that small percentage is at the margin. Any reduction in the amounts of the rate decisions would have reduced only two items: earnings for common stock and income taxes.

(29) ✓
Page 42-43 The draft must explain the distinction between straight-line and accelerated depreciation. The reference to "ill-gotten gains" on page 42 must refer to the deferral of income taxes through accelerated depreciation, as indeed must the reference to incentives to invest at the beginning of the paragraph. The description provided, however, - "... simply a recognition that the value of an asset deteriorates over time. A taxpayer, therefore, is allowed to deduct from his tax base a portion of the value of the asset each year as compensation for this 'wear and tear.'" - clearly relates to the concept of straight-line or economic depreciation. Without accelerated depreciation there are no tax advantages, simply recovery of an investment on an economic basis.

(30) ✓
Page 43 The "benefits and liabilities of taxation" are not generally shared between investors and ratepayers. Ratepayers are responsible for the taxes as a cost of service and hence benefit almost exclusively if a utility can reduce its tax liability. The only real exception to this is the small return allowed utilities on investment tax credit. Deferred taxes, for example, are generally treated as either a reduction in rate base or cost-free capital. The benefits discussed throughout this draft are benefits that GPU sought on behalf of its ratepayers not its investors.

Page 43 The description of normalization is unintelligible. It should either be expanded or discarded.

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✓ Page 62 It is also important to consider the financial condition of GPU in late 1978 to understand the weight they may have attached to advancing the receipt of the \$28 million. If they anticipated possible uprating of their bonds from single-A to double-A, they probably were financially healthy and fairly liquid.

X Page 71 Concern about deterioration of earnings coverage of fixed charges should only have encouraged GPU, if considered from a financial viewpoint only, to delay commercial operation of TMI Unit 2 as long as possible. Given the future test periods used in two of the three pending rate cases, delay of the unit would not have affected the revenues resulting from those applications but would have increased earnings from AFDC.

*In Graham
LM*

Section V:

✓ Pages 149-150 The incentives regarding the timing of commercial operation relative to rate treatment depend upon whether a utility uses historical or future test periods. The report should address these differences before making recommendations for the entire industry.

Section VI:

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The recommendation on pages 158-160 that the Nuclear Regulatory Commission (NRC) increase the scope of its financial qualification review seems misguided. Utilities are economic entities; not just investor-owned utilities but all utilities with cost sensitivity strive with varying degrees of success to provide adequate service at the lowest possible cost. It is the nature of economic entities constantly to seek efficiencies and cost reductions. Utilities are always on a critical path and always pressured to complete a project, and failure to grasp that fact represents a fundamental lack of comprehension of business and economic environments.

Legions of additional accountants at the NRC will only be able to reaffirm that there are always opportunities to reduce costs, and such opportunities do indeed represent incentives to economic entities. To the extent that a utility, proceeding in good faith, attains economies through trade-offs which do not affect the safety of a facility, those trade-offs are desirable. Cost effectiveness represents a far different criteria than that used by the NRC, which sets standards for safe operation which must be met regardless of cost.

How can this report conclude that efforts at efficiency played no discernable role in the accident at TMI, and then recommend financial regulation involving "the most intimate financial details of a licensee's operations"? Given that there is no evidence presented in this report that financially strong utilities build and operate nuclear plants more

Mr Mitchell Rogovin

Page 4

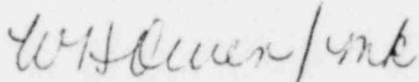
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safely than do financially weaker utilities, the NRC should devote its energies to enforcing its technical regulations, whatever they might be, fully cognizant that to the extent compatible with safety, all licensees will attempt to build and operate their facilities more efficiently.

Other recommendations in this draft, such as increased reliance on construction-work-in-progress in rate base and better coordination between various regulatory agencies, are commendable. These recommendations could produce real changes in the incentives that concern the authors. That represents a far more realistic approach than added NRC financial surveillance of literally thousands of such incentives over a period of a decade most of which are perfectly unrelated to safety and quite constructive in their effect.

I hope these comments will be of use to you in preparing your report.

Very truly yours,

A handwritten signature in cursive script, appearing to read "W H Owen / mk".

W H Owen

WHO/mk

Dictated but not
read by W H Owen.