

MEMORANDUM

To: CR3 Joint Owners & Duke Municipal Wholesale Customer

From: Nicholas P. Guarriello; Frederick M. Bryant; Jody Lamar Finklea; Dan O'Hagan

Date: May 30, 2014

Re: Proposed CR3 Settlement Agreement

I. Introduction

FMPA has been negotiating with Duke Energy on behalf of the Crystal River 3 (“CR3”) Joint Owners (“JOs”) and Duke Energy Municipal Wholesale Purchasers (together the “Florida Cities”¹) regarding the failed CR3 steam generator replacement project, resulting delamination, extended outage, and early retirement. The negotiations involved numerous complicated legal and technical issues; however, we have come to terms on a proposed settlement agreement for your consideration and approval. The purpose of this memorandum is to (a) provide some background on CR3, including the Steam Generator Replacement Project and early CR3 retirement; (b) briefly explain the CR3 decommissioning plan and estimated costs; (c) discuss the Florida Cities’ potential claims against Duke that are being settled; (d) summarize the proposed CR3 settlement agreement structure and terms; and (e) highlight some of the benefits and avoided risks in the proposed settlement agreement.

On October 11, 2012, at Duke’s request, Duke representatives, including Duke’s then-CEO, met with FMPA to provide a CR3 SGR Project update. At the meeting, Duke expressed their intent to initiate settlement discussions between Duke and the Florida Cities regarding potential CR3-related claims.² FMPA reached out to the Florida Cities to determine whether, as had been done for previous CR3-related disputes, the Florida Cities would like FMPA to represent them in CR3 settlement negotiations. In October and November, the Florida Cities entered into agreements with FMPA authorizing FMPA to negotiate on their behalf. Over the next several months, FMPA met with Duke and the Florida Cities numerous times to negotiate settlement the Florida Cities’ various potential claims against Duke. On October 31, 2013, with input and guidance from the Florida Cities, FMPA and Duke “shook hands” on the general settlement terms, subject to finalizing a definitive settlement agreement and getting the Florida Cities’ approval. We have since finalized a mutually agreeable draft settlement agreement that we believe represents a fair and final settlement of all CR3 issues and is in the Florida Cities’ best interest.

¹ The Florida Cities include: the City of Alachua, City of Bartow, City of Bushnell, City of Chattahoochee, Gainesville Regional Utilities, Town of Havana, City of Homestead, Kissimmee Utility Authority, City of Leesburg, City of Mount Dora, City of Newberry, City of New Smyrna Beach, city of Ocala, Orlando Utilities Commission, City of Quincy, City of Williston, and FMPA All-Requirements Power Supply Project.

² Note that FMPA represented the Florida Cities in a CR3-related dispute that resulted in a 2002 settlement agreement.

The terms of the settlement agreement is summarized in greater detail in Section IV below; however, in short, the proposed settlement agreement provides for:

- CR3 JOs receive \$55 million cash payment;
- CR3 JOs transfer CR3 ownership to Duke;
- CR3 JOs transfer CR3 nuclear decommissioning trusts to Duke;
- For two years after the transfer, CR3 JOs indemnify and hold Duke harmless from liabilities for CR3 JOs' acts/omissions relating to CR3 JOs' management of trust funds prior to transfer
- CR3 JOs have no further CR3 liability, responsibility or risk, including CR3 decommissioning;
- Duke indemnifies CR3 JOs for all CR3 related liabilities;
- CR3 JOs cease all CR3 O&M, A&G, decommissioning, and all other CR3 related costs as of October 1, 2103 (reimbursed for those previously paid);
- Duke waives its claim to \$13.6 million in non-SGR costs that Duke alleges is payable by CR3 JOs;
- CR3 JOs and Duke settle and waive all CR3 related claims;
- Wholesale Customers receive \$8.4 million cash payment; and
- Wholesale Customers and Duke settle and waive all CR3 related claims

II. **CR3, SGR Project and Retirement Background**

Seven minority CR3 joint owners cumulatively own approximately 8.2% of Duke's Crystal River Unit 3 ("CR3") nuclear power plant. The proposed CR3 settlement agreement involves six (6) of the seven (7) CR3 joint owners, representing approximately 6.52% CR3 ownership interest. A list of the CR3 JOs and their CR3 percentage ownership interest is included in this memo as Schedule 1.

CR3 was issued an operating license on December 3, 1976, with an initial expiration of December 3, 2016. On December 16, 2008, Duke f/k/a Progress Energy Florida³, submitted to the Nuclear Regulatory Commission ("NRC") an application to renew the license for an addition 20 years, or through 2036.

On February 5, 2013, Duke Energy announced its intention to retire the Crystal River 3 Nuclear Power Plant. The following is a summary of events that led to the decision to retire CR3, followed by a brief discussion of the retirement implications:

In September 2009, CR3 began a planned outage for refueling and maintenance. During the planned outage, Duke scheduled an uprate project to increase CR3's generating capability, which included the replacement of two aging steam generators (the "Steam Generator Replacement Project" or "SGR Project"). In an admitted effort to reduce costs, Duke decided to self-manage the SGR Project. While cutting an opening in the CR3 containment wall in order to remove and replace the steam generators, a delamination (or separation) occurred within the concrete on the periphery of the building,

³ Note that in July 2012, Duke Energy merged with Progress Energy. References to the company in the memo will use the post-merger company name of "Duke" or "DEF."

which resulted in an unplanned extension of the outage. After analysis, it was determined that the concrete delamination at CR3 was caused by redistribution of stresses in the containment wall that occurred when an opening was created to accommodate the replacement of the unit's steam generators. Duke replaced the steam generators and then undertook extensive repair efforts to a large portion of the delaminated containment wall.

In March 2011, after having substantially completed the containment wall repair, monitoring equipment identified a new delamination that occurred in a different section of the containment wall during the late stages of retensioning the tendons within the containment building. A third delamination was discovered later in July 2011. CR3 remained out of service while Duke conducted an engineering analysis to determine the extent of the delaminations and evaluate possible repair options, costs and risks.

Based on the engineering analysis of possible repair options, Duke initially selected a repair option that would entail systematically removing and replacing concrete in substantial portions of the containment structure walls. The preliminary cost and duration was estimated at \$900 million to \$1.3 billion and 24-30 months. However, in March 2012, Duke commissioned an independent review team led by Zapata Incorporated (Zapata) to review and assess Duke's CR3 repair plan, including the repair scope, risks, costs and schedule. In its final report, Zapata found that the repair scope appeared to be technically feasible, but that there were significant risks that would need to be addressed regarding the approach, construction methodology, scheduling and licensing. Zapata performed four separate analyses of the estimated project cost and schedule to repair CR3, with estimates for costs ranging from \$1.49 billion to \$3.43 billion and project duration of ranging from 31 months to 96 months.

Between March 2012 and the end of 2012, Duke continued its technical feasibility evaluation of the Zapata CR3 repair options, while simultaneously initiating a formal nonbinding mediation process with its insurer, Nuclear Electric Insurer Limited ("NEIL"). Duke indicated that Duke and NEIL were at odds over the extent of coverage and potential amounts owed under the various CR3 insurance policies. After the initial mediation process, Duke indicated that there was no resolution, but that there was not yet an impasse.

In February 2013, Duke Energy announced its intention to retire CR3, as well as a resolution of the company's insurance coverage claims with NEIL through the mediation process. The parties agreed on a \$530 million settlement, which is in addition to the \$305 million NEIL previously paid under the replacement power policy (\$162 million) and property damage policy (\$143 million) – for a cumulative insurance payout of \$835 million.

III. CR3 Decommissioning

In December 2013, Duke filed with the Nuclear Regulatory Commission a Site Specific Decommissioning Cost Estimate, and on March 21, 2014, Duke filed for Florida Public Service Commission ("FPSC") approval of the same. In its FPSC filing, Duke indicated that it had selected the NRC-approved SAFSTOR method of decommissioning, which includes, in general terms, placing the unit in a safe and stable condition and maintaining in that state for decades to allow levels of

radioactivity to decrease through radioactive decay thereby reducing the quantity of radioactive material to be removed during final decontamination. After the safe storage period, the plant will be decontaminated and dismantled to permit license termination. Per NRC requirements, under the SAFSTOR decommissioning method, decontamination and dismantlement must be within 60 years. According to the 2014 Decommissioning Study, the safe-storage period is planned until 2067 at which time CR3 will begin to be decontaminated and dismantled and the site released for alternative use by 2074 – approximately 60 years after the 2014 filing.

In its FPSC filing, Duke estimates the total cost of decommissioning, when adjusted for inflation over the decommissioning period and including the Joint Owners' share, to be approximately \$3.5 billion.⁴

Nuclear power plant licensees are required by NRC regulations to provide adequate financial assurance of decommissioning. This is generally accomplished through a nuclear decommissioning trust fund. Until final license termination at the end of the decommissioning process, licensees are required to periodically report on the status of their trust funds, as well as provide updated decommissioning cost estimates. If, at any time, the decommissioning trust funds are not adequate to cover the estimated decommissioning costs, the licensees is required to provide further financial insurance, including additional trust fund financial contributions.

IV. Potential Florida Cities' CR3-Related Claims⁵

As a result of the early CR3 retirement instead of the planned 20-year renewal license, although the CR3 JOs will save O&M and capital costs associated with additions or repairs during this period, the CR3 JOs have lost the value of CR3 nuclear-priced energy and capacity until the plant would have otherwise been retired. While Duke contemplates that decommissioning will not likely take place for at least forty years, there are a number of capital projects currently under way in order to safely repair, weatherize and store the unit while awaiting decommissioning. In addition, the CR3 JOs are at risk for any additional decommissioning costs that may be associated with an early, unplanned shut down. The CR3 JOs have contractual claims against Duke arising under the CR3 Participation Agreement for, among others, Duke's failure to complete the SGR Project in prudent manner and in accordance with good utility practice and Duke's failure operate and maintain CR3 in accordance with all applicable regulatory requirements.

The Wholesale Customers have suffered increased energy costs since October, 2009, lasting until the expiration of their wholesale energy contracts. This is because Duke energy sales did not include CR-3 nuclear-priced energy. They have benefitted from recently reduced natural gas and

⁴ In the FPSC filing, Duke estimates the total (Duke and CR3 Joint Owners') decommissioning cost to be \$1,180,133,000 in 2013 dollars. When escalated at 2.8% over the 60 year decommissioning period, Duke estimates that the escalated decommissioning costs for its 91.7806% ownership share of CR3 to be \$3,189,345,899. When the CR3 Joint Owners' share is added using the same escalation assumptions, the total escalated estimated decommissioning costs are \$3,474,967,367.

⁵ This is intended as a high level overview of the Florida Cities' most apparent CR3-related claims against Duke. This is not intended to be an all-inclusive list of potential claims.

market energy prices and some of the wholesale power energy price increases have been offset by flow throughs of insurance payments. They are paying for capacity through fixed demand charges, including CR-3 capacity costs. However, they are at risk for increased wholesale power energy costs for the remainder of their contract terms. Wholesale power contracts are subject to the Federal Power Act, and therefore the Wholesale Customers likely have a case against Duke before the Federal Energy Regulatory Commission for unjust and unreasonable wholesale rates due to Duke's imprudence in performing the SGR Project.

FMPA, on behalf of the Florida Cities entered into a Tolling Agreement with Duke effective June 21, 2012, and lasting until 60 days after any of the Florida Cities or Duke gives written notice of termination. The purpose of the Tolling Agreement is to toll any statutes of limitation that might otherwise apply to the Florida Cities' or Duke's potential claims during the settlement negotiations period.

V. Proposed Settlement Terms

1. \$55 million lump sum payment to Joint Owners ("JOs") at Closing (§2.3)
 - \$2,000 reserved as payment for CR3 (§2.3)
 - Payable at "Closing" (§2.3)
 - Settlement payment made by Duke Florida, but Duke Energy parent company guarantees Duke Florida obligations (§2.3(b); Consent and Joinder; §8.6)
2. Duke waives claim for \$13.6 million in claimed non-Steam Generator Replacement ("SGR") project repair costs (§2.7)
3. JOs transfer CR3 ownership interest to Duke at Closing (§2.2)
 - Transfer of ownership via special warranty deed (§6.3; Exhibit K)
 - Includes any future CR3-related recoveries (e.g. insurance, DoE spent fuel recoveries, equipment salvage, etc.) (§2.2(b))
 - Duke to acquire waiver of participation Agreement §9.2 right of first refusal from non-settling parties to the Participation Agreement; and indemnifies JOs from any claims if it fails to receive waiver. (§5.5; § 8.4(b)(iv))
 - Regulatory approval of ownership transfer and decommissioning trust transfer is condition precedent to closing, including NRC approval of license amendment (§6.7; §7.6)
4. JOs transfer decommissioning trust funds to Duke at Closing; Duke assumes all future decommissioning responsibility and liability (§2.4)
 - Transfer takes place at "Closing" (§2.4)
 - Duke takes on all future decommissioning liability, and indemnifies JOs for the same (§§2.2; 2.4; 2.6; 8.4(b)(v))

- Duke responsible for funding combined trust to NRC required levels (§2.4)
 - JOs allowed to withdraw \$429,560.21 prior to transfer; prohibited from any other withdrawals (§2.4)
 - JOs must maintain funds in accordance with applicable regulatory requirements until transfer (§2.4)
 - JOs indemnify and hold Duke harmless from liabilities for JO acts/omissions relating to JOs' management of funds prior to transfer. Indemnity applies only for two years following transfer. (§2.4; Exhibit D)
 - JOs must cooperate with Duke on regulatory requests (§2.4)
 - Provide Duke with quarterly reports until transfer (§2.4)
5. JOs assign interest in CR3 Participation Agreement to Duke; terminate as to JOs (§2.5; Exhibit F)
 6. As of Oct 1, 2013, JOs not responsible for payment of any CR3 O&M, A&G, capital, or any other CR3-related costs that would otherwise payable under the CR3 Participation Agreement (§2.6)
 - Duke to refund amounts paid for post Oct 1 costs - \$1,311,402.90 (§2.6)
 - No future "true-ups" for past amounts (§2.6)
 - JOs not entitled to future insurance premium refunds, if any (§2.6)
 7. Lump sum payment of \$8.4 million to Wholesale Purchasers (§2.8(b))
 - Wholesale Purchaser consent and joinder to portions of settlement condition precedent to Closing with JOs (§2.8(c); Consent and Joinders)
 8. Total settlement of all JO and Wholesale Customer CR3 related claims (§2.1; Exhibit C; §2.8(a); Exhibit H)
 - Waiver of claims and mutual release (incl. those under CR3 Participation Agreement, 2002 Settlement Agreement, NEIL policies, and wholesale contracts)
 9. No third party assistance in prosecution of claims against Duke (Exhibit C; Exhibit H)
 10. DEF indemnifies JOs from all CR3 related liabilities – past present and future; (§8.4(b))
 11. JOs indemnify Duke for any CR3 related liability that is not being assumed by Duke (§8.4(a))
 12. Reservation of rights and claims if final settlement is not reached (§2.10)
 13. No confidentiality requirements

- Entire agreement may be public once it is final.
- Requested to use best efforts to maintain confidentiality per confidentiality agreement until it must be made public for approval (i.e. agenda package release)
 - Requested to inform Duke of earliest public release for public relations purposes

VI. Estimated CR3 Proposed Settlement Benefits

We believe there are a number of significant benefits in the settlement – both in terms of direct financial benefit and risk mitigation. Attached to this memo as Schedule 1 is a summary of the quantifiable, direct financial benefits. In addition to the \$63.4 million cash settlement payment, we successfully negotiated a moratorium on the CR3 JOs’ payment of any Duke CR3 invoices beginning October 1, 2013, a fact that is memorialized in the final draft settlement agreement. As a result, the CR3 JOs avoided approximately \$4.3 million (through April 2014) – an amount that will continue to grow each month over the proposed 60 year decommissioning schedule. Furthermore, the Florida Cities have received over \$21 million in NEIL insurance reimbursement through Duke. Duke has also waived its claim to \$13.6 million in what Duke believes are non-SGR related costs owed by the CR3 JOs. In addition to these amounts, there is significant risk in continued CR3 ownership. Specifically, there is much uncertainty and risk involved in decommissioning a nuclear power plant. The project is planned to take up to sixty years to complete, and involves complex dismantling and transportation of contaminated material. In addition, there is currently great uncertainty regarding the long term storage of spent nuclear fuel by the federal government. The current, short term plan is to store spent nuclear fuel on the site in dry casks. By transferring all CR3 ownership, responsibility, liability, and decommissioning obligations to Duke, the CR3 JO are receiving the benefits of the avoided risk and cost uncertainty in all of these decommissioning activities, which, although they cannot be quantified, we believe to be significant.

VII. Settlement Agreement Structure & Closing

The settlement agreement is structured as a global settlement agreement intended to finally resolve all disputes between the Florida Cities and Duke relating to CR3. Upon approval, Duke and the CR3 JOs will execute the CR3 Settlement, Release, and Acquisition Agreement. However, a number of conditions precedent must be met before the parties can proceed to closing, during which the CR3 ownership transfers and settlement payments will be completed.

Once executed, Duke will file a license amendment application with the Nuclear Regulatory Commission. Duke has indicated that, due to an NRC back-log – it could take between 12-18 months to receive NRC approval. During that time, we will work with Duke to finalize the real property conveyance instruments (i.e. title insurance, legal description of real property, etc.). Once the NRC license amendment is received, the parties will proceed to Closing, at which the Closing Documents will be executed. These are attached to the Settlement Agreement as Exhibits, and include: the Special Warranty Deed and Bill of Sale; Trust Conveyance Documents, Assignment and Assumption Agreement; Closing Certificate; Opinion of Counsels; and Mutual General Release. Upon execution of

the Closing Documents, title to CR3 and the decommissioning trusts will be transferred to Duke, and Duke will make the settlement payment to the Florida Cities.

VIII. Recommended Approval

As drafted, the settlement agreement is in substantially final form. There are some non-controversial, closing related attachments left to be filled in, such as the Closing Certificates and Legal Description of Real Property. Also, the Closing Documents, which are included as exhibits to the settlement agreement, are in template form, and, as in most closings, we expect that there will be some modifications to those documents between execution of the settlement agreement and closing. Because of this, we recommend, to the extent possible, seeking approval of the settlement agreement, including the exhibits, in substantially final form and granting the City Manager/Utility Director/Mayor, or other appropriate individual, the authority to (a) approve changes that do not materially affect the approved settlement terms; and (b) execute the Closing Documents at closing, without the need to seek further Commission approval.

SCHEDULE 1

CR3 JO Ownership Interest⁶

<u>Applicable Joint Owner</u>	<u>Applicable Tenant in Common Undivided Percentage Interest in Realty</u>
City of Alachua	0.0779
City of Bushnell	0.0388
City of Gainesville	1.4079
City of Kissimmee	0.6754
City of Leesburg	0.8244
City of New Smyrna Beach and New Smyrna Beach Utilities Commission	0.5608
City of Ocala	1.3333
City of Orlando and Orlando Utilities Commission	1.6015

⁶ Note that Seminole Electric Cooperative also owns 1.6994% of CR3; however, Seminole is not a party to the proposed settlement agreement with the other CR3 JOs listed above.

SCHEDULE 2

Summary of Quantifiable Settlement Benefits

[To be provided under separate cover]