DEPARTMENT OF ENERGY & CLIMATE CHANGE

THE ENERGY ACT 2008

Government response to the Consultation on The Financing of Nuclear Decommissioning and Waste Handling Regulations 2010

18 October 2010

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Introduction

1. On 25 March 2010, the Government issued a consultation document (the Consultation) on draft Regulations on the Financing of Nuclear Decommissioning and Waste Handling Regulations 2010 (the draft Regulations) and the draft Energy Act 2008 (Designated Technical Matters) Order 20** (the draft Order). The Consultation closed on 18 June 2010.

The Consultation

2. The draft Regulations and the draft Order were intended to be made under powers contained in Part 3, Chapter 1 of the Energy Act 2008 (the Act). The draft Regulations included provisions:

   a. To recover the costs associated with the consideration of a Funded Decommissioning Programme (FDP), including the costs of obtaining advice in relation to the FDP or in relation to the information about the FDP;

   b. Amending the procedure as set out in the Energy Act 2008 for modifying an approved FDP;

   c. On reporting requirements;

   d. On the verification of a FDP;

   e. On the content of a Funded Decommissioning programme.

3. The draft Order set out those technical matters relating to decommissioning, waste management and waste disposal, the funding of which the Secretary of State considered to be sufficiently significant as to be designated technical matters under S45(6) of the Act.

The Consultation Response

4. Responses received to the consultation came from energy companies, regulators, and a mix of Local Authorities, campaign groups and individuals. A list of respondents is given at Annex A. The responses were broadly supportive of the proposals set out in the Consultation. Amongst those to whom the draft Regulations and the draft Order would most likely apply the key concerns were:

   a. Clarity of charging; avoiding excessive costs; ensuring value for money and transparency under the fee-charging provisions.

   b. Excessive and burdensome third-party verification: the qualifications of a verifier; the test of prudence; role of the Secretary of State.

   c. The practicality of the provisions relating to cumulative modifications.

   d. The broad scope of designated technical matters.

e. Burdensome reporting requirements, especially annual reporting.

5. Among respondents more broadly the key concerns were:

a. Concern over the appropriateness of putting a cap on fees.

b. The independence and qualification of verifiers and scope of their work.

6. A few respondents questioned the validity of the consultation given that it ran during a General Election period.

7. The specific points raised in the consultation are discussed in turn below. The Government's conclusions on these points are reflected in the Regulations (which have been renamed The Nuclear Decommissioning and Waste Handling (Finance and Fees) Regulations 2010) which are being published alongside this Government Response and will be laid before Parliament in autumn 2010. The draft Order, which has subject to a small number of revisions to improve clarity was laid before Parliament on 18 October 2010 and is subject to the affirmative procedure. Subject to the views of Parliament the Order will come into effect once it has been approved by Parliament. The Regulations will be laid once the Order has been made and will come into effect on 6 April 2011.

Cost Recovery Provisions

8. Section 2 of the Consultation summarised the provisions relating to cost recovery and table 1 set out the proposed basic fees that would apply: these ranged from £500 to £75,000 depending on the activity being undertaken. If the basic fee exceeded the amount of costs incurred by the Secretary of State, the balance would be re-funded. Table 1 also set out the maximum supplementary fees that would apply (a supplementary fee being chargeable in circumstances where the Secretary of State's costs exceeded the amount of the basic fee): these ranged from £1000 to £425,000 depending on the activity being undertaken. The Secretary of State would not have been able to recover costs above the level of the applicable amount. Consultees were asked the following question:.

Question 1: Do the proposals create a transparent and effective means of recovering the costs incurred by the Secretary of State in relation to the matters described in Table 1? Could the cost recovery proposals be improved to enhance their transparency and effectiveness? Is the proposed maximum fee set at a suitable level?

Summary of Respondents' comments on the cost recovery provisions

9. Most respondents supported the provisions for cost recovery through fees for the consideration/approval of an FDP. However, a significant number of respondents argued that the proposed maximum supplementary fee is inconsistent with full cost recovery since any costs incurred by the Secretary of State over the maximum would be borne by the taxpayer. More generally, respondents sought greater clarity over how the fees regulations would be applied (for example: late payment, interest and indexing) and what costs would be recovered from operators. Prospective operators were concerned about excessive costs and ensuring value for money. Most respondents also emphasised the need for transparency in charging.

The Government's response

10. The Government agrees with those respondents who argued that the cap on fees should be removed. It is important that the Secretary of State is able to commission such expert analysis as is required for him to approve an FDP. Given that the operator will derive the full economic benefit from operating the power station to which the FDP in question relates, it is appropriate that the operator pays the costs of seeking approval and ensuring ongoing compliance.

11. The onus is on a prospective operator to submit an FDP that contains all the necessary information that will enable the Secretary of State to approve the

programme. Submission of a comprehensive and accurate FDP is less likely to result in substantial fees than one that is incomplete or inadequate. When approving or considering an FDP the Secretary of State may, under Section 45 of the Act, commission advice in relation to consideration of an FDP and these costs will be recovered from the Operator. If the operator provides robust and properly verified information in its FDP these further costs are highly likely to be avoided.

12. That said, the Government understands the need for operators to have clarity over the scale of possible charges and the necessity of securing value for money when commissioning expert analysis. To this end, the draft Regulations have been amended to ensure that any fees charged under the Regulations shall not exceed the sum of costs reasonably incurred. The Regulations now also make clear that the advice being charged for is that provided by the Nuclear Liabilities Financing Assurance Board (the NLFAB), or any other person who is independent of the operator but not civil servants employed by central Government. The Secretary of State will keep the operator (or prospective operator) informed about the expert advice being commissioned and the likely costs. The Secretary of State will endeavour to bill the operator at appropriate, regular intervals to enable financial planning.

13. Removal of the maxima will mean that concerns around indexing no longer apply.

14. In respect of late payment, we would not generally expect to charge interest although, if necessary, the Government would take action through the courts for non payment, in which case interest may be payable from the date of judgement.

Independent third-party verification provisions

15. Section 3 of the Consultation summarised the provisions relating to the requirement to have certain aspects of an FDP verified by an independent third-party expert. The purpose of doing so is to provide the Secretary of State with additional assurance as to the accuracy of the operator's estimates of the costs of the designated technical matters and to provide an independent assessment of the level of prudence made for the financing of the designated technical matters. Consultees were asked the following question:

Question 2: Do the proposals create an effective framework for verification to take place? Are the responsibilities and requirements clear? Is it clear how the Secretary of State would expect the verification to take place?

Summary of Respondents' comments on the independent third-party verification provisions

16. There was widespread support for independent third-party verification, which was seen as an important element in ensuring public confidence in the financing arrangements for decommissioning, waste management and disposal. For this reason a number of respondents stressed the importance of ensuring that the verifier is fully independent of the operator and properly qualified. Some respondents saw the risk of conflicts of interest as the verifier will be appointed by the operator; to mitigate this, several respondents suggested that the Secretary of State should either appoint the verifier or approve their appointment.

17. While supporting the requirement for independent third-party verification, a number of industry respondents expressed concern about the potential for excessive, burdensome or dual verification and raised a number of technical points.

18. Some respondents raised questions regarding disputes that might arise from verification reports. For example the circumstances under which the Secretary of State might reject a verification report, or in the case where the verification was deficient. For example, what would the verifier's liability be, or could the Secretary of State seek damages from the verifier?

19. Several respondents commented on provision 5(8) in the draft Regulations that enables the verifier to make "necessary recommendations…that in the verifier's view would further improve the prudence" of the FDP noting that it would always be possible to take steps to make an FDP more prudent. Some

respondents were concerned about whether it would be possible for an objective assessment of prudence to be made, as it is largely a matter of judgement.

20. A number of respondents argued that the Regulations should not require the verifier to assess whether the FDP represented a "true and fair" view, as "true and fair" is a recognised term in relation to financial reporting, where it applies to financial statements compiled using historic data.

The Government's response

Independence of the verifier

21. The Government agrees any verifier should be clearly and demonstrably independent. Although the verifier will be contracted to the operator, the Government regards the role of the verifier as analogous to that of a external company auditor.

22. The Government does not consider it appropriate itself to appoint the verifier because the broad thrust of the legislative framework is to put the onus on the operator to satisfy the Secretary of State that the FDP is prudent. Key to achieving this is the operator appointing verifiers who are independent and credible. If the Secretary of State is not able to rely on the verifier's report then he will commission further advice and recover the cost of that advice from the operator. The Regulations set out the requirements for the Secretary of State to be able to rely on the verification report.

23. The Government considers the provisions as proposed in the draft regulations relating to independence to be broadly sufficient, and notes that the verifier will be required to apply clear and objective criteria in making their assessment. Accordingly only minor and technical changes have been made to this aspect of the draft Regulations.

The Scope of Verification

24. The Government's view is that verification must focus on those areas of principal concern to the Secretary of State. Under the original proposals the full annual report needed to be subject to independent third-party verification. This will no longer be the case. In the annual report only changes to the cost estimates of the designated technical matters (decommissioning and waste management and disposal costs to be met from the fund) will need to be verified. In response to the consultation details relating to the financial provision will not now need to be verified. If the Secretary of State is not content with the annual report so far as it relates to the financing arrangements (or any other aspect), he has powers under the Act to require further information to be provided. Overall, greater emphasis will be placed on the Quinquennial Report (QQR), which will need to be verified in full. .

The test for prudence and the ability of the verifier to make recommendations

25. The Government is keen to ensure that verification is proportionate to its purpose, which is to provide the Secretary of State with additional assurance as to the accuracy of the operator's estimates of the costs of the designated technical matters and to provide an independent assessment of the level of prudence of the provision made for the financing of the designated technical matters . In the original proposals, the verifier was able to make necessary recommendations to further improve the prudence of the cost estimates and financing for the designated technical matters. Given that arrangements can always be made more prudent, through the addition of greater contingency, there is a risk that the level of prudence achieved could become disproportionate to the underlying risks. Therefore, the Government agrees that the Regulations should no longer enable the verifier to make such recommendations. Instead, the verifier's recommendations, which will only be made where the verifier considers the cost estimates or financing of the designated technical matters are not prudent, will be those which if complied with, will make in the verifier's opinion the cost estimates or the financing of the designated technical matters prudent.

True and fair view

26. The Government accepts that the use in the draft Regulations of the "true and fair view" test was problematic and confusing given that it is a recognised term in financial reporting. Under the revised proposals, the Government is no longer proposing to use the "true and fair view" test. Instead, the verifier is required to confirm that the cost estimates of the designated technical matters in the FDP are prudent and also that any provision for the financing of the designated technical matters is prudent. In making these assessments, we would expect the verifier to satisfy himself that the estimates are consistent with current knowledge and technology, applying appropriate standards and take prudent account of risk and uncertainty. In regard to verifying the prudence of the operator's financial provision, the verifier will need to satisfy himself as to the accuracy and completeness of the operator's financial reporting.

Disputes arising from verification reports

27. The consultation set out the competences the Secretary of State would expect to see in an independent verifier. In the Government's view, if a verifier meets these competencies the Secretary of State would normally expect to rely on the verifier's assessment. However the Secretary of State retains the option to commission further advice and recover the costs of that advice from the operator if it is deemed necessary in order to be able to make a decision in relation to an FDP.

28. The verifier will wish to operate under an appropriate level of professional indemnity cover; we would expect this to be dealt with in the arrangements between the operator and the verifier. The verifier may set out in the report limitations on liability or alternatively directly seek the Secretary of State's acknowledgement as to such limitations in order to be able to rely on the

verification. We would therefore expect issues of liability of the verifier to the Secretary of State, to be dealt with in this way.

29. The Government recognises that the verification will involve the professional judgement of the verifier, and will expect to see evidence that the verifier is taking account of current knowledge and experience (including information derived from operating and decommissioning experience from the broad corporate group to which the operator might belong), and making due allowance for risk and uncertainty, in making their assessment of the prudence of an operator's FDP.

Provisions relating to modifications to an approved programme

30. Section 4 of the Consultation summarised the draft Regulation's provisions in relation to modifications to an approved FDP. Given the length of time that an FDP will be in effect, modifications are inevitable and necessary to ensure that prudent provision is being made throughout the lifetime of the FDP. The Government is keen to ensure that the regime is proportionate and to this effect, proposed a materiality threshold in the draft Regulations, below which modifications would not need the approval of the Secretary of State. Consultees were asked the following question:

Question 3: It is Government's intention that only changes that meet the definition of the materiality threshold should require the Secretary of State 's prior approval. Given the checks and balances in place, (annual and quinquennial reviews, independent verification, and in extremis, the Secretary of State's power to modify), is the proposed materiality threshold set at a level that will capture strategic changes to the FDP but still protect the taxpayer? Is the proposed approach for the notification of modifications to an FDP that are below the materiality threshold a reasonable one? Does the definition of the content of a funded decommissioning programme in draft regulation 3 accurately define the liabilities to be captured by the modification?

Summary of respondents' comments on the modification provisions

31. There was general support for the application of a materiality threshold in determining which changes to an operator's FDP should require the Secretary of State's approval, and in most cases the proposal to set this threshold at +/- 5% of liabilities was thought appropriate. However, it was suggested that more information would need to be provided on the proposal to set this threshold in relation to the "current net present value of the cost estimate, adjusted from time to time for inflation" (draft Regulation 6(2)(a)).

32. Also, a number of respondents argued that the cumulative modifications provisions were impractical and expressed concern that a requirement to track all modifications, however small, to an FDP was onerous; a large number of modifications was expected, and operators should not be required to track and report all such changes. Instead several respondents proposed applying a "de minimis threshold" in which modifications would only be notified to the Secretary of State if their impact was above a certain level. Other respondents took the view that all modifications that affect the estimated cost of future liabilities should be notified to the Secretary of State.

33. Some respondents were concerned that the requirement to notify and seek approval for modifications to the FDP implied that the Secretary of State would be exercising control over operational decision making at the nuclear site, and that this could conflict with the operator's obligations under the existing regulatory regime. This included questions about the reference in the draft Regulations (in Regulation 6(2)(b)) to possible conflicts with an operator's licence conditions or environmental permits. It was also suggested that local authorities and regulators should be included as statutory consultees in the modifications process.

34. Some respondents raised concerns regarding what they considered to be the unlimited powers of the Secretary of State to modify an FDP.

35. It was also suggested that the definition of waste disposal costs in Regulation 3(2) be amended, so that rather than capturing a wide range of waste streams, it should just refer to spent fuel and intermediate level waste (ILW) as those are by far the most significant waste streams in cost terms and will be subject to a separate agreement between the operator and the Government.

The Government's response on the modification process

36. The Government is pleased to note the widespread support for the +/-5% materiality threshold. However the Government has concluded that the regulations should not set the threshold in relation to the "current net present value of estimated cost", but rather the threshold should be in relation to the cost estimates, however calculated, contained in the operator's FDP. It will be for the operator to propose, and the Secretary of State to agree, how inflation should be accommodated in the operator's FDP and this will provide the basis for the assessment of the financial impact of any modification to an approved FDP.

37. With regard to the definition of waste disposal costs in draft Regulation 3(2), the Government agrees that it would be better for the disposal costs of ILW and spent fuel to be shown separately from the all other costs and this change has been made in the revised Regulations

38. The Government considers it essential that the operator maintains an up-to-date and accurate FDP. Therefore the Government's view is that all modifications to an operator's FDP must be tracked, the financial impact assessed and the modification reported to the Secretary of State.

39. The Government does, however, recognise the risk that this requirement could become onerous if there were to be a great many minor, perhaps even trivial, modifications to an FDP. This appears to be a particular concern in relation to the coverage of operational and technical issues in the Decommissioning and Waste Management Plan (DWMP) element of the FDP. The Government does not expect day-to-day operational matters to necessitate frequent, minor modifications to the DWMP. The Government's view is that the operators should provide sufficient detail in their DWMPs on both the technical matters and designated technical matters to enable the Government to have confidence

that they have a realistic, clearly defined and achievable plan. The amount of information that operators provide on activities should be such that the Secretary of State is able to assure himself that the operator's cost estimates are prudent. The level of detail should be proportionate to the impact that the activity will have on the level of their liabilities. Therefore day-to-day operational matters are expected rarely to have any impact on the DWMP, but where there is such an impact it should be recorded, the cost consequences assessed and the modification notified to the Secretary of State. Under the Regulations operators have the option of notifying of modifications which have been made under the Regulations in the annual report or the quinquennial report.

40. The Government notes the concern expressed by some respondents that the requirement for the Secretary of State to approve certain modifications to an FDP implies that the Secretary of State could be exercising control over operational decision-making at the nuclear power station and wishes to clarify the purpose of this requirement. In deciding on an operator's proposed modification to an FDP that results from an operational or technical change to their nuclear power station, the Secretary of State will not be deciding on the appropriateness or otherwise of that operational or technical change. Rather, the Secretary of State will be deciding whether that change has been adequately reflected in the operator's FDP, for example whether the additional costs relating to the designated technical matters have been prudently estimated, and whether there is prudent financial provision for those additional costs.

41. Therefore in the event that an operator was required to make an operational or technical change to avoid breaching its licence conditions or environmental permits, and this change required the operator to propose a modification to the FDP ;the Secretary of State in considering this modification would not be deciding whether or not that change is appropriate, as that is the role of the regulators. However, the Secretary of State would wish to establish that the financial consequences of the operational or technical change, whether to the operator's cost estimate or financial provision, have been reflected in the proposed modification to the FDP, so that the estimates and provision remain prudent. Therefore the Government has decided that the draft Regulation 6(2)(b) which referred to possible conflicts between the FDP approval process and the regulatory regime, is unnecessary and it has not been included in the final regulations.

42. The Government's view is that the operator's obligations in relation to their FDP should not contradict or undermine the requirements of the regulators. However, the Government recognises that close working between the regulators and the Secretary of State will be essential to ensure that any risk of overlaps or contradictions between the two regimes is minimised.

Secretary of State's power to modify an FDP

43. In respect of the Secretary of State's power to modify an FDP, the Government has announced its intention to amend the Energy Act 2008 to (by way of the Energy Security and Green Economy Bill) ensure that there is an appropriate

balance between the Secretary of State's powers to protect the taxpayer by modifying an FDP and the operator's need for clarity over how those powers will be exercised.

Designated Technical Matters

44. Section 5 of the Consultation set out the provisions relating to the designated technical matters. These were included in the draft Order. Designated technical matters are the decommissioning of the installation and clean up the site (which includes the management and disposal of waste) once the nuclear power station has ceased generation for the final time. The Act also enables the Secretary of State to designate by Order certain activities undertaken during the generating life of the station as "designated technical matters". The consultation proposed that the construction and maintenance of interim stores for ILW and spent fuel and the steps undertaken in preparation for decommissioning of the installation and clean up of the site - in each case during the operation of a power station – are to be designated technical matters. These are significant costs and designation would ensure that money was available to carry out the relevant work, which could otherwise be competing with revenue-generating activities and might not get prioritised. Consultees were asked the following question:

Question 4: Do the proposed designations strike the right balance between protecting the taxpayer on the one hand whilst avoiding undue administrative burdens on the operator?

Summary of respondents' comments on designated technical matters

45. Some respondents commented that it was inappropriate to ring fence the costs of the construction of interim stores for spent fuel and ILW in this way. It was argued that such facilities are integral to the operation of the nuclear power station and must, therefore, be provided for during the life of the station. This contrasts with decommissioning, which takes place after generation has ceased and main economic benefit has been derived. To include interim stores in the designated technical matters is unnecessarily costly.

46. Other respondents emphasized the uncertainties over storing spent fuel for long periods of time on site and the arrangements omitted to include the full cost of safely managing spent fuel and radioactive waste.

The Government's Response

47. The Government understands the argument that the provision of interim stores is integral to the long-term operation of the station. However, the Government notes that the construction and maintenance of interim stores will require substantial, periodic expenditure and the Government remains of the view designation is appropriate, to ensure that money is available to carry out the relevant work, which could otherwise be competing with other revenue-

generating activities. Moreover, given the importance attached by the public to robust arrangements for spent fuel and ILW management, including long-term on-site interim storage, that the Government feels that it is entirely appropriate that these facilities be provided for from day one through contributions to the fund. By doing so, the Government will ensure through the verification process that the cost estimates are robust and the financing arrangements for the stores are prudent. The Government has not, therefore, made any changes of substance following consultation to the Nuclear Decommissioning and Waste Handling (Designated Technical Matters) Order 2010..

Provisions relating to reporting requirements

48. Section 6 of the Consultation set out the provisions relating to reporting requirements. The purpose of the reports is to ensure that the operator's waste and decommissioning liability can be regularly monitored and assessed against the size and performance of the Fund, to ensure that the operator is making prudent provision. Consultees were asked the following question:

Is the annual and quinquennial reporting period appropriate? Are the timescales for submitting the reports adequate? Is there any additional information that should be included in either report? Given the nature of the liabilities and the content of the quinquennial report, should the in-depth quinquennial review be undertaken on a more frequent basis?

Summary of respondents' comments on the reporting requirements

49. There was broad support for the proposed reporting requirements. Many respondents emphasized the importance of the quinquennial review (QQR) process. However, prospective nuclear operators argued that the submission deadlines for the quinquennial report were too tight and the reporting requirements in the QQR were onerous, in particular the need for a detailed review of the technical matters. (Under the provisions relating to verification, the QQR would need to be verified in full). Prospective operators also commented that annual reporting was too frequent and again, that the submission deadline was too short.

The Government's response

50. The Government is determined to ensure that the reporting requirements focus on the areas of principal interest to the Secretary of State and are proportionate to the risks to the taxpayer. The Government is also keen to ensure that the cost of reporting is minimized wherever possible. To this effect, the Government proposes to place greater emphasis on the QQR as the principal means of reviewing the programme and thereby ensuring the taxpayer is protected. The Regulations require the QQR to include changes, to the technical matters, to the estimates of costs and to the financing arrangements, as opposed to a detailed review of these matters. Further, the Regulations require a verification report of any changes to the estimates of costs and any changes to the financing arrangements. The annual report needs to detail any changes to the cost estimates and any changes to the financing arrangements. However, verification is only required in relation to the changes to the cost estimates. Whereas previously the annual report had to be verified in full.

51. Under the Regulations operators may include notification of modifications made under the regulations in the annual report or in the quinquennial report where the modification is to take effect on or after the date of the report.

52. The Government also accepts that the proposed submission deadlines for the annual and QQR reports were too short. Accordingly the Government is extending the deadline for the annual report from two to three months after the end of the relevant period and for the QQR report from three to six months after the end of the relevant period.

Annex A: List of Respondents

Blackwater Against New Nuclear Group

Braystones Residents

Mr Bryan Norris

Centrica Energy

Copeland Borough Council

Cumbria County Council

Dr David Whitworth

Dr Peter Foreman

EFDF Energy

Environment Agency

Greenpeace UK

Horizon Nuclear Power Ltd

Nuclear Decommissioning Authority

Nuclear Industry Association

Nuclear Free Local Authorities Secretariat

Nuvia Ltd

Scottish Environment Protection Agency

Scottish Power

Scottish & Southern Energy

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