PROPOSED RULE PR 50
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USNRC

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June 30, 1988

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

Re: 10 CFR Section 50.54 (w)
Property Insurance Requirements for
NRC Licensed Nuclear Power Plants

Dear Sirs:

The Committee on Nuclear Technology and Law of the Association of the Bar of the City of New York wishes to comment on the above-referenced rule (the "Rule"), which was issued on July 31, 1987, 52 Fed. Reg. 28963. 49 FR

The Committee has long supported the position that the Commission's regulations and policies should provide assurance that sufficient funds will be available to stabilize and decontaminate a damaged nuclear reactor to the extent necessary to protect public health and safety. Despite the changes made to the 1984 Proposed Rule, however, we believe that the Rule in its present form may not fully achieve the Commission's objective. We are concerned that because the Rule continues to refer to onsite "property"

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insurance, it still does not adequately deal with potential claims on insurance proceeds by the indenture trustee. We therefore urge that the Commission give consideration to further revising the Rule so as to require licensees to purchase insurance for the "liability" or "obligation" to stabilize and decontaminate a damaged reactor. For the reasons discussed below, the Rule should not refer to insurance intended to protect the mortgaged property.

We are also concerned that exclusive reliance on a special trust to avoid the creditors' claims in the event of a bankrupt licensee may be unnecessarily restrictive and may foreclose viable alternatives. We suggest that the Commission give further consideration to accepting alternate methods of providing assurance that the insurance proceeds necessary for stabilization and decontamination will not be subject to the claims of such creditors.

I. BACKGROUND

Since the accident at Three Mile Island, the Commission had wrestled with various mechanisms for ensuring that sufficient funds will be available to stabilize and decontaminate a nuclear reactor following an accident. Much of the discussion on this matter has focused on the amount of onsite property damage insurance available and on concern regarding possible competing claims on the proceeds of such insurance.

Commission's Advance Notice of Proposed Rulemaking on Mandatory Property Insurance for Decontamination of Nuclear Reactors (47 Fed. Reg. 27371) (the "1982 Advance Notice"), the Commission asked, among other things, whether "it should require that all proceeds from property insurance be used to pay for decontamination after an accident before claims of creditors and owners are satisfied. . . ." 47 Fed. Reg. at 27372-73. By letter dated September 22, 1982 (the "1982 Committee Letter"), we urged the Commission to require that onsite property insurance policies provide for a decontamination priority to the extent necessary to protect public health and safety.

The Commission issued a proposed rule in 1984 entitled Changes in Property Insurance Requirements for NRC Licensed Nuclear Power Plants (49 Fed. Reg. 44654) (the "1984 Proposed Rule"). The 1984 Proposed Rule would have required that licensees purchase at least $1.02 billion of property insurance, and that the insurance contain the decontamination priority suggested by the Committee.

By letter dated February 5, 1985 (the "1985 Committee Letter"), we noted that the 1984 Proposed Rule might not effectively provide for the priority sought by the Commission. We reiterated concerns expressed in the 1982 Committee Letter that the indenture trustee might not release funds to the utility for decontamination, and expressed new concerns that in the event of a bankruptcy,

payment directly to the utility would not sufficiently insulate the insurance proceeds from claims of creditors. 1985 Committee Letter, at 4-5. We recommended that the Commission require licensees to obtain liability insurance to cover their liability to decontaminate a reactor. We suggested a policy similar to the excess policy used by Nuclear Electric Insurance Limited ("NEIL"). We also recommended that the Commission require the insurance proceeds be paid to a separate trust established to pay for the decontamination.

The Commission has now issued the Rule in final form. It requires that a licensee obtain on site property damage insurance of at least $1.06 billion. Licensees can comply with the Rule by purchasing the maximum amount of insurance offered by either of the primary insurers plus the excess insurance coverage offered by NEIL.

The Rule also requires that the proceeds of the property insurance be used first to stabilize the reactor. After the reactor has been stabilized, the licensee must submit a cleanup plan identifying the operations necessary to restart the reactor or bring it to the point of decommissioning. If the Commission so orders, all insurance proceeds not used to stabilize the reactor must first be used to carry out the cleanup operations described in the Commission's order. The Rule also requires that property insurance proceeds subject to the decontamination priority

must be paid to a separate trust established solely to pay the costs incurred in decontaminating the reactor and removing radioactive debris.

The trust and decontamination priority provisions of the Rule are intended to avoid possible competing claims on the proceeds of onsite property insurance. In particular, the Commission has expressed concern regarding claims of the trustee under the utility's mortgage indenture and the claims which may arise in connection with the insolvency or bankruptcy of the utility.

After reviewing the Rule, we conclude that it still does not deal adequately with potential competing claims on insurance proceeds, and thus may fall short of achieving the Commission's fundamental objective -- to provide assurance that sufficient funds will be available to stabilize and decontaminate a damaged reactor.

II. DISCUSSION

1. Indenture Trustee Issue

The standard utility mortgage indenture requires that the utility maintain such property insurance as is maintained by similar companies operating similar properties. In the 1982 Committee Letter we stated that in our view a policy provision specifying a decontamination

priority would not violate the standard uitility mortgage indenture, noting that this provision of the indenture does not give the bondholder any vested rights to a given amount or type of insurance. We restated our view in the 1985 Committee Letter. The Commission, in its notice of rulemaking, concurred with our comments. 52 Fed. Reg. at 28969.

The standard utility mortgage indenture does require, however, that the proceeds of any property insurance which the utility does purchase (even though it may not be required to do so), must be paid in the first instance to the indenture trustee. In the 1985 Committee Letter, we pointed out that requiring payment of property insurance proceeds to an entity other than the indenture trustee would violate this provision of the mortgage indenture. In order to avoid this problem we suggested the use of insurance covering non-property risks, referring specifically to the hybrid form of liability/property insurance policy offered by NEIL. We stated:

> "[U]tility indentures generally require the utility to maintain in force property insurance to the same extent as companies similarly situated and operating like properties, and not a particular level of coverage. We therefore believe that the present form of primary property insurance policy would have to be modified along the lines of the NEIL II excess policy to become something of a hybrid decontamination liability and property insurance policy. Otherwise as a pure property insurance policy, the proceeds must, according to

> the indenture, be paid to the indenture trustee. By specifying coverage for decontamination liability as distinct from property damage, we believe that the NEIL II approach overcomes the utility indenture problem discussed above." 1985 Committee Letter, at 14.

The decontamination liability insurance approach overcomes the indenture trustee problem because the insurance coverage for the licensee's liability to decontaminate does not constitute "insurance on the mortgaged property." Instead, this coverage insures against the risk that the licensee will be liable to pay decontamination expenses. Thus, because the insurance protects the licensee and not the property, the indenture trustee should not have a claim on the insurance proceeds.*

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* In our 1982 Letter we advised that some nuclear fuel financing agreements require utilities to maintain nuclear property damage insurance which creates a priority of payment in favor of the lessor of the fuel. We noted that ordering a priority for decontamination in the property policy would directly conflict with such leases. Ordering such a priority either in a liability insurance policy or the liability coverage of a "hybrid" policy should not conflict with those leases.

Other considerations pertain to sale-leaseback plants. In recent years several licensees have sold their interest in the plant to a trust (financed in large part by public debt) and leased the plant from the trust under a long term lease (typically 30 years). This device has often permitted the licensee to reduce so-called "rate shock" which would otherwise be caused by including plant investment in rate base at one time. Such leases typically require that the lessee (the (Cont'd)

As the Rule has been promulgated, however, it might be read as conflicting with typical utility mortgage indentures. As a consequence, there is at present insufficient assurance that insurance proceeds will be available for decontamination in the event of a major accident. We therefore urge that further consideration be given to modifying the Rule to require utilities to purchase insurance for the risk of concern to the Commission, namely the risk that the licensee will have to stabilize and decontaminate following accidental damage. The NEIL excess policy, as noted in the 1985 Committee Letter, is an example of a policy which a provides such insurance.

2. Bankruptcy Issue

In the 1985 Committee Letter we discussed the consequences that the licensee's bankruptcy might have on

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* licensee) carry nuclear property insurance in amounts consistent with NRC requirements. Several such recent transactions require the licensee to maintain nuclear property insurance of at least $900,000,000. Changing the NRC requirement to"liability" insurance would require licensees to either (1) carry an additional $900 millon of insurance for property risks, or (2) renegotiate or default under the lease. Allowing the licensees to meet the liability insurance requirement through the use of a hybrid form (such as the NEIL policy) solves this problem since the hybrid form has already been accepted by the lessors.

its obligation to clean up after an accident. On the basis of bankruptcy law as it stood in February 1985, the Committee doubted whether the NRC could require a bankruptcy trustee to decontaminate a damaged nuclear reactor. The Committee also expressed doubt as to the priority in bankruptcy proceedings that might be accorded a claim by a regulatory agency for reimbursement of cleanup costs. 1985 Committee Letter, at 8-11. Given this uncertainty, the Committee recommended that the Commission require that insurance proceeds be paid to a separate trust established for the purpose of paying cleanup costs. Id., at 13.

In reviewing the trust provisions of the Rule, it must be kept in mind that this particular trust formulation has never been called upon to function in practice, and that, as with other trusts, the effectiveness of such a trust as a means of avoiding claims against the bankrupt estate would be heavily dependent on the terms of the trust instrument.* Although administrative problems could be

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* For example, if the licensee is deemed to be the beneficiary of the trust, the trust assets will likely be regarded as a part of the bankrupt estate and available to pay estate creditors. Until such a trust is put in place and accepted trust practices developed for this application, there may also be problems encountered in locating an acceptable trustee, determining whether a private or public sector trustee is available and acceptable, developing a form of trust document acceptable to trustee, licenses and regulators, resolving conflicts of interest, and addressing questions of trustee indemnification.

encountered with the trust requirement, the Committee is unable to assess, prospectively, whether they could hinder achievement of the trust objectives. Nonetheless, the Committee has reviewed the rationale for its 1985 recommendation and now believes that exclusive reliance on a special trust as a device for avoiding the creditors of a bankrupt licensee may be unnecessarily restrictive. We are of the view that there may be alternatives to a trust which would provide acceptable levels of assurance that insurance proceeds would first be applied to the stabilization and decontamination of a damaged reactor.

We note first that the need to avoid making payment of unencumbered insurance proceeds directly to the utility may now be less compelling than it was three years ago. There have been significant judicial developments in this area in the past three years.* While we cannot conclude

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* See Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494, 88 L. Ed.2d 859 (1986) (holding that "a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards"); In re Wall Tube and Metal Products Co., 831 F.2d 118 (6th Cir. 1987), (holding that if the trustee could not abandon the site, "neither then should he have maintained or possessed the estate in continuous violation" of the applicable environmental law); See also In re Peerless Plating Co., 70 B.R. 943, 947 (Bkrptcy, W.D. Mich. 1987).

that the issue is free from doubt, the Committee believes these recent decisions strengthen the Commission's ability to compel a bankrupt licensee to decontaminate a damaged reactor.

Furthermore, there may be effective means of restricting access to the insurance proceeds through policy provisions which are specifically drafted for that purpose. In the Committee's view, the insurance policy proceeds can be adequately protected from claims of estate creditors if (1) the insurance policy contains a priority for the payment of decontamination expenses, (2) the policy provides coverage for decontamination expenses only as they are incurred, and (3) the policy requires the utility to use the proceeds received for payment of the decontamination expenses it has incurred. The utility would then have a contractual obligation to use the insurance proceeds for decontamination and not for other purposes. These restrictions should only apply to the extent necessary to protect public health and safety.

In a pre-bankruptcy situation, the licensee would be bound by the terms of its insurance contract. If the policy contains a decontamination priority, it will not be possible to divert the insurance proceeds to other purposes. In addition, if the policy so provided the proceeds for decontamination would not be payable until decontamination expenses were actually incurred, thus the licensee would

need to make suitable arrangements for the work to be done before submitting its claim for insurance. Finally, once it were to receive the insurance proceeds, the licensee would be required by its contract to use the proceeds to pay the expenses which form the basis of its insurance claim.

In the post-bankruptcy situation, the trustee in bankruptcy or its equivalent may, subject to court approval, assume or reject executory contracts such as the insurance policy.* Once the trustee assumes the insurance contract,** it too would be bound by the terms of the insurance agreement and would be required to use the insurance proceeds in a manner consistent with that agreement.*** Creditors of the bankrupt licensee would have no claim on the insurance proceeds since the utility's right to the proceeds would be conditioned both on its incurring decontamination expenses and on its using the proceeds to

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* Bankruptcy Code, Section 365(a).

** Since the trustee's right to receive up to $1.06 billion of insurance proceeds would depend upon an assumption of the contract, we regard it as unlikely that any trustee would reject it.

*** See In Re Nitec Paper Corporation, 43 B.R. 492, 498 (S.D.N.Y. 1984) and cases cited therein.

pay the expenses which form the basis of its claim.*

There may be other methods to protect the insurance proceeds from the claims of creditors. Accordingly, we do not believe the trust should be viewed as an exclusive or necessary vehicle for achieving the Commission's objective of decontamination priority.

III. CONCLUSION

In the Committee's view, licensees should be required to provide adequate assurance that sufficient funds will be available to stabilize and decontaminate a damaged reactor following a serious accident. We believe the best way to provide such assurance is to minimize the possibility of claims on the insurance proceeds by the indenture trustee and other creditors of the licensee.

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* We do not think, particularly in the pre-bankruptcy situation, that it is likely third party contractors would be concerned about reimbursement for work undertaken by them. As noted above, payment of the proceeds would be conditioned upon their use to pay the expenses on which the insurance claim is based. It is also likely that a licensee would assign its interest in the insurance proceeds to a contractor, in advance of the bankruptcy, in exchange for the contractor's agreement to perform the cleanup work. The assignment should effectively remove the insurance proceeds from the estate of the bankrupt. See Maloney v. John Hancock Mutual Life Ins. Co., 271 F.2d 609 (2d Cir. 1959); Matter of Armando Gerstel, Inc., 65 B.R. 602 (S.D. Fla. 1986); In re Moskowitz, 14 B.R. 677 (S.D.N.Y. 1981)

The indenture trustee's claim to the insurance proceeds would depend on characterizing the coverage as insurance on the mortgaged property. Thus, we urge that the Commission avoid reference to property insurance and instead require licensees to purchase coverage for their liability or obligation to stabilize or decontaminate a damaged reactor. A hybrid form of "liability/property" insurance policy similar to the excess policy offered by NEIL would meet this requirement, provided the policy contains a priority for the payment of the decontamination liability expenses.

With respect to bankruptcy considerations, there are several ways to avoid the claims of creditors of the bankrupt estate. In the Committee's view, the Commission should be able to require a bankrupt licensee to stabilize and decontaminate a damaged reactor. We believe that recent judicial decisions in this area reduce the uncertainties associated with payment of unencumbered funds directly to the utility. In addition, there may be alternatives to the trust requirement which are easier to implement and also provide an acceptable level of assurance that decontamination will be funded by insurance proceeds. We therefore

urge that the Commission entertain revisions to its rule so that the use of a trust mechanism is not the sole method by which utilities can achieve compliance.

Respectfully submitted,

COMMITTEE ON NUCLEAR
TECHNOLOGY AND LAW

By: _____
Brent L. Brandenburg
Chair