

ANNEX 7

FUNDED DECOMMISSIONING PROGRAMME

This Annex summarises certain key points in relation to the review by the Board of the FDP as follows.

1. Part A (*Factual Background*) of this Annex covers the factual background and central considerations in relation to the FDP.
2. Part B (*Life Cycle of the FAP*) of this Annex summarises the FAP developed pursuant to the FDP, the key stages in the life cycle of the FAP and the relevant provisions of the FAP applicable at each stage.

PART A – FACTUAL BACKGROUND

1. FAP

- 1.1 The Operator has structured its FAP as a contract with an independent fund company (being the FDP Implementation Company) in order to create legally binding rights and obligations between the Operator and the FDP Implementation Company. The Secretary of State is not a party to the FAP but is granted certain third-party rights in the FAP.
 - 1.2 The FAP is intended to be in place prior to First Criticality and to remain in place until decommissioning activities have achieved the Site End State (subject to various early termination scenarios) after generation has ceased, and is therefore structured to address several different phases in Sizewell C's life cycle. This is reflected in the terms of the FAP, which include different requirements for the various periods, principally differentiating between:
 - (A) the construction and commissioning period prior to First Criticality (note that although the FAP will be in place prior to First Criticality, if the Reactors never achieve criticality, it plays no role in site decommissioning);
 - (B) the Operational Period; and
 - (C) the Decommissioning Period after generation has ceased.
 - 1.3 There are also provisions in the FAP to provide flexibility to address certain low-probability events which are recognised as a possibility during the FAP's lifetime, such as the agreed measure of inflation ceasing to be published, force majeure or the adoption of an alternative currency by the United Kingdom.
 - 1.4 The detailed terms of the FAP are further described in Part B (*Life Cycle of the FAP*) of this Annex.
- #### **2. DWMP**
- 2.1 The DWMP is a non-binding plan which sets out the Operator's current objectives and strategy in relation to decommissioning and waste disposal for Sizewell C.

- 2.2 The Board understands that the Operator's rationale for preparing the DWMP on a non-binding basis is that its Nuclear Site Licence contains an obligation to decommission the Site and this plan sets out the manner in which such obligations are proposed to be met.
- 2.3 Certain provisions in respect of the DWMP (such as those relating to verification and the updating of cost estimates) are included in the FAP rather than the DWMP in order to ensure that such provisions are both legally binding and subject to criminal sanctions for breach under Section 57 of the 2008 Act.
- 2.4 The DWMP is itself underpinned by the Detailed DWMP, setting out costs and scope in greater detail. The Detailed DWMP has not been reviewed by the Board. The Board understands that, for practical reasons, this document has not been included as part of the FDP, but that the FAP requires the Detailed DWMP to be maintained and requires the DWMP to be reconciled to it.
- 2.5 Periodic updating of the DWMP is required by the FAP. The DWMP (both the steps to be taken and estimated costs) is required to be updated at the first Quinquennial Review to take place following First Criticality and thereafter must be updated at least once every five (5) years as part of the Quinquennial Review process set out in the FAP. In addition, it is contemplated in the explanatory notes to clause 1.4 of Schedule 9 (*Quinquennial Review Programme*) of the FAP that the as-built DWMP will review and revise the P80 calculation "*taking onboard lessons from the Hinkley Point C*".
- 2.6 Schedule 9 (*Quinquennial Review Programme*) of the FAP provides that the five (5) yearly Quinquennial Reviews will involve a substantive review of the DWMP and the Detailed DWMP in order to determine appropriate amendments, including based on technical parameters (such as advances in decommissioning technology), the economic environment, and any significant operational changes to the Site to provide an updated understanding of the then anticipated costs of funding the Designated Technical Matters. The DWMP shall, however, be updated annually to account for significant events, Indexation and, in the Disbursements Period, liabilities that have been discharged.
- 2.7 The mechanism for determining Contributions to the FDP Implementation Company is contained in the FAP, and the annual calculation of Contributions is based on the updated DWMP and is therefore designed to respond to events during the Operational Period which have an impact on the End of Generation Target (such as an increase in forecast decommissioning costs).
- 2.8 The Board has been instructed, pursuant to paragraph 17 of the Terms of Reference, to assume that the Secretary of State is satisfied with the terms of the DWMP. Therefore, the Board has not reviewed the DWMP and has relied solely on the NDA review of the DWMP. As referred to in row A.1 of Annex 5 (*Risk Matrix Identifying Key Potential Risks to Shortfall in Funding the Cost of FDP Liabilities*) and Annex 15 (*Decommissioning and Waste Management Plan (DWMP) Analysis*), the NDA has concluded the DWMP is consistent with the Guidance and contains realistic, clearly defined and achievable plans for decommissioning and waste management, with any technology or gaps identified.

3. FDP IMPLEMENTATION COMPANY

- 3.1 The FDP Implementation Company is a special purpose vehicle with one share (the Non-Voting Operator Share) held by the Operator (in order to ensure that it is an “associated” company of the Operator for the purposes of the 2008 Act) and the remaining majority of shares owned by either:
- (A) the Independent Directors; or
 - (B) the FDP Company Administrator in circumstances (beyond the control of the Operator) where there are no Independent Directors.¹
- 3.2 It is a requirement of the FAP that the FDP Implementation Company be operated by the Independent Directors, who must constitute the majority of the board of directors at all times. The Independent Directors select their own successors by a majority vote pursuant to clause 62.1 (*Existing Independent Directors decide on all new Independent Director appointments*) of the FAP. In addition, clause 62.2 (*Independent Directors must satisfy the Independence Criteria*) of the FAP sets out the Independence Criteria against which independence is to be judged, and the FAP provides for the removal of Independent Directors who cease to be independent. Additional conditions in relation to the requisite skill set and educational background for the appointment of prospective directors are contained in the FDP Implementation Company AoA.
- 3.3 Whilst the Operator holds the Non-Voting Operator Share and may appoint up to two (2) directors of the FDP Implementation Company, neither the Operator in its capacity as shareholder nor its directors have voting rights in the ordinary course of business.²
- 3.4 Clause 10 (*FDP Implementation Company will hold the Fund Assets Remote from the Operator*) of the FAP requires that the Fund Assets must be held by or on behalf of the FDP Implementation Company. The FDP Implementation Company has a significantly expanded role in terms of investment decision-making compared to HPC. It is accordingly responsible for formulating the Investment Strategy in accordance with Schedule 7 (*Investment Rules*) of the FAP and taking decisions in relation to investments and/or the appointment of investment advisors (subject to limited Operator veto rights). Please refer to paragraph 5 of Part B of this Annex for further consideration.
- 3.5 Given that, under the Operator’s proposed structure, the Fund Assets are held by the FDP Implementation Company, the FDP Implementation Company is intended to be insolvency-remote from the Operator itself (i.e., the creditors of the Operator should not have a claim on the Fund Assets in the event of the Operator’s insolvency).
- 3.6 In order to help protect the Fund Assets, the FDP Implementation Company has been established with restricted discretionary powers in order to minimise the risk of incurring

¹ **Note:** This is, however, unlikely in the ordinary course of business.

² **Note:** In summary, the Operator may only exercise its votes as a shareholder, and the Operator-appointed directors may only vote at Board meetings, if the FDP Implementation Company has failed to implement a FAP modification, a direction given by the Secretary of State or an arbitration, adjudication or court order. The Operator may also exercise its votes as a shareholder in respect of certain reserved matters which relate to fundamental aspects of the operation of the FDP Implementation Company.

liabilities (other than disbursements from the Fund Assets to fund Allowable Costs in respect of decommissioning pursuant to the FAP). The FDP Implementation Company cannot borrow, give guarantees, or pledge its assets (noting that it may collateralise the derivative or hedging arrangements which it is permitted to enter into under the terms of the FAP³).

- 3.7 Additionally, the FDP Implementation Company cannot enter into agreements with third parties (under which it might have liabilities) except as permitted by the FAP and on arm's-length terms. The FAP requires these limitations on third-party contracts to remain in place for the term of the FAP and stipulates that they cannot be amended without the Secretary of State's consent and the approval of the Independent Directors.
- 3.8 The terms of the FAP also require the FDP Implementation Company's primary purpose to be the implementation of its obligations and, to the extent it considers appropriate, the exercise of its rights under the FDP. The Independent Directors therefore have a duty to promote this objective in their capacity as directors and have separately undertaken to do so in their capacity as shareholders of the FDP Implementation Company. Taken together, these provisions ensure that the FDP Implementation Company is restricted from either incurring debt or engaging in secondary business activities and thus incurring the associated risks.
- 3.9 The Operator has set up the proposed decommissioning structure such that there is limited recourse against the Operator's group. The Operator's primary obligations are to fund Contributions and FDP Implementation Company operating costs, and if the measures set out in the FAP and the FDP Budget and Services Agreement do not ensure that the Fund Assets are sufficient, neither the Secretary of State nor the FDP Implementation Company will have recourse to other members of the Operator's group. In addition, as discussed in row 3.13.2 of Annex 6 (*Guidance Analysis*), the Secretary of State is not expected to be able to modify the FDP to allow such recourse.
- 3.10 The Operator is responsible for funding the FDP Implementation Company's expenses in advance by means of payments every six (6) months pursuant to the FDP Budget and Services Agreement and has undertaken pursuant to clause 66.2 (*Budgets for the FDP Implementation Company will be agreed or determined by an Expert*) of the FAP to do so. The fee the Operator is required to pay is net of any sums previously paid for amounts which were not subsequently incurred by the FDP Implementation Company and of disputed amounts not yet determined to be payable by an Independent Expert. The FAP requires the amount to be paid to be determined on the basis of the costs which the FDP Implementation Company reasonably expects to incur (including, amongst other things, the remuneration of the Independent Directors, insurance costs and tax liabilities) and to include an appropriate level of contingency.
- 3.11 Were the Operator to fail to pay any amounts due, the FDP Implementation Company would be entitled to have recourse to the Fund Assets to meet its expenses (with the Operator being obliged during the Operational Period to make up any resulting deficit via Correction Contributions in accordance with clause 66.3 (*FDP Implementation Company may have recourse to the Fund Assets if the Operator fails to pay*) of the FAP. The End of Generation

³ **Note:** See further explanation in relation to the FDP Implementation Company's possible use of derivatives in row 12 of Part A (*Fund Insolvency*) of Annex 13 (*Insolvency Remoteness Analysis*).

Target is designed to include provision for the ongoing costs and expenses of the FDP Implementation Company, including in respect of tax and investment management fees, that it is expected to incur after the end of the Operational Period of the Plant. However, if the operating costs are underestimated, it will not be possible to top up funding post-closure.

- 3.12 The Board understands that DESNZ does not expect that the FDP Implementation Company's expenses will be of a magnitude that (even if provisional sums prove insufficient and calls are made on the Fund Assets) these will threaten the sufficiency of the Fund Assets.⁴ The FDP Implementation Company will also rank as a super senior secured creditor under the contractual terms of the Security Trust and Intercreditor Deed in a post-enforcement scenario in respect of any liabilities owed by the Operator under the FAP and, therefore, would be able to recover unpaid Contributions and the Accelerated Decommissioning Contributions Amount from the proceeds of the Common Security Documents and the FDP Additional Security Documents in a post-enforcement scenario.

4. ANCILLARY DOCUMENTS

Various ancillary documents relating to the FDP Implementation Company do not form part of the FDP. These are the FDP Implementation Company's AOA, FDP Implementation Company SHA and FDP Budget and Services Agreement (the "**Ancillary Documents**"). The FAP designates certain terms of the Ancillary Documents as "mandatory".⁵ These terms cannot be amended without the Secretary of State's consent and cannot be contradicted or overridden by other amendments. The FDP Implementation Company and the Operator have undertaken in the FAP not to knowingly take any step which would render provisions of the Ancillary Documents inconsistent with the requirements of the FAP. The FDP Implementation Company and the Operator have further undertaken in the FAP to use their reasonable endeavours to ensure that the Ancillary Documents are consistent with those requirements.

5. OTHER DOCUMENTS

- 5.1 The Board has been instructed pursuant to paragraph 17 of the Terms of Reference to assume that the Secretary of State is satisfied with the terms of the DWMP, Waste Transfer Contracts, the Section 46 Agreement and the ancillary documentation related to the RAB. The Board has, in this advice, highlighted these documents or arrangements only where they believe (based on advice received from the Board's legal advisors) that the terms of the FAP may require their consideration.
- 5.2 The Board has not otherwise commented on any of these documents, and the Board understands that the Secretary of State will receive separate advice on each of these and is satisfied that such task is outside the Board's remit.

6. DURATION OF REACTOR OPERATION AND ECONOMIC LICENCE

⁴ **Note:** The Board has however not been provided with the modelling to illustrate this.

⁵ **Note:** See row 4 of Part A (*Fund Insolvency*) of Annex 13 (*Insolvency Remoteness Analysis*).

- 6.1 The FAP is structured such that Contributions requirements of the Operator are aligned to a Funding Path from year 1 to year 60, and it provides that any cessation of both Reactors generating electricity, and the subsequent closure of Sizewell C, before 60 years have lapsed from the year in which First Criticality occurs is treated as early closure for the purposes of the FAP.
- 6.2 However, notwithstanding the above, the FAP has been structured to fully fund the total decommissioning liabilities after 55 years (other than the expected Costs of Spent Fuel Disposal between years 55-60). To the extent there is a delay to First Criticality such that the FDP Allowance Building Block will be scheduled to be in effect for less than 60 years (being an FDP Building Block Term Event), the Primary Funding Period will be reduced from 55 years by the difference in the number of years for which the FDP Allowance Building Block is available and sixty (60).
- 6.3 The FAP has therefore been agreed on the basis that “fully funded” status is to be targeted at the end of the Primary Funding Period (year 55 after First Criticality). Thereafter the Fund Assets are intended to grow, and additional sums are required to be paid into the fund where necessary by way of Correction Contributions, to accumulate sufficient sums to cover the increased costs incurred through the remaining five years to year 60 of the FDP. Any Correction Contribution may continue to be spread over periods up to the end of the Secondary Funding Period in year 60.
- 6.4 It is, however, possible that the Reactors will be able to continue generating electricity beyond year 60. Although the FDP does not necessarily preclude the possibility that the FAP may still be in force if the Reactors continue to generate electricity beyond year 60, the Operator will need to propose appropriate modifications to the FDP should a life extension beyond 60 years be sought. This is because a new funding pathway would be required to fund disposal of the additional waste that would be produced, and associated revisions to the Waste Transfer Contracts would have to be agreed to as a prerequisite. The possibility of such life extension and the risks relating thereto are discussed further in row B.7 of Annex 5 (*Risk Matrix Identifying Key Potential Risks to Shortfall in Funding the Cost of FDP Liabilities*).

PART B - LIFE CYCLE OF THE FAP

1. BEFORE FIRST CRITICALITY - INITIAL STEPS

- 1.1 The Operator submitted an application to the ONR on 30 June 2020 for a nuclear site licence to install and operate a nuclear installation at Sizewell C. The Nuclear Site Licence was granted on 7 May 2024.
- 1.2 Under the 2008 Act, an entity which applies for a nuclear site licence in respect of a site on which it intends to construct a nuclear installation must give written notice of the application to the Secretary of State and then prepare and submit a funded decommissioning programme, which, in the case of Sizewell C, is expected to include a decommissioning and waste management plan and a funding arrangements plan (see paragraph 1 (*Introduction*) of the Main Report).
- 1.3 Operators are prohibited, under the 2008 Act, from beginning construction work on buildings with nuclear safety significance (for instance, by pouring the first structural concrete for such buildings) until they have an approved funded decommissioning plan in respect of the site. Once the funded decommissioning plan is approved, construction work may commence.
- 1.4 Once construction of the nuclear installation has begun, one of the key early dates from an FDP perspective — towards which much of the initial steps in the life cycle of the funding arrangements plan build — is “**First Criticality**”, which is the date on which a self-sustaining nuclear chain reaction first occurs in either reactor core at the nuclear installation. Pursuant to the Guidance, the Operator must satisfy the Secretary of State that effective and transparent arrangements are in place as part of the approved FDP, no later than First Criticality, to ensure that the Operator will meet its obligations to discharge its liabilities in full, including decommissioning and waste disposal liabilities. The date of First Criticality triggers the commencement of the Primary Funding Period for the purposes of the Annual Contributions and the Monthly Contributions to the FDP Implementation Company.
- 1.5 Pursuant to clause 26.2 (*Security for the benefit of the Secretary of State and the FDP Implementation Company*) of the FAP, the Operator is required to grant security in favour of the FDP Implementation Company (securing liabilities in respect of Contributions and FDP Implementation Company expenses due under the FAP) and the Secretary of State (in relation to amounts under the SF Transfer Contract and the ILW Transfer Contract) prior to the earlier of:
 - (A) the date on which the Operator first grants any fixed charge or any floating charge; and
 - (B) the date that occurs five (5) Business Days before First Criticality.
- 1.6 The current target dates for full commissioning of the first and second Reactors at Sizewell C (it is expected that full commissioning will occur shortly after First Criticality) pursuant to the SZC Economic Licence have not been confirmed so are currently unknown by the Board. Once either Reactor has been commissioned, the Plant will be operational and generating power.

- 1.7 Paragraph 2c.39 of the Guidance provides that the Secretary of State will expect the first payment to be made to the FDP Implementation Company no later than First Criticality. Accordingly, under clause 4.2 (*First Contributions Notice will be produced before First Criticality*) of the FAP, the Operator is required to produce and send a copy of the First Contributions Notice (setting out the first and second Annual Contributions to be made) to the Secretary of State and the FDP Implementation Company by no later than 1 November of the Financial Period immediately prior to the Financial Period in which the First Criticality Payment Date is expected to occur. The First Criticality Payment must then be made by the Operator five (5) Business Days before the expected date of First Criticality.

2. REMEDIES THROUGHOUT LIFETIME OF FDP

- 2.1 The FAP provides that certain events constitute 'Compliance Events' on the part of the Operator or the FDP Implementation Company and that such events will be deemed breaches of the FAP unless exempted. The FAP goes on to set out the specified exemptions, which include:

- (A) where the Operator has proposed a statutory modification to the FDP in respect of the relevant event on the grounds that compliance is not lawful or reasonably practicable; and
- (B) where the relevant event is caused by the taking of steps by a lender to enforce security under security documents to which the Secretary of State is party (such as the appointment of an administrator, administrative receiver, receiver or other similar person under or party to any Common Security Document or FDP Security Document).

- 2.2 The FDP Implementation Company is required to notify first the Operator and subsequently the Secretary of State if under clause 46.1 (*Certain events will be notified by the FDP Implementation Company to the Operator*) of the FAP it believes that certain breaches have occurred, including any payment default, any breach relating to maintaining the FDP creditors' priority of security and breaches relating to the rule that FDP investments must be made under Investment Orders. The Operator must respond to a notice from the FDP Implementation Company within ten (10) Business Days in order to confirm or reject the occurrence of the circumstances constituting a potential breach.

- 2.3 The sole and exclusive remedies available to each party (and to the Secretary of State) under the terms of the FAP are set out in the document, and include judgment in relation to debt, injunction, specific performance, and declaratory relief. These remedies are, of course, overlaid with the threat of criminal sanctions, pursuant to the 2008 Act, for breach of the provisions of the FDP and with the Secretary of State's other statutory powers.

- 2.4 If a 'force majeure' event occurs (which includes any event not of the relevant party's making nor within its reasonable control) which prevents either party from performing its obligations under the FAP, such obligations remain in effect but become suspended without liability for breach of the FAP for so long as the force majeure event prevents them from performing such obligations (provided the affected party notifies the other party as soon as reasonably practicable and uses reasonable endeavours to mitigate the effects of such suspension and resume performance of the obligations as soon as reasonably practicable).

3. AFTER FIRST CRITICALITY - PRIMARY FUNDING PERIOD AND CONTRIBUTIONS PROCESS

- 3.1 Once First Criticality occurs, the Primary Funding Period under the FAP commences, during which the Operator will be required to make regular Contributions to the FDP Implementation Company in order to make prudent provision for the relevant decommissioning liabilities. The Primary Funding Period runs from First Criticality to the end of the 55th year following that date (subject to adjustment following the occurrence of an FDP Building Block Term Event).
- 3.2 A Funding Path is determined and updated in accordance with Schedules 2 and 3 of the FAP which sets out target Contributions to the Fund Assets and is applied in both the Primary Funding Period and Secondary Funding Period.
- 3.3 For each remaining year during the Primary Funding Period, the FAP sets out a “straight-line” Funding Path with Contributions split evenly in real money terms (i.e., net of Indexation) across each Annual Contribution in the Primary Funding Period based on the End of Generation Target.
- 3.4 The target is that the fund is fully funded (i.e., the fund contains sufficient monies to decommission the Site at that point in time and deal with disposal of waste generated in that period of the operation of the Plant) by FYE End of Primary Funding Period (i.e., year 55). The FAP assumes that the final Contribution of the Primary Funding Period will be made in the Annual Contribution Period ending on the FYE End of Primary Funding Period.
- 3.5 The structure of the Funding Path for the Secondary Funding Period (designed to cover the disposal of the additional waste created during the period from year 55 to year 60) is set out in paragraph 4 of this Part B of this Annex.
- 3.6 The Operator is required to make cash payments of Contributions to the FDP Implementation Company, but such Contributions may be paid by any person. The amount to be paid in any given Financial Period is specified in a Contributions Notice. The first annual Contribution is due five (5) Business Days before the expected date of First Criticality. Thereafter, each Annual Contribution is payable by way of Monthly Contributions. The Operator must ensure that the value of each Annual Contribution has been paid to the FDP Implementation Company by the end of the relevant Annual Contribution Period (i.e., the relevant Financial Period).
- 3.7 Although a different procedure applies in respect of the First Draft Contributions Notice for the first and second Annual Contributions, thereafter, the FDP Implementation Company is required to produce a Draft Contributions Notice as part of each Annual Review Process and Quinquennial Review Process (i.e., the Draft Contributions Notice for any given year will be produced each spring). The annual report which confirms the amount of the Contribution will be published each autumn. The Draft Contributions Notice will set out each of the Monthly Contributions which shall be payable in the relevant Annual Contribution Period.
- 3.8 There is a set of minimum Contribution calculation rules in the FAP which apply both during an Annual Review and Quinquennial Review year and are described below. These rules do not, however, apply to the initial two Contributions which will be determined separately based on the DWMP submitted on approval of the FDP.

- 3.9 Although the mechanism for determining the Contributions remains fixed, the annual calculation of Contributions to be paid is based on the updated DWMP and consequently is designed to respond to events that the Operator feels require inclusion in the updated DWMP. All costs are recalculated at least quinquennially.
- 3.10 The Contributions mechanism is based on two (2) different target values: the End of Primary Funding Period Target (used for Contribution calculations up to year 55) and the End of Generation Target (used for Contributions calculations up to year 60). Both targets are made up of four basic elements: the Costs of Decommissioning (which the Board expects to include FDP Implementation Company operating costs post Plant closure), the Costs of Spent Fuel Management, the Costs of ILW Disposal and the Costs of Spent Fuel Disposal. The key distinction is that the End of Generation Target for the Secondary Funding Period includes the Costs of Spent Fuel Disposal arising during the period between FYE End of Primary Funding Period (i.e., years 55) and FYE End of Generation (i.e., year 60) which are to be met by Contributions during the Secondary Funding Period.
- 3.11 Costs of Decommissioning and Costs of Spent Fuel Management are determined for the purposes of the targets on a P80 plus 25 per cent. (25%) basis. In other words, the cost estimates for each of decommissioning and waste management for the Operator's FDP are set at a level such that there is an 80 per cent. (80%) chance of the actual costs proving to be lower than the estimates, and the Operator is required to fund to the P80 figure together with a further 25 per cent. (25%) contingency buffer.⁶ The Costs of ILW Disposal and Costs of Spent Fuel Disposal are determined on the same P80 basis without the application of 25 per cent. contingency. As part of the Quinquennial Reviews, the P80 contingency levels will be re-estimated on the basis of the re-evaluated Costs of Decommissioning as further detailed in row A.1 of Annex 5 (*Risk Matrix Identifying Key Potential Risks to Shortfall in Funding the Cost of FDP Liabilities*) and Annex 17 (*P80 Methodology*).
- 3.12 The waste disposal costs (both Costs of ILW Disposal and Costs of Spent Fuel Disposal) are provided for in the amounts determined by the Secretary of State in accordance with the provisions of the Waste Transfer Contracts in respect of ILW and Spent Fuel. See also row C.7 of Annex 5 (*Risk Matrix Identifying Key Potential Risks to Shortfall in Funding the Cost of FDP Liabilities*).
- 3.13 Further details as to the calculation of the targets are set out below (note the Board's advice regarding early closure risks at Guiding Factors 7(B), in relation to achieving these targets):
- (A) **the End of Primary Funding Period Target:** this is determined so as to require sufficient assets to be in the Fund at the end of year 55 (this period to year 55 referred to as the Primary Funding Period (subject to an adjustment following the occurrence of an FDP Building Block Term Event)) to decommission the Plant and manage, store and dispose of the waste were the Plant to close at this point, rather than at the Operator's expected end of economic life for the Plant (i.e., year 60). This involves:

⁶ **Note:** These concepts are however different, and it should be noted that that P80 plus 25% contingency does not equate to P100 or P105.

- (i) providing the Costs of Decommissioning equal to the Annual Milestone for FYE End of Primary Funding Period;
 - (ii) providing the Costs of Spent Fuel Management and Costs of ILW Disposal equal to the Annual Milestone for FYE End of Primary Funding Period;
 - (iii) providing only for the Costs of Spent Fuel Disposal for Spent Fuel generated during the Primary Funding Period (in other words, 55 years' worth of Spent Fuel rather than 60); and
 - (iv) providing for the additional costs of waste storage that will be incurred prior to disposal; and
- (B) **the End of Generation Target:** this is determined such that, on the date when the Site is assumed to cease operation (year 60), all liabilities are provided for. Given what is already required to have been accumulated by the end of year 55, as described above, this involves:
- (i) providing for disposal of the additional volumes of Spent Fuel created in the period between year 55 and year 60 (on the basis that the Spent Fuel generated prior to year 55 has already been provided for); and
 - (ii) providing an additional Spreading Period over which any Correction Contributions may be made beyond the end of the Primary Funding Period.

3.14 Each Annual Contribution (and consequently each Monthly Contribution) comprises two core Contribution calculations: (i) the Base Case Contribution; and (ii) the Correction Contribution. The Base Case Contribution shall be derived from the Funding Path and is set such that the fund is projected to accumulate to the End of Generation Target assuming Annual Milestones during the previous Quinquennial Review Period were achieved. The projection should assume that the asset returns are:

- (A) in respect of the Growth Portfolio, the expected annual rate of return of the Growth Portfolio less the Projected Inflation Rate; and
- (B) in respect of the De-Risking Period, a combination of the expected annual rate of return of the Growth Portfolio and the expected annual rate of return of the Long Term Portfolio as the FDP Implementation Company considers appropriate, less the Projected Inflation Rate.

Correction Contributions are designed to correct the fund to address any historic surplus or deficit. They look retrospectively at the actual financial position of the fund (i.e., the actual fund value, which depends on how well the investments have actually performed) at the end of the previous financial period and compare this with the relevant target Annual Milestone.

3.15 When preparing the Funding Path, the Base Case Contributions shall be calculated such that:

- (A) the projected Fund Assets Value as at the first day of the revised Funding Path is equal to the Funding Path Starting Asset Value (which is essentially the projected asset value as at the current QQR Reference Date taken from the previous Funding Path and expressed in money terms at the QQR Reference Date);
- (B) during the Primary Funding Period, the amount of each Base Case Contribution is equal to the amount of each other Base Case Contribution set out in the Funding Path when expressed in real monetary terms (without uplifting for Indexation) after any pro-rata adjustment for any Base Case Contributions related to any Annual Contribution Period in the Funding Path which is not equal to 12 months, and with the exception of the Base Case Contribution in the Quinquennial Review Year⁷;
- (C) the projected Fund Assets Value as at FYE End of Primary Funding Period is equal to the End of Primary Funding Period Target;
- (D) during the Secondary Funding Period, the projected Fund Assets Value as at FYE End of Secondary Funding Period is equal to the then applicable estimate of the End of Generation Target; and
- (E) when paid into the Fund from the Financial Period following the Quinquennial Review Year until the FYE End of Primary Funding Period, and remaining invested to FYE End of Generation, the expected Fund Assets at FYE End of Generation are equal to the End of Generation Target,

assuming that:

- (F) the Annual Contributions will be received on a monthly basis as Monthly Contributions; and
- (G) returns will be calculated on an annual basis and assumed to be constant in each Financial Period.

3.16 The Correction Contribution mechanism allows a deficit Contribution to be added to the Base Case Contribution and a surplus deduction to be offset against the Base Case Contribution. This is so that the Fund Assets value may move closer to the relevant Annual Milestone. There are six stages to the calculation of the Correction Contribution:

⁷ **Note:** The rationale for this exception in the Quinquennial Review Year is as follows. The period covered by a Quinquennial Review is five years. The Quinquennial Review Year is the first of those years (or the first year after a five-year Quinquennial Reporting Period). Without the exception for the Quinquennial Review Year, the FAP could require that the Base Case Contribution for that year should be equal to the Base Case Contribution in the most recent Contributions Notice (presumably carried forward from the previous Funding Path before being recalibrated upon the Quinquennial Review). As the quinquennial recalibration of the Funding Path (from which the Base Case Contributions are derived) will probably result in a different level of Base Case Contributions from that prior to the Quinquennial Review, it will need to take account of the fact that the contribution in the first period of the current review may be different to those calculated for years after that.

- (A) determine the Actual Fund Assets as at the QQR Reference Date;
- (B) determine the annual calculation of the deficit or surplus by comparing the expected Fund Assets to the applicable Annual Milestone showing in the relevant Funding Path, Indexed to be in monetary terms as at the QQR Reference Date;
- (C) consider any Provisional Contributions Notices and any subsequent updated Contributions Notices covering the equivalent Annual Contribution Period;
- (D) determine the first and last dates in the applicable Spreading Period;
- (E) determine the End of Spreading Period Funding Target; and
- (F) complete the calculation of the Correction Contribution by:
 - (i) starting with the Actual Fund Assets as at the QQR Reference Date, project the Fund Assets over the Spreading Period; and
 - (ii) over the Spreading Period, determine the additional level of Correction Contributions required such that projected value of Fund Assets equals the End of Spreading Period Funding Target. When calculating the Correction Contributions, the value shall be assumed to be invested from the date on which they are paid and accrue investment returns (such assumed returns being at rates which are equal to those applied during the period between the date on which a Correction Contribution is paid and FYE End of Secondary Funding Period as determined in accordance with the most recent Quinquennial Review).

3.17 An Annual Contribution (and consequently a Monthly Contribution) is calculated by taking the Base Case Contribution and adding or subtracting the Correction Contribution.

4. THE SECONDARY FUNDING PERIOD

4.1 The Secondary Funding Period is defined in the FAP as the period beginning on the day immediately after FYE Year 55 and ending on FYE End of Generation, i.e.:

- (A) FYE Year 60; or
- (B) the financial year-end of the financial period during which the permanent shutdown of Reactor 2 is expected to occur as stated in the DWMP if the Board of the Operator has resolved that both of the Reactors will Permanently Cease to Generate Electricity in the period between FYE Year 55 and FYE Year 60 and the Secretary of State has approved a DWMP which reflects the revised lifetime assumptions of the Operator (including an ILW Transfer Payment and an SF Transfer Payment which are calculated based on the volumes of waste expected to be generated up to the revised expected date of closure).

Contributions

- 4.2 The additional costs accounted for during the Secondary Funding Period are for the incremental costs incurred in the disposal of Spent Fuel from the period from year 55 to year 60. The mechanism for the calculation of the Base Case Contributions and Correction Contributions operates in the same way for both the Primary Funding Period and Secondary Funding Period.

De-Risking

- 4.3 During the period from two (2) years prior to the FYE End of Primary Funding Period to three (3) years following the FYE End of Primary Funding Period, the Investment Strategy is expected to de-risk (in accordance with the Investment Rules), lowering its risk profile from that set under the Growth Portfolio to that set under the Initial Long Term Portfolio (i.e., a more balanced split between the Growth Portfolio and the Final Long Term Portfolio). During the period from three (3) years following FYE End of Primary Funding Period until FYE End of Secondary Funding Period, the Investment Strategy should reflect the Initial Long Term Portfolio.
- 4.4 During the period from FYE End of Secondary Funding Period until the SF Transfer Date, the Investment Strategy is expected to further de-risk (in accordance with the Investment Rules), lowering its risk profile from the Initial Long Term Portfolio, as set out above in paragraph 4.3, to that set out under the Final Long Term Portfolio (i.e., a de-risked and lower returning portfolio, with allocation to cash and high quality fixed income or similar low-risk investments with low risk of default). This would mean that this “Final Long Term Portfolio” does not need to be achieved until the SF Transfer Date, thereby providing for continued de-risking during the Disbursement Period. This is distinct from the HPC FAP, which effectively required the de-risked position to be achieved from the last day of the Primary Funding Period (and a “fully” de-risked position, being 100% government securities, to be achieved from the last day of the Secondary Funding Period). See further discussion in paragraph 8.2(A) of the Main Report.

Accelerated Decommissioning Contributions Amount

- 4.5 The Accelerated Decommissioning Contributions Amount is different depending on whether a Security Trigger Event Action is taken prior to, during or after the Secondary Funding Period. During the Secondary Funding Period, the Accelerated Decommissioning Contributions Amount payable on the occurrence of a Security Trigger Event Action is an amount equal to the End of Generation Decommissioning Target (rather than the End of Primary Funding Period Target), discounted on an annual compound basis at rates which are equal to those applied during the period between FYE End of Primary Funding Period and FYE End of Secondary Funding Period, as determined in accordance with the most recent Quinquennial Review (less the Projected Inflation Rate) from FYE End of Generation until the last day of the Financial Period in which the Security Trigger Event Action is taken.

5. AFTER FIRST CRITICALITY - INVESTMENT STRATEGY AND DE-RISKING

- 5.1 The provisions of the FAP require the FDP Implementation Company to prepare the Initial Investment Strategy and, subsequently, a revised Investment Strategy as part of each Quinquennial Review. The Operator is permitted to challenge a draft Investment Strategy if it

is of the opinion that the same is materially inconsistent with the requirements set out in schedule 7 (*Investment Rules*) of the FAP.

5.2 The FDP Implementation Company is required to make investments in a suitably diverse portfolio of assets. In determining an Investment Strategy and any associated Investment Orders, FDP Implementation Company is required to ensure that:

- (A) during the period from First Criticality until two (2) years before FYE End of Primary Funding Period, the Investment Strategy should adhere to the principles of being “risk-on, return-seeking”, taking long-term views and seeking commensurately higher levels of expected return than traditional, low-risk investments;
- (B) during the period from two (2) years before FYE End of Primary Funding Period until three (3) years after FYE End of Primary Funding Period, the Investment Strategy should de-risk, lower its risk profile set out in (A) above to that set under (C) below; and
- (C) during the period from three (3) years after FYE End of Primary Funding Period until FYE End of Secondary Funding Period, the Investment Strategy should reflect the Initial Long Term Portfolio as summarised in paragraph 4.3 above and thereafter, the de-risking profile as summarised in paragraph 4.4 above.

5.3 The FDP Implementation Company may elect to de-risk earlier to the extent it is satisfied that the Fund Assets are on track to meet the End of Generation Target earlier than expected.

5.4 The FDP Implementation Company must take professional advice on the Investment Strategy.

5.5 **Post-Closure Inflation Risk**

(A) Prior to Plant closure, indexation-related risks are partly mitigated through the Quinquennial Review update of costs for actual inflation to date and revision of forecast inflation in the future; however, this will only apply until the last Quinquennial Review. There is a risk that decommissioning and waste management cost inflation turns out higher than expected at the last Quinquennial Review. This could result in a Funding Shortfall if the Investment Strategy does not provide adequate correlation with inflation. This latter risk can be partially mitigated by the combination of:

- (i) the use of index-linked investments;
- (ii) the choice of Nuclear Inflation Premium to estimate future cost liabilities; and
- (iii) independent financial verification of indexation measures. However, the risk should be better understood and adjusted for by the end of the Plant life.

Given the very extended Decommissioning Period, a further risk allowance should be contemplated (e.g., through an explicit adjustment in the calculation of the Long Term Discount Rate). As such, upon the Board’s recommendation, paragraph 1.3.3 of Schedule 11 (*Financial Verification*) of the FAP includes an explanatory note setting out the expectations as to how the Long Term Discount Rate may be calculated for

Quinquennial Reviews at different points in time. See paragraph 8.2(A) of the Main Report for a further discussion on the Long Term Discount Rate more generally.

- (B) Even if some of the investments held by the FDP Implementation Company provide some protection against inflation (either directly or expected as a result of historical correlation), there is a further risk that the Costs of Decommissioning inflate faster than market-wide inflation indices. The End of Generation Decommissioning Target accordingly includes a Nuclear Inflation Premium, which is consistent with market practice for similar nuclear decommissioning projects. When calculating the End of Generation Decommissioning Target, the Costs of Decommissioning other than Pre-Closure Planning Costs are inflated on an annual compound basis at one plus the Nuclear Inflation Premium from the first day of the Quinquennial Review Year to the first day of the Financial period during which the relevant amount is to be incurred, and discounted on an annual compound basis at one plus the Long Term Discount Rate less the Projected Inflation Rate.
- (C) Pursuant to paragraph 1.24 of schedule 9 (*Quinquennial Review Programme*) of the FAP, the FDP Implementation Company shall calculate a Draft Contribution Notice in accordance with the Minimum Contribution Calculation Rules. In particular, a Draft Contributions Notice shall include details of any Indexation applied.

5.6 Post-Closure Investment Risk

- (A) Post Plant closure (assuming this occurs at the end of the Initial Regulatory Period) there is a risk in relation to investment return shortfalls, as these cannot be met through further Quinquennial Review adjustments to the Contribution profile. The risks to the level of investment returns include market risk, counterparty risk, liquidity risk and tax risk (e.g., change in legislation) and can be mitigated (but not completely) by prudent implementation of the Investment Strategy in conjunction with independent investment advice.
- (B) This is partially mitigated through the FDP Implementation Company identifying an Investment Strategy that minimises the chance that there will be insufficient funds when needed considering the factors referred to in paragraph 5.2 above. Clause 8.1 (*FDP Implementation Company Objective*) of the FAP provides that the FDP Implementation Company's objective is to invest Fund Assets in accordance with the Investment Strategy with the intention of achieving the relevant funding targets and, following FYE End of Secondary Funding Period, "so as to ensure that the value of the Fund Assets are sufficient to discharge the Operator's DTM Costs during the Disbursements Period". Clause 8.2 (*FDP Implementation Company Objective*) of the FAP requires that FDP Implementation Company use reasonable endeavours to invest Fund Assets in such a way that seeks to achieve, over the long term, the investment returns anticipated by the Funding Path.
- (C) Pursuant to paragraph 4 of Schedule 7 (*Investment Rules*) of the FAP, the FDP Implementation Company is required to take professional advice on the Investment Strategy, which includes consideration of risks arising due to concentrations. However,

the FAP does not require the FDP Implementation Company to seek professional advice in determining its investment strategy that tests the strategy against an appropriate range of market outcomes and can demonstrate the probability of a shortfall in funding the P80+25% cost envelope.

- (D) Further, the FAP does not require that the Investment Rules are benchmarked against the practice in the pension sector, as the Operator and DESNZ do not consider pension schemes to be analogous to the Fund Assets or the FDP Implementation Company. However, the FDP Implementation Company is required to have regard to best practice for the funding of long term liabilities from a close-ended fund and such other factors as the FDP Implementation Company considers appropriate.
- (E) As discussed in paragraph 8.2(A) of the Main Report, one area where the Sizewell C FAP is less prudent than the HPC FAP is that the Long Term Discount Rate is set at a higher level than on HPC, meaning that, all other things being equal, the End of Generation Target for Sizewell C could be lower than on HPC. As highlighted in row 13 of Annex 4 (*Key Differences with Hinkley Point C*) and paragraphs 4.3 and 4.4 above, the Investment Strategy on Sizewell C will involve the majority of the de-risking occurring during the Disbursement Period, unlike on HPC where the de-risking was to be done from year 32 to year 37 (i.e. well before the expected Plant closure at year 60). All of these *prima facie* indicate potentially significant risk of investment return shortfalls in the Disbursement Period, as discussed further in paragraph 8.2(A) of the Main Report.
- (F) This post Plant closure investment risk is however mitigated by a feature that was not included in the HPC FAP – namely, the Funding Outcomes Report, which is intended to function as an early warnings measure to assess any such risk during the Operational Period. The Funding Outcomes Report is to be prepared by the Independent Financial Verifier at each of FYE EPFP – 10, FYE EPFP – 2 and FYE EPFP. This report will contain an estimate of the Probability Distribution (i.e., a statistical model defining the range of possible outcomes and their corresponding likelihood) of the excess or shortfall in projected Fund Assets at the SF Transfer Date once all DWMP cashflows have been discharged as they fall due for a range of potential investment strategies during the disbursement period. In preparing the report, the Independent Financial Verifier is to take into account, *inter alia*, the option of using a more or less conservative value for the Growth Rate and/or Long Term Discount Rate assumptions than those which would automatically be derived. The Funding Outcomes Report Reviewer (being a third-party independent adviser instructed by the FDP Implementation Company) is to carry out an assessment as to whether or not the methods and assumptions used by the Independent Financial Verifier for the purposes of preparing the modelling review process to produce such Probability Distribution in the report are reasonable.
- (G) The explanatory note to Part C (*Assessment of the Likelihood of Funding Outcomes*) of Schedule 11 (*Financial Verification*) of the FAP states that the Secretary of State is expected to review this report with the purpose of determining whether the likelihood of the sufficiency of the Fund Assets is sufficient based on its view of risk, value for

money considerations and any other criteria that the Secretary of State considers is appropriate at the relevant time. As such, the Section 46 Agreement contains a trigger for a modification of the FDP in the event that the Secretary of State determines that this report demonstrates that the FDP no longer provides prudent provision for the Technical Matters.

- (H) In this regard however, it is important to note that pursuant to the Section 46 Agreement, the Secretary of State would not be able to make a modification to change the Long Term Discount Rate so that it is different from the expected return of the Long Term Portfolio (see paragraphs 4.3 and 4.4 above for what such Long Term Portfolio entails). This is because:
 - (i) in such a circumstance where the Secretary of State initiates an FDP modification process under the Section 46 Agreement after determining that the Funding Outcomes Report demonstrates that the FDP no longer makes prudent provision for the Technical Matters, the Secretary of State cannot propose a modification, the effect of which would be to conflict with, or which would not be consistent with, the intended aim or effect of the Limited Fixed Parameters;
 - (ii) the Limited Fixed Parameters include the processes and criteria for calculation and verification of the Long Term Discount Rate (which is a Key Assumption); and
 - (iii) paragraph 1.3.3 of Part B (*Key Assumptions Verification*) of schedule 11 (*Financial Verification*) of the FAP provides that the Long Term Discount Rate is to be a single equivalent rate of return reflecting either (i) the average of the Initial Long Term Portfolio and the Final Long Term Portfolio allocations or (ii) the level and incidence of cashflows to be paid out of the Fund Assets over such period and the intended pattern of de-risking from the Initial Long Term Portfolio to the Final Long Term Portfolio as outlined in paragraphs 4.3 and 4.4 above.
- (I) As such, if, upon the receipt of a Funding Outcomes Report, the Secretary of State determines that a margin for prudence for investment risk should be added to the Long Term Discount Rate on top of such expected rate of return, the Secretary of State would not be able to do so directly by modifying the Long Term Discount Rate.
- (J) Separately, if the above-mentioned trigger event under the Section 46 Agreement applies upon the receipt of a Funding Outcomes Report, the Secretary of State could modify the FAP to align the Investment Strategy on Sizewell C with the lower risk, lower return investment strategy on HPC, provided that such modification is appropriate and reasonable in light of the trigger event. This should address the risk with the departure from HPC investment strategy as highlighted in row 13 of Annex 4 (*Key Differences with Hinkley Point C*), provided that such modification is made in a manner so as to ensure that the Long Term Discount Rate follows the lower expected investment return from following the modified Investment Strategy. This should be achievable, albeit not

straight-forward because of the way in which the Long Term Discount Rate is to be determined pursuant to paragraph 1.3.3 of Part B of Schedule 11 of the FAP, as summarised in paragraph (H)(iii) above. That is:

- (i) how the Long Term Discount Rate is to be determined in accordance with paragraph 1.3.3 of Part B of Schedule 11 of the FAP is a Limited Fixed Parameter as noted above, meaning it cannot be modified by the Secretary of State pursuant to the Section 46 Agreement; and
- (ii) due to the references made in this paragraph 1.3.3 to specific defined terms (i.e., the Initial Long Term Portfolio, the Final Long Term Portfolio and the Long Term Portfolio), portfolio allocations and pattern of de-risking, each as set out in the current Investment Rules in Schedule 7 of the FAP, any changes to these Investment Rules in the FAP will need to be made so that these references still work in this paragraph 1.3.3 whilst substantively providing for the Investment Strategy that aligns with the investment strategy on HPC. In other words, the modification will not simply be an exercise of bringing across the relevant provisions from the HPC FAP.

In this regard, the Board expects the Secretary of State will be well-advised at the relevant time to ensure that any modification of the FAP pursuant to the Section 46 Agreement would have the effect intended by the Secretary of State to ensure that prudent provision is made for the Technical Matters. Therefore, the Board has assumed that if the relevant circumstances arise, both the default scenario (where the Sizewell C FAP maintains its higher risk, higher return Investment Strategy) and the alternative scenario (where the Investment Strategy on Sizewell C is modified to align with that on HPC), in each case with the Long Term Discount Rate following the expected investment return in the Disbursement Period, will be available to be achieved by way of the Secretary of State's modification of the FAP in accordance with the Section 46 Agreement.

- (K) Furthermore, the Secretary of State may be able to indirectly achieve a similar outcome as adding a margin for prudence for investment risk to the Long Term Discount Rate. That is, the Limited Fixed Parameters would not stop the Secretary of State if they determined that further contingency for investment risk should be added to how the End of Generation Target is calculated pursuant to schedule 3 (*Minimum Contribution Calculation Rules*) of the FAP. The Secretary of State however would not be able to propose a modification so as to increase the contingency applied on the estimated End of Generation Spent Fuel Disposal Target and the End of Generation Decommissioning Target in excess of 40%, due to the limitations set out in the Section 46 Agreement. As discussed further in paragraph 8.2(A) of the Main Report, the Board has been instructed to assume that prudent provision has been made for any investment risk after the closure of the Plant, and that insofar as such prudent provision has been

made, DESNZ considers it remote that recourse to public funds would be required to mitigate this risk.⁸

- (L) Accordingly, the enhanced process for the preparation and review of the Funding Outcomes Report from ten years before the End of Primary Funding Period (being year 45 from First Criticality) has been designed with the purpose of detecting any post Plant closure investment risk prior to Plant closure (and crucially while the FDP Allowance Building Block is still available to support the Funding Path as recalibrated in accordance with the FAP). This will be available to give the Secretary of State the option to modify the FDP as and when it considers appropriate based on its view of risk, value for money considerations and other criteria,⁹ subject to the limitations identified in paragraphs (H) to (K) above. As discussed in paragraph 8.2(A) of the Main Report, the Board is not itself in a position, absent the requested complex stochastic analysis, to fully assess whether this is a sufficient mitigant against the risk identified in paragraph (E) above.
- (M) For completeness, the Board notes that, whilst the Funding Outcomes Report process can be used to assess the extent to which modification of the FDP or FAP is necessary, such review will not occur until after year 45, meaning that any adjustment would fall disproportionately on consumers during the remaining 15 years of the Plant's operational life. This is a similar risk to the risk of a back-ended substantial increase in Contributions potentially being politically unpalatable as discussed in row B.4 of Annex 5 (*Risk Matrix Identifying Key Potential Risks to Shortfall in Funding the Cost of FDP Liabilities*). As discussed therein, this is a risk within the control of the Secretary of State.

6. AFTER FIRST CRITICALITY - ANNUAL REVIEWS/QUINQUENNIAL REVIEWS

- 6.1 The FAP requires the DWMP (both the steps to be taken and the estimated costs) be updated at least once every five (5) years in a Quinquennial Review, and more frequently if a significant operational event occurs. When carrying out this quinquennial update, the Operator must consider factors such as:
 - (A) good industry practice in cost estimation;
 - (B) its own assessment of risks and uncertainties;
 - (C) the volumes of waste generated as at the end of the Quinquennial Reporting Period and the Operator's projections of the volumes that will be generated during the remainder of the Operational Period;

⁸ **Note:** See the full FDP Assumption in paragraph 7 of Annex 3 (*Assumptions*).

⁹ **Note:** The version of the Section 46 Agreement reviewed by the Board contains a few drafting errors in this regard; for example, the relevant trigger in the Section 46 Agreement refers to an "ALFSR", which is defined as the "Assessment of the Likelihood of Funding Success Report" or "ALFSR" as defined in the FAP, but these terms are not defined in the FAP (the correct term in the FAP instead is "Funding Outcomes Report").

- (D) any relevant experience in decommissioning accumulated by any of its affiliates; and
- (E) relevant operational changes at the Site and making those amendments to the DWMP which it considers necessary to reflect these factors.

6.2 In this context, the Board notes that the Operator will not be required to take account of the actions of others in the industry with regards to costs estimation unless and until those actions become Good Industry Practice (defined in the FAP as, in summary, standards, practices, methods and procedures conforming to the Applicable Laws and the degree of skill, care, diligence, prudence and foresight which would be expected from a skilled and experienced person engaged in a similar type of undertaking in similar circumstances). The estimated costs for these purposes are calculated in the money of the day as at each Quinquennial Review. The estimated costs are updated every year at the time of the Annual Review to take account of the effect of inflation (calculated for these purposes using CPI or the Replacement Inflation Index over the relevant period) and every five (5) years at each Quinquennial Review to reflect the real cost increases since the latest Quinquennial Review.

7. AFTER FIRST CRITICALITY - VERIFICATION PROCESSES

- 7.1 As part of each Annual Review (if a significant event has occurred) or Quinquennial Review, an Independent Technical Verifier must confirm various matters regarding the Operator's costs estimates in the updated DWMP. The FAP sets out the statements which the Independent Technical Verifier and Independent Financial Verifier are to be requested to provide and requires the Independent Technical Verifier to follow a specified process in reaching its conclusion. The Independent Technical Verifier must assess whether, in its opinion, the Operator has taken account of the factors listed in the FAP in a reasonable way. It must also confirm whether the changes to the cost estimates and/or applicable steps in the updated DWMP are reasonable. The FAP does not require the Independent Technical Verifier to provide any more detailed opinion statements beyond the confirmation that the DWMP is reasonable.
- 7.2 In this context, the Board notes that this reflects the requirements of the 2013 Regulations. The 2013 Regulations require, at a minimum, that the Independent Technical Verifier confirms that the Operator's cost estimates are reasonable. The agreed procedures in the FAP for the technical verification as part of each Quinquennial Review require the Independent Technical Verifier to make a number of specific assessments which, taken together, are intended to confirm that the Operator's cost estimates in the DWMP are reasonable and consistent with Good Industry Practice, including in respect of the risks and uncertainty in relation to the cost estimates.
- 7.3 The Board notes that the Secretary of State will require that a copy of the report be produced at the end of each Quinquennial Review and that this will include the revised DWMP and the Independent Technical Verifier's confirmation that the revised DWMP is reasonable. The Board would expect the Secretary of State to review the revised DWMP and commission advice on it as appropriate, bearing in mind their contractual right to enforce the terms of the FAP as a third party and their statutory powers under the 2008 Act.

- 7.4 Verification is a key component of the Annual Review and Quinquennial Review process. It is the only means by which any person other than the Operator has any input into the process before the relevant documentation is sent to the Secretary of State. The FDP Implementation Company's obligation to arrange verification is limited to its reasonable endeavours, although the Operator is required under the 2013 Regulations to ensure that Quinquennial Reports are accompanied by a verification report assessing whether the Operator's estimates are reasonable.

8. EARLY CLOSURE

- 8.1 The FAP is currently structured on the assumption that the Operator will continue to operate until its fully funded target at year 55 and is likely to continue to operate until year 60. In order to extend the life of the Plant beyond year 60, the Operator would be required to undertake a modification of the FDP under the 2008 Act in accordance with the modification process set out in paragraph 4 of Annex 10 (*Legislative Background*).
- 8.2 The risk of inadequacy of the fund due to an early closure is mitigated by the Partial Revocation regime under the SZC Economic Licence. As further detailed in paragraph 3 of Annex 11 (*SZC Economic Licence*) and row B.6 of Annex 5 (*Risk Matrix Identifying Key Potential Risks to Shortfall in Funding the Cost of FDP Liabilities*), the FDP Allowance Building Block cannot be revoked while an FDP Shortfall is outstanding (including following early closure) until the FDP Final Amount (sized to account for the forecast FDP Shortfall) has been paid.
- 8.3 In the event that early closure of the Plant results in the FDP no longer making prudent provision for the Costs of Decommissioning, the Secretary of State is permitted to modify the FAP under the Section 46 Agreement (although this could be a lengthy process and either require the parties to agree or require referral to arbitration for resolution).
- 8.4 If the early closure is an unforeseen event that the Plant cannot recover from, the regime assumes that the Operator will enter a special administration regime (pursuant to Part 3 of the 2022 Act). Should the objectives of the special administration be unsuccessful (i.e., that the Plant cannot be rescued as a going concern), the Secretary of State can transfer control of the Plant (through a share or asset transfer of the Operator) to the NDA or another publicly owned company for the purposes of decommissioning. Any FDP Shortfall would be primarily addressed through payment of the FDP Final Amount determined in accordance with the SZC Economic Licence during Partial Revocation (see paragraph 4 of Annex 11 (*SZC Economic Licence*)). If an FDP Shortfall remains (such as if the initial forecasting used to calculate the FDP Final Amount is incorrect or the Secretary of State otherwise directs that the Authority may revoke the SZC Economic Licence in full without payment of the FDP Final Amount), then the FDP Shortfall will become a Secretary of State liability (with corresponding implications for recourse to public funds) following a transfer pursuant to the Nuclear Transfer Scheme. Allowed Revenue continues to be paid even during Nuclear Administration as noted above in paragraph 6.7 of Part A (*Factual Background*) of this Annex.
- 8.5 The FAP provides that, upon the Operator making a decision to implement an Unplanned Permanent Shutdown of both Reactors, the Operator must notify the FDP Implementation Company and Secretary of State and invite representatives of both (and any significant

creditors) to attend a meeting to discuss the Unplanned Permanent Shutdown, including any appropriate mitigation measures and the expected financial consequences. Emergency DTM Payments may be drawn from the Fund Assets following a Shutdown Notice to cover operation, maintenance and defueling costs where operational revenue and make-safe reserves are insufficient (in accordance with the waterfall in clause 28.2 (*Payment of the Funded SF Transfer Fee and Funded ILW Transfer Fee will be deferred if there is insufficient Available Cash*) of the FAP) and there is no separate building block for this under the SZC Economic Licence. However, the FDP Allowance Building Block would continue to flow in an early Unplanned Permanent Shutdown and, as referred to in paragraph 8.2 above, the SZC Economic Licence can only be fully revoked following payment of the FDP Final Amount (which would account for any FDP Shortfall amount caused by the drawing of Emergency DTM Payments from the fund).

9. PARTIAL CLOSURE

- 9.1 In the event of a Single Reactor Early Shutdown, as further detailed in row B.11 of Annex 5 (*Risk Matrix Identifying Key Potential Risks to Shortfall in Funding the Cost of FDP Liabilities*), it is likely that the affected Reactor would be defueled and then either (i) decommissioned or (ii) placed into a state of 'care and maintenance' (and decommissioned after the end of generation) and the DWMP would be updated to reflect the chosen strategy.
- 9.2 Where there is a Single Reactor Early Shutdown, the costs of operating and maintaining the Site are expected to be funded in the following order of priority:
- (A) firstly, from any available operational revenues;
 - (B) secondly, from any available make-safe reserves; and
 - (C) thirdly, from payments from the Fund Assets constituting Emergency DTM Payments.
- 9.3 The FDP mechanics may need to be adjusted accordingly to ensure that appropriate provision is made for the early decommissioning of one (1) Reactor (which could take place through modification to the DWMP and FAP (including corresponding adjustments to the Contributions profile and FDP Allowance Building Block)), which would be proposed by the Operator or, if the FDP no longer makes 'prudent' provision to carry out the decommissioning activities, through a modification by the Secretary of State subject to the Section 46 Agreement. Refer to row B.11 of Annex 5 (*Risk Matrix Identifying Key Potential Risks to Shortfall in Funding the Cost of FDP Liabilities*) for further analysis.

10. DECOMMISSIONING PERIOD (INCLUDING PAYMENTS AND DISBURSEMENTS POLICY)

- 10.1 The Decommissioning Period for a Reactor is defined in the FAP to mean the period commencing on the date certified in a certificate provided by the Operator to the FDP Implementation Company and Secretary of State, signed by two (2) directors of the Operator and as the date that such Reactor will, in the Operator's judgement, Permanently Cease to Generate Electricity and ending on the date the Site End State is achieved. The Disbursement Period means the period commencing on the first day of the first Financial Period during which DTM Costs were paid and ending on the later of the date that all of the Operator's liabilities

under the SF Transfer Contract have been discharged or the date that the Site achieves the Site End State.

- 10.2 The FAP contains a specific set of provisions relating to the release and use of Fund Assets. A distinction is made between Allowable Costs (that is to say, those costs which the Operator is permitted to discharge using Fund Assets) and Disallowable Costs. The Operator shall not knowingly, and shall use its reasonable endeavours to procure that it does not, include any Disallowable Costs in its Annual Work Plan and Budget. Whether any Disallowable Costs have been included is subject to verification by the Independent Technical Verifier and correction mechanisms (ultimately, the Operator must remove any such Disallowable Costs from its Annual Work Plan and Budget).
- 10.3 Allowable Costs are, in relation to any Financial Period within the Disbursements Period:
- (A) in the event of an Unplanned Permanent Shutdown or a Single Reactor Early Shutdown, the costs and expenses arising in that Financial Period in relation to Designated Technical Matters, including Attributable Overhead and excluding Disallowable Costs;
 - (B) any costs to which the Detailed DWMP gives rise;
 - (C) any contingency or overrun drawn down in accordance with the FAP (which contains detailed requirements for withdrawing amounts in respect of cost overruns);
 - (D) any costs arising in that Financial Period directly from any instructions from a regulator with jurisdiction over the Operator, except to the extent that such costs fall under paragraph (B) above;
 - (E) any other costs of Designated Technical Matters which have been agreed in writing with the FDP Implementation Company as comprising Allowable Costs;
 - (F) without any double recovery, any Taxes payable by the Operator; and
 - (G) any Emergency DTM Payments payable in accordance with the FAP.
- 10.4 For ease of administration, rather than the Operator drawing from the fund as and when its liabilities for decommissioning fall due, the FAP permits the Operator to withdraw an amount equal to the costs expected to be incurred in each year, plus a 10 per cent. (10%) contingency, at the start of the year by submitting an Annual Work Plan and Budget. This must be verified by the Independent Technical Verifier as not including Disallowable Costs of an amount which is likely to be more than £250,000. The Annual Work Plan and Budget is accompanied by an Allowable Costs Certificate, being a certificate signed by two (2) of the Operator's directors acting on behalf of the Operator's Board (one (1) of whom must be the managing director or chief executive) confirming that, to the best of their knowledge and belief, all the costs set out in the Annual Work Plan and Budget are Allowable Costs.
- 10.5 In order to receive a payment from the FDP Implementation Company, the Operator must submit an annual claim notice for Designated Technical Matters setting out the amount it is

claiming from the fund in the relevant financial period. Payments for Designated Technical Matters are made by the FDP Implementation Company to the Operator and are held on trust by the Operator for the purpose of discharging Allowable Costs. The payments are made into a designated and segregated account, and the Operator must use reasonable endeavours to procure that the only payments made into that account are the payments for Designated Technical Matters which it receives from the FDP Implementation Company. The Operator is prohibited from using payments made to it in respect of Designated Technical Matters for anything other than Allowable Costs.

- 10.6 The reconciliation regime carried out subsequent to each financial period provides for the calculation of a reconciling amount which is deducted from or added to the Operator's assessment of its estimated Allowable Costs for the next Financial Period. The Operator is required as part of the reconciliation process to prepare a report including a reconciliation of the work and activities undertaken by the Operator and related expenditure as against the corresponding Annual Work Plan and Budget. The Operator provides a certificate with the report to the FDP Implementation Company and the Independent Technical Verifier which contains either: (i) a statement that all expenditures incurred by the Operator during the period were in respect of Allowable Costs; or (ii) a statement of the amount the Operator considers constituted Disallowable Costs, together with an explanation of why Disallowable Costs arose and the steps the Operator intends to take to prevent such circumstances arising in the future.
- 10.7 The Operator prepares a reconciliation report which is reviewed by the Independent Technical Verifier who submits his/her own Reconciliation Verification Report. This report contains, among other things, a statement of whether, in the Independent Technical Verifier's reasonable opinion, the Operator's assessment of the Allowable Costs and Disallowable Costs that occurred during the relevant period is reasonable. The Operator is then required to submit both reports to the Secretary of State and the FDP Implementation Company. The reconciling amount is to be included in the calculation of amounts claimed in an Annual DTM Claim Notice and comprises:
- (A) unclaimed Allowable Costs; less
 - (B) unspent DTM Payments; less
 - (C) payments made to the Operator incorrectly by the FDP Implementation Company; less
 - (D) the aggregate amount of DTM Payments that the Operator applied to discharge Disallowable Costs.
- 10.8 During the year, the Operator has relative freedom to withdraw further amounts up to that year's budget plus 25 per cent. (25%), subject to verification for the proportion over 10 per cent. (10%) that any withdrawals when aggregated do not constitute Disallowable Costs of more than £250,000. However:
- (A) amounts in excess of that year's budget plus 25 per cent. (25%) are subject to verification as being reasonably assessed by the Operator to be necessary or efficient; and

- (B) any spending on Disallowable Costs must be declared during the reconciliation process, albeit that there is no obligation on the Operator to make up these sums (and additional funds would not necessarily be available to do so in any case), and the Secretary of State's ability to amend the DWMP and its associated timetable are limited.

10.9 In addition to these controls, the Operator has undertaken to send a copy of any Material Affiliate Contract which is not tendered on a competitive basis¹⁰ to the FDP Implementation Company and the Independent Technical Verifier for review. The Operator also has an option, but not an obligation, to submit Long Term Contracts (i.e., over twelve (12) months in duration) to the verification process.

10.10 If the Contract Verification Report identifies that a Long Term Contract or Material Affiliate Contract gives rise to a Disallowable Cost or that a Material Affiliate Contract is not on arm's-length terms, the Operator shall refer the matter to an Independent Expert for determination as to whether it gives rise to Disallowable Cost or it is on arm's-length terms, or make such amendments as necessary to remove the scope which gives rise to a Disallowable Cost and/or to ensure it is on arm's-length terms.

11. TAX LIABILITIES

The position in relation to whether the FDP Implementation Company will incur any tax liabilities, and whether the Operator will incur any tax liabilities during the Decommissioning Period, has been unclear to the Board until recently. Following receipt of the tax analysis paper from Herbert Smith Freehills LLP dated 4 February 2025, it appears that some tax liabilities will be incurred by the FDP Implementation Company (e.g., receipt of interest or crystallisation of capital gains) on its Fund Assets during the operations and decommissioning phases and potentially by the Operator in relation to the FDP liabilities. In light of this, the position in the FDP in relation to tax liabilities can be briefly summarised as follows.

11.1 Operational Period

- (A) FDP Implementation Company can use the Fund Assets to pay any taxes that it is liable to pay. To the extent that any extra Contributions are required to cover such tax liabilities, it will happen by the operation of the so-called "Tax Assessment" process included in the Quinquennial Review process for the first 45 years¹¹ of the Operational Period (with any shortfalls being made up whatever the cause).
- (B) From year 45, the Quinquennial Review process will be shifted from the above-mentioned "Tax Assessment" process to a "Detailed Tax Assessment" process (the main distinction being that whereas a Tax Assessment assumed that during the Disbursement Period, 100% of the Fund Assets will be invested in debt instrument, a

¹⁰ **Note:** Such tender is to be publicly announced and open for a reasonable period of time. Also, where the participants of such tender process comprise solely of Affiliates of the Operator, this will not constitute a tender on a competitive basis.

¹¹ **Note:** Please note that the references to 45 years in this paragraph 11.1 refer to the period from the commencement of the Operational Period to FYE EPFP – 10, which is expected to be around 45 years. Similarly, the references to year 45 in this paragraph 11.1 mean FYE EPFP – 10.

Detailed Tax Assessment will look more closely at the Investment Strategy for the relevant Quinquennial Reporting Period). As such, from year 45 there will be a shift to prospective funding of tax for the remaining operational period with estimates for the likely tax to be paid by year 60.

- (C) This will be updated at all the remaining Quinquennial Reviews during the Operational Period from year 45 (as the Investment Strategy for the Decommissioning Period will become increasingly refined). At each such Quinquennial Review, it will be based on the tax laws as at the date of the Quinquennial Review and will not seek to make provision for the risk of changes to tax law or treatment during this period. As such, the risk of such changes resulting in higher tax liabilities not provided for in the Quinquennial Review remains, and such risk could result in a Funding Shortfall if the changes occur after the last Quinquennial Review during the Operational Period (such that there is no scope to true up the Contributions and accordingly increase the FDP Allowance Building Block during the Operational Period).
- (D) Paragraph 1.3.4(a)(iv) of schedule 7 (*Investment Rules*) of the FAP requires the FDP Implementation Company to demonstrate how its Investment Strategy is appropriate in light of any relevant tax costs of the FDP Implementation Company and the Operator and the risk that tax liabilities may change.

11.2 Decommissioning Period

- (A) The tax liabilities of the Operator and the FDP Implementation Company during the Disbursements Period will be picked up in the End of Generation Decommissioning Target.
- (B) Accordingly, these tax liabilities of the FDP Implementation Company and the Operator will be met from the disbursement of the Fund Assets. There will be no other source of funds to meet such tax liabilities during the Decommissioning Period.
- (C) The tax liabilities included in the End of Generation Decommissioning Target will be estimates determined through the Quinquennial Review process in the FAP. The Operator has not provided the Board with any estimates of what those tax liabilities might amount to, and nothing is therefore included in the DWMP or any estimates of the total cost of Sizewell C.
- (D) In any case, the Board is satisfied that there are future processes, including the Quinquennial Review process in the FAP, to determine these estimates of tax liabilities accurately and for them to be included in the End of Generation Decommissioning Target in due course.
- (E) The residual risk therefore is that the actual tax liabilities exceed the estimates of tax liabilities determined at the final Quinquennial Review during the Operational Period, and no allowance has been made for that risk. In this regard, the Board understands from DESNZ that it can draw full comfort from the fact that, to the extent any such Funding Shortfall at the end of Decommissioning is a result of taxes being higher than anticipated, in DESNZ's view this could not be considered in any reasonable sense to

represent a “loss to taxpayers”. Furthermore, DESNZ’s view is that making provision for such a circular risk would add unjustifiable cost to consumers.