POLICY ISSUE
NOTATION VOTE

November 7, 2007 SECY-07-0197

FOR: The Commissioners

FROM: Luis A. Reyes
Executive Director for Operations

SUBJECT: REACTOR DECOMMISSIONING TRUST FUND OVERSIGHT BY OTHER AGENCIES AND RECOMMENDATIONS REGARDING FURTHER COMMISSION ACTION

PURPOSE:

To provide the Commission with: (1) a description of the power reactor decommissioning trust fund balance and investment oversight activities conducted by the Federal Energy Regulatory Commission (FERC), state public utility commissions (PUCs), and other agencies; and (2) recommendations regarding further Commission action in these areas.

SUMMARY:

About two-thirds of PUCs review information submitted by licensees regarding their decommissioning trust fund balances. Only five of these PUCs receive information directly from trustees. The FERC, which regulates about half of the U.S. Nuclear Regulatory Commission's (NRC) licensees with respect to their wholesale power sales, requires such licensees to submit to the FERC original copies of trustees' financial reports showing fund balances.

Practically all states have investment standards or restrictions, and the FERC also has an investment standard. Several Federal bank regulators oversee trustee operations, and on a risk-informed basis audit trustees' compliance with investment standards and restrictions.

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Although the NRC staff believes that verification of trust fund balances by trustees is not necessary to supplement the biennial decommissioning funding reports filed by licensees, the staff recommends that the NRC periodically spot-check at licensees' offices original trustee financial statements sent to the licensee and other related original documents that disclose trust fund balances to confirm that biennial reports filed by licensees with the NRC do not contain inadvertent mistakes or, in the worst case, false information.

BACKGROUND:

On February 6, 2006, the Office of the Inspector General (OIG) issued its audit report entitled "Follow-up Audit of the Nuclear Regulatory Commission's Decommissioning Fund Program" (OIG-06-A-07). The purpose of the audit was, among other things, to identify opportunities for improvement in the NRC's decommissioning funding assurance program for operating power reactors. Upon completion of the audit, the OIG concluded that rather than simply relying upon licensees' reports for trust fund balance information, the NRC should require that trustees report directly to the NRC trust fund balances for verification purposes. The OIG also concluded that the NRC's investment restrictions applicable to decommissioning trusts are not specific enough. In making these findings, the OIG noted that the NRC's decommissioning funding assurance program has relied on certain PUC oversight of licensees concerning decommissioning trust funds, but that the staff has not "undertaken any systematic review" of PUC "regulatory schemes to establish a basis for such reliance."

The OIG recommended that the Executive Director for Operations seek, and the Commission provide direction, as to whether to require: (1) verification of decommissioning trust fund balances from trustees; and (2) specific prudent investment restrictions for decommissioning trust funds. The staff, in SECY-06-0065, "Office of the Inspector General Recommendations on Decommissioning Funding Assurance," dated March 23, 2006, stated that it did not believe there is a need to require verification of trust balances by trustees, nor to require specific investment restrictions beyond the restrictions contained in 10 CFR 50.75(h). Consequently, the staff recommended to the Commission that no changes be made to the NRC's decommissioning funding assurance program. The Commission approved the staff recommendation in the Staff Requirements Memorandum (SRM) dated May 17, 2006, and on that basis, the OIG closed the recommendations. However, the SRM directed the staff to provide a more detailed discussion of decommissioning trust oversight activities performed by PUCs, the FERC, and other organizations, along with recommendations for further Commission action, if appropriate.

DISCUSSION:

The SRM stated that the staff should hold a public workshop, if necessary, to collect information regarding PUCs', the FERC's, and other organizations' oversight of decommissioning funding. Based on the staff's experience with PUCs and the FERC, the staff determined that the most efficient method of gathering the most complete information would be by individual interviews and follow-up interactions. The staff engaged ICF International (ICF), a contractor used by the staff on numerous occasions for decommissioning funding issues, to perform the interviews and gather other relevant information. The staff also conducted its own research to supplement the information gathered by ICF. The following is a summary of key findings.

Public Utility Commissions

All 31 PUCs in states where at least one commercial nuclear power reactor is operating were contacted for information. The depth of the responses varied, generally depending upon the available contact's familiarity with details. Responses were obtained from all but one PUC (Louisiana).

With respect to trust fund balances, about two-thirds of all PUCs perform decommissioning trust balance reviews. The frequency of the reviews varies. Generally, the range is semi-annually to a maximum of every 5 years. The frequency is often tied to the schedule of rate case proceedings, where a substantial amount of other corroborating information in the form of documents and testimony may become part of the record. Reviews are authorized or required by statute, regulation, or PUC order. The information reviewed is submitted by the licensees, except that for five PUCs information is also received directly from trustees.

Nine PUCs (Arizona, Illinois, Massachusetts, Mississippi, Nebraska, New Jersey, Pennsylvania, Tennessee, and Washington) reported that they do no reviews of decommissioning fund balances for operating power reactors. The Arizona PUC reported that it does require the filing of information, but the PUC does not regularly review it.

Two PUCs review only some of the nuclear plant licensees in their states: Iowa reviews electric utility licensees only; while Alabama reviews information from Alabama Power, but not Tennessee Valley Authority.

With respect to decommissioning trust investment restrictions, 14 PUCs have individual state or PUC investment standards or restrictions, which may be in addition to the NRC's and other agencies' standards or restrictions, such as those of the FERC. And as the staff pointed out in SECY-06-0065, practically all states have adopted the Uniform Prudent Investor Act (UPIA) or a quasi-UPIA, which provide for trustee (not limited to decommissioning trust trustees) duties and responsibilities relating to investment portfolios.

Federal Energy Regulatory Commission

Under 18 CFR 35.33, FERC annually receives original copies of trustee financial reports, which are submitted to the FERC by entities subject to the FERC's jurisdiction. The reports are not necessarily regularly reviewed, but are used as source documents on an "as needed" basis. Required information includes trust fund assets, and summaries of the fund's activity for the year. In 2005, the FERC amended this regulation to delete from financial reports listings of all purchases and sales of trust fund investments. However, such records must be maintained for possible audits. As of 2005, the FERC received financial reports forwarded by 53 companies, compared to the over 90 separate NRC licensees subject to the NRC's biennial decommissioning funding reporting requirements under 10 CFR 50.75(f)(1) for the 104 power reactors holding operating licenses. The OIG mentioned in OIG-06-A-07 that the FERC has oversight with respect to approximately half of the commercial nuclear power plants.

The FERC has investment standards or restrictions contained in 18 CFR 35.32(a), namely the "prudent investor" standard of care as described in the Restatement of the Law (Third), Trusts

Section 227. These standards or restrictions apply directly to entities subject to the FERC's jurisdiction, which do not include all NRC licensees.

Federal Bank Regulatory Agencies

Under 10 CFR 50.75(e)(1)(i) and (ii), trustees must be "regulated and examined by a Federal or State agency." ICF gathered information from three federal bank regulatory agencies - the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Federal Reserve Board (Banking Agencies) - that have oversight of the trust departments of financial institutions that typically act as trustees for nuclear decommissioning trusts. Since the Banking Agencies do not regulate NRC licensees, the primary focus here was on the Banking Agencies' oversight of trustees, and whether such oversight is relevant to the NRC's decommissioning funding assurance program.

Generally, Banking Agencies conduct examinations of trust departments on a two to three year cycle. These examinations are resource intensive (six weeks involving eight staff would not be unusual) and use processes and tools to render the examinations more risk-informed. During an examination, a trustee organization's compliance with its fiduciary obligations and general fiduciary principles are evaluated. The trustee's adherence to governing instruments (e.g., a trust agreement, which may specify investment restrictions) and applicable law (e.g., statutes that govern prudent investments) comes within the scope of the trustee's fiduciary obligations.

The trustee organization's management has the responsibility to detect and deter fraud by instituting strong internal controls and establishing appropriate procedures. These controls and procedures, in turn, are reviewed during examinations.

Trust Fund Balances

In OIG-06-A-07, Recommendation 1; to require verification of trust fund balances from trustees, the OIG suggests that accepting information regarding trust fund balances from licensees alone is not prudent. As the results of the PUC surveys show, most of the PUCs that are performing trust fund balance reviews obtain their information from licensees and do not obtain information from trustees; only five PUCs do. The FERC obtains trustee reports, but indirectly through the entities it regulates. Thus, under a worst-case scenario, the trustee reports could be altered by the regulated entities before being filed with the FERC. As mentioned above, the FERC does not receive reports from all NRC licensees. Therefore, the FERC does not fulfill a role as a second oversight body for numerous NRC licensees.

In connection with the most recent amendments to 10 CFR 50.75 in 2002, the Commission recognized that in light of deregulation, the NRC may need to take a more active oversight role regarding the terms and conditions of decommissioning trusts for licensees no longer regulated by state authorities or the FERC. Before 2002, while the staff had imposed terms and conditions in decommissioning trusts for non-electric utilities (typically subject to reduced oversight by state authorities) during license transfers on a case-by-case basis, there were no comparable regulatory provisions. With respect to trust balances, however, the current biennial reporting requirements have applied to all licensees since 1998, whether or not regulated by state authorities or the FERC. Notwithstanding this full coverage, the OIG was still not

convinced that the NRC's decommissioning funding assurance program is adequate because any licensee may report false information to the NRC (or to a PUC or the FERC for that matter).

In SECY-06-0065, the staff provided several reasons why it did not believe additional verification of trust fund balances by trustees was necessary. First, licensees are subject to a range of sanctions for filing false information with the NRC. Second, an assumption that a licensee could file false information could equally apply to a trustee. Third, the NRC is aware of no previous case where false trust fund balance information was filed.

The recent information on oversight by PUCs and FERC analyzed by the staff makes it clear that most oversight bodies are apparently satisfied with receiving trust fund balance information from licensees, given that trust fund balance information is obtained directly from trustees in very limited cases. However, in light of the OIG's concern that licensees could be filing false or inaccurate information, the staff developed the following three options for the Commission's consideration.

Option 1: Maintain the status quo. The Commission could decide to make no changes to the decommissioning funding assurance program based on the staff's original reasons in SECY-06-0065 restated above. Since only five PUCs receive information on trust fund balances directly from trustees, and the FERC accepts information forwarded through licensees, the Commission would not be out of step with most other oversight bodies in accepting and relying upon information submitted directly from licensees.

Option 2: NRC staff periodically spot-check at the licensee's offices original statements and other related original documents sent to a licensee from its trustee that disclose the trust fund balance. With this option, the OIG's concern that a licensee is providing false information in its biennial reports to the NRC should be significantly reduced. If discrepancies in the biennial reports filed with the NRC are discovered, the staff could then recommend further revisions to the decommissioning funding assurance program depending upon the nature and seriousness of the discrepancies.

Option 3: Initiate rulemaking to require decommissioning trust agreements to provide that trustees shall file statements on the balance of decommissioning trusts directly with the NRC. These trustee filings could be made biennially at the same time licensees file their biennial reports, allowing a side-by-side comparison with licensees' reports. Because rulemaking is involved, this option would involve the most significant additional resources, at least at the outset.

The staff recommends Option 2. While the staff continues to believe that verification of balances by trustees is not necessary, there may be some value in performing periodic spot-checks of original trustee documentation if simply to confirm that biennial decommissioning funding status reports submitted by NRC licensees normally do not contain inadvertent mistakes or, in the worst case, do not contain false information. This option also would seem to address, at least partially, the OIG's concerns regarding trust balances. Specific details, of course, would need to be worked out regarding such issues as how often trustee statements would need to be reviewed, whether certain categories of licensees are more appropriate candidates for reviews, and whether regional inspectors might be able to perform some of the reviews instead of headquarters financial staff to reduce staff travel time or expenses.

Investment Restrictions

The information gathered from PUCs regarding their investment restrictions does not change the staff's original view in SECY-06-0065 that more specific investment restrictions are not necessary. The staff previously found that practically all states have adopted the UPIA or a quasi-UPIA. The current survey shows that 14 PUCs or states have their own investment restrictions specific to decommissioning funding. These restrictions are in addition to the NRC's current investment restrictions as well as the FERC's. The staff continues to believe that as a general matter the NRC should not inject itself into the financial management details of licensees, or intrude into matters under the authority of the states and the FERC absent compelling circumstances. Moreover, the staff still does not have the expertise to design specific investment programs. In sum, the staff stands by its disagreement with the OIG's view that specific investment restrictions are needed, and recommends no further action to establish additional investment restrictions.

Compliance with Investment Restrictions

The NRC's decommissioning funding assurance program does not entail monitoring or otherwise ensure trustees' compliance with applicable investment restrictions. The OIG did not raise an issue of the lack of this type of monitoring in its audit. Nonetheless, the staff sought additional information (summarized above) on the relevant regulators' oversight of trust investments to see if a gap existed.

As the information regarding the Banking Agencies shows, the Banking Agencies' examination process provides a certain amount of assurance that trustees are complying with applicable investment restrictions, whether they are the NRC's or those of any other agency or those of a state. The Banking Agencies' examination process also provides a degree of assurance that the risk of fraud is minimized. As was pointed out earlier, in 2005, the FERC amended its regulations to delete a requirement that all purchases and sales of trust fund investments be reported. According to the FERC, such information was often overwhelming, and the FERC did not have the staff to review the information, even though such information could be used to determine compliance with investment restrictions. The NRC staff believes that given the Banking Agencies' oversight, the NRC's decommissioning funding assurance program needs no changes with respect to monitoring compliance with investment restrictions.

RECOMMENDATIONS:

With respect to the verification of trust fund balances, the staff recommends Option 2, which would entail a modest change to the decommissioning funding assurance program and minimal additional resources. Otherwise, the staff recommends no further changes.

RESOURCES:

For Option 2, the staff would budget an additional 0.3 full-time equivalent (FTE) each year for a program involving headquarters financial staff spot-checking trustee documents at licensees' corporate offices. This resource estimate could generally be managed within the current resources allotted for financial policy and plant-specific reviews. Should the Commission decide to pursue Option 3, the staff would typically budget 2.4 FTE over a 2-year period for the

rulemaking effort. These resources would be factored into the common prioritization process for rulemaking in the next budget cycle. Implementation costs of Option 3 to review new trustee statements filed biennially with the NRC pursuant to a new rule would be estimated to entail an increase of 0.2 FTE above the 0.7 FTE currently allotted every other year for the biennial decommissioning funding report reviews. Such increase could be drawn from current resource allocations for financial policy and plant-specific reviews.

COORDINATION:

The Office of the General Counsel has reviewed this paper and has no legal objection. The Office of the Chief Financial Officer has reviewed this paper for resource implications and has no objection.

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