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DEPOSITION OF HERMAN M. DIECKAMP

Before President's Commission on the Accident at Three Mile Island

August 15, 1979
at the offices of Shaw, Pittman

Portions relevant to COMMERCIAL Operation

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looked into that matter.

Q Could you explain what it means to have a nuclear plant declared commercial?

A Yes. It goes back to FPC and FERC accounting, and it means a number of things in a number of senses.

One thing that it means, which is a less important thing, but one thing that it means within the PJM families of companies that form that pool is that when we declare a plant commercial, it is made available to the system dispatchers to call upon that plant for generation when it is needed. So it is, in effect, officially made available to provide power to the pool, but that is -- I don't know -- not a terribly significant thing.

The more critical feature relates to the FPC accounting rules, which I think needs to be there, is, as I was saying, that while I am sure that there is an underlying presumption that "commercial" means that the plant has reached some degree of dependability relative to usefulness and power output and availability and reliability. There are no criteria along that line that, to my knowledge, are articulated or are available or established by the FPC. The only evidence of a rule or regulation says that in the event that 120 days passes from the time of initial power operation and the plant has not been declared commercial, you are obligated to inform the FPC as to why that has not occurred.

The specific things, then, that happen that are important to the company relative to declaring it commercial are that you change the accounting basis; you no longer capitalize the interest charges, and you no longer capitalize the operating and maintenance costs associated with startup. You being to charge those operating and maintenance costs to the income statement. You begin to take depreciation charges against income. You cease the capitalizing of the returns on investment, sometimes referred to as the AFC -- in other words, you begin again to incur expenses directly reflected in the income statement for the interest on any associated bonds, preferred stock, or common stock dividends, and they now are reflected directly against the operating income statement of the company, and so now, absent rate relief or rate recognition that grants operating revenues to offset those items of expenses that are now recognized currently, the income of the company begins to suffer a significant impact. And that is really the most concrete and definitive thing that happens when you declare a plant commercial.

So in these times, probably more so than in periods 20 years ago or 15 years ago, with the extreme investments of, you know, several hundred million dollars that are outstanding at the time that a plant is ready to be made commercial, it becomes terribly important that rate-making activities with the State regulators have a chance to go forward so as to attempt, as best you can, to synchronize the granting of revenues to offset those expenses and the time at which you declare the plant commercial and begin to incur those expenses. If you do not, there is a time period of expense for those items of O&M depreciation and fixed charges that are forever lost and directly impact the income of the company.

(Continued on Page 107.)

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Q Were there certain tax advantages that would accrue to the company if Unit 2 was declared commercial prior to the end of 1978?

A Let me just back up one minute and say that I am sure that in the material that you have collected through the, you know, the process of subpoena and the like has provided a letter in 1978 to the Pennsylvania PUC and the Jersey PUC in which we attempted to, as simply as possible, protray the exact effects and criteria and results of declaring the plant commercial. So there is a good reference from our point of view.

One of the motivations for us having done that with the absence of definitive criteria on books of the FPC that could be used, so we were attempting to provide a set of ground rules that everyone could work to.

Now, on the matter of taxes, let's just identify that there are two tax related items that are of significance; one, the investment tax credit, and that tax credit is taken in a way with respect to deferral of taxes such that the effect of that tax credit shows up in the income statement over a period of years and gets recognized in the rate-making so

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that any benefits of the investment tax credit flow to the rate payer and not to the investor, so that that tax credit gets recognized in calculating or reflecting the tax obligations of the company which, in turn, the derivation of the revenues required or thus the rates that the customers must pay. So since that credit is reflected in these tax obligations in the future over a normalizing time period of some number of years -- I think generally over the life of the plant -- in effect, the tax credits flow to the customer and do not flow to the investors.

The second area of tax effects relate to what is sometimes, I guess, called the half year convention on depreciation that says if a plant goes in service anytime during the year, and let's say specifically the last half of the year, for tax purposes, you are able to take a full half year of depreciation but you need to show on the books for income purposes only a pro rata share of appreciation in accordance with the actual number of days, weeks or months that the plant is in service. So there can be, in effect then, acceleration of the availability of that tax deduction associated with accelerated depreciation which can be of benefit to the company in terms of cash flow which, in turn, gets recognized many times in rate-making as being called customer supplied capital. It is not capital that we had to put up by selling bonds or stock but rather capital that is made available by the customers having paid revenues but we did not have to pay the tax obligations until later. So there is some cash leftover in the meantime, so there is that effect, but that gets recognized in rate-making.

Then there is the further effect then that to the extent that that depreciation impact in a year in one of our jurisdictions, in New Jersey, is normalized -- that is spread over the future, again so that it gets recognized in rate-making whereas in Pennsylvania they do not recognize normalization and thus it can be taken currently and can have a minor impact on the stated income of the company for that time period, keeping in mind though that to the extent that you have taken that tax effect and that credit down, it isn't available to you later at some other time in the life of the property. So it is really a timing difference on that depreciation benefit of property ownership.

So, yes, there is a degree of benefit to the

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company from the six-month convention on accelerated depreciation if we could get to the point where the plant could be recognized as depreciable property in this time period before the end of the year. Detailed looks at the tax law indicate so that one did not have to declare the plant commercial in order to be able to do that. There are tax cases in the case histories and records, or whatever you legal folks call them, that say that when the plant gets to a certain degree of readiness to operate or some fuzzy measure of operability, that then one can qualify for this six-month conventional depreciation and the impact that has on the income statement and the like.

Q Were you advised of that in the fall or late fall of 1978?

A We were aware of that tax effect and that accounting treatment. Frankly, we worried mostly about whether or not the regulatory environment, whether we should treat the Pennsylvania piece the same way as the Jersey piece, namely of normalizing it so it would be spread over the life of the property and subsequently taken to account in rate-making or whether to do it immediately as an effect on 1978

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income. That was the principal feature of our concern, again recognizing that the rate-making process is one that has so many degrees of freedom in terms of the manner in which costs and expenses and revenues are adjusted and normalized and rates of return are established in that the regulator always has the ability to adjust the numbers to get the end results, and so one can simply fool himself by trying to take advantage of a timing differential on the recognition of a certain tax deduction. But we ultimately did go ahead and take advantage of that six-month convention in the Pennsylvania portion of our revenues and expenses and earnings, keeping in mind then that this was not a unique situation; this absence of the normalization procedure is pretty well established in the Pennsylvania regulation. It had been done before by us and others with other plants. I could hardly identify it as having been a major consideration relative to the specific activities of the plant startup program.

Q In 1978 did GPU take that half year convention or what they called a modified half year convention?

A Joan, you are beyond my detailed knowledge of

6.6 the tax law with respect to that difference, whatever it is.

MS. GOLDFRANK: I would like to request that we be provided wi'' the GPU consolidated tax return for 1978.

Q You indcated that with respect to investment tax credits, that that would be passed onto the consu..r in establishing the rates.

A Yes.

Q Would all of that be passed onto the consumer or is a certain percentage of it --

A I think all of it because it all shows up in calculating the tax obligations of the company and thus the revenue requirements to provide a given level of earnings in the regulatory process.

Q It is all calculated in to determine the rate base; is that how --

A Not the rate base, the earnings required to give a rate of return so, you know, after we get down to the operating revenue, operating income and after we take off the income taxes, which income tax is then an add in the income taxes, which income taxes may be reduced by virtue of some investment tax credits. That, in turn, leads then to an operating income of

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income taxes which the regulator then relates to a rate of return on the capital that is employed in the business, giving recognition to the actual interests costs, the actual preferred dividend costs, and then setting an allowed rate of return on the common equity and then using those three parameters against the capitalization ratios, and many times also adding a fourth increment of capital, namely customer-supplied capital at a zero rate of return. Then it equates this income to that rate of return on rate base and the income is calculated, recognizing any income tax obligations that are there.

Again, that can be different on a cash flow basis. While one has a statement of income tax obligation, those taxes may not be paid in cash in that time period but ultimately they have to be paid if normalized and spread over some time period in the future.

Q You indicated that you were aware that this half year convention could apply independent of when Unit 2 was declared commercial.

A Yes.

Q Were you aware of that in 1978?

A Yes.

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Q And who advised you as to that?

A I think it came as a combination from our comptroller and the Tax Department that reports to him and the general counsel of the corporation.

(Discussion was held off the record.)

MS. GOLDFRANK: If the manner in which Unit 2 was depreciated by GPU in 1978 is not attached to its consolidated tax return, we would request that we be provided with a schedule of that depreciation.

Q In the fall of 1978 a Commercial Operation Review Board was established?

A Yes.

Q To determine the technical and operational readiness of Unit 2 to be declared commercial?

A Yes.

Q Were you involved in establishing that board, that mechanism?

A Yes, I was involved in establishing the mechanism and I think it effectively was applied before Unit 2 of TMI. It seemed to me that because of the interface, organizational interface relationship between the service company conducting the design and the construction and the operating companies being the

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owners of the plant and the subsequent operators of the plant, there was a need for a degree of formalization of this transition in responsibility, and as I say, it seemed to me to be an appropriate thing to formalize that transition and to provide some assurance that the state of the job was known at the time of the transition and that any remaining problems were identified on a punch list for completion, that responsibility for that completion was assigned and that there was evidence that the operating companies were aware of what they were getting, you know, and had gone through a systematic review of the pieces and parts and systems and equipment and everything associated with the plant. It just seemed to me like a good way to do business.

Q This is what we have previously marked as Finfrock Exhibit 2, an October 26, 1978 pamphlet concerning the Commercial Operation Review Board manual. Were you involved in establishing the criteria that begins on Page 2 of this Exhibit which was used to assess the readiness of Unit 2?

A Joan, I think I would say that I was involved in terms of discussions at the time. I think this was before -- this is Three Mile 2 -- but what led to this

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manual started out to be put into place earlier than the Three Mile 2 application.

I notice this is dated 6/27/78. The concept of the service company manual was sort of in process for a couple of years. I think the basic concept of the formalized aspect of the turnover, maybe some elements of it, were applied to TMI 1, but then I think the next level of refinement on that approach showed up on the Homer City 3 plant and I am sure that I was involved both with Bill Verrochi and his staff and then Bob Arnold and his staff and indicating the areas that I thought were important for such a review to include, but I was not involved in the specifics of enumerating them or the specific language or that sort of thing. I left that to the staff to arrive, themselves, at what those things should be.

Q Do you know if outside of Met Ed or GPU anybody or any organization was contacted or consulted concerning the criteria for determining readiness of Unit 2?

A Not that I know of, no. I am sure that -- I suspect -- I guess I shouldn't say "sure" -- I have to suspect or assume that in the course of the review B&W and Burns & Roe in some ways participated in that

6.11 review, but I don't think, to my knowledge, they were involved or even should have been involved in the establishment of these criteria for the turnover. As far as I was concerned, that was an internal management discipline kind of matter, internal to GPU.

Now, whether there was someone along the line of a consultant of some sort that we might have talked to about this, I don't know. You know, it is conceivable that there could be, but I don't know, you know, of any conscious study where we went to somebody and said, "Hey, if you want to do this, what do you thin' you ought to do," and therefore wrote a set of recommendations to us.

Q So as far as you know there wasn't any contact or consultation with the NRC?

A Not to my knowledge at all. This is not a requirement of the NRC in anyway, to my knowledge. I think, you know, the NRC regulations don't particularly contemplate the kind of organizational structure or arrangement that we have. I don't know of any NRC involvement in this. Of course, being able to fulfill the NRC requirements on procedures, quality assurance plans, and things like that, certainly are an element of readiness, but the concept of a formalizing of the

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turnover and a review of the state of readiness as we go through it, I have no knowledge at all of any relationship between that and the NRC.

You know, in a sense, maybe some of this comes out of my background with some of the space program activities where we tended to have these kinds of formalized turnover reviews as you passed a piece of equipment from one set of organizational responsibilities to another.

Q As of March 1, 1979, Gary Miller was made a manager reporting directly to the vice-president of generation.

A Right.

Q As opposed to reporting to the manager for generation operations.

A Nuclear operations or something, who was Sandy Lawyer, yes.

Q Did you have any involvement in the decision to raise Gary Miller to the position of station manager reporting directly to the vice-president?

A You know, while it did not happen as a result of my strict direct directions, I certainly feel that I influenced the organization and the direction of the organization because I felt that there was no