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(47 FR 27371)

Office of the Secretary of the Commission
United States Nuclear Regulatory Commission
Washington, DC 20555

RE: 10 CFR Part 50
Mandatory Property Insurance For
Decontamination of Nuclear Reactors
(47 Fed. Reg. 27371, June 24, 1982)

Dear Sirs:

We act as counsel to Nuclear Mutual Limited ("NML"), a utility-owned Bermuda mutual insurance company which provides primary property insurance for nuclear power plants. On behalf of NML, we respectfully submit comment upon NUREG-0891, the report on nuclear property insurance prepared by Dr. John D. Long, "Nuclear Property Insurance: Status and Outlook" (hereinafter referred to as the "Long Report"); the questions raised by the NRC in its "Advance notice of proposed rulemaking," dated June 24, 1982 (47 Fed. Reg. 27371); as well

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ADD: Robert Wood AR-5037

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as certain aspects of nuclear insurance which need to be evaluated in considering both the Long Report and the NRC's questions.

The operations of NML are generally familiar to the NRC. In addition, the Long Report describes its operations in some detail.* No additional description is deemed necessary here, except to note that effective August 1, 1982, NML increased its primary property insurance policy limits to $500 million.

A current listing of NML's member insureds is appended as Attachment A hereto.

Introduction

NML believes the Long Report to be a significant and useful contribution to an understanding of the United States nuclear property insurance market. Two of the recommendations made, however, risk adverse consequences of major concern: The first is the proposal that operating licensees be required to purchase both primary property insurance coverages currently

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* Long Report at 17-25.

available.* The second is the proposal that all nuclear property insurance policies be required to provide priority for payment of decontamination costs before responding to any other policy claims. These proposals are commented upon below, as are certain of the specific questions posed by the NRC and certain basic concepts reflected in the Long Report.

I. Mandated Purchase of all Primary Insurance Capacity

As a means of increasing the policy limits available for the insurance of nuclear power plants, the Long Report recommends that utilities be required to purchase the maximum amount of insurance offered by both NML and ANI/MAERP.** The recommendation should be rejected. Its anticompetitive effect would likely retard the long term growth of nuclear insurance capacity; the effect on competition, moreover, has other disadvantages which should not be ignored. While in the short term some increase in capacity would result, that benefit is outweighed by the negative impact of purchasing combined coverage.

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* The current primary insurers of nuclear property risks are NML and the nuclear insurance pools - American Nuclear Insurers and Mutual Atomic Energy Reinsurance Pool ("ANI/MAERP").

** Long Report at 99.

A. The Benefit of Competition

From the time of the decision taken in 1972 to form NML to today, NML and its members have been totally convinced that the existence of two competitive sources of insurance has been highly beneficial to the development of maximum nuclear property insurance capacity, technical improvements benefitting plant reliability, and flexibility of coverage. Mandating purchase from both sources sharply affects, and ultimately threatens to eliminate, such competition. Given the demonstrable benefits of prior competition, imposing the suggested requirement would be unwise.

1. Importance of Providing Alternative Insurance Markets

The Long Report's thesis, in essence, is that the social benefit of maximizing insurance capacity for nuclear risks warrants bringing all resources under a single roof. It stops short, necessarily, of suggesting that a merger of all nuclear insurers be sought. But it would be naive to think that requiring the entire universe of customers to buy a "standardized" product, to be jointly supplied by current competitors, leads to something much different in practical result.

There are other areas, within and outside the nuclear industry, where benefits arising from combined operations could be urged. Perhaps a single nuclear steam supply or turbine generator would provide benefit, as could a unified commercial air transport system. To date, however, our society has consistently opted for plurality.

The accident at Three Mile Island forcefully demonstrated that the existence of two independent alternate markets for primary insurance coverage can be of key importance. For insurance purposes, TMI-1 and TMI-2 are a single site. Shortly after the accident, when it became reasonably clear that the costs of the accident might well exhaust the $300 million policy limit, the GPU companies sought to have the policy reinstated to a full $300 million limit.* ANI/MAERP were not in a position to do so, which led to a critical problem for GPU: Without insurance for the undamaged TMI-1 unit, it was unlikely that financial institutions from which the GPU system was seeking hundreds of millions of dollars of financing would agree to make those funds available. Without these funds, however, the GPU system faced insolvency. Approached by GPU, NML agreed to insure the TMI-1 unit and accepted the GPU companies as member insureds. Very prompt

* Nuclear property insurance policies are written on an annual aggregate basis. Each loss incurred reduces the policy limit remaining for the rest of the policy year.

action was required, but coverage was bound in time to permit the GPU system to consummate its financing arrangements.

A further illustration of the need to preserve independent markets is found in the basic distinction between NML and ANI/MAERP: assessable policies versus guaranteed cost insurance. NML's financial resources are based heavily on the ability to obtain funds from its insureds, by a call for retrospective premium adjustment, if and when needed. By contrast, once premium for a policy has been paid, ANI/MAERP has virtually no interest in the financial condition of the insured. In any case where NML may be forced to decide, no matter how reluctantly, that a given utility cannot meet its financial responsibility standards, ANI/MAERP would be available as an alternate market.

2. Impact of Competition on Capacity

From 1957 to 1972, ANI/MAERP was the sole source of nuclear property insurance. During that fifteen year period policy limits increased modestly, from $63.9 million in 1957 to $84 million in 1971. Following the announcement in 1972 that NML would begin business on January 1, 1973 with a $100 million policy, the limits offered by ANI/MAERP also rose to $100 million, the largest increase in any single year up to that time. From 1972 through 1978, both insurers successively increased policy limits and were offering coverage of $300 million in 1979, before the Three Mile Island accident. In the three years following, NML increased its limits to $375 million, then $450 million, and now to $500 million. ANI/MAERP, in each case, followed closely in its policy limit increases.* With ANI/MAERP as the sole market, policy limits increased some 30 percent from 1957 to 1972. With the entry of NML, capacity increased nearly 500 percent from 1972 to 1982. While other factors -- inflation and TMI -- have played a role, there can be little doubt that the competitive pressures exerted by the presence of two insurers in the field have had a significant impact on ANI/MAERP's efforts to generate capacity.

3. Impact of Competition on Engineering Standards, Policy Terms and Cost

Competition between ANI/MAERP and NML has had a beneficial effect in other areas as well. The start-up of NML in 1973 led to the establishment of an Engineering Advisory Committee of the member insureds of NML, whose purpose is to advise NML on the establishment of its rating system, property loss prevention standards and related engineering and technical matters. The existence of this group of high level industry engineers working together to limit the group's loss experience

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* ANI/MAERP now offers $460 million, but has announced its intention to reach $500 million by year's end.

has had a beneficial impact on loss control technology and plant reliability. Similarly, the establishment of an Insurance Advisory Committee of NML's member insureds, which advises NML on matters affecting the scope of policy coverage, has helped make NML's coverage highly responsive to its members' needs.

NML and ANI/MAERP each have sought to adapt their coverages to reflect improvements -- in loss prevention standards or greater protection for the insured -- made by the other insurer. The insureds and the industry have benefitted.

For the sake of completeness, it should be mentioned that competition has also had a healthy impact on the cost of nuclear property insurance. For example, ANI/MAERP did not introduce the Nuclear Property Insurance Industry Experience Guide until 1972, by which time it was apparent that NML was entering the market.*

4. Antitrust Considerations

NML and its utility members have opposed joint operations with ANI/MAERP both because of the anticompetitive impact such an agreement would have on the nuclear property

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* Long Report at 19, fn. 2.

insurance market and because of the legal risks, under antitrust law, of such an agreement.

With respect to the legal risks, we note that, contrary to the assumption made in the Long Report,* NML is not immune to the strictures of United States antitrust law. Activities of foreign companies which have a significant impact on interstate commerce clearly are subject to scrutiny.** Because of the anticompetitive effects of active or passive collaboration between ANI/MAERP and NML, and because an agreement between them could effectively force utilities to buy coverage from both, there is a serious risk that any agreement would be characterized as a "contract, combination or conspiracy . . . in restraint of trade," in violation of Section 1 of the Sherman Act. The argument that increasing insurance capacity has a socially beneficial effect would not excuse a Section 1 violation.*** In addition, such an agreement would not be protected by the McCarran-Ferguson Act's exemption from the antitrust laws for companies engaged in the business of insurance because one of the parties, NML, is not

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* Id. at 94.

** United States v. Aluminum Co. of America, 148 F.2d 416, 443 (2d Cir. 1945).

*** Standard Oil Co. of N.J. v. United States, 221 U.S. States 1 (1911).

subject to state regulation in the manner required by the McCarran-Ferguson Act.*

The NRC should not compel indirectly by regulation of operating licensees that which ANI/MAERP and NML may not agree to do voluntarily. In doing so, the NRC would be thwarting the congressional purposes of the antitrust laws, and encouraging the anticompetitive effects described above. Such action by the NRC would also risk creation of additional antitrust difficulty. With ANI/MAERP and NML providing joint coverage on each risk, lack of coordination, in areas such as loss adjustment or inspection, would be highly disruptive. Yet any agreement between ANI/MAERP and NML to use the same adjusters or inspectors also risks antitrust violations.**

5. Long-Term Capacity Growth

Perhaps the most questionable aspect of mandating the purchase of insurance from both sources as a means of enhancing capacity is with regard to long-term growth. The competitive pressures which have provided the impetus for capacity growth would be eliminated.

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* F.T.C. v. Travelers Health Association, 362 U.S. 293 (1960).

** See, e.g., United States v. General Motors Corp., 384 U.S. 127 (1966).

In addition, a change in the composition of NML's membership could have an adverse impact on NML's capacity growth. The Long Report fails to give full weight to the significant difference in business judgment with respect to risk assumption which led some 14 operating licensees to form NML in 1972, and all others to decide to remain insured by ANI/MAERP. The ANI/MAERP insured prefers a fixed premium, thus avoiding any exposure in the event of a loss to another. The NML insured seeks to pay premium which -- over the course of time -- is no more and no less than the amount required to pay for the aggregate of the actual losses and related expenses of all NML insureds. Losses exceeding premium income and earnings thereon must be met through payment of retrospective premiums. The willingness to do the latter, through a commitment to pay up to 14 times a full year's premium if losses so require, in large measure delimits the group willing to participate in NML. It explains the reluctance of many utilities to participate in an assessment mutual when a fixed premium alternative is available.

The willingness to assume the risk of assessment has significantly shaped the growth in NML capacity. Over the years, as its premium volume steadily grew,* NML's members

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* Through completion of new units, and growth in insurable values, not through membership increases. Except for the special case of GPU which joined NML in 1979 (<u>see</u> above, p. 5), NML added its first new utility members in 1982.

have consistently elected to keep the assessment multiple at 14, placing the increased resources available behind capacity increases rather than utilizing them to lower the multiple.* If current non-members are forced into NML, their aversion to such assessment risk would presumably reflect itself in NML's future capacity development. The group of new entrants is large enough, it should be noted, so that it could control NML's course: Members' voting rights are calculated by reference to annual premiums paid. Aggregate premium of the new members could exceed that of present members.

B. Short Term Impact on Capacity

It may be reasonable to assume that some increase in capacity would result were purchase to be mandated from both NML and ANI/MAERP. The assumption that this would lead to a mathematical addition of capacity offered by each, however, fails to consider the source of NML's financial resources available to pay claims. While the resources represented by reinsurance and accumulated surplus are significant, NML's primary resources are current premiums and the retrospective premium adjustments which are callable from its member insureds.

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* The Business Insurance article cited by Dr. Long, Long Report at 51 n., which stated that NML has reduced its multiple, is incorrect.

If, as suggested, NML were required to discount its premiums to recognize the purchase by its members of insurance from ANI/MAERP, both NML's premium income and thus the amount of retrospective premium adjustment callable from each present member would be reduced.*

While the compulsory purchase of insurance from NML by all ANI/MAERP insureds would generate premium which would offset these reductions, the approximate doubling of the number of sites insured can be expected to double the frequency of losses. Without a substantial increase in aggregate premium and retro- spective premium resources, NML can only write coverage on twice as many sites if its exposure per site is proportionately reduced.** Thus, were the Long Report's recommendation to be adopted, NML would have no choice but to reduce its policy limits or risk seriously jeopardizing its financial stability.

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* See Section C, page 16, below for more detailed discussion of the propriety of mandating premium discounts.

** The issue is one of conservatism. Were NML and ANI/MAERP jointly to provide $1 billion in capacity, NML's exposure in frequency to losses of $500 million or less would double, but it would pay only one-half of each loss. The exposure to full policy losses would also double, without a corresponding increase in resources available to cover such losses.

As the Long Report notes, reinsurance available to NML and ANI/MAERP would probably diminish. Many of the reinsurers who participate in NML's reinsurance program are also reinsurers of the ANI/MAERP program. Were both NML and ANI/MAERP to provide coverage on the same plants, the exposure of these reinsurers would be increased. A number of such reinsurers have advised NML that they do not wish to accept such double exposure since the effect would be to increase their committment to nuclear risks beyond the level they are prepared to accept. To the extent that either NML or ANI/MAERP loses reinsurance as a result of their providing coverage on the same plants, capacity would be less than the sum of their individual capacities.

The disposition of NML's accumulated surplus - at $146.6 million* an important element of its financial resources - presents a problem of significance if all operating licensees not currently NML members were required to become member insureds. The surplus results from premium payments made by present members, and benefits all insureds. Were there to be a large number of new members, an equitable adjustment would be required. The two alternatives available to NML are both troublesome: New members could be required to invest a pro-rata amount of capital as a contribution to surplus, which

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* Based on unaudited financial statements for the seven months ending July 31, 1982.

would imply indirectly mandating an investment of some $170 million.* Alternatively, the surplus could be distributed to present members before new members join. This would permit all members to participate on equal footing, but is clearly undesirable in terms of NML's financial strength and would make it impossible for NML to write insurance at current levels. While NML has accepted a limited number of new members without dealing with this issue, the addition of a large group of new members at one time would require that the issue be resolved.

The growth in capacity from the two principal sources of insurance over the past three years has been dramatic and significant - from $450 million to $932 million** in the last nine months alone. It is now necessary to plan the next stage of sound orderly expansion. All involved are conscious of the need for continued growth and have the will to work for it.

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* NML currently insures 29 nuclear sites, including 36 units with operating licenses. ANI/MAERP insures 34 sites, including 39 units with operating licenses. If one assumes that NML and ANI/MAERP have the same "average" premium per operating unit, approximately $170 million would be required from the new members to preserve current surplus "ownership" ratios.

** A utility may accumulate $932 million in coverage by purchasing: (1) primary property insurance from NML, which offers coverage of $500 million (ANI/MAERP currently offers coverage of $460 million but expects to offer $500 million by year end); (2) excess property insurance from Nuclear Electric Insurance Limited ("NEIL"), which offers coverage of $365 million excess of $500 million in the event of a full policy loss; and (3) excess property insurance from ANI/MAERP, which offers coverage of 13.4 percent of any loss in excess of $500 million, with the maximum recovery limited to $67 million.

Mandating a change in the present approach is unwarranted. At any capacity level, combining primary coverage from separate insurers may lead to some short term increase in capacity. As has been shown by the discussion above, the amount to be gained is uncertain and the consequences of mandating such action - in terms of long term growth - problematic.

C. Premium Discounts for Combined Coverage

To the extent the Long Report views NML's concern about reducing its premiums, in cases where other insurance is purchased on the same risk, as intransigence or discrimination, there is a serious misapprehension involved. Conventional insurers risk their assets when assuming a risk and calculate their premiums so as to be adequate to cover expected losses, overhead and a reasonable profit. No single insurance company places a significant portion of its assets at risk in the event of a loss; if losses exceed premiums, there is still no significant diminution in the assets of any individual insurer. When a year is closed, any profit is retained by the insurer; if there are losses, they may occasion an increase in future premium or, perhaps, withdrawal from the market.

NML, by contrast, represents an agreement by its participants to commit limited resources to cover losses within the group. Premiums and potential retrospective assessments provide the asset pool available to pay each year's potential losses.* The level of premium charged is basically <u>only</u> relevant to determining the level of conservatism desired: assets available to pay losses are determined by amount of premium charged. If premiums are set too high, the members have erred on the side of conservatism; the "excess" payment, however, goes into surplus or is distributed as a dividend and thus benefits the members of the group. If too high when paid to ANI/MAERP they benefit the profits of the pool's participants, but are lost to the insureds.**

These considerations apply regardless of the absolute level of premiums; the emphasis on a discount or its absence is misplaced. The premiums paid to NML are not directly comparable to the premiums paid to ANI/MAERP. In short, there is no need or propriety in requiring the premium established by an assessment mutual to be identical to that charged by the commercial insurance market.

It is also extremely difficult to see merit in the argument that failure to "discount" has any significant impact on willingness to purchase dual coverage. Clearly, the primary

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* Reinsurance and accumulated surplus provide an important, but subsidiary, source.

** It should be noted that favorable loss experience could result in a reduction of future premiums through the Nuclear Property Insurance Industry Experience Guide.

reason ANI/MAERP insureds do not purchase NML coverage is their reluctance to accept the obligation to pay an assessment of up to 14 times annual premium. NML insureds have had the conviction, described above, that the proper framework for their insurance arrangements is one in which they share losses and costs with other participants, even though that may lead to uncertainties in their annual outlays.

To accomodate the preferences of both groups of insureds, the efforts toward reaching a property insurance capacity of $1 billion or more were directed at establishing a new source of property insurance - excess of both primary insurance carriers - rather than seeking to combine existing programs. The establishment of an excess property insurance program by NEIL not only preserved the competitive structure of the primary insurance market, but also kept the exposure of ANI/MAERP insureds to assessments at a level far below the NML 14 times multiple.

It is also worth noting that the cost of purchasing such coverage from a primary insurer and NEIL is not markedly different from the purchase of coverage from both primary carriers, even with premium discounts. For example, for $500 million coverage for a nuclear plant with a value of $1 billion, NML would currently charge a "base" premium of $2 million, increased to $3.1 million by application of the co-insurance factor. Were ANI/MAERP coverage purchased on the same plant, and if ANI/MAERP's premium calculations were similar,* the co-insurance charge would be eliminated and both insurers, if they fully reflected that fact, would charge on the order of $2 million or $4 million together. In contrast, NEIL's premium for $500 million of excess coverage for a plant valued at $1 billion would be $1.1 million and, when added to the $3.1 million for primary coverage, gives an aggregate premium of $4.2 million.

Given the foregoing considerations, the NRC should be wary of entanglement in the general regulation of insurance rates and practices which the deceptively simple idea of enforcing a discount necessarily entails.

II. Decontamination Priority

Both NML and ANI/MAERP currently provide all-risk property insurance in the primary policies. They insure against radioactive contamination and all other risks of direct physical loss, with exclusions not here relevant. The insurance as written specifically covers "expenses necessarily incurred by the Insured(s) in removing debris of and in decontaminating the property covered by this Policy following direct physical

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* An assumption, since not known to NML.

damage to such property caused by any peril not excluded hereunder."

These policies do not order the priority of claim payments. By contrast, the NRC will wish to note that NEIL has announced that it will issue a new excess policy, giving priority to payment of decontamination losses, on November 15, 1982. NML does not believe that a similar change is desirable for the primary insurance coverage.

To understand the reason for this view, a description of the interrelationship between utility trust indenture requirements and property insurance is necessary. Briefly summarized, utilities are required under standard trust indentures to carry such insurance on their mortgaged property as is customary among utilities similarly situated. The proceeds of all insurance covering the mortgaged property are required to be paid directly to the trustee for the bondholders in the event of loss. The trustee, however, must release the proceeds to the utility to the extent that such proceeds are needed to repair, replace or restore the damaged property. Where the utility plans to restore its damaged plant to service, expenses incurred in decontaminating the damaged property are treated as expenditures necessary to repair, replace or restore. Thus, in such cases, insurance proceeds would routinely be available for decontamination which, logically, would precede both repairs or replacement of damaged property. It is only in the case where restoration of the damaged unit to service is not planned or possible that policy proceeds are paid to <u>and remain</u> with the trustee.*

There are two basic reasons not to require change in the present primary coverage to meet this special case. First, for many possible loss scenarios, limiting first use of insurance proceeds to decontamination expense may rob the insurance mechanism of needed flexibility. It is extremely difficult to predict what application of insurance funds may be needed to best place a utility in position to deal safely and expeditiously with the aftermath of an accident. There is risk inherent in structuring <u>all</u> insurance coverage by reference to the accident at Three Mile Island.

Second, billions of dollars for financing nuclear power plants have been raised on the footing that property insurance proceeds are available either to repair or replace damaged property, or to serve as substitute assets if repair or replacement is not undertaken.

The system which will be in place by the end of this year offers the most desirable combination of protection

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* Under some indentures, insurance proceeds may be recoverable if the utility certifies property additions.

coupled with flexibility. The primary insurers -- NML and ANI/MAERP -- offer $500 million of coverage available to pay decontamination costs and all other costs of repair and replacement. NEIL's excess program* will offer the next $500 million, giving priority to decontamination claims, if needed, and otherwise also making funds available for further costs of repair and replacement.

It is important to recognize that NEIL's policy would, if required, pay the "first dollar" of decontamination losses if the underlying primary property policy proceeds have been exhausted. In the case of an accident so severe that all such proceeds are retained by the trustee under the terms of the mortgage indenture, NEIL's policy is immediately available to pay any decontamination costs that may be involved. Accordingly, even in this extreme hypothetical case there would be at least $500 million available solely for decontamination expense. Moreover, this amount can reasonably be expected to increase.

III. NRC Questions

In this section we comment briefly upon other aspects of the specific questions raised by the NRC in its "Advance

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* And presumably also that of ANI/MAERP.

notice of proposed rulemaking." No comment is made with respect to Question 4 since it does not affect NML.

1. What dollar limits of property insurance coverage should the NRC require?

We do not believe that the NRC should require specific dollar limits of property insurance coverage. As noted above, a requirement that operating licensees purchase all primary property insurance available from NML and ANI/MAERP is not likely to result in greatly increased coverage.

NML and its members believe that the existence of competition has resulted in the maximum amount of nuclear property insurance capacity and will continue to do so.

2. If the NRC changes its requirements for property insurance, should there be special provisions for certain types of licensees?

While NML has not independently analyzed the potential for lower dollar value losses at small units (i.e., older facilities with lower megawatt output and property values), NML has set premiums in such cases as a function of the lower value of such units. In addition, NML has recognized that decontamination expense may exceed the property value of a given unit and therefore makes available (by endorsement) decontamination coverage up to the maximum policy limit currently offered.

3. To what extent, if any, should the NRC become involved with the structure and terms and conditions of the property insurance offered?

(a) General

We do not comment on the statutory authority of the NRC to become involved in the structure and terms and conditions of nuclear property insurance. We do point out, however, that both the insurance industry, and the utilities through such vehicles as NML and NEIL, have responded rapidly and effectively to the insurance needs of operating licensees.* Unless there are specific advantages to be gained by NRC regulation, we do not believe that the NRC should become involved in the nuclear property insurance area.

However, were NRC involvement deemed appropriate, consideration would need to be given to the resources available to the NRC to develop and maintain the considerable expertise necessary to regulate this area.

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* It is worth noting that the property insurance available to United States operating licensees vastly exceeds that available to utilities anywhere else in the world.

(b) Specific Proposals

We have responded above to the proposals to mandate purchase of all primary insurance capacity and to mandate decontamination priority.* Further comment is appropriate with regard to the Long Report's concerns regarding the soundness of assessment programs. The Long Report views reliance on assessments or retrospective premium adjustments in nuclear property insurance with serious concern.** For example, the Long Report notes that historically (in far different mutual companies involving fire or life insurance) assessable policies have not always worked to provide the resources necessary to pay claims and have encouraged litigation.

Clearly a promise to pay is not the full equivalent of cash in hand. That truism, however, does not automatically condemn a system that combines pre-loss and post-loss funding. NML was established to fill a need when insurance capacity was not increasing as rapidly as many operating licensees thought necessary. NML has established a premium structure designed to collect premiums on a yearly basis adequate to cover normally

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* See pages 19-22 above.

** Long Report at 76-85.

expected losses. In lieu of devoting large amounts to fund unexpectedly severe losses, however, it was structured so that in the event of abnormal loss experience, funds would be available from each utility on a retrospective premium adjustment basis.* Every reasonable effort has been made to assure that member insureds meet standards of financial responsibility adequate to assure that funds will be available if a call need be made. All appropriate steps have been taken to assure that the obligation to meet any call made is legally binding upon each insured.

There are additional reasons for providing an assessment mechanism instead of large capital contributions upon formation of a mutual insurance company such as NML. A number of those reasons are set forth quite succinctly in a report prepared for the NRC entitled "Design, Costs, and Acceptability of an Electric Utility Self-Insurance Pool for Assuring the Adequacy of Funds for Nuclear Power Plant Decommissioning Expense" (NUREG/CR-2370). For example, the report points out that the tax deductibility of payments made as premium versus capital favors the former. The advantages in using an offshore assessment mutual insurance company for a

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* See discussion at pages 16-17.

pooling arrangement in the form of NML are recognized by the report to make this approach the "obvious choice."*

IV. Comments On The Long Report

A. Assumptions Concerning Accumulation of Assessments

In analyzing NML's financial structure, the Long Report postulates a "worst case" situation which deserves comment.** NML requires that each insured undertake responsibility for losses that occur in a policy year during which it is insured. The maximum assessment obligation assumed is 14 times the insured's premium for that year. To deal with situations where the extent of loss, or need for an assessment, cannot be immediately determined, the obligation remains for six years after the end of the year in which the loss occurred. The Long Report's concern is that, if there were to be losses requiring maximum assessment in a number of succeeding years, each member utility could be liable for an alarming amount of aggregate retrospective premium assessment.

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* NUREG/CR-2370 at 5.

** Long Report at 52.

We agree with the footnoted statement in the Long Report that the "situation is farfetched."* Whether or not there has been a covered loss under the NML property insurance policy -- unlike the case in some liability insurance -- can be established with reasonable certainty within a relatively brief period after the close of a policy year. No insured is conceivably going to be faced with a cumulation of Three Mile Island magnitude claims which have both taken place annually and remained undiscovered.

The alternative hypothesis is equally untenable. A steady succession of loss years in which each NML insured suffers a full 14 times premium call -- and patiently continues to remain a member -- stretches credulity.

Nor is the impact of this "worst case" scenario significantly different if postulated for the commercial insurance market. If ANI/MAERP were required to respond to successive losses of equal magnitude over a period of years it is likely that most participating insurers indeed could pay their share of losses. It is equally likely, however, that in such a scenario the insurers and reinsurers would see the loss history as a commercial disaster. Either the insurers and reinsurers would leave the market, or completely and radically revised premiums would be charged.

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* Long Report at 52.

A final comment: In this "worst case" hypothetical it is unrealistic to expect the nuclear industry to continue unchanged if such a series of losses occurred. Rather, the entire industry would reassess its goals, direction and future and the issues of insurance would play only a small part.

B. Disclosure Requirements

The Long Report evidences strong concern with respect to provisions of the NML insurance policy which expressly limit recovery by the insured to NML's available assets.* Rather than being a "revealing indication of insurer philosophy", these disclosures were made for reasons that are totally unrelated to insurance considerations.

It is correct, as the Long Report notes, that available assets define the limit of any insurer's ability to pay in all cases, and that it is not usually necessary to point out the obvious. A conventional insurance company need make no such disclaimer since its assets will be adequate -- under virtually all circumstances -- to pay out the full amount of the policy in question. Such is not the case with NML. The resources of the company are adequate for payment of two full policy losses and no more. It is this which distinguishes the

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* Long Report at 52.

theoretical risk in purchasing NML insurance from the purchase of commercial nuclear property insurance, and if membership in NML is offered, the risk must be disclosed.

The offer of membership in a mutual insurance company, with purchase of its insurance policies, may be deemed to be the offer of a security within the meaning of United States securities laws.* If so, disclosure by NML of its resource limitations is mandated by the disclosure and anti-fraud provisions of the securities laws. Failure to disclose such material information could subject NML to significant civil liability.** Given the crucial role that disclosure plays in the securities markets, it is prudent to disclose the limit of ability to pay. The sole purpose of the language questioned, accordingly, is to make certain that NML has met its obligation fully to disclose risk factors in what may be deemed to be the offering of a security.

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* See the "No Action" letter from the staff of the United States Securities and Exchange Commission regarding NML dated October 27, 1971. This letter does not conclude that there is no "security" involved, but confirms that the staff will not recommend any action if the offering of membership and insurance by NML is not registered under Securities Act of 1933.

** Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934; Sections 11, 12 and 14 of the Securities Act of 1933; see also <u>Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.</u> 495 F.2d 228, 234-36 (2d Cir. 1974); <u>Feit v. Leasco Data Processing Equip. Corp.</u>, 332 F.Supp. 544, 563-68 (E.D.N.Y. 1971).

C. Insurance Regulation and Taxation

The Long Report appraises NML's selection of a foreign domicile as motivated by a desire "to escape" state insurance regulations and "to avoid" federal and state taxes.* This somewhat uncharitable characterization of motives is not warranted by the facts. The primary consideration in selecting a foreign domicile was the fact that NML did not -- and does not -- meet the requirements for standard insurance company financial ratios required by state insurance regulation. NML has limited resources and there is at least the remote risk that an extraordinary series of losses would exhaust its resources. State insurance regulation, charged with protecting the individual insured, is designed to avoid such risk. For example, Section 47 of New York State Insurance Law requires that "no insurer doing business in this state shall expose itself to any loss on any one risk in an amount exceeding 10 percent of its surplus to policy holders."** Thus, were NML to conduct an insurance business in New York State, it could only write its current insurance coverage of $500 million if it had a surplus of $5 billion. The feasibility of NML's establishing such a surplus obviously is unrealistic.

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* Long Report at 22.

** N.Y. Ins. Law § 47 (McKinney 1966 & Supp. 1982).

Once established abroad, it _is_ desirable for NML to so conduct its activities that it is not engaged in a trade or business in the United States. The considerable tax savings which result permit NML to maximize its resources to pay for losses. For the sake of even-handedness, it may be appropriate to point out that ANI/MAERP, as the Long Report notes,* reinsures more than half of the risks it writes through foreign sources, which premium income also "escapes" United States taxation.

It is significant to note that the utility of a Bermuda domicile for risk sharing ventures which do not fit into conventional patterns of United States insurance regulation has been recognized by Congress (in the Product Liability Risk Retention Act of 1981**), by the Department of Health and Human Services (in the Medicare Reimbursement Regulations***), by NUREG/CR-2370 and by ANI/MAERP (in its initial proposal to establish a Bermuda insurer for its excess property insurance program).

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* Long Report at 9.

** 15 U.S.C. § 3901 et seq.

*** _See_ Provider Reimbursement Manual, Part I, § 2162.2, regarding "Insurance Purchased from a Limited Purpose Insurance Company."

NML appreciates the opportunity to comment on these issues.

Respectfully submitted,

BAKER & McKENZIE

By: Peter D. Lederer

Peter D. Lederer

ATTACHMENT A

NUCLEAR MUTUAL LIMITED

Member Insureds

Alabama Power Company

Carolina Power & Light Company

City of Anaheim

City of Riverside

Commonwealth Edison Company

Consolidated Edison Company of New York, Inc.

Consumers Power Company

Duke Power Company

Florida Power & Light Company

Georgia Power Company

Iowa-Illinois Gas and Electric Company

Jersey Central Power & Light Company

Middle South Energy, Inc.

Pacific Gas and Electric Company

Public Service Electric and Gas Company

San Diego Gas & Electric Company

Southern California Edison Company

Tennessee Valley Authority

Wisconsin Electric Power Company