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May 24, 1988

BY MESSENGER

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Re: Alabama Power Company
Joseph M. Farley Nuclear Plant, Units 1 and 2
Docket Nos. 50-348A, 50-364A

Dear Mr. Vogler:

I. Introduction

This responds to the April 29, 1988 letter from counsel for Alabama Electric Cooperative, Inc. ("AEC") which objects to the proposal submitted by Alabama Power Company ("APCO") to the NRC on January 25, 1988, a proposal which at long last would resolve the issue of the terms of APCO's offer of sale of an ownership interest in Plant Farley.

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That proposal would provide for AEC to become an owner of Plant Farley with the same benefits and risks as APCO. The benefits include the low cost of Farley capacity and energy. The risks include the unlikely but potentially enormous costs that could arise in the event a catastrophe or some other unforeseen circumstance renders Plant Farley an economic liability rather than an asset. The subordinated guarantees proposed by APCO provide a relatively modest form of assurance that AEC will not leave APCO stuck with AEC's share of those costs, and reflect the culmination of a negotiating process that has gone on for many years.

AEC's response is to condemn the proposal categorically; accuse the NRC's enforcement staff of being APCO's "unwitting tool"; charge that any provisions which assure that AEC will honor its ownership obligations in the future are contrary to "antitrust policy"; and propose that, at most, AEC should only have to provide a Letter of Credit for five percent of its gross investment in the plant, a patently inadequate amount. AEC thus would sweep aside all of the past history of this case, including the last four years of negotiations which have led to the settlement proposal, and re-negotiate and re-litigate the issues. The time has come to resolve this matter, not to begin the process all over again. 1/

1/ As APCO has pointed out in previous submissions, AEC has every incentive to prolong this matter. Currently, there are alternative power sources available to AEC that are less (footnote continued)

The antitrust policy issues in this case were decided by the Appeal Board which imposed License Conditions decreeing that APCO must be paid its "total costs," including all costs of ownership, in any purchase of a share of Plant Farley. 2/ The Eleventh Circuit affirmed on the basis that APCO would not be required in any way to subsidize participation in Plant Farley by AEC. 3/ The issue here is whether it is unreasonable for APCO to insist on terms which assure, as the License Conditions require, that APCO will be paid for AEC's share of total costs. AEC's letter once again confirms that it is unwilling to commit to pay those costs if the downside risks of Plant Farley ownership come to pass. 4/

(footnote continued from previous page)
costly than Plant Farley although in the 1990s this situation might change. See APCO's Response to the Notice of Violation (Aug. 27, 1986 at 11-12.) AEC thus would prefer to delay indefinitely making a decision on purchasing Farley and in the interim use the possibility of such a purchase as bargaining leverage in negotiating with other power suppliers.

2/ Alabama Power Co. (Joseph M. Farley Nuclear Plant, Units 1 and 2), ALAB-646, 13 NRC 1027, 1112 (1981).

3/ Alabama Power Co. v. NRC, 692 F.2d 1362, 1367 (11th Cir. 1982), cert. denied, 464 U.S. 816 (1983).

4/ Indeed, it is AEC's position that is fundamentally inimical to the policies of the antitrust laws. Under antitrust policy no firm is entitled to share the benefits of a productive activity with another firm unless it also shares the economic risks. Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 281 (2d Cir. 1979). See also Olympia Equipment Leasing Co. v. Western Union Telegraph Co., 797 F.2d 370, 375-76 (7th Cir. 1986). Moreover, under the antitrust laws, AEC and its members are regarded as one entity. City of Mt. Pleasant, Iowa v. Associated Elec.
(footnote continued)

Rather than address its unwillingness to provide any reasonable assurance that it will honor its commitment to pay these costs, AEC seeks refuge in the Notice of Violation as if the Notice somehow controlled the Staff's action now. The Commission's regulations are to the contrary. APCO's proposal if accepted by the NRC would settle the matters raised in the Notice and result in the dismissal of this proceeding. AEC would then have to decide whether to purchase an interest in Farley or not, and would no longer be able to prolong these proceedings.

II. Guarantee

Apart from the now familiar litany that guarantees are novel and viscerally displeasing to AEC and its members, AEC makes two arguments.

The first argument, based on a letter by Mr. Bennett of the REA, is that the "credit worthiness of the power supply borrower" would be undermined because the guarantee "would apparently not be subordinate to the distribution cooperatives' obligations pursuant to their AEP [sic] wholesale power contract." (Bennett Letter, at 1). That, of course, is wrong, as would be apparent to virtually any lawyer with even passing acquaintance with creditors' rights. A distribution coopera-

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Coop., Inc., 838 F.2d 268, 276-77 (8th Cir. 1988) (the cooperative organization and its members constitute "a single enterprise"); Greensboro Lumber Co. v. Georgia Power Co., 643 F. Supp. 1345, 1367 (N.D. Ga. 1986). To be meaningful, a commitment must bind the enterprise.

tive's payments under a power supply contract are operating expenses, which take priority over the rights of unsecured creditors, e.g., guarantee holders.

APCO is prepared to acknowledge what it thought was obvious: that the guarantees would be subordinate to any right to payment that AEC is found to have under its wholesale power contract with a distribution cooperative. 5/

The second argument, stated in various ways in each of the Affidavits submitted by AEC, is that by executing guarantees the distribution cooperatives would weaken their own financial condition and perhaps be able to borrow less money in the future. Thus, AEC's arguments in opposition to the guarantees have now turned around one hundred eighty degrees. On the one hand, it has argued that the guarantees are unneeded, because the wholesale power contracts with AEC provide full assurance that the distribution cooperatives will meet their obligations. APCO has demonstrated, in an earlier submittal, that private lenders in fact are not willing to commit funds solely on the security of the contracts, but require backup guarantees either by the REA or by the CFC, an entity with some $1.147 billion of equity capital. That submittal dated August 12, 1986 is attached for your

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5/ The issue is spurious in any event. The purpose of the guarantee is to address a situation in which AEC is unable to pay APCO. This would occur only when AEC, in turn, is not paid by the distribution cooperatives. There is no reason why APCO would interfere with a distribution cooperative's performance of its contract with AEC, even if it could do so.

reference as Appendix A. On the other hand, AEC now contends that execution of the guarantees would impose significant new obligations on the distribution cooperatives.

Obviously, both of these claims cannot be valid. The simple, and we believe conclusive, answer to the argument made now by AEC is that the guarantees amount to nothing more than additional legal assurance that the distribution cooperatives will make payments that AEC contends they already are obligated to make. If putting that obligation in writing, and disclosing it plainly to potential lenders, means that the distribution cooperatives will only be able to borrow in the future to the extent consistent with their ability to meet their existing obligations, that appears to be a commercially reasonable, and indeed salutary, result. This is confirmed in the Affidavits of Mr. Phillip Kron, Vice President of Citibank, and Mr. John Huneke, Principal in the Public Utility Group at Morgan Stanley & Co. Incorporated, submitted herewith as Appendices B and C. 6/

6/ In the words of Mr. Kron, a man experienced with the financial difficulties faced by Cajun Electric Power Cooperative and other cooperative associations:

> The collateral value of AEC's Members continues to be only as good as their ability to recover the cost of electric service through rates; thus, when assessing the creditworthiness of AEC's Members, a lender must review all of the cooperatives' obligations and their ability to raise rates, if necessary, to meet these obligations. The obligation to pay Farley ownership costs either exists or it does not. If it exists, then a lender will take it into account in determining

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Thus, the arguments made by AEC, and which form the basis for the concerns expressed in the letters attached to AEC's letters, ultimately lack substance. The plain fact is that the wholesale power contracts between distribution cooperatives and generation and transmission ("G&T") cooperatives have proven themselves inadequate where extraordinary nuclear plant costs are involved. 7/ States have asserted the authority to deny G&T cooperatives recovery of those costs; 8/ some cooperatives have sought refuge in bankruptcy; 9/ and others have massively

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creditworthiness, as it would and should for any other owner of a nuclear plant. In other words, the guarantees are merely a confirmation in writing of an obligation that AEC states already exists and lenders will understand this. Once the obligation exists, the guarantee is immaterial to credit standing. Appendix B at 8.

7/ AEC's claim that acceptance of the subordinated guarantees here will somehow bind all future transactions is even more specious. Most cooperative financing now is provided through the REA or the CFC both of which already require more security than APCO seeks. With respect to private lenders, bankers are not lemmings and banking is a highly competitive business. Private lenders dealing with cooperatives in the future will individually assess the merits of proposed transactions and act accordingly. See Kron Affidavit, Appendix B at 9-10.

8/ See, e.g., In re Petition of Wabash Valley Power Ass'n, Inc. for Approval of a Change in Its Rates and Charges for Elec. Service to Its Member Systems, Cause No. 37472 (Ind. Public Service Comm'n Jan. 14, 1987) (LEXIS, States library, Inpuc File).

9/ Two examples are Wabash Valley and Washington-St. Tammany. Wabash Valley Power Association, a participant in the Marble Hill nuclear plant, filed for bankruptcy on May 23, 1985. See 1985 Form 10-K of the National Rural Utilities
(footnote continued)

defaulted on their obligations. 10/

Indeed, the inadequacy of the wholesale power contracts in light of these developments has been described by AEC's own witness. AEC submits a letter from Mr. Edmiston of Shearson Lehman Hutton concerning the possible effect of the proposed subordinated guarantees. However, in another proceeding not involving their long-time client CFC, Shearson Lehman Hutton has recently provided testimony, through Mr. Edmiston's colleague, S. Paul Kovich, opining that anyone relying on the financial obligations of a cooperative association should have such

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Cooperative Finance Corp. at 15. Washington-St Tammany is a member co-op that has declared bankruptcy and seeks to reject its power sale agreement with Cajun Electric Power Co-op out of displeasure over the costs of Cajun's investment in the River Bend Nuclear plant. See Louisiana Co-op to Seek Chapter 11; Fears Nuclear-Related Rate Impacts, Elec. Util. Wk., June 22, 1987, at 1,4.

10/ For example, in 1985 Big Rivers Electric Corporation defaulted on REA-guaranteed loans used to construct a coal plant when the cooperative discovered it could not use the additional capacity. See 1985 Form 10-K of the National Rural Utilities Cooperative Finance Corp. at 15; see also Starr, Uncle Sam Pulls the Plug on a Rural Cooperative, Bus. Wk., Feb. 4, 1985. The financial problems of Cajun Electric, are discussed in the attached Affidavit of Mr. Kron (Appendix B). Other financially-troubled co-ops, reportedly on the verge of bankruptcy, include Vermont Electric Cooperative and Sunflower Electric Cooperative. See UPI Press Release, May 14, 1987; Vermont Elec. Coop. Averts Bankruptcy Following REA Assurances, Elec. Util. Wk., Sept. 1, 1986, at 3; Sunflower Debt Reworking Okayed By Kansas Regulators; Still Big Ifs, Elec. Util. Wk., March 21, 1988, at 6-7.

guarantees. 11/ Mr. Kovich provided valuation testimony in the bankruptcy proceedings concerning Wabash Valley. He stated that his approach was to evaluate Wabash Valley as if he were determining its value to a private investor, and indicated that the value of Wabash Valley would be dependent upon the extent to which the investor could rely on the distribution members. He stressed that before providing a disclosure statement to potential investors:

> I would ask Wabash, request Wabash strenuously to go back and try to have those contracts either reaffirmed or guaranteed by its members, to do something to bind those distribution members even more tightly to Wabash than is currently evidenced by the contracts that exist. (Appendix D at 25.)

Thus, AEC's own witnesses, when testifying objectively, have indicated that a party relying on a cooperative association for financial obligations in today's world needs "to do something" to obtain the guarantees of the distribution members. Significantly, nowhere in AEC's Letter and various attachments is it disputed that, without such guarantees, APCO may be such with AEC's share of Farley costs.

Under the applicable License Conditions, APCO is entitled to reasonable contractual provisions to assure that the Farley obligations undertaken by AEC, a thinly-capitalized corporate shell acting for the benefit of its member distribution

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11/ The pertinent portions of Mr. Kovich's testimony are submitted herewith as Appendix D.

cooperatives, will actually be performed. The heavily subordinated guarantees described in the settlement proposal, and as clarified above, clearly meet this criterion. 12/

III. AEC's Letter of Credit Proposal

For the last four years AEC has adamantly refused even to sit at the bargaining table and discuss, much less negotiate about, contractual provisions assuring APCO that it would not be left holding the bag for AEC's share of Farley ownership costs in the event that circumstances render Farley an economic liabil ty. In the face of this intransigence, APCO and the NRC staff in good faith, and over a considerable period of time, have developed a settlement agreement which equitably resolves the matters in the Notice of Violation. The guarantee agreed upon provides APCO with a relatively modest form of assurance that AEC will honor its obligations both for better and for worse.

Now, at the eleventh hour, and more than three months after it received APCO's proposal, AEC responds with a Letter of Credit proposal that only confirms explicitly what its refusal to negotiate for four years has already made clear -- AEC has no intention of assuring APCO that AEC will pay its ownership costs if the negative risks of Plant Farley ownership becomes a reality. While no one today can quantify those risks with precision, they are known to be of potentially enormous

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12/ The Affidavits of Mr. Kron and Mr. Huneke provide elaboration on APCO's need for the assurances the guarantees provide. See Appendices B and C.

magnitude. The Three Mile Island accident resulted in costs which exceeded insurance coverages by over a billion dollars. 13/ AEC's share of such a liability would be over $60 million. AEC's proposal that it provide a Letter of Credit for five percent of its gross investment, i.e., approximately $5-6 million, is so blatantly inadequate in light of the magnitude of the potential liability that even had AEC proposed it four years ago when asked to negotiate in good faith on the matter, it would not have been a reasonable point of departure for fruitful negotiations. Offered now at a point where the matter, in fairness, must be finally concluded, this knowingly inadequate "proposal" should be regarded for what it is--another dilatory tactic by AEC. 14/

13/ Nine years of inflation, of course, would make this number far larger in terms of today's dollars.

14/ In an apparent effort to renegotiate still another matter, Mr. MacGuineas, in footnote 3 of his letter, for the first time expresses dissatisfaction with the method by which each joint owner's responsibility for decommissioning costs of the plant will be determined. This is a matter not raised in AEC's request for enforcement action or in any of AEC's numerous pleadings submitted in the last several years, and has been only challenged now that AEC perceives that a settlement is imminent. That AEC never previously deemed this objection credible is not surprising. The proposal for sale and the discussions between the parties have always been based on the purchase price being reduced by the entire amount of the depreciation recorded by Alabama Power and the plant. This includes the effect of the "negative salvage value" amount by which the net book cost of AEC's projected ownership share has been reduced.

If anything is plain from AEC's Response, it is that AEC has no intention of ever accepting the risks of nuclear power plant ownership and seeks to be bestowed only the benefits. The License Conditions make it clear that such an approach is invalid.

Conclusion

The Director should affirm the settlement proposal negotiated between APCO and the NRC staff and bring this seemingly interminable matter to an end.

Respectfully submitted,

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