

NUCLEAR LIABILITIES FINANCING ASSURANCE BOARD

ADVICE TO THE SECRETARY OF STATE

FUNDING ARRANGEMENTS PLAN FOR HINKLEY POINT C

1. INTRODUCTION

- 1.1 This document sets out the advice of the Nuclear Liabilities Financing Assurance Board (the **Board**) to the Secretary of State for Energy and Climate Change (the **Secretary of State**) in relation to the suitability of the funding arrangements plan (the **FAP**) within the Funded Decommissioning Programme (the **FDP**) presented by NNB Generation Company Limited (**NNB**) to the Secretary of State in respect of Hinkley Point C (**HPC**). The Board is content for this advice to be published at the Secretary of State's discretion.
- 1.2 Under the Energy Act 2008 (the **2008 Act**), a prospective operator of a new nuclear power station is required to have an approved funded decommissioning programme in place before the start of construction of the new nuclear power station and to comply with such programme thereafter. The FDP submitted by NNB is the first submission of an FDP in the UK made to the Secretary of State. This advice is specific to NNB's FAP for HPC and nothing herein should be taken as a precedent for, or guidance as to, the Board's views on any modifications to the FDP or on any subsequent funded decommissioning programmes which may be submitted to the Secretary of State.
- 1.3 The Secretary of State retains an absolute discretion to approve or reject the FDP, subject of course to her statutory obligation to exercise her powers with the aim of securing that prudent provision is made for the technical matters (as defined in the 2008 Act). Any approval may be made with or without modifications and unconditionally or subject to conditions.
- 1.4 Please note that this advice describes the provisions of the FAP only to the extent necessary to convey the views of the Board, and should be read in conjunction with the FAP, the Decommissioning and Waste Management Plan (the **DWMP**) and other relevant documents referred to herein.

2. SUMMARY OF ADVICE

- 2.1 The 2008 Act provides that where the proposed operator of a nuclear site (in the case of Hinkley Point C, NNB) applies for a nuclear site licence, it must prepare and submit an FDP for approval by the Secretary of State. The FDP must make provision for the decommissioning of the nuclear plant, the cleaning-up of the site and the treatment, storage, transportation and disposal of hazardous waste.
- 2.2 The FDP must also set out how the implementation of such provisions of the FDP is to be financed. This element of the FDP is set out in NNB's proposed FAP for HPC. The Board's responsibility is to provide independent advice to the Secretary of State on the suitability of NNB's proposed FAP.

- 2.3 The proposed FAP would establish an independent fund, administered by an independent fund company, The Nuclear Decommissioning Fund Company Limited (the **FDP Company**). Once HPC has been constructed and First Criticality has occurred (see paragraph 1.4 of Annex 5, *Life Cycle of the FAP*), the phases of HPC can broadly be divided into two parts: the operational life and the decommissioning period. NNB will be required to make annual contributions to the fund during the operational life of the plant, which in the FAP is split into two distinct periods:
- (A) for an initial 37 year funding period during the operational life of the plant (the **Primary Funding Period**), NNB is required to make annual contributions to the fund which are designed to render the fund 'fully funded' (including a contingency buffer) for covering the costs of decommissioning and costs related to the treatment, storage, transportation and disposal of waste created during the Primary Funding Period by the end of such period (the **Year 37 Target**); and
 - (B) from the end of the Primary Funding Period until the expected end of the operational life of HPC (the **Secondary Funding Period**), NNB is required to make annual contributions to the fund which are designed to maintain the fund at the requisite level and to deal with additional waste generated prior to the beginning of decommissioning (see paragraph 3 of Annex 5, *Life Cycle of the FAP* for further details regarding contributions, and to paragraph 6 of Annex 3, *Factual Background* regarding the life of the reactors).
- 2.4 The FAP will also set out provisions governing, among other things: the independence and governance of the FDP Company; how the FDP Company is required to invest the fund assets; NNB's review and reporting requirements in relation to the liabilities (elements of which will be subject to independent verification); the security rights in favour of the Secretary of State and the FDP Company and the protection of those rights; and drawdown and disbursement of the fund assets during the decommissioning period.
- 2.5 The Board is content that NNB's proposed FAP provides a clear structure for the purpose of the Department of Energy & Climate Change's Funded Decommissioning Programme Guidance for New Nuclear Power Stations dated December 2011 (the **Guidance**). The FDP is divided into the DWMP (which sets out the steps to be taken to decommission HPC and dispose of waste generated at the plant) and the FAP, which is a contract (to which the Secretary of State is granted third party rights) between NNB and the FDP Company, governing the operation, governance and funding of the Fund and access to the Fund during decommissioning, as well as other obligations of each party. Certain discrete obligations which may in the future apply to the Secretary of State, NNB and its lenders are set out in a separate Standstill Agreement, which does not form part of the FDP. There are also various ancillary documents relating to the FDP Company which do not form part of the FDP, but the Board is content that there are suitable safeguards in the FAP to ensure that the provisions of the ancillary documents which are required in order for the FDP to meet the Objective set out in the Guidance (the **Objective**) are sufficiently protected.
- 2.6 The DWMP is not within the scope of the Board's review and, accordingly, the Board is not advising as to whether the FDP contains realistic, clearly defined and achievable plans for decommissioning, waste management and waste disposal. The Board notes

that provisions governing the verification and updating of the cost estimates in the DWMP have been included in the FAP to ensure that they are legally binding and subject to the 2008 Act regime, which includes criminal sanctions.

- 2.7 In terms of the suitability of the funding arrangements in the FAP in relation to costs likely to be incurred in connection with the designated technical matters (as defined in the 2008 Act, **the DTMs**), the Board has asked the Secretary of State to note that the FAP contemplates certain steps and includes certain requirements relating to the DWMP, such as the process for updating it and relevant verification requirements. The Board has noted a number of points in its advice below in relation to these steps and requirements, including matters relating to the requirements for the independent technical verifier to confirm that the relevant operator's cost estimates are reasonable.
- 2.8 The Board is content that the provisions of the FAP are transparent for the purposes of the Guidance. The Board has asked the Secretary of State to note that the FAP contains references to certain future agreements and concepts which are not in existence at the time that the Board gives this advice, but that in all such cases the terms of the FAP require such documents to have been approved, entered into or designated by the Secretary of State, so that any such terms remain within her control. Additionally, the Board has noted the proposal that there will be a form of Standstill Agreement as agreed between the Secretary of State and NNB in relation to the security interests granted in accordance with the FAP, which is a form of 'FDP Direct Agreement' and to which lenders of NNB may later accede in order to benefit from its terms.
- 2.9 The Board is content that the division of roles and responsibilities within the FAP is clear, albeit that certain responsibilities are qualified and that the FDP Company's role is broadly mechanistic rather than influential. The Board has additionally noted that obligations of both NNB and the FDP Company in the FAP are, in many instances, qualified rather than absolute; that there is an obligation on the FDP Company to notify only a small number of specifically listed, material breaches; and that the FDP Company's obligation to arrange verification is limited to its reasonable endeavours (although there are separate requirements in relation to verification of NNB's cost estimates under the Nuclear Decommissioning and Waste Handling (Finance and Fees) Regulations 2013 (the **2013 Regulations**) and the FAP).
- 2.10 The Board is content that the terms of the FAP are designed to ensure that the FDP represents a durable arrangement which has sufficient flexibility to adapt over time. This is based on, among other factors, the fact that the estimates of liabilities for which the FAP makes provision are periodically updated throughout its lifetime (for instance, to take account of inflation).
- 2.11 Although there are only limited grounds on which the FDP Company may challenge investment orders made by NNB, the Board is content that the terms of the FAP provide for the fund to be independent of NNB. The Board notes that there are restrictions on NNB itself in terms of its investment orders; that the FDP Company is required to be structurally separated from NNB; and that there are restrictions placed on NNB to prevent it from dealing directly with the fund assets.

- 2.12 In terms of sufficiency of the fund, the Board notes that the structure of the FAP is such that NNB will provide annual contributions over time rather than by way of an upfront endowment, the latter being an option contemplated by the Guidance. The 'funding path' for these contributions is designed to ensure that the fund reaches its 100 per cent. 'fully funded' target at the end of the Primary Funding Period (in order to coincide with the end of the consistent revenues assured by the operation of NNB's contract for difference with the Low Carbon Contracts Company Limited (the **CfD**)), but the Board notes that the build-up of the fund is severely 'back-ended'. There is potentially a risk to the sufficiency of the fund (exacerbated by this back-ending) should the plant experience an early closure, a prolonged unexpected outage or a force majeure event, or need significant repair. However the consistent revenues ensured by the CfD are likely to provide sufficient incentive for NNB to keep the plant running in order to receive those revenues, and hence provide sufficient comfort that the fund will attain its target value by year 37 (although the Secretary of State will need to satisfy herself (i) that the provisions of the CfD are sufficiently robust and that NNB is reasonably certain to receive the benefit of the CfD for its full 35-year term and (ii) that the likelihood of HPC being closed early for political reasons is remote).
- 2.13 Additionally, the Board derives comfort from the fact that the fund target values set for both year 37 and year 60 are calculated on a P80 plus 25 per cent. contingency basis in respect of the estimated costs of decommissioning and waste management. In other words, the cost estimates for each of decommissioning and waste management for NNB's FDP are set at a level such that there is an 80 per cent. chance of the actual costs proving to be lower than the estimates, and NNB is required to fund to the P80 figure together with a further 25 per cent. contingency buffer.
- 2.14 In relation to sufficiency of the fund, the Board has set out various further points to note in its advice below, including matters related to the financing of the plant; the gearing covenants to which NNB is subject (which are weaker than one would expect to see in a usual structured or project financing, reflecting the nature of the transaction and the requirement for any operator of the plant to continue to make annual contributions to the FDP fund so long as the plant remains operational); and the provisions relating to the security granted to the Secretary of State and FDP Company.
- 2.15 The Board is content that, on balance, the review, reporting and payments and disbursements provisions of the FAP construct suitable precautions against the risk of fund assets being used for purposes other than decommissioning and disposal of waste. Given, however, the inability of the FDP Company to require NNB to contribute future funds after the end of the operational period of the plant if funds are mismanaged, the Secretary of State will need to be vigilant and mindful of her contractual rights under the FAP and her statutory powers. The Board also asks the Secretary of State to note certain points in relation to the disbursements provisions (including the fact that NNB would not be required, for example, to set off amounts for works which the independent technical verifier thought were excessive or premature against NNB's claim from the fund for the following year, provided that such works constitute Allowable Costs).
- 2.16 The Board is content that the fund assets are insolvency remote from NNB on the grounds that, among other things, the FDP 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; that the terms of the FAP require these limitations to remain in place

and stipulate that they cannot be amended without the Secretary of State's consent; and that these limitations can only be amended with the approval of the independent directors.

- 2.17 In summary, the Board's advice to the Secretary of State is that the FAP makes prudent provision for the financing of the designated technical matters and meets the Objective and Guiding Factors (the **Guiding Factors**) set out in the Guidance. In coming to her decision as to whether or not to approve the FAP and whether or not to do so with or without conditions, the Board has drawn the Secretary of State's attention to the various judgments made and issues raised in coming to its position, including the Board's assumptions made in Annex 6, *Assumptions* and the observations set out in paragraph 4.3 below.

3. BACKGROUND AND INFORMATION

The Board's advice is set out in paragraph 4 below. The subsequent Annexes contain the relevant background information regarding HPC, the FAP and the Board's role and assumptions made in giving its advice. These Annexes, which also define various terms used in this advice, should be read in conjunction with the Board's advice:

- (A) Annex 1, *NLFAB Members* lists the members of the Board and their relevant experience;
- (B) a summary of the Board's role and scrutiny of the FAP may be found in Annex 2, *the Board's Role and Scrutiny of the FAP*;
- (C) the factual background to the FDP is set out in Annex 3, *Factual Background*;
- (D) the legislative background to the FDP and related matters are set out in Annex 4, *Legislative Background* which includes an explanation of provisions of the 2008 Act, the 2013 Regulations and the Guidance;
- (E) Annex 5, *Life Cycle of the FAP* describes the life cycle of the FAP and summarises its key concepts;
- (F) a set of assumptions made by the Board in formulating its advice may be found in Annex 6, *Assumptions*;
- (G) a summary of the contemplated financing arrangements as they have been presented to the Board is set out in Annex 7, *Financing Arrangements*;
- (H) a list of parties with whom the Board has consulted with regard to its advice is set out in Annex 8, *List of Parties Consulted by the Board*; and
- (I) an indicative timeline of key FAP dates, based on assumed dates as at the date of this advice, is set out in Annex 9, *Indicative Timeline of the FAP*.

4. ADVICE

4.1 The table below sets out the advice of the Board to the Secretary of State with respect to each Guiding Principle set out in the Guidance:

Guiding Principle	Principle as set out in Guidance	Advice
Guiding Principle 1	<i>The FDP provides a clear structure</i>	<ul style="list-style-type: none"> ○ The Board notes the structure of the proposed HPC FDP, as set out in Annex 3, <i>Factual Background</i>. The FDP is divided primarily into the DWMP (which sets out the steps to be taken to decommission HPC and dispose of waste generated at the plant) and the FAP, which is a contract (to which the Secretary of State is granted third party rights) between NNB and the FDP Company governing the operation, governance and funding of the Fund and access to the Fund during decommissioning, as well as other obligations of each party. In terms of clarity of structure, the Board notes in particular that: <ul style="list-style-type: none"> (A) NNB has structured its FAP as a contract with the FDP Company, an independent fund company, creating legally binding obligations between those parties. This is consistent with the Guidance, which, as referred to above, notes that elements of the FDP may be reinforced through, or may include, contractual arrangements; and (B) the Board understands that the non-binding nature of the DWMP means that certain provisions which might have been expected to appear within the DWMP (such as those relating to the updating of cost estimates) have been included within the FAP instead, in order to ensure that such provisions are both legally binding and subject to criminal sanction for breach under Section 57 of the 2008 Act. ○ Certain discrete obligations which may in the future apply to the Secretary of State, NNB and its lenders are set out in a separate Standstill Agreement, which does not form part of the FDP. Further details regarding the Standstill Agreement are set out in paragraph 5 of Annex 3, <i>Factual Background</i> and further details regarding the Board's role and scrutiny are set out in Annex 2, <i>The Board's Role and Scrutiny of the FAP</i>. ○ Various ancillary documents relating to the FDP Company do not form part of the FDP. These are the FDP

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		<p>Company's articles of association, shareholders' agreement and budget and services agreement. It was envisaged by the Guidance that these documents would require the Secretary of State's consent for amendment, but NNB has chosen to omit them from the scope of the FDP. This omission is primarily due to the FDP Company's unwillingness to shoulder the risk of criminal liability for breach of the provisions of these documents. However:</p> <ul style="list-style-type: none"> (A) the FAP sets out specific requirements for some of the matters dealt with in these documents in a manner which meets the Objective and complies with the specific requirements of the Guidance. For example, both the FAP and the articles of association require the 'independent directors' to satisfy demonstrable criteria of independence; (B) the FDP Company and NNB have undertaken in the FAP not knowingly to take any step which would render provisions of the ancillary documents inconsistent with the requirements of the FAP; (C) the FDP Company and NNB have further undertaken in the FAP to use their reasonable endeavours to ensure that the ancillary documents are consistent with those requirements; and (D) the FAP designates certain terms of the ancillary documents as "mandatory"; these terms cannot be amended without the Secretary of State's consent and cannot be contradicted or overridden by other amendments. <p>The Board is content that these safeguards are suitable to ensure that the provisions of the ancillary documents which are required in order for the FDP to meet the Objective are sufficiently protected.</p> <p><u>Conclusion:</u> the Board is content that NNB's proposed FAP has a clear structure for the purpose of the Guidance.</p>

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Guiding Principle 2	<i>The FDP contains realistic, clearly defined and achievable plans for decommissioning, waste management and waste disposal</i>	The DWMP itself is not within the Board's remit (see Annex 2, <i>the Board's Role and Scrutiny of the FAP</i>). Accordingly, the Board is not advising as to whether the FDP contains realistic, clearly defined and achievable plans for decommissioning, waste management and waste disposal. The Board notes that the Secretary of State has received comments from the Nuclear Decommissioning Authority (NDA) concerning these and other technical and methodological aspects of the DWMP. The Board notes, however, that provisions governing the verification and updating of the cost estimates in the DWMP (which relate to such plans) have been included in the FAP to ensure that they are legally binding and subject to the 2008 Act regime, which includes criminal sanctions. The descriptions of the verification processes are summarised in paragraph 8 of Annex 5, <i>Life Cycle of the FAP</i> .
Guiding Principle 3	<i>The FDP contains robust cost estimates which take due account of risk and uncertainty</i>	<ul style="list-style-type: none"> ○ The process for reviewing cost estimates is set out in paragraphs 7 and 8 of Annex 5, <i>Life Cycle of the FAP</i>. ○ While it is not within the Board's remit to advise as to whether the DWMP element of the FDP contains robust cost estimates which take due account of risk and uncertainty, the Board is advising as to the suitability of the funding arrangements in the FAP in relation to costs likely to be incurred in connection with the Designated Technical Matters. The FAP arrangements contemplate certain steps relating to the DWMP, in particular: the process for the updating of the DWMP; relevant verification requirements and the extent to which they will in practice result in robust cost estimates; and the treatment of risk and uncertainty in the risk estimates. ○ The Board notes the comments of the NDA regarding the contingency modelling used in the present DWMP and, in particular: (i) the description of that modelling as a "hybrid approach" with a statistical assessment of some costs, but a non-statistically based subjective assessment of others; and (ii) the conclusion that this hybrid approach provides an appropriate basis for deriving a contingency provision for the DWMP at this stage, developed against the current set of defined baseline assumptions. ○ In this respect, the Board notes that the FAP includes an explicit requirement for any DWMP produced from and including the first quinquennial review to combine estimating uncertainty, discrete risk and cost, using a

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		<p>statistical model to produce a probability distribution from which an appropriate probability value can be derived.</p> <ul style="list-style-type: none"> ○ The Board notes that the FDP Company's obligation to arrange verification is limited to its reasonable endeavours. However, the 2013 Regulations require that an independent technical verifier confirms that the relevant operator's cost estimates are reasonable. Further, the FAP stipulates that NNB must provide information to the independent technical verifier. The procedures in the FAP for the technical verification as part of each quinquennial review require the independent technical verifier to assess reasonableness in accordance with certain specified factors. These include whether assessments of risk and uncertainty of possible cost performance are in accordance with good industry practice and whether the estimates stated by NNB can reasonably be regarded as representing the 'Approved P Value'. ○ In this context, the Board notes that NNB will not be required to take account of the actions of others in the industry with regard to costs estimation unless and until those actions become good industry practice (defined in the FAP as, in summary, standards and practices conforming to 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 RPI) and every five years at each quinquennial review to reflect the real cost increases since the latest quinquennial review. ○ The Board notes that the Secretary of State's ability to influence the DWMP after approval of the FDP will be limited. However, given the critical role of the DWMP in the FDP, the Board would expect the Secretary of State to review any revised DWMP and commission advice on it as appropriate. Depending on the advice received, she may then wish to take account of her contractual right to enforce the terms of the FAP as a third party and her statutory powers under the 2008 Act. <p>Conclusion: the Board is content that provided NNB acts reasonably in the preparation of the first DWMP after</p>

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		<p>the first quinquennial review, there is an adequate process in the FAP for the updating and verification of the technical basis for the cost estimates set out in the DWMP, which takes due account of risk and uncertainty.</p>
Guiding Principle 4	<i>The FDP is transparent</i>	<ul style="list-style-type: none"> ○ The Board is advising only on the transparency of the FAP element of the FDP. The FAP requires a considerable volume of information to be provided to the Secretary of State periodically, at annual reviews and quinquennial reviews, as set out in paragraph 7 of Annex 5, <i>Life Cycle of the FAP</i>. The processes relating to the making of contributions and the drawdown of the fund provide further transparency as to how funds are to be contributed and distributed as explained in paragraph 3 of Annex 5, <i>Life Cycle of the FAP</i>. ○ The Board is satisfied that the FAP does not contain restrictions which would prevent the FDP Company from requesting information from NNB or inhibit the ability of the FDP Company to raise issues or concerns with, or give information to, the Secretary of State. Further, NNB is obliged to provide information reasonably required by the FDP Company or a verifier in order to perform their respective functions. ○ The Board notes that the FAP contains references to certain future agreements and concepts which are not in existence at the time that the Board gives this advice (such as references to ‘Project Finance Secured Documents’). In all such cases, however, the terms of the FAP require such documents to have been approved, entered into or designated by the Secretary of State, so that any such terms remain within her control. It may be appropriate for the Secretary of State to seek the views of the Board or a similar body prior to approving, entering into or designating any such agreement to ensure that the provisions of the FAP continue to remain prudent. ○ The Board asks the Secretary of State to note that it is proposed that there will be a form of Standstill Agreement, as agreed between the Secretary of State and NNB in relation to the security interests granted in accordance with the FAP, to which lenders of NNB may later accede in order to benefit from its terms (for further details on the Standstill Agreement see paragraphs 5.8 to 5.12 of Annex 3, <i>Factual Background</i>). The Standstill Agreement is a form of ‘FDP Direct Agreement’ for the purposes of the FAP, a concept which includes any direct

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		<p>agreement or other intercreditor agreement in respect of the FAP or certain other specified documents that may be entered into between the Secretary of State, NNB, the FDP Company (if relevant) and relevant financing parties from time to time.</p> <ul style="list-style-type: none"> ○ While NNB's waste transfer agreements are not within the Board's remit and the Board is not able to advise on their terms, the Board also notes that NNB is to enter into waste transfer agreements with the Secretary of State to govern the calculation of the waste transfer price for disposal of the waste and other practical steps regarding disposal. If NNB wishes to enter into alternative waste disposal arrangements then, given the material nature of the modifications to the DWMP which would be required to give effect to any alternative arrangements, we have assumed that, if NNB should wish to enter into any such alternative arrangements, it would need to seek a statutory modification to the FDP in order to do so. This would, again, require the approval of the Secretary of State under the 2008 Act. <p><u>Conclusion:</u> the Board is content that the provisions of the FAP are transparent for the purposes of the Guidance.</p>
Guiding Principle 5	<i>The FDP contains clear terms and clear divisions of roles and responsibilities</i>	<ul style="list-style-type: none"> ○ As noted above, the FAP has been structured as a legally binding contract between NNB and the FDP Company and, as such, sets out their respective obligations. Please see Annex 3, <i>Factual Background</i> for further details regarding this structure. ○ Obligations of both NNB and the FDP Company in the FAP are, in many instances, qualified rather than absolute; that is to say, the obligation is to use their reasonable endeavours, or to do what is within their power, to achieve the desired result. The Board understands from the Office for Nuclear Development (OND) that this is due to the unwillingness of both parties to accept the risk of criminal prosecution under the 2008 Act in circumstances where they have used their reasonable endeavours to comply with an obligation or where compliance is out of their control or dependent on a third party. It is important to note, however, that certain key obligations of NNB, such as the obligation to pay contributions and to carry out reviews of the DWMP, are

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		<p>unqualified.</p> <ul style="list-style-type: none"> ○ The Board also notes, in particular, that: <ul style="list-style-type: none"> (A) while it is envisaged in the Guidance that an FAP should provide appropriate procedures for the notification of breaches likely to have a material adverse effect on, or which could reasonably be considered material to, the ability of NNB or the FDP Company to make or receive contributions; and (B) while the FAP explicitly states that it is the expectation of all parties that the FDP Company will notify to the Secretary of State material breaches of the FAP by NNB, <p>there is an obligation on the FDP Company to notify only a small number of specifically listed, material breaches. The FDP Company has no legally binding obligation to notify the Secretary of State of other breaches.</p> <ul style="list-style-type: none"> ○ While verification is a key component of the annual review and quinquennial review process, being the only means by which any person other than NNB has any input into the process before the relevant documentation is sent to the Secretary of State, the FDP Company's obligation to arrange verification is limited to its reasonable endeavours. The Board notes, however, the nature of the requirements under the 2013 Regulations in relation to verification of NNB's cost estimates and the provisions of the FAP, described at Guiding Principle 3 above. ○ The FDP Company's role is more limited in some respects than was envisaged by the Guidance. It will, for instance, act only in accordance with the provisions in the FAP and the ancillary documents; it will not play an active role in setting contributions (which are calculated mechanically in accordance with the contributions mechanism in the FAP); and it will not be consulted in relation to the investment strategy, financing of NNB or any other key matters.

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		<ul style="list-style-type: none"> ○ However, NNB is required to use its reasonable endeavours to procure that the fund assets are consistent with the full set of investment rules as at the last day of each annual and quinquennial reporting period. If it has been verified or determined that there was an inconsistent portfolio (meaning a portfolio which is not, as a whole, consistent with the investment rules) as at the last day of such a period, NNB must restore consistency by the last day of the current financial period by making cash contributions or issuing investment orders. <p><u>Conclusion:</u> the Board is content that the division of roles and responsibilities within the FAP is clear, albeit that certain responsibilities are qualified and that the FDP Company’s role is broadly mechanistic rather than influential (the Board has taken these points into account when assessing the other Guiding Factors).</p>
Guiding Principle 6	<i>The FDP is a durable arrangement</i>	<ul style="list-style-type: none"> ○ The FAP will remain in place for a long period and through several different stages in HPC’s lifetime. The terms of the FAP reflect this and include different requirements for the various periods. For example, certain covenants apply only while the plant is operational, and other, separate, provisions apply in relation to the decommissioning period and the disbursement of funds after generation has ceased. ○ As described in paragraph 3 of Annex 5, <i>Life Cycle of the FAP</i>, the FAP requires periodic updating of the DWMP, to take account of changing events and practices and of inflation. 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. ○ The FAP also contains provisions to provide flexibility to deal with certain events which, although not considered likely, are acknowledged to be a possibility during the FAP’s lifetime, such as the agreed measure of inflation ceasing to be published, force majeure, and the adoption of a different currency by the United Kingdom. ○ The Board is not (at the Secretary of State’s request) providing advice in respect of the Section 46 Agreement, but it notes that the Secretary of State will be agreeing under the Section 46 Agreement only to exercise her power under the 2008 Act to propose modifications to an approved FDP in a certain manner (in accordance with

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		<p>the 2008 Act).</p> <p>Please see further paragraphs 3 and 5 of Annex 5, <i>Life Cycle of the FAP</i> regarding updating of the DWMP and the cash sweep provisions. These mechanisms provide extra protection against potential future events (such as the potential adverse effect of a switch from an assumed discount rate in respect of the Year 37 Target to a market rate, in the case of the cash sweep provisions) which could affect the value of the Fund or NNB's annual contributions to it.</p> <p>Conclusion: the Board is content that the terms of the FAP are designed to ensure that the FDP represents a durable arrangement which has sufficient flexibility to adapt over time. The Board notes that the Secretary of State will need to consider the FAP in conjunction with the CfD, the Section 46 Agreement, the Standstill Agreement and the terms of the financing arrangements, each of which could have a fundamental impact on the FAP (see the Board's assumptions in this regard set out in Annex 6, <i>Assumptions</i>).</p>
Guiding Principle 7(A)	<p><i>The FDP sets out a Fund structure that demonstrates: <u>independence of the Fund</u></i></p>	<ul style="list-style-type: none"> ○ The structure of the fund is described in Annex 3, <i>Factual Background</i>. The Board has considered the structural separation between NNB and the FDP Company, the restrictions placed on NNB to prevent NNB dealing directly with the fund assets and the independence requirements for the independent directors. ○ The Board asks the Secretary of State to note that (i) there is an obligation on the FDP Company to comply with investment orders, and (ii) there are limited grounds on which the FDP Company may challenge the investment orders it receives from NNB or its authorised representatives, but (iii) despite the provisions outlined in (i) and (ii), there are obligations placed on NNB in respect of investment orders, including the requirement that the investment order itself contains a statement that NNB has no reason to believe that the investment order being made will cause or represent a manifest breach of the investment rules. For further details regarding the investment rules, see paragraph 6 of Annex 5, <i>Life Cycle of the FAP</i>. ○ Since investment orders may be issued by either NNB or its authorised representatives and since the FAP does not prevent a person who is not independent from NNB from providing investment advice, the Secretary of State

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		<p>should be mindful that it would be possible for an affiliate of NNB to be appointed as an authorised representative or investment adviser. The Board would request the Secretary of State to note, however, the following protections in the FAP:</p> <ul style="list-style-type: none"> (A) the FAP contains obligations on NNB that require it to hold the fund assets remotely from itself and its affiliates, and it prohibits NNB from knowingly dealing directly with the fund assets at any time; (B) NNB is prohibited from knowingly giving investment orders which do not comply with the investment rules, and must use its reasonable endeavours to ensure that its authorised representatives do not do so; (C) the FDP Company is required to challenge all investment orders which it considers do not comply with the investment rules; and (D) the FDP Company is required to appoint a professional custodian to take custody of the fund assets and be responsible for their safekeeping. <ul style="list-style-type: none"> ○ The FDP Company may only accept investment orders from NNB (or its authorised representatives) which contain a statement confirming that NNB has no reason to believe that the investment order will be inconsistent with the restrictions of the investment rules or cause a manifest breach of those rules. <p><u>Conclusion:</u> the Board is content that the provisions of the FAP provide for the fund to be independent of NNB.</p>
Guiding Principle 7(B)	<i>The FDP sets out a Fund structure that demonstrates: <u>measures to ensure</u></i>	<p><i>Non-recourse</i></p> <ul style="list-style-type: none"> ○ The Board requests that Secretary of State note that the proposed decommissioning structure is set up on a non-recourse basis. If, despite the provisions of the FDP, the fund assets prove to be insufficient, neither the

Guiding Principle	Principle as set out in Guidance	Advice
	<p><u>sufficiency of the Fund</u></p>	<p>Secretary of State nor the FDP Company will have recourse to other members of NNB's group, nor will the Secretary of State be able to modify the FDP to allow such recourse.</p> <p>Contributions</p> <ul style="list-style-type: none"> ○ The structure of the FAP is such that NNB is to provide annual contributions to the fund governed by the FDP Company over time, rather than by way of an upfront endowment, with a funding path that reaches its 100 per cent. 'fully funded' target to cover all waste generated by the plant by year 37 (in order to coincide with the end of the consistent revenues ensured by the operation of the CfD). For further details regarding the life of the reactors, see paragraph 6 of Annex 3, <i>Factual Background</i>. ○ The Board notes that the build-up of the fund is severely 'back-ended'. As an illustration of this, if the fund were to be built up evenly over the 37 year period rather than being back-ended, the fund would be 34 per cent. funded after 15 years rather than 15 per cent., and 77 per cent. funded after 30 years rather than 61 per cent. (assuming a level annual contribution in real terms and that asset returns match the assumed long-term discount rate). ○ This back-ending exacerbates the risk of the fund assets being inadequate to cover the costs of decommissioning and the management, storage and disposal of waste in a scenario where the HPC plant closes early. However, the Board believes that the majority of potential early closure scenarios, other than those which are politically motivated, arise as a result of the plant's becoming uneconomic to run (for instance, due to a material outage and the associated capital expenditure). The Board is satisfied that in such scenarios, the CfD gives whomsoever is in control of NNB sufficient incentive to repair the plant and to keep it running at least for the period that the CfD remains in place. The consistent revenues ensured by the CfD, coupled with this incentive for NNB to keep the plant running in order to receive those revenues, provide sufficient comfort that the fund will attain its target value by year 37. Additionally, the Board derives comfort from the fact that the fund target values set for both year 37 and year 60 are calculated on a P80 plus 25 per cent. contingency basis

Guiding Principle	Principle as set out in Guidance	Advice
		<p>in respect of the estimated costs of decommissioning and waste management; in other words, the cost estimates for each of decommissioning and waste management for NNB's FDP are set at a level such that there is an 80 per cent. chance of the actual costs proving to be lower than the estimates, and NNB is required to fund to the P80 figure together with a further 25 per cent. contingency buffer.</p> <ul style="list-style-type: none"> ○ The Secretary of State will need to satisfy herself that the provisions of the CfD are sufficiently robust and that NNB is reasonably certain to receive the benefit of the CfD for its full 35-year term. The Board notes that it has not reviewed the CfD, at the request of the Secretary of State. The Board's advice is predicated upon the CfD assumptions set out in Annex 6, <i>Assumptions</i>. ○ The FAP seeks to ensure the fund maintains its value, especially after it has reached its Year 37 Target (when consistent revenues may no longer be available), through: <ul style="list-style-type: none"> (A) investment rules regarding investment of the fund assets. These include requirements to 'derisk' the investments as the Year 37 Target approaches; and (B) restrictions regarding NNB's accessing or drawing down the fund prior to decommissioning. ○ It is to be noted that the Board understands the Secretary of State will be agreeing there should be no recourse to any person other than NNB should the fund be insufficient to complete the decommissioning process. <p>Financing</p> <ul style="list-style-type: none"> ○ The sufficiency of the Fund may be significantly affected by the way in which the plant is financed by NNB. The FAP provides that no repayments of debt may be made by NNB at any time while an annual contribution or cash sweep payment has become due and remains unpaid. Further, even if NNB becomes insolvent, as long as the plant remains operational then whoever takes over its operation will be required to continue to make the FAP's

Guiding Principle	Principle as set out in Guidance	Advice
		<p>specified annual contributions to the fund. It is on an early closure of the plant only that such contributions might be at risk of ceasing (see discussion of early closure risk above). Note, however, that too much debt or too tight an amortisation schedule for that debt may place NNB at greater risk of financial distress or insolvency (especially if large debt repayments become due from FDP years 30 to 37, when the payments to the fund are at their largest), which in turn may increase the risk for the Secretary of State of a 12-month 'standstill' being triggered under the Standstill Agreement.</p> <ul style="list-style-type: none"> ○ The Board asks the Secretary of State to note that NNB will be subject to a gearing covenant under the FAP which would prevent it from paying dividends or borrowing further for as long as it exceeds its permitted gearing level. For further details on the gearing covenant see paragraph 4 of Annex 5, <i>Life Cycle of the FAP</i>. The Board notes that the gearing covenants in the FAP are weaker than one would usually expect to see in a regular structured or project financing. This reflects the nature of the transaction and the requirement for any operator of the plant to continue to make annual contributions to the FDP fund so long as the plant remains operational (even if NNB has become insolvent). ○ Set out in paragraph 4 of Annex 5, <i>Life Cycle of the FAP</i> is the Board's understanding of the manner in which the Secretary of State may control (or otherwise) the introduction of debt in the future. She will need to consider whether the rights given to her in the FAP are sufficient to protect the position of the FDP fund. She may also wish to consider the impact of the Standstill Agreement and the Section 46 Agreement (which we have not reviewed, at the request of the Secretary of State). ○ Given that the FAP is dependent, in a number of respects, on the terms of the CfD and the financing arrangements for HPC, we recommend that the Secretary of State consider whether to defer her final approval of the FAP until she is satisfied that the final terms of the CfD and the anticipated terms of the financing arrangements do not affect the validity of her conclusions on the FDP (see Annex 7, <i>Financing Arrangements</i> for a summary of the contemplated financing arrangements as they have been presented to the Board). The Board asks that the Secretary of State note its assumptions regarding the CfD and financing arrangements set out in

Guiding Principle	Principle as set out in Guidance	Advice
		<p data-bbox="730 352 2002 456">Annex 6, <i>Assumptions</i>, and asks that she note, in particular, the assumptions it has made with regard to the possibility of potential alternative arrangements which she may have to consider in the event of a successful State aid challenge to the CfD.</p> <p data-bbox="636 501 743 531">Security</p> <ul data-bbox="685 576 2047 1353" style="list-style-type: none"> <li data-bbox="685 576 2047 794">○ The Board relies primarily on those provisions of the FAP which prevent NNB from making repayments to debt-holders at any time while an annual contribution or cash sweep payment is due and remains unpaid. However, these obligations are bolstered by the requirement in the FAP for the Secretary of State to be granted a first-ranking floating charge, and the FDP Company also to be granted a first-ranking floating charge (subject only to the prior ranking of the Secretary of State's floating charge) over the assets of NNB before First Criticality. NNB is required to procure to the extent of its power that those charges remain in force and retain their ranking <li data-bbox="685 839 2047 979">○ The obligations are also bolstered by the fact that the FAP is designed to operate regardless of the owner of the plant (so that NNB would still be required to pay annual contributions even if a lender takes control of it and the plant) and the fact that the Secretary of State has a cross-acceleration provision in relation to early closure of the plant. <li data-bbox="685 1024 2047 1353">○ Furthermore, the effect of the prohibition in the FAP on NNB's making debt payments when an annual contribution or cash sweep payment is outstanding is that if a lender accelerates and takes control of the plant, the lender is legally obliged to continue to make annual contributions to the fund when they fall due prior to repaying itself from the revenues generated by the plant. The Secretary of State should note that, because of the above protections, the FAP does not contain a general cross-acceleration provision for the secured amounts due to the Secretary of State and FDP Company which would provide for those amounts to accelerate automatically if another lender accelerates their debt. She should also note that lenders could take funds out of NNB in amounts that do not prejudice NNB's ability to operate the plant and make annual contributions in the short term, but which could have an effect on that ability in the longer term (and, as set out below, that NNB may

Guiding Principle	Principle as set out in Guidance	Advice
		<p>hold funds in subsidiary, parent or other group companies).</p> <ul style="list-style-type: none"> ○ Regarding the security interests of the Secretary of State and FDP Company, the Secretary of State should note that NNB may be subject to certain security interests in favour of suppliers in respect of particular assets (such as retention of title provisions, sale and leaseback arrangements, assignments of rights, pledges and liens etc.), which would effectively give the holders of such security interests priority over the floating charges granted to the Secretary of State and FDP Company pursuant to the terms of the FAP. Further, as the restrictions upon creating security attach only to NNB, this would not prevent any subsidiaries of NNB or other NNB group companies from opening reserve accounts (funded by NNB) and securing those accounts in favour of debt providers. The Secretary of State should note the impact that this could potentially have on the ranking and priority of her own, and the FDP Company's, security interests and the ability of NNB to fulfil its funding targets in the event of insolvency of NNB or early closure of the plant. The Board is satisfied that the consistent revenues ensured by the CfD and the incentive for NNB to keep the plant running in order to receive those revenues will be shared by any lenders to NNB, whether they are party to the same security package as the Secretary of State or not. This incentive to ensure that revenues continue to flow, when coupled with the need for NNB to pay the annual contributions due under the FAP prior to any repayment of debt, would seem to provide sufficient mitigation against this risk. ○ The Secretary of State should also note that NNB may take out unsecured borrowings subject to a cap and the providers of such unsecured borrowings may still benefit from the standstill arrangements without those unsecured lenders acceding to the Standstill Agreement (if other creditors have acceded) and therefore being required to comply with the obligations contained in it. However, despite this benefit, whenever either a standstill under the Standstill Agreement is in force, or if an annual contribution or cash sweep payment has become due and remains unpaid under the FAP, NNB is prohibited from making debt repayments until such deficit is rectified. ○ The Board asks the Secretary of State to note that the 'Accelerated Decommissioning Contributions Amount'

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		<p>(described at paragraph 9.7 of Annex 5, <i>Life Cycle of the FAP</i>) only becomes payable when the Secretary of State takes Security Trigger Event Action¹. Such action may be taken only if: (i) NNB does not pay an annual contribution or provisional cash sweep payment; (ii) NNB becomes insolvent; or (iii) an early closure trigger event occurs. It should be noted that such amount is not due from NNB if the taking of the Security Trigger Event Action is delayed either because: (i) the Secretary of State has chosen to enter into the Standstill Agreement and the provisions of that agreement are operative or (ii) the Secretary of State decides not to enforce her qualifying floating charge.</p> <ul style="list-style-type: none"> ○ The amount that NNB has available to it to pay the Accelerated Decommissioning Contributions Amount will, as a result of the non-recourse structure, in practice be simply the monies that NNB has available to it. To the extent that the lenders have taken out cash from NNB and/or NNB is retaining its cash reserves in affiliated companies, whether or not such actions may amount to a breach of the FAP or the Standstill Agreement, there is a risk that NNB will not have the monies available to it to pay such amount. In the event that such actions were to breach: (i) the FAP, NNB would be at risk of criminal sanctions; and/or (ii) the Standstill Agreement, the Secretary of State would have the benefit of contractual remedies. However, the actions will only amount to a breach of the FAP and/or the Standstill Agreement in certain limited circumstances.

¹ Defined as: "(a) the taking of any steps to enforce or require the enforcement of any FDP Qualifying Floating Charges (including the crystallisation of any floating charge forming part of the FDP Qualifying Floating Charges or the appointment of an insolvency official); (b) initiating, petitioning, applying or voting for, or the taking of any steps in relation to, any composition, compromise, assignment or arrangement with the Operator; or (c) initiating, petitioning, applying or voting for, or the taking of any steps (including the appointment of any liquidator, receiver, or similar officer) in relation to (i) the winding up, dissolution, administration, receivership or reorganisation of the Operator, or any of the Operator's assets; or (ii) any suspension of payments or moratorium of any indebtedness of the Operator; or (iii) any scheme of arrangement, voluntary arrangement or assignment for the benefit of any creditors of the Operator; or (iv) any analogous procedure or step in any jurisdiction".

Guiding Principle	Principle as set out in Guidance	Advice
		<p data-bbox="685 352 2051 568">○ Additionally, the FDP Company cannot enforce its qualifying floating charge until the Secretary of State enforces hers. This puts the FDP Company’s right to enforce its qualifying floating charge, provided that the conditions to enforcement are met, within the control of the Secretary of State. The Secretary of State should note that any delay imposed on the FDP Company preventing it from enforcing its qualifying floating charge (e.g. if the Secretary of State chooses not to enforce her qualifying floating charge for political reasons) may have an impact on the fund.</p> <p data-bbox="636 616 976 643"><u>Conclusion on sufficiency:</u></p> <ul data-bbox="685 691 2051 1355" style="list-style-type: none"> <li data-bbox="685 691 2051 754">• the FDP has been structured in such a way that NNB is required to fund its FDP over time, rather than by way of an upfront endowment. The Board is content with this approach; <li data-bbox="685 802 2051 1018">• the Board believes that the Year 37 Target and the Year 60 Target have been set at a sufficiently high level (determined for the purposes of the targets on a P80 plus 25 per cent. contingency basis, as described at paragraph 3.10 of Annex 5, <i>Life Cycle of the FAP</i>) that, provided these Targets are met, the likelihood that the fund will be insufficient to decommission the plant and deal with the waste produced (as a result of, for instance, cost inflation or low investment returns after the end of generation), while not completely negligible, is remote; <li data-bbox="685 1066 2051 1209">• the Board predicates its advice on the assumption that CfD support will be available to provide consistent returns to NNB through to the ‘fully funded’ target date at year 37, although it notes that, in a scenario where the plant were to close early, the risk of insufficiency of the fund increases the earlier before the Year 37 Target the plant closes; and <li data-bbox="685 1257 2051 1355">• the Board requests that Secretary of State note its caveats regarding NNB’s ability to take on debt and the manner, noted above, in which certain structures could be utilised to affect the efficacy of the Secretary of State and FDP Company’s security interests, and to consider these items if ever she is

Guiding Principle	Principle as set out in Guidance	Advice
		asked to designate, agree or approve any financing arrangements that NNB may enter into.
Guiding Principle 7(C)	<i>The FDP sets out a Fund structure that demonstrates: <u>restrictions on the use of Fund Assets</u></i>	<ul style="list-style-type: none"> ○ In addition to the controls set out in Annex 5, <i>Life Cycle of the FAP</i>, NNB has undertaken to act in accordance with good industry practice in entering into contracts relating to decommissioning. The Board notes that NNB is permitted to enter into decommissioning contracts with affiliates subject to these undertakings in the FAP. ○ The Board notes that fund assets which are released in accordance with the drawdown provisions will be released annually in advance, be held in a separate account pending application and be segregated from NNB's other assets, and that a trust will be in place to protect such funds until they are used to discharge the relevant DTM Costs. ○ In respect of the verification process and the procedure for drawing down the fund, the Board notes that the definition of Allowable Costs includes costs to which the Detailed DWMP (rather than the Annual Work Plan and Budget) relates. This provides NNB with flexibility to carry out works which are not in accordance with the anticipated schedule while retaining the ability to draw down sums from the fund for such works. ○ As part of this process, a reconciling amount is calculated and offset against NNB's claim from the fund for the following year. However, the reconciling amount will not extend to any costs which are expressed to be costs that are unreasonable in the reconciliation verification report produced by the independent technical verifier, provided that such costs are not Disallowable Costs. This means that NNB would not be required, for example, to set off amounts for works which the independent technical verifier thought were excessive or premature, provided that such works constitute Allowable Costs. ○ The concept of Allowable Costs also extends to a contingency or overrun which allows NNB to draw down funds of up to 25 per cent. more than the budgeted annual decommissioning costs which are not subject to a prior independent verification process. Where any such amounts are unspent during the year, however, or constitute Disallowable Costs, these will be offset against NNB's claim from the fund for the following year as part of the

Guiding Principle	Principle as set out in Guidance	Advice
		<p>reconciliation process. The Board requests that Secretary of State note that, if any costs are expended which are not Allowable Costs, there would not be any additional funds available to NNB for decommissioning.</p> <ul style="list-style-type: none"> ○ During the year, NNB has relative freedom to withdraw further amounts up to that year's budget plus 25 per cent., subject to verification that any withdrawals when aggregated do not constitute Disallowable Costs of more than £500,000. However, amounts in excess of that year's budget, plus 25 per cent. are subject to verification as to whether they have been reasonably assessed by NNB to be necessary or efficient. Additionally, any spending on Disallowable Costs must be declared during the reconciliation process (albeit that there is no obligation on NNB 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). ○ There is no retention mechanism in respect of annual contributions, since contributions are made in advance on a 'pay-as-you-go' basis; no such contributions are held back or retained. ○ The Board also notes that whilst the Secretary of State will retain limited rights in the Section 46 Agreement to modify the FDP in respect of the payment and disbursement provisions, the Secretary of State is also limited in her ability to propose modifications to the DWMP and its associated timetable by the terms of the Section 46 Agreement. <p><u>Conclusion on restrictions on use of fund assets:</u> the Board is content that, on balance, the terms of the FAP provide suitable precautions against the risk of fund assets being used for purposes other than decommissioning, spent fuel management and intermediate-level waste (ILW) and spent fuel disposal. Given the approach adopted, however, the Secretary of State will need to be mindful of the contractual rights under the FAP and of her statutory powers, and should give consideration to using them to ensure that decommissioning is carried out (and, in particular, that contracts are let) in accordance with the spirit of the provisions of the FAP.</p>

Guiding Principle	Principle as set out in Guidance	Advice
Guiding Principle 7(D)	<p><i>The FDP sets out a Fund structure that demonstrates:</i></p> <p><u>insolvency remoteness</u></p>	<ul style="list-style-type: none"> ○ There are two aspects to insolvency remoteness as described in the Guidance: (i) the risk to the fund assets; and (ii) the risk to payments to the fund in the event of NNB's insolvency. Given that, under NNB's proposed structure, the fund assets are held by the FDP Company and cannot be dealt with directly by NNB, the FDP Company is intended to be insolvency remote from NNB itself. In other words, were NNB to become insolvent, the creditors of NNB would have no claim on the fund assets. ○ In relation to the risk to payments to the fund in the event of NNB's insolvency, the Board notes that there are no retention mechanisms in NNB's proposed structure which provide for payments to be held back from NNB (other than the possible reserve accounts referred to in Guiding Principle 7(B) above); for example, under a trust or escrow structure. This is consistent with the proposed decision of the Secretary of State to agree not to claim against any of the owners of NNB should the fund be insufficient. Additionally, the floating charges in favour of the Secretary of State and FDP Company, referred to in Guiding Principles 6 and 7(B) above, are designed to ensure that upon an insolvency of NNB, the Secretary of State and FDP Company will have first call on the assets of NNB to secure the relevant amounts due to them. ○ The FDP Company has been set up as a special purpose vehicle with limited corporate powers: for example, it cannot borrow, give guarantees or pledge its assets (noting that it may collateralise its derivative or hedging arrangements which it is permitted to enter into under the terms of the FAP). Additionally, it 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 terms of the FAP require these limitations to remain in place and stipulate that they cannot be amended without the Secretary of State's consent. Further, these limitations can only be amended with the approval of the independent directors. ○ The terms of the FAP also require the FDP 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 object in their capacity as directors, and have separately

Guiding Principle	Principle as set out in Guidance	Advice
		<p>undertaken to do so in their capacity as shareholders.</p> <ul style="list-style-type: none"> ○ Taken together, these provisions are designed to ensure that the FDP Company is restricted from either incurring debt or engaging in other business and thus incurring the associated risks. ○ NNB is responsible for funding the FDP Company's expenses in advance by means of payments every six months and has undertaken as part of the terms of the FAP to do so (with the result that any failure to pay would be a criminal offence). The FAP requires the amount to be so paid to be determined on the basis of the costs which the FDP Company reasonably expects to incur (including, amongst other things, the remuneration of the independent directors and tax liabilities) and to include an appropriate level of contingency. ○ Were NNB to fail to pay any amounts due, the FDP Company would be entitled to have recourse to the fund assets to meet its expenses (with NNB being obliged during the operating period to make up any resulting deficit in accordance with the contributions mechanism). After the end of the operational period of the plant, the target values for the fund are designed to include the ongoing costs and expenses of the FDP Company. Note that these expenses are taken into account in the calculation of the target amounts, but that there will be no additional funds available to pay these if the forecasts are incorrect. It is not expected that the FDP Company's expenses will be of a sufficient magnitude that (even if provisional sums turn out to be insufficient and calls are made on the fund) these will threaten the sufficiency of the fund. <p>Please see further Annex 3, <i>Factual Background</i> regarding the structure of the FDP Company.</p> <p><u>Conclusion on insolvency remoteness:</u> the Board believes that the FAP and ancillary documents are appropriately designed to ensure that the risk that the FDP Company becomes insolvent is sufficiently remote.</p>

- 4.2 In summary, the Board's advice to you is that the FAP makes prudent provision for the financing of the designated technical matters and meets the Objective and Guiding Factors set out in the Guidance.
- 4.3 In coming to your decision as to whether or not to approve the FAP and whether or not to do so with or without conditions, the Board wishes to draw your attention to the various judgments made and issues raised in coming to its position as set out in the advice above, including the Board's assumptions made in Annex 6, *Assumptions*. The Board also notes that its advice is subject to the following observations:
- (A) this advice applies solely to the FAP submitted by NNB in respect of its application to build Hinkley Point C;
 - (B) you retain absolute and sole discretion in determining whether to approve or reject any FDP and whether to approve such FDP with or without modifications, and whether unconditionally or subject to conditions;
 - (C) given that the FAP is dependent, in a number of respects, on the terms of the CfD and the financing arrangements for HPC, we recommend that you consider whether to defer your final approval of the FAP until you are satisfied that the final terms of the CfD and the anticipated terms of the financing arrangements do not affect the validity of your conclusions on the FDP. The Board asks you to note its assumptions regarding the CfD and financing arrangements set out in Annex 6, *Assumptions*. The Board asks that you note, in particular, the assumptions it has made with regard to the possibility of potential alternative arrangements which you may have to consider in the event of a successful State aid challenge to the CfD;
 - (D) the Board's role is to advise on the suitability of the FAP, and the DWMP is not within the Board's remit. The Board asks you to note its assumptions in this respect as set out in Annex 6, *Assumptions*;
 - (E) if you are minded in the future to designate any agreements as Project Finance Secured Documents or to enter into further agreements directly with any lenders to NNB (or other related financing parties) concerning the FAP, you will need to be mindful as to whether or not such arrangements affect the FAP in such manner as to render its provision no longer prudent. It may be appropriate for you (i) to revert to this Board or an equivalent body, at that time, for advice as to the FAP's continued prudent provision; and/or (ii) to treat entry into that agreement as a modification to the FAP;
 - (F) the Board gives the advice set out in this letter on the basis of its understanding of the factual and legal context of the matters referred to in this document as at the date of this advice. If that factual or legal context should prove to be inaccurate or subsequently change this may

have a material effect on the Board's advice or the FAP. We assume that in such circumstances you will seek further advice, if appropriate, as to the continuing suitability of the FAP; and

- (G) we expect that you will review the operation of the FDP regime from time to time and that any such review may include looking at the 2013 Regulations again in the light of practical experience accumulated.

Having received this advice, you will now wish to determine whether to approve NNB's FDP and, if so, with or without modifications, and unconditionally or subject to any conditions.

ANNEX 1**NLFAB MEMBERS**

Lady Balfour of Burleigh, CBE, D.Phil., DL, DLitt, FRSE was appointed as Chairman of the Nuclear Liabilities Financing Assurance Board in November 2008 and re-appointed in November 2011 and from November 2014. She is currently a non-executive director of Murray International Trust plc, The Scottish Oriental Smaller Companies Trust plc, Albion Enterprise VCT plc and NDA Archives Ltd. Lady Balfour's previous non-executive directorships include Stagecoach Group plc, BPB plc, Cable & Wireless plc and Midlands Electricity plc. She was a trustee of the Nuclear Trust and a director of the Nuclear Liabilities Fund Ltd since inception in 1996 and was its chairman from 2001 to 2014.

Anne Baldock, LLB Hons is the former Global Head of Projects, Energy and Infrastructure at international law firm Allen & Overy LLP. She is a non-executive director of Thames Tideway Tunnel Ltd, Bazalgette Tunnel Limited, Hydrogen Group plc, Low Carbon Contracts Company Ltd, Electricity Settlements Company Limited and a former trustee of Cancer Research UK. Anne was appointed to the Nuclear Liabilities Financing Assurance Board in March 2009 and re-appointed in March 2012 and from March 2015.

Antony Barker is a Director at Santander UK plc with responsibilities covering Pensions and Enterprise-Wide Risk Management, as well as being Chief Investment Officer of one of the UK's largest pension funds. His previous roles include Managing Director at JLT, leading the corporate finance practice, Global Head of Pensions Advisory at BNP Paribas and Global Head of Investment Services at Deloitte. Antony is a Fellow of the Institute and Faculty of Actuaries. Antony was appointed to the Nuclear Liabilities Financing Assurance Board in March 2009 and re-appointed in March 2012 and from March 2015.

Norman Harrison, CChem, FRSC, FNI, FRSA is the former Director of Strategic Development at Babcock International Group plc. As Chief Executive Officer of the UK Atomic Energy Authority he led the sale of the Authority into the private sector. A chemist by profession, Norman has over 30 years' experience in the nuclear industry. He is a board member of the Nuclear Liabilities Fund, Deputy Chairman of the board of governors at Manchester Metropolitan University, Adviser to the Executive Team at the Culham Centre for Fusion and a senior adviser to AMEC plc. Norman was appointed to the Nuclear Liabilities Financing Assurance Board in March 2009 and re-appointed in March 2012 and from March 2015.

Simon O'Regan, B.Bus Sci, FIA is President of the North America Region for Mercer. Since joining Mercer in 1988, Simon has served as the CEO of Mercer Australia and Mercer UK, and as President of the Europe-Pacific Region, before being appointed to his current role in July 2015. Simon is a Fellow of the Institute and Faculty of Actuaries. Simon was appointed to the Nuclear Liabilities Financing Assurance Board in March 2009 and re-appointed in March 2012 and from March 2015.

Dr Anthony White, MBE, BA, DPhil, MBA, FEI is a non-executive director of the Low Carbon Contracts Company Ltd, Crown Estate, Green Energy Options Ltd, The Green Deal Financing Company and 2OC Ltd. He was a co-founder of investment management and advisory group Climate Change Capital Ltd. Anthony now provides advice to utilities, energy companies and

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ANNEX 2**THE BOARD'S ROLE AND SCRUTINY OF THE FAP****1. THE BOARD'S ROLE**

- 1.1 The Board was established for an initial three-year term in March 2009. The seven Board members were all re-appointed for a further term from March 2012, and these appointments were subsequently extended so that they will all run until 31 October 2015.
- 1.2 The terms of reference for the Board set out its responsibilities as follows:
- (A) The Board will provide independent advice to the Secretary of State, to be made public, on the suitability of the FAP element of funded decommissioning programmes submitted by operators for approval by the Secretary of State, as required by the 2008 Act. Suitability should be determined by the extent to which the proposals put forward by operators will meet the Objective and Guiding Factors outlined in the Guidance. The Board notes that the Secretary of State will need to take into account any agreement she may reach with an operator under Section 46 of the 2008 Act in making her decision.
 - (B) The Board will decide how it reaches its conclusions.
 - (C) The Board will provide independent advice to the Secretary of State, to be made public, as to the ongoing suitability of an approved FAP at the time of annual and quinquennial reviews of an operator's approved FDP, on whether the FAP still adheres to the Guiding Factors and whether it still meets the Objective set out in the Guidance.
 - (D) The Board will provide independent advice to the Secretary of State, to be made public, on any proposed changes to the Guidance, or to an approved FAP, including advice on modifications proposed by the Secretary of State.
- 1.3 Section 46(4) of the 2008 Act requires the Secretary of State to exercise her power of approval with the aim of securing that prudent provision is made for the DTMs. The Guidance defines the Objective as being to ensure that operators make prudent provision for the full costs of decommissioning their installations and their full share of the costs of safely and securely managing and disposing of their waste, and that, in doing so, the risk of recourse to public funds is remote. (Further details are set out in Annex 4, *Legislative Background*).
- 1.4 In its review, the Board has focused on whether the FAP makes prudent provision for the costs of decommissioning HPC and the cleaning-up of the site, noting that the Secretary of State has taken responsibility for determining the adequacy of the payments provided for in the FDP and due to her to meet the costs of waste transfer and disposal (which arrangements will be set out in waste transfer contracts to be entered into between the Secretary of State and NNB, the **Waste Transfer Contracts**).

- 1.5 The Guidance further notes that, when considering whether to approve an FDP, the Secretary of State will consider whether the FDP is consistent with a number of Guiding Factors. The Board's advice considers each of these Guiding Factors in turn to the extent that such Guiding Factors apply to the FAP. The Board notes that the Secretary of State should be mindful of the Guidance as a whole and is required under the Guidance to take account of the Board's advice as to the suitability of the FAP.
- 1.6 For the purposes of assessing the FAP, the Board reviewed and relied on advice from leading counsel on the interpretation of prudence. The Board has also received legal advice from Slaughter and May.
- 1.7 The Guidance is non-prescriptive and contemplates that different operators may satisfy the Objective and Guiding Factors in different ways. NNB has made its own proposal and the Board has assessed that proposal as a whole when considering the suitability of the FAP. As the various elements of NNB's proposal interact with each other, a change to an individual element may affect the overall assessment.
- 1.8 The Board notes that NNB's FAP is structured as a contract between NNB and an independent fund company (the **FDP Company**). That arrangement is supplemented by various contractual arrangements, such as the budget and services agreement between NNB and the FDP Company. This is in line with the Guidance, which explains that elements of the FDP may be reinforced through, or may include, contractual arrangements between interested parties.
- 1.9 The Board has not advised the Secretary of State on, and understands she is satisfied with, the terms of the DWMP, the Waste Transfer Contracts, the Section 46 Agreement, the CfD and the documentation related to the CfD.
- 1.10 While the Board has not commented on the DWMP, this task being outside its remit, it has considered the requirements in the FAP relating to the updating and verification of the DWMP cost estimates. The Board notes that the Guidance did not envisage that the updating and verification provisions relating to the DWMP would be in the FAP. NNB's FAP, however, does include these requirements. Therefore, although the Board is not commenting on the DWMP, it has nevertheless considered the relevant provisions in the FAP insofar as they relate to the suitability of the funding arrangements in the context of the Guiding Factors.
- 1.11 The DWMP is itself underpinned by a detailed DWMP (the **Detailed DWMP**), setting out costs and scope in greater detail. 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. The Board understands that the Secretary of State will receive separate advice in relation to the current DWMP and Detailed DWMP.

2. CONCEPT OF REMOTENESS

- 2.1 In the initial stages of its work, the Board considered the statutory requirement for prudent provision and the degree of certainty as to the availability of funds which this

requires. The Board reviewed and relied on advice obtained in this context from leading counsel.

2.2 The Board believes that prudence does not require all risks to be provided against and that prudence is a minimum standard, the satisfaction of which is a matter of assessment and judgement. It is ultimately for the Secretary of State to assess the risks involved and the likelihood of their occurrence. In assessing prudence, the Secretary of State should ask herself:

- (A) what the chance is of a particular event happening or a particular risk materialising and what the associated cost would be if it did;
- (B) what she could or would do following such an event (for example, whether she could propose a modification under the Section 46 Agreement, as referred to in paragraph 3 of Annex 4, *Legislative Background*);
- (C) bearing in mind whatever actions she is reasonably likely to take, would or might there be sufficient funds to meet the liabilities in full; and
- (D) if not, do the arrangements nonetheless meet the minimum objective standards for prudence?

2.3 The Board believes that the remoteness of any particular risk is a valid basis for concluding, at the fourth stage of the analysis above, that the arrangements, taken in the round, are prudent notwithstanding that there might not be sufficient funds to meet the liabilities in full in the event of a risk materialising at a particular point in time (for example, early in the assumed life of the plant). If a risk is negligible, it is not a necessary requirement of the 2008 Act (i.e. prudence would not necessarily dictate) that the FDP makes provision for that risk.

2.4 By extrapolation, it is clear that the 2008 Act does not require the Secretary of State to achieve the most risk-free position that she can achieve. Rather, it requires the Secretary of State, when considering an FDP, to be satisfied that the FDP passes certain minimum objective standards as to both the practicalities and the financing arrangements such that it is prudent. Whilst these minimum standards would be applicable to all operators, they could be achieved in different ways by different operators.

3. SCRUTINY OF THE FAP

3.1 Prior to initial receipt of NNB's draft FAP, the Board considered various outline proposals made by NNB and had a series of meetings with NNB. As the Guidance is non-prescriptive, NNB put forward a number of variations on its proposed structure, on which the Board commented. The Board also considered additional information provided by NNB, including its detailed responses to questions asked by the Board.

3.2 On 15 March 2012, the Board received the first draft of NNB's FAP with a firm proposal as to its intended structure and detailed provisions. In order to maintain their

independence and ensure their role was one of observation and challenge, the Board decided that it should remain detached from the direct negotiation process between OND and NNB. However the Board has met regularly with OND and with its legal, financial and technical advisers to discuss the issues raised by the FAP and ancillary documents. The Board has continued to provide OND with advice and support on these issues and has assisted OND to identify areas of concern in NNB's proposals. The Board also met with NNB on several occasions to discuss the intended structure and detailed provisions of the FAP.

- 3.3 Initially, the issues relating to the FAP fell naturally into a number of key categories; namely (i) structure and governance, (ii) contributions and sufficiency, (iii) security and risk, (iv) verification, and (v) payments and disbursements. Lists of emergent issues were provided to the Board and maintained by OND. Board members also worked with OND's advisers on discrete issues, such as discounting, investment strategy, early closure and payments and disbursements. More recently, the Board has worked with its advisers and OND on various issues including but not limited to (i) the gearing covenant, (ii) the cash sweep mechanism, (iii) the proposed provisions relating to financing, security and standstill, and (iv) the investment rules. Throughout, the Board's collective advice has been conveyed to OND in a continual process.
- 3.4 To assist its thinking and build its capacity to develop an informed position, the Board has also had a number of general and private sessions with its advisers on the detail of the FAP.
- 3.5 The Board's understanding is that NNB has various different financing options potentially available to it (and that these may include Infrastructure UK (**IUK**) guaranteed debt - a summary of the contemplated financing arrangements as they have been presented to the Board is set out in Annex 7, *Financing Arrangements* below).
- 3.6 The Board has set out in Annex 6, *Assumptions* to this letter its fundamental assumptions, based, in part, on information supplied by OND. In giving its advice, the Board has relied on the sufficiency and accuracy of these assumptions.
- 3.7 Although key to various assumptions made by the Board in consideration of the FAP, the Board has been instructed not to review the terms of the CfD itself. The Secretary of State has a dedicated team, supported by external advisers, which is negotiating the terms of this document and ensuring its adequacy.
- 3.8 In giving our advice to the Secretary of State, we have made certain assumptions as to the terms of the CfD and their impact on NNB's ability to make contributions, as set out in Annex 6, *Assumptions*. While, as instructed, we have not reviewed the CfD, we received a paper from OND summarising its key terms and, for the purposes of drafting this advice, we have relied on the content of that paper.

ANNEX 3**FACTUAL BACKGROUND**

This Annex sets out certain key points in the factual background to the HPC FDC and the Board's review.

1. FAP

- 1.1 NNB has structured its FAP as a contract with an independent fund company (the **FDP Company**, described below), creating legally binding obligations between NNB and the FDP 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 will remain in place for a long period and through several different stages in HPC's lifetime. This is reflected in the terms of the FAP which include different requirements for the various periods. For example, certain covenants apply only while the plant is operational, and other, separate, provisions apply in relation to the disbursement of funds after generation has ceased.
- 1.3 There are also provisions in the FAP to provide flexibility to deal with certain events which, although not considered likely, are acknowledged to be a possibility during the FAP's lifetime, such as the agreed measure of inflation ceasing to be published, force majeure or the adoption of a different currency by the United Kingdom.
- 1.4 The terms of the FAP are described in further detail in Annex 5, *Life Cycle of the FAP*.

2. DWMP

- 2.1 The DWMP is a non-binding plan which sets out NNB's current intentions in relation to steps to be taken to decommission HPC and dispose of waste generated at HPC. NNB's reason for making the DWMP non-binding is that its nuclear site licence already contains an obligation to decommission the site and this plan sets out the manner in which such obligations are proposed to be met.
- 2.2 Certain provisions relating to 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.
- 2.3 The DWMP is itself underpinned by the Detailed DWMP, setting out costs and scope in greater detail. This 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.
- 2.4 Periodic updating of the DWMP is required by the FAP. The DWMP (both the steps to be taken and estimated costs) will be updated at least once every five years as part of

the quinquennial review process set out in the FAP. It may, however, be updated annually to account for aspects such as significant events or indexation.

- 2.5 The mechanism for determining contributions to the FDP Company is fixed in the FAP but the annual calculation is based on the updated DWMP and is therefore designed to respond to events (such as an increase in expected decommissioning costs). The contributions process is described in further detail below.

3. FDP COMPANY

- 3.1 The FDP Company is a special purpose vehicle, with 20 per cent. of the equity owned by NNB (in order to ensure that it is an associated company of NNB for the purposes of the 2008 Act) and the remaining 80 per cent. owned by the independent directors of the FDP Company (the **Independent Directors**). It is a requirement of the FAP that the FDP Company be operated by the Independent Directors, who must constitute the majority of the board at all times. The Independent Directors select their own successors. In addition, the terms of the FAP set out criteria against which independence is to be judged and provide for the removal of Independent Directors who cease to be independent. Whilst NNB holds 20 per cent. of the shares and may appoint up to two directors of the FDP Company, neither NNB in its capacity as shareholder nor its directors have voting rights in the ordinary course of business².
- 3.2 Under the terms of the FAP, the fund assets must be held by or on behalf of the FDP Company. NNB has undertaken not knowingly to deal with fund assets directly and to use its reasonable endeavours to ensure that it does not inadvertently do so. The FDP Company acts only in accordance with the provisions in the FAP. It does not play an active role in setting contributions and it will not be consulted in relation to the investment strategy. Contributions are paid in cash to the FDP Company and then invested by the FDP Company in accordance with NNB's instructions, which are given in accordance with the investment rules set out in the FAP. The FDP Company is, however, required to challenge investment orders which it considers do not comply with the investment rules.
- 3.3 Given that, under NNB's proposed structure, the fund assets are held by the FDP Company and cannot be dealt with directly by NNB, the FDP Company is intended to be insolvency remote from NNB itself. In other words, were NNB to become insolvent, the creditors of NNB should have no claim on the fund assets.
- 3.4 In order to help protect the fund assets, the FDP Company has been set up as a special purpose vehicle with limited corporate powers: for example, it cannot borrow, give

² In summary, NNB may only exercise its votes as a shareholder, and NNB appointed directors may only vote at board meetings, if the FDP Company has failed to implement a modification, a direction given by the Secretary of State or an arbitration, adjudication or court order. NNB 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 Company.

guarantees or pledge its assets (noting that it may collateralise its derivative or hedging arrangements which it is permitted to enter into under the terms of the FAP). Additionally, it 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 terms of the FAP require these limitations to remain in place and stipulate that they cannot be amended without the Secretary of State's consent. Further, these limitations can only be amended with the approval of the Independent Directors.

- 3.5 The terms of the FAP also require the FDP 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 object in their capacity as directors, and have separately undertaken to do so in their capacity as shareholders. Taken together, these provisions ensure that the FDP Company is restricted from either incurring debt or engaging in other business and thus incurring the associated risks.
- 3.6 NNB has set up the proposed decommissioning structure on a non-recourse basis. If measures set out in the FAP do not ensure that the fund is sufficient, neither the Secretary of State nor the FDP Company will have recourse to other members of NNB's group, nor will the Secretary of State be able to modify the FDP to allow such recourse.
- 3.7 NNB is responsible for funding the FDP Company's expenses in advance by means of payments every six months and has undertaken as part of the terms of the FAP to do so (with the result that any failure to pay would be a criminal offence). The fee NNB is required to pay is net of any sums previously paid for amounts which were not subsequently incurred by the FDP Company and for disputed amounts 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 Company reasonably expects to incur (including, amongst other things, the remuneration of the Independent Directors and tax liabilities) and to include an appropriate level of contingency.
- 3.8 Were NNB to fail to pay any amounts due, the FDP Company would be entitled to have recourse to the fund assets to meet its expenses (with NNB being obliged during the operating period to make up any resulting deficit in accordance with the contributions mechanism). After the end of the operational period of the plant, the target values for the fund are designed to include the ongoing costs and expenses of the FDP Company. Note these expenses are taken into account in the calculation of the target amounts, but of course there will not be additional funds available to pay these if the forecasts are incorrect. It is not expected that the FDP Company's expenses will be of a sufficient magnitude that (even if provisional sums turn out to be insufficient and calls are made on the fund) these will threaten the sufficiency of the fund.

4. ANCILLARY DOCUMENTS

- 4.1 Various ancillary documents relating to the FDP Company do not form part of the FDP. These are the FDP Company's articles of association, shareholders' agreement and budget and services agreement (the **Ancillary Documents**). The FAP designates certain terms of the Ancillary Documents as "mandatory". These terms cannot be

amended without the Secretary of State's consent and cannot be contradicted or overridden by other amendments. The FDP Company and NNB have undertaken in the FAP not knowingly to take any step which would render provisions of the Ancillary Documents inconsistent with the requirements of the FAP. The FDP Company and NNB have further undertaken in the FAP to use their reasonable endeavours to ensure that the Ancillary Documents are consistent with those requirements.

- 4.2 The Board understands that the Secretary of State is satisfied with the terms of the DWMP, Waste Transfer Contracts, the Section 46 Agreement, the CfD and the documentation related to the CfD. The Board has, in this advice, highlighted these documents or arrangements only where they believe (based on advice received by them) that the terms of the FAP may require their consideration.
- 4.3 The Board has not otherwise commented on any of these documents, as the Secretary of State will receive separate advice on each of these and is satisfied that such task is outside the Board's remit.

5. FINANCING

Financing

- 5.1 A summary of the contemplated financing arrangements as they have been presented to the Board is set out in Annex 7, *Financing Arrangements*.
- 5.2 A description of the protections in the FAP in relation to NNB's financing arrangements, including the gearing covenant, is set out in paragraph 4 of Annex 5, *Life Cycle of the FAP*.

Security package

- 5.3 The FAP provides that there will be a security package over NNB's assets for the benefit of the secured creditors of NNB (including the **FDP Creditors**, being the Secretary of State and the FDP Company). These restrictions on the granting of security do not attach to other members of the NNB group.
- 5.4 If NNB becomes insolvent as a result of a permanent early closure, then (unless the Secretary of State has had the ability to utilise rights given to her under the FAP to prevent this) the assets of value which are subject to these security arrangements could well be minimal and it is likely that external lenders will have access to other assets within the relevant group which are not available to the FDP Creditors.
- 5.5 The security to be granted in favour of the FDP Creditors to secure their interests under the FAP is required to consist of qualifying floating charges in respect of NNB's assets, properties and undertakings, benefitting the FDP Creditors either directly or by way of a security trust.
- 5.6 NNB is required to ensure this security package is in place at the same time as or prior to the date NNB grants any fixed or floating charge, or the date the first annual

contribution to the fund is due (being five business days before either of the reactors first achieves criticality), whichever is earlier. NNB undertakes that it will not permit either reactor to achieve criticality until such security in favour of the FDP Creditors is in place.

- 5.7 NNB is required to procure, to the extent within its power, that the qualifying floating charges granted in favour of the FDP Creditors remain in force and continue to rank in priority to any other security granted by NNB. NNB is prohibited from granting any fixed charge other than pursuant to a security package to which the Secretary of State is a party (and thus over which she has control).

Standstill Agreement

- 5.8 The Secretary of State and NNB have agreed the form of a standstill agreement in relation to the security interests granted in accordance with the FAP (the **Standstill Agreement**), to which lenders of NNB may later accede in order to benefit from its terms.
- 5.9 The Standstill Agreement provides reassurance to lenders that, if certain ‘trigger events’ occur that would normally trigger the Secretary of State’s right to enforce her security, she will instead be required to ‘stand still’ for a period of 12 months, allowing lenders the opportunity to consider the situation and decide whether to rescue the plant themselves.
- 5.10 In return for the Secretary of State agreeing to be stood still in certain circumstances, NNB undertakes in the Standstill Agreement not to make specified payments to debt or equity during the same period. Lenders grant the Secretary of State the protection of ‘turnover’ provisions, which provide that any monies received by the relevant lenders from NNB in breach of key restrictions under the Standstill Agreement must be held on trust for, and then paid to, the FDP Creditors.
- 5.11 The relevant ‘trigger events’ for the standstill provisions are: non-payment of an annual contribution or cash sweep payment; the insolvency of NNB; and certain types of creditors to NNB taking steps to enforce their security as a result of the anticipated early closure of the plant. The Secretary of State undertakes not to seek to enforce its security for a period of 12 months from the occurrence of a trigger event, subject to certain exceptions (such as, among other things, if NNB has remedied the trigger event or if NNB has acted with the intent of subverting certain of its own key restrictions under the Standstill Agreement, in which cases the standstill provisions will cease to apply).
- 5.12 Any lenders to NNB to whom a floating charge or security interest in NNB’s shares has been granted (or whom NNB and the Secretary of the State otherwise agree may accede) may choose to accede to the Standstill Agreement. The standstill restrictions will not apply to the Secretary of State prior to the accession of a lender to the Standstill Agreement, and will cease to apply if NNB grants a floating charge to a lender which is not also party to the agreement (or NNB has unsecured borrowings exceeding £2 billion with lenders who are not parties to the agreement or has no outstanding debt with any lender who is a party to the agreement).

- 5.13 The Standstill Agreement falls within the definition of an FDP Direct Agreement (see paragraph 5.15 below).

FDP Direct Agreement

- 5.14 The ranking and priority of any security granted to creditors by NNB over its assets are governed by provisions in the FAP. The Board understands it is anticipated that the Standstill Agreement between the Secretary of State and NNB will be signed at the time the FAP is signed, although its key provisions will not come into force until a lender subsequently accedes to it.
- 5.15 The FAP expressly contemplates the potential existence of further FDP Direct Agreements, if any should be entered into at a later date. However, an agreement can only meet the definition of 'FDP Direct Agreement' for the purposes of the FAP if it is one to which the Secretary of State is a party. The Secretary of State thus has control over the terms of any such agreements, and will exercise her discretion as to whether to enter into any FDP Direct Agreement at the time such an agreement is proposed. The FDP Company is obliged to enter into any such FDP Direct Agreement if certain conditions are satisfied.
- 5.16 The FAP contemplates that an FDP Direct Agreement may contain provisions enabling NNB to grant a fixed charge in favour of a lender in respect of certain bank accounts ('Excluded Bank Accounts') falling outside of the Secretary of State's security package. However, the Secretary of State has control over the terms of such FDP Direct Agreements and always retains the power to refuse to enter into any particular such agreement. The Board expects that the Secretary of State would refuse to enter into any such agreement containing terms which could adversely affect the operation of the FAP or the value of the fund.
- 5.17 Should there be a proposal for a further FDP Direct Agreement in addition to (or as a replacement to) the Standstill Agreement, it may be appropriate for the Secretary of State to seek the views of the Board or a similar body regarding the ongoing suitability of the FAP prior to entering into such an agreement.

6. REACTOR LIFE

- 6.1 The FAP is structured in a way that sets out contributions requirements on NNB along a funding path from year 1 to year 60, and provides that any cessation of the reactors generating electricity, and the subsequent closure of HPC, before 60 years has 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 Board has made the assumption, in line with the Base Case set of assumptions in the Guidance, that each reactor's technical expected economic life will be 40 years (rather than 60 years), a more conservative assumption in terms of prudence (see Annex 6, *Assumptions*). The FAP has therefore been agreed on the basis that "fully funded" status is to be targeted in line with the expected life of the CfD, so as to target that status at year 37 of the FDP. Thereafter the

fund is targeted to grow, and additional sums are required to be paid into the fund where necessary, to accumulate sufficient sums to cover the increased costs incurred through to year 60 of the FDP.

- 6.3 It is, however, possible that the reactors will be able to continue generating electricity beyond year 60. The FDP has been constructed with a view to ensuring that the FAP may still be in force if the reactors continue to generate electricity beyond year 60, although NNB 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 so as to fund disposal of the additional waste that would be produced, and associated revisions to the waste transfer arrangements would have to be agreed as a pre-requisite.

ANNEX 4**LEGISLATIVE BACKGROUND**

This Annex was prepared by NLFAB's legal advisers and sets out the legislative and statutory background to the FDP, which includes reference to relevant provisions of the 2008 Act, the 2013 Regulations and in relation to that background, the Guidance.

1. Submission of an FDP

1.1 Section 45 of the 2008 Act provides that where an operator applies to the Office for Nuclear Regulation (the **ONR**) for a nuclear site licence for a site on which it intends to construct a nuclear installation it is required to:

- (A) give written notice of the application to the Secretary of State; and
- (B) to prepare and submit an FDP to the Secretary of State.

1.2 An FDP is defined as a programme which makes provision for the 'technical matters' and specifies how the implementation of that provision, so far as it relates to the 'designated technical matters', is to be financed. It must contain, among other things: details of the steps to be taken under the programme in relation to the technical matters; estimates of the costs likely to be incurred in connection with the designated technical matters; and details of any security to be provided in connection with those costs.

- (A) **Technical matters:** the technical matters in relation to a site are defined in the 2008 Act as:
 - (i) during the operation of the nuclear installation, the treatment, storage, transportation and disposal of hazardous material; and
 - (ii) after the end of the relevant nuclear installation's operation, its decommissioning and the cleaning-up of the site (and any activities preparatory to such decommissioning and clean-up).
- (B) **Designated technical matters (DTMs):** the 'designated technical matters' in relation to a site are the decommissioning and the cleaning-up of the site after the nuclear installation ceases operation. In addition, it also includes any activity preparatory to those described above and the construction and maintenance of an interim store built during the operation of the plant (each as specified in The Nuclear Decommissioning and Waste Handling (Designated Technical Matters) Order 2010).

2. Approval of an FDP

2.1 Once the FDP is submitted in respect of a site the Secretary of State may then approve or reject it. It is a criminal offence for the operator to use the site by virtue of the

licence, or permit another person to do so, without an approved FDP having been submitted and approved.

- 2.2 The Secretary of State must exercise the power to approve the FDP with the aim of securing that prudent provision is made for the technical matters. If the programme is approved, it may be done so with or without modifications, and unconditionally or subject to conditions.
- 2.3 Before deciding whether to approve or reject a programme, the Secretary of State must consult the ONR and the Environment Agency regarding the FDP and any proposed modification or proposed condition. The site operator and any other person with obligations under the programme must be given the chance to make written representations about the proposed modifications or conditions.
- 2.4 The Secretary of State must act without unreasonable delay in reaching a decision and may not reject a programme without informing the site operator of the reasons for doing so.

3. Modification of an FDP

- 3.1 Where an FDP has been approved, either the Secretary of State, the site operator or any other person who has obligations under the programme may propose a modification of the programme or a modification of the conditions to which the approval of the programme is subject. The proposal must be made in writing.
- 3.2 The Secretary of State must then decide whether the proposed modification is to be made and give notice of the decision, and the reasons for it, to every person who has obligations under the approved funded decommissioning programme. Again, the Secretary of State must consult the ONR and Environmental Agency so far as the modification relates to a function conferred on either body and exercise the powers in relation to approving modifications with the aim of securing that prudent provision is made for the technical matters. The modification takes effect at the time specified in the notice given by the Secretary of State (or the site operator).
- 3.3 When approving an FDP, Section 46 of the 2008 Act provides that the Secretary of State may agree to exercise, or not to exercise, the statutory power to propose a modification in a particular manner and within a particular period (known as a **Section 46 Agreement**). In order to enter into such an agreement the Secretary of State must be satisfied that the agreement includes adequate provision for the modification of the FDP if the provision it makes for the technical matters ceases to be prudent.
- 3.4 The 2008 Act permits the Secretary of State to make regulations which disapply the requirement for the site operator to follow this formal modifications procedure in order to amend the FDP in certain limited circumstances. These circumstances are specified in the 2013 Regulations. These circumstances are subject to conditions and include:
 - (A) where the proposed modifications are expressly contemplated in the FAP as being 'relevant modifications' and would result only in a change in the estimates

of the costs of the disposal of ILW and spent fuel or other DTMs (or which relate only to the funding of the costs likely to be incurred in connection with the DTMs); and

- (B) where the proposed modifications would result only in a change in the estimates of costs of the disposal of ILW and spent fuel or other DTMs (or relate to the details of the steps to be taken under the programme in relation to the technical matters), and the proposal would result in a change in the estimates of such costs either of five per cent. or less, or more than five per cent. where the value of the fund is greater than or equal to the subsequent required value under the FDP.

4. Failure to comply with an FDP and power of direction

- 4.1 The 2008 Act provides that failure to comply with an obligation imposed on a party by an approved FDP in respect of the site is a criminal offence.
- 4.2 Where a party fails to comply with its obligations under an approved FDP (or has been finally found guilty by a court in the UK of unlawful conduct which the Secretary of State thinks may affect the FDP), the Secretary of State may direct that party to take steps which the Secretary of State considers necessary or appropriate to comply with the obligation or remedy the effects of its unlawful conduct. If the party fails to comply with the Secretary's of State's direction it is open to the Secretary of State to make an application to the High Court to seek a court order requiring certain steps for securing that the direction is complied with.

5. Waste transfer contract

The 2008 Act contemplates that the Secretary of State may enter a waste transfer contract for, or in connection with, the disposal of relevant hazardous material by or on behalf of the Secretary of State in return for a fee (subject to consent of the Treasury in relation to the amount of the fee).

ANNEX 5**LIFE CYCLE OF THE FAP**

This Annex sets out a summary of the Board's interpretation of what the Board considers are the key stages in the life cycle of the FAP and the key provisions of the FAP applicable at each stage. It is not intended to be an exhaustive summary of the FAP and should be read in conjunction with the FAP itself.

1. BEFORE FIRST CRITICALITY - INITIAL STEPS

- 1.1 NNB submitted an application to the ONR in July 2011 for a nuclear site licence to install and operate a nuclear installation at HPC. The licence was granted in November 2012.
- 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 an FDP, which is expected to include a DWMP and a FAP (see Annex 4, *Legislative Background*).
- 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 FDP in respect of the site. Once the FDP is approved the operator may begin such construction work.
- 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 FAP 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 (**First Criticality**). Pursuant to the Guidance, NNB 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 NNB 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 NNB's annual contributions to the fund. The FAP provides that First Criticality may not occur unless and until the floating charges in favour of the Secretary of State and the FDP Company have been granted.
- 1.5 The current target dates for full commissioning of the first and second reactors at HPC (it is expected that full commissioning will occur shortly after First Criticality) under the CfD are 1 May 2025 and 1 November 2025. Once either reactor has commissioned the plant will be operational and generating.
- 1.6 It is provided in the Guidance that the Secretary of State will expect the first payment to be made to the Fund no later than First Criticality: accordingly, under the terms of the FAP NNB is required to produce and send a copy of its first draft Contributions Notice (setting out the first and second annual contributions to be made) to the FDP Company and the Independent Financial Verifier at least 35 business days before First Criticality.

The first annual contribution must then be made by NNB five 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 NNB or the FDP 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 NNB has proposed a statutory modification to the FDP in respect of the relevant event on the grounds that compliance is not lawful or reasonable 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 Project Security Documents, which are documents which are required to be in a form approved by the Secretary of State and FDP Company).

2.2 The FDP Company is required to notify first NNB and subsequently the Secretary of State if certain specified 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.

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 NNB will be required to make regular contributions to the fund in order to make prudent provision for the relevant decommissioning liabilities. The primary funding period runs from First Criticality to the end of the 37th year following that date.

- 3.2 There is a funding path in the FAP which sets out target contributions to the fund and is applied in both the Primary and Secondary Funding Periods.
- 3.3 The structure of the funding path for the primary funding period is that for each year during the primary funding period, the FAP sets out a percentage of the Year 37 Target amount which should be in the fund (annual milestones which are set out in the FAP). This funding path is shown in the diagrammatic representation in Annex 9, *Indicative Timeline of the FAP*. These milestones provide for a back-ending of payments to the fund, with contributions in the initial years of the primary funding period being relatively low and the contributions in the final years of the primary funding period being relatively high. 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 Year 37 as this is the last year in which a contribution may be made while it is anticipated that a CfD is still in place. The FAP assumes that the final annual contribution of the primary funding period will be made in January 2061. As detailed in the timeline set out in Annex 9, *Indicative Timeline of the FAP*, it is anticipated that the CfD for Reactor One will end in April 2060 and the CfD for Reactor Two will end in October 2060.
- 3.4 The structure of the funding path for the Secondary Funding Period (designed to cover the additional waste created during the period from year 37 to year 60) is set out in paragraph 9 of this Annex.
- 3.5 NNB is required to make cash payments of contributions to the FDP Company but such contributions may be paid by any person. The amount to be paid in any given year is specified for the relevant financial period in a contributions notice. The annual contribution is due on 1 January of each year, save for the first annual contribution which is due five Business Days before the expected date of First Criticality.
- 3.6 Although a different procedure applies in respect of the contributions notice for the first and second annual contributions, thereafter, NNB is required to produce a draft contributions notice as part of each annual review and quinquennial review programme (i.e. the draft contributions notice for any given year will be published each spring). The annual report which confirms the amount of the contribution will be published each autumn. The contribution is due each 1 January.
- 3.7 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.
- 3.8 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 NNB feel require inclusion in the updated DWMP. All costs are recalculated at least quinquennially.
- 3.9 The contributions mechanism is based on two different target values: the Year 37 Target (used for contribution calculations up to year 37) and the Year 60 Target (used for

contributions calculations from year 37 to year 60). Both targets are made up of four basic elements: the costs of decommissioning, the costs of spent fuel management, the costs of ILW disposal and the costs of spent fuel disposal.

- 3.10 Decommissioning costs and costs of spent fuel management are determined for the purposes of the targets on a P80 plus 25 per cent. basis. In other words, the cost estimates for each of decommissioning and waste management for NNB's FDP are set at a level such that there is an 80 per cent. chance of the actual costs proving to be lower than the estimates and NNB is required to fund to the P80 figure together with a further 25 per cent. contingency buffer (note the difference in these concepts however, and that this does not equate to P100).
- 3.11 The waste disposal costs (both ILW and spent fuel) are provided for at the amount determined by the Secretary of State in accordance with the provisions of the Waste Transfer Contracts in respect of ILW and spent fuel.
- 3.12 Further details as to the calculation of the targets are set out below (note the Board's advice regarding early closure risks at Guiding Principle 7(B), in relation to achieving these targets):
- (A) **the Year 37 Target:** this is determined such as to require sufficient assets to be in the Fund at the end of year 37 (this period to year 37 referred to as the primary funding period) to decommission the plant and manage, store and dispose of the waste were the plant to close at this point, rather than at NNB's expected end of economic life for the plant (year 60). This involves:
- (i) discounting the decommissioning costs (for the purposes of calculating the contributions to be paid), from the date at which they are expected to be incurred (should the plant close in year 37) to the end of the primary funding period (year 37). An assumed real discount rate of 1.5 per cent. per annum will be used initially, with a market determined real discount rate applying from year 33;
 - (ii) providing only for the disposal of the waste volumes generated during the primary funding period (in other words, 37 years' worth of waste rather than 60); and
 - (iii) providing for the additional costs of waste storage that will be incurred for the 23 years between year 37 and year 60 if the plant is closed at year 37.
- (B) **the Year 60 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 37, as described above, this involves:

- (i) providing for the additional volumes of waste created in the period between year 37 and year 60 (on the basis that the waste generated prior to year 37 has already been provided for); and
- (ii) the removal of the additional waste storage costs included in the Year 37 Target (referred to in item (iii) of the preceding list).

3.13 Each annual contribution comprises two core contribution calculations: the base case contribution and the correction contribution. The base case contribution is calculated based on certain investment assumptions (i.e. that the value of the fund will only grow between annual contributions at the short-term gilt rate, assumed to be 1.5 per cent. real until Year 33 of the funding period). The base case contribution does not vary due to changes in the fund asset value over time. It only varies in response to changes in the DWMP costs or a change in the assumed long-term discount rate; both of which determine the Year 37 Target amount, and in turn, the Fund's annual milestones. 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.

3.14 A base case contribution due to be paid in January of the year N+1 is calculated by:

- (A) dividing the real annual milestone for the year N+1 (the target fund value for 31 December of Year N+1) by one plus the real short term gilt rate and subtracting;
- (B) the annual milestone for Year N to calculate the base case contribution that must be made at the start of the year N+1 and multiplying by;
- (C) one plus the projected rate of inflation to convert the real calculations to nominal and reflect the one year of inflation between the annual milestone for Year N and the annual milestone for Year N+1; and
- (D) the base case contributions are affected by changes in the Year 37 Target amount; such changes could either be due to changes in assumed annual RPI inflation, a change in the DWMP costs, or because of a change in the long-term discount rate after Year 33.

3.15 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 two stages to the calculation of the correction contribution:

- (A) the annual calculation of the deficit or surplus by comparing the annual milestone to the actual fund assets value³ (known as the Total Correction Amount⁴); and
 - (B) the calculation of the proportion of the Total Correction Amount to be paid (the correction contribution) by multiplying an agreed correction adjustment percentage⁵ by the Total Correction Amount to derive the provisional correction amount.
- 3.16 A consequence of applying correction adjustment percentages in order to calculate correction contributions is that in theory, a deficit may never be fully remedied as the correction contributions would reduce over time if a fund deficit got smaller without ever fully eliminating the deficit. The contributions ratchet addresses this: where there has been a deficit for at least two consecutive years, the correction contribution paid in any year will never be lower than the correction contribution paid in the previous year plus inflation for the duration of the deficit in the fund.
- 3.17 An annual contribution is calculated by taking the base case contribution and adding or subtracting the provisional correction amount.

4. AFTER FIRST CRITICALITY – GEARING COVENANT

- 4.1 The FAP includes a gearing covenant in order to mitigate against the risk of NNB taking on too much debt, or an amortisation schedule for that debt which causes too much stress on NNB (particularly in light of the back-ending of the FDP fund's funding path), in relation to its revenues.
- 4.2 There are two tests which constitute the gearing covenant. It will suffice if NNB passes either one of them. These tests are:
- (A) **Fixed amount plus headroom (Test 1):** under this test, the principal amount of all specified borrowings of NNB may not exceed whichever is the highest of either (i) the amortisation amount set out in the FAP for the corresponding financial period, under which the initial maximum principal amount is £16 billion, or (ii) peak debt (being the principal amount drawn down under finance documents designated by both NNB and the Secretary of State). In the latter

³ The Fund Assets Value is calculated as at the final day of the previous financial period.

⁴ The Total Correction Amount considers the actual financial position of the fund at the end of the previous financial period and compares it with the target annual milestone for the same period. Inflation is added to the Total Correction Amount.

⁵ During the financial periods 1 to 32, the correction adjustment percentage is 10%, rising to 11.1% in year 33, 12.5% in year 34, 14.3% in year 35, 16.7% in year 36, 20% in years 37 to 56, 25% in year 57, 33% in year 58, 50% in year 59 and 100% in year 60.

case, the first £16 billion of such debt must be amortised in accordance with the same amortisation amounts set out in the FAP for the corresponding period. Any amounts in excess of £16 billion may be amortised in accordance with an amortisation schedule which NNB notifies to the FDP Company at the beginning of the period during which the gearing covenant operates and, accordingly, the Secretary of State will need to be satisfied with these arrangements before agreeing to designate the relevant Project Finance Secured Documents. The test also permits an additional £2 billion (indexed) of headroom, and an additional £1 billion in respect of any SZC Bonds (see 4.6 below); and

- (B) **50 per cent. of value (Test 2):** under this test NNB may not have net debt (which means the outstanding sum of specified borrowings) in excess of 50 per cent. of its enterprise value, measured either by reference to the book value of NNB as shown in its latest accounts or (at NNB's option) by reference to its fair value as determined by an independent valuer as at the same date.

- 4.3 The tests will be performed on an annual basis as at the balance sheet date of NNB. Test 1 will compare the specified borrowings of NNB against the maximum amount permitted in respect of the relevant year. Test 2 will compare the net debt of NNB against 50 per cent. of the book value (or at the option of NNB, which it will exercise if book value does not pass the test) 50 per cent. of the fair value of NNB as at the balance sheet date. The tests are also required to be carried out prior to NNB taking on any new material specified borrowing to ensure that such borrowing does not cause the permitted gearing level to be breached. NNB will not have to carry out both tests if it can demonstrate that it passes one of them. The test is not required to be met continuously throughout each year, provided that NNB incurs no new borrowings; it is required to be met only once a year as at the date of testing. (Note that during the Secondary Funding Period the gearing tests will only need to be run if the fund is in deficit or if new material specified borrowings are taken on, rather than annually.)
- 4.4 Two key consequences of breach of the covenant (neither consequence being repayment of any debt or an event of default giving rise to an ability to alter the funding pathway) are the following:
- (A) a prohibition on NNB drawing down new debt in excess of the permitted gearing level; and
- (B) a dividend block while the permitted gearing level is exceeded.
- 4.5 Note that a breach of the gearing covenant does not affect the required contributions to the fund or give the Secretary of State the right to review the funding path for the contributions.
- 4.6 The Board understands, on the basis of advice received by OND and its legal advisers, that the CfD also includes a provision for the Strike Price to reduce if a final investment decision (**FID**) is taken in respect of a proposed new nuclear power station at Sizewell C (**Sizewell C**) during the lifetime of the CfD. This difference is to reflect the benefit to the Sizewell C project company (**SZC Co**) of the 'first of a kind' knowledge and experience

built up during the development of HPC by NNB. If a FID in respect of Sizewell C is made before HPC is operational, the HPC CfD strike price will be slightly lower but provision is made for the SZC Co to make a direct payment of an amount capped at £1 billion to NNB to compensate for this. If no SZC FID is made, the strike price will be higher and an additional IUK debt amount may be available to NNB (the **SZC Bonds**). If a Sizewell C FID is made after HPC is operational, the strike price will switch to the slightly lower level at the point of the Sizewell C FID; the unamortised portion of the SZC Bonds must be prepaid and SZC Co will make a proportionate payment to NNB.

5. AFTER FIRST CRITICALITY – CASH SWEEP MECHANISM

- 5.1 For the purposes of calculating the Year 37 Target amount prior to year 33, an assumed real discount rate of 1.5 per cent. per annum is applied to the costs of decommissioning and the management, storage and disposal of waste, from the date of incurrence of such costs (assuming that decommissioning begins immediately following the end of year 37) back to year 37. At the specified Switch Date, which is 30 June 2056 (in year 33), there will be a switch to a market determined real discount rate, which will be determined by reference to the yield on long term gilts of matching maturity (or other securities which provide a better match) to the decommissioning liabilities.
- 5.2 The Board notes that (depending on trends in gilt yields in the years leading up to the switch) there is a risk that the switch from the assumed real discount rate of 1.5 per cent. to the market determined real discount rate could cause the Year 37 Target amount to increase materially and suddenly following the Switch Date. This could cause a deficit in the fund as against the target annual milestones applying in the periods leading up to year 37. To address this risk, and to try to ensure the Year 37 Target amount can be achieved by year 37, the FAP includes a cash sweep arrangement in addition to the ordinary deficit correction mechanism.
- 5.3 The cash sweep arrangement provides that for four years from the date of the switch to a market determined real discount rate, 50 per cent. of NNB's 'available cash' will be used exclusively in order to repair any deficit in the fund caused by the switch in the real discount rate. During the period of the cash sweep a dividend block will also apply. Debt service can be met through any available cash after the sweep.
- 5.4 The Board notes that the structure of the cash sweep and the timing of the switch to the market determined real discount rate has been designed to balance the needs of various interested parties in a manner acceptable to them – in particular, it provides an incentive to NNB and its capital providers (equity and debt) to keep the plant operational and thus funding the FDP throughout the 37 year period. Whilst one could have had a market determined discount rate throughout, the cash sweep deficit repair mechanism is expected to improve the probability that the Year 37 Target will be achieved.

6. AFTER FIRST CRITICALITY – INVESTMENT RULES AND DERISKING

- 6.1 Contributions are paid in cash to the FDP Company and then invested by the FDP Company pursuant to NNB's instructions, which are given in accordance with the investment rules set out in the FAP. NNB is prohibited from knowingly giving investment

orders which do not comply with the investment rules, and must use its reasonable endeavours to ensure that its authorised representatives do not do so.

- 6.2 The FDP Company is required to check such instructions against the investment rules and is generally forbidden from making investments or disposals of the fund assets, except in accordance with NNB's investment orders. Where the FDP Company considers that an investment stated in an investment order would constitute a prohibited practice or prohibited direct investment (described below), the FDP Company is obliged to issue an inconsistent investment notice to NNB as soon as reasonably practicable. NNB must then either withdraw the order or refer the matter to an investment expert for dispute resolution. The FDP Company is not obliged to comply with the investment order unless the dispute is resolved in NNB's favour. Further, the FDP Company is not required to make the investment if it does not have sufficient available cash and shall notify NNB of this fact as soon as reasonably practicable.
- 6.3 NNB is required to use its reasonable endeavours to procure that the fund assets are consistent with the full set of investment rules as at the last day of each annual and quinquennial reporting period. If it has been verified or determined that there was an inconsistent portfolio (meaning a portfolio which is not, as a whole, consistent with the investment rules) as at the last day of such a period, NNB must restore consistency by the last day of the current financial period by making cash contributions or issuing investment orders.
- 6.4 NNB has agreed to take the investment risk – in other words, to remedy any deficits in the fund from a failure to achieve the annual milestones for so long as the plant is generating. Given that NNB is taking the investment risk, the investment rules which apply up until the derisking period set broad boundaries only. They contain some limitations, such as restrictions on asset classes, the maximum size of individual investments and maximum exposures to particular institutions, but give NNB wide flexibility to determine and vary investments.
- 6.5 As explained above, prior to the derisking period, tests are applied annually to the fund assets and on the issue of an investment order to the direct investment portfolio to ensure that certain limits in respect of specified types of investment are not exceeded. The limits are designed to encourage NNB to diversify the investment portfolio of the fund and to prevent NNB from excessive investment in EDF group companies or the electricity sector.
- 6.6 A prohibited practice includes investment in the shares of NNB or its affiliates, shorting of securities and making loans or investing in derivatives other than loans or derivatives permitted by the investment rules. A prohibited direct investment includes any prohibited practice, anything which is not a permitted practice and anything not being in accordance with the portfolio restriction requirements. Permitted practices include certain investments in financial institutions with specified credit rating and certain other permitted investments (including investments in certain equity and bond indices, real estate and infrastructure in certain countries, investments in collective investment schemes subject to certain conditions and in derivatives, subject to conditions).

- 6.7 During the derisking period, the investment rules tighten and require the fund assets to be progressively derisked with four key derisking dates, by which time NNB is required to have implemented specific actions to derisk its investment portfolio:
- (A) by year 25 and until year 32, no more than 35 per cent. of the fund assets value may be invested directly or indirectly in equities (subject to an exception for certain collective investment schemes);
 - (B) by year 32 and until year 37, no more than 30 per cent. of the fund assets value may be invested directly or indirectly in equities (subject to an exception for certain collective investment schemes);
 - (C) by the last day of year 37, at least 50 per cent. of the fund assets must comprise specified government securities and the fund assets must contain no assets other than specified government securities or corporate bonds;
 - (D) from year 32 until year 37, NNB may only issue investment orders for specified government securities, corporate bonds or permitted derivatives and from the last day of year 37, the total value of corporate bonds may not exceed 50 per cent. of the fund assets value;
 - (E) from the last day of year 60 until site end state is achieved, 100 per cent. of the fund assets must comprise specified government securities, cash and cash equivalents or permitted derivatives; and
 - (F) from year 55 until site end state is achieved, NNB must only issue investment orders which provide for investment in specified government securities and permitted derivatives.
- 6.8 Given that the duration of NNB's liabilities may exceed the terms of the longest dated available approved government securities, and/or the extent of the gilts required may frustrate their purchase on terms acceptable or they may not be available, NNB is permitted as part of the derisking process to use derivatives to hedge risks which arise in relation to the Fund Assets and the liabilities in relation to the discounted DTM Costs. Any use by NNB of derivatives for such permitted purposes must be done in compliance with the investment rules.

7. AFTER FIRST CRITICALITY – ANNUAL REVIEWS/QUINQUENNIAL REVIEWS

- 7.1 The FAP requires the DWMP (both the steps to be taken and the estimated costs) to be updated at least once every five years, in a quinquennial review, and more frequently if a significant operational event occurs. When carrying out this quinquennial update, NNB must consider factors such as:
- (A) good industry practice in cost estimation;
 - (B) its own assessment of risks and uncertainties;

- (C) any relevant experience in decommissioning accumulated by any of its affiliates;
and
- (D) relevant operational changes at the site,

and make those amendments to the DWMP which it considers necessary to reflect these factors.

- 7.2 In this context, the Board notes that NNB 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 and practices conforming to 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 RPI) and every five years at each quinquennial review to reflect the real cost increases since the latest quinquennial review.

8. AFTER FIRST CRITICALITY – VERIFICATION PROCESSES

- 8.1 As part of each annual review (if a significant event has occurred) or quinquennial review, an independent technical verifier must confirm various matters regarding NNB'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, NNB 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.
- 8.2 In this context, the Board notes that this reflects the requirements of the 2013 Regulations. The 2013 Regulations require, as a minimum, that the independent technical verifier confirms that NNB'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 NNB'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.
- 8.3 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 her contractual

right to enforce the terms of the FAP as a third party and her statutory powers under the 2008 Act.

- 8.4 Verification is a key component of the annual review and quinquennial review process. It is the only means by which any person other than NNB has any input into the process before the relevant documentation is sent to the Secretary of State. Moreover, the Secretary of State's rights to propose modifications to the DWMP are limited. The FDP Company's obligation to arrange verification is limited to its reasonable endeavours, although NNB is required under the 2013 Regulations to ensure that quinquennial reports are accompanied by a verification report assessing whether NNB's estimates are reasonable.

9. THE SECONDARY FUNDING PERIOD

- 9.1 The Secondary Funding Period is defined in the FAP as the period beginning on the day immediately after FYE Year 37 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 Two is expected to occur as stated in the DWMP if the board of NNB has resolved that both of the reactors will permanently cease to generate electricity in the period between FYE Year 37 and FYE Year 60 and the Secretary of State has approved a DWMP which reflects the revised lifetime assumptions of NNB (including an ILW Transfer Payment and a 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

- 9.2 The secondary funding path for contributions during the Secondary Funding Period is on a 'straight line' basis. The additional costs accounted for during the Secondary Funding Period are for the incremental costs incurred in the disposal of ILW and spent fuel from the period from year 37 to year 60. The mechanism for the calculation of the base case contributions and correction contributions is identical in both the primary and Secondary Funding Periods.
- 9.3 Unlike during the primary funding period, where the annual milestones are calculated using fixed percentages that are 'back-ended', the annual milestones for the Secondary Funding Period are calculated on a simple "straight line" basis between the Year 37 Target and the Year 60 Target, recognising the incremental changes in spent fuel and waste management costs.
- 9.4 The correction adjustment percentages for the Secondary Funding Period are as follows (see the Board's advice regarding back-ending of the fund contributions generally at Guiding Principle 7(B)):

- (A) 20 per cent. from the start of the Secondary Funding Period until the fourth financial period prior to the plant's end of generation;
- (B) 25 per cent. in the third financial period prior to the plant's end of generation;
- (C) 33 per cent. in the second financial period prior to the plant's end of generation;
- (D) 50 per cent. in the financial period prior to the plant's end of generation; and
- (E) 100 per cent. as at the plant's end of generation.

Permitted Gearing Level

- 9.5 The permitted gearing level is only tested during the Secondary Funding Period (see further paragraph 4 of this Annex, above) if the Fund is shown to be in deficit during an annual or quinquennial review or if NNB proposes material additional borrowings.

Derisking

- 9.6 NNB is required to implement derisking measures during the Secondary Funding Period with broadly, the requirements being tightened in the years running up to FYE Year 60. Further details about the derisking requirements are set out in paragraph 6 of this Annex, above.

Accelerated Decommissioning Contributions Amount

- 9.7 The Accelerated Decommissioning Contributions Amount, as defined in the FAP, is different depending on whether a security trigger event 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 is an amount equal to the end of generation decommissioning target (based on the most recent annual report or quinquennial report, as applicable), discounted on an annual compound basis at the long term discount rate from FYE End of Generation until the last day of the financial period in which the security trigger event action is taken.

10. EARLY CLOSURE

- 10.1 The FAP is currently structured on the assumption that HPC will continue to operate until its fully funded target at year 37 and is likely to continue to operate until year 60. In order to extend the life of the plant beyond year 60, NNB would be required to undertake a modification of the FDP under the 2008 Act in accordance with the modification process set out in paragraph 3 of Annex 4, *Legislative Background*.
- 10.2 The risk of inadequacy of the fund, were there to be early closure of the plant between years 37 and 60, is low given the 'straight line' funding basis and the year 37 'fully funded' target. However, the earlier a closure occurred prior to year 37, the greater the risk of inadequacy of the fund assets to pay for the costs of decommissioning the plant and cleaning-up the site (indeed, the fund assets would be almost certainly inadequate

if closure occurred during the early years of the primary funding period). However the consistent revenues ensured by the CfD coupled with the incentive for NNB to receive those revenues provide comfort that the fund is likely to attain its value.

- 10.3 The FAP provides that, upon NNB taking a decision to implement an unplanned early permanent shutdown of both reactors, NNB must notify the FDP Company and Secretary of State and invite representatives of both (and any significant creditors) to attend a meeting to discuss the unplanned early permanent shutdown, including any appropriate mitigation measures and the expected financial consequences.

11. DECOMMISSIONING PERIOD (INCLUDING PAYMENTS AND DISBURSEMENTS POLICY)

- 11.1 The decommissioning period is defined by the term Disbursements Period in the FAP to mean the period commencing on the first day of the first financial period during which costs incurred in relation to the decommissioning and removal of waste processes (DTM costs) are paid by NNB (or are scheduled to be paid in the Detailed DWMP⁶) and ending on the later of: (a) the date that all of NNB's liabilities under the spent fuel transfer contract have been discharged or (b) the date that the site achieves its end state.

- 11.2 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 NNB is permitted to discharge using fund assets) and 'Disallowable Costs'. NNB is prohibited from knowingly including any Disallowable Costs in its annual work plan and budget; due to the criminal sanctions for breach of the FAP there is no outright prohibition on the inclusion of Disallowable Costs in such budgets, but whether any Disallowable Costs have been included is subject to verification by the independent technical verifier and correction mechanisms (ultimately, NNB must remove any such Disallowable Costs from its annual work plan and budget).

- 11.3 Allowable Costs are, in relation to any particular year:
- (A) in the event of early closure, the costs for designated technical matters in relation to the site, 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);

⁶ The Detailed DWMP is not a document which requires the approval of the Secretary of State, but it is derived from the DWMP which does require approval as part of the FDP (s.47 Energy Act 2008).

- (D) any costs arising in that year directly from any instructions from a regulator with jurisdiction over NNB, except to the extent that such costs fall under paragraph (A) above; and
 - (E) any other costs of designated technical matters which have been agreed in writing with the FDP Company as comprising Allowable Costs.
- 11.4 For ease of administration, rather than NNB drawing from the fund as and when its liabilities for decommissioning fall due, the FAP permits NNB to withdraw an amount equal to the costs expected to be incurred in each year, plus a 10 per cent. 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 £1.5 million. The annual work plan and budget is accompanied by an Allowable Costs certificate, being a certificate signed by two of NNB's directors (one 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.
- 11.5 In order to receive a payment from the FDP Company, NNB must submit an annual claim notice for DTMs setting out the amount it is claiming from the fund in the relevant financial period. Payments for DTMs are made by the FDP Company to NNB and are held on trust by NNB for the purpose of discharging Allowable Costs. The payments are made into a designated and segregated account and NNB must use reasonable endeavours to procure that the only payments made into that account are the payments for DTMs which it receives from the FDP Company. NNB is prohibited from using payments made to it in respect of DTMs for anything other than Allowable Costs.
- 11.6 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 NNB's assessment of its estimated Allowable Costs for the next financial period. NNB is required as part of the reconciliation process to prepare a report including a reconciliation of the work and activities undertaken by NNB and related expenditure as against the corresponding annual work plan and budget. NNB provides a certificate with the report to the FDP Company and the independent technical verifier which contains either: (i) a statement that all expenditure incurred by NNB during the period was in respect of Allowable Costs or, (ii) a statement of the amount NNB considers constituted Disallowable Costs, together with an explanation of why Disallowable Costs arose and the steps NNB intends to take to prevent such circumstances arising in the future.
- 11.7 NNB 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 and Disallowable Costs that occurred during the relevant period is reasonable. NNB is then required to submit both reports to the Secretary of State and the FDP 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 NNB incorrectly by the FDP Company; less
 - (D) the aggregate amount of DTM payments that NNB applied to discharge Disallowable Costs.
- 11.8 During the year, NNB has relative freedom to withdraw further amounts up to that year's budget plus 25 per cent., subject to verification for the proportion over 10 per cent. that any withdrawals when aggregated do not constitute Disallowable Costs of more than £500,000. However:
- (A) amounts in excess of that year's budget plus 25 per cent. are subject to verification as being reasonably assessed by NNB 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 NNB 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.
- 11.9 In addition to these controls, NNB has undertaken to send a copy of any material affiliate contract which is not tendered on a competitive basis to the FDP Company and the independent technical verifier for review. NNB also has an option, but not an obligation, to submit long term contracts (over 12 months in duration) to the verification process.

ANNEX 6**ASSUMPTIONS***General*

1. The Board gives the advice set out in this letter on the basis of its understanding of the factual and legal context of the matters referred to in this document as at the date of this advice. If that factual or legal context should prove to be inaccurate or subsequently change this may have a material effect on the Board's advice or the FAP. We assume that in such circumstances the Secretary of State will seek further advice, if appropriate, as to the continuing suitability of the FAP.

Contract for Difference

2. We assume that the final terms of the CfD are identical to the terms that were described to the Board by OND and that in particular:
 - (A) the strike price is that which was described to us;
 - (B) the term of the CfD for each reactor is thirty-five years, and the CfD will remain in effect for this period (and in this regard we assume the Secretary of State is comfortable that the likelihood of provisions of the CfD taking effect to foreshorten the CfD term and/or to lead to non-payment under the CfD is sufficiently remote to pose an acceptable risk);
 - (C) the relative timings of payments under the CfD and the FAP mean that, so long as the CfD remains in effect for its full 35 year term, the annual contribution to the FDP fund for FDP year 37 will fall within the period covered by the CfD);
 - (D) the anticipated cashflows arising from the CfD are sufficiently certain and will follow the pattern described to us by OND;
 - (E) HPC will not operate such that the generation cap under the CfD is reached during the 35 year CfD term of either reactor, so that the CfD term for one or both reactors is reduced;
 - (F) that the gainshare adjustments and the 'pay when paid' model provided for under or in relation to the CfD will not operate in such a way as to impact adversely the cash flows available to NNB to make contributions under the FAP; and
 - (G) that NNB will manage its revenues in such a way that the price it receives on the market for its electricity is at a level at least approximate to the reference price calculated under the CfD.
3. We are aware that the Secretary of State may have to consider potential alternative arrangements. We assume that, should there be a proposal for any material

amendment to the terms of the CfD as were described to the Board by OND, whether as a result of a successful State aid challenge or otherwise, or if partial indexation provisions were to be invoked, the Secretary of State would seek appropriate advice prior to agreeing to implement any such amendment to the terms of the CfD or invoking the partial indexation provisions and would act at all times in accordance with her statutory obligations regarding the aim of securing that prudent provision is made for the financing of the decommissioning and the disposal of waste.

DWMP and other agreements

4. We assume that the Secretary of State has obtained or will obtain separate advice on the terms of the DWMP, Waste Transfer Contracts, the Section 46 Agreement, the CfD and the documentation related to the CfD, and that she is or will be satisfied with that advice.
5. In particular, we assume that the Secretary of State will be satisfied with the content of the current DWMP and the Detailed DWMP as well as the concept of 'splitting' the two documents.

Secretary of State Investor Agreement

6. The NLFAB is aware there may be put in place a Secretary of State Investor Agreement (of which it has not had sight and has not reviewed, at the request of the Secretary of State) which, among other things, would provide for certain payments to be made by the Secretary of State to NNB in certain early closure circumstances. We assume that none of the provisions of such a Secretary of State Investor Agreement, in particular in relation to an early closure of the plant due to a political act or decision, will have an adverse effect upon the terms of NNB's FAP, the provisions made pursuant to NNB's FAP or the contributions made by NNB to the FDP fund. We assume the Secretary of State will be mindful of any impact on the FAP and the FDP fund when taking any decision regarding such a 'political' shutdown, and is satisfied that the likelihood of this event is sufficiently remote, in light of the fact that any early closure of the plant increases the risk of insufficiency of the FDP fund.

Financing and Security

7. We assume the floating charges to be granted in favour of the Secretary of State and the FDP Company, capturing liabilities comprising the annual contributions, cash sweep payments, payments due to the FDP fund pursuant to the cash sweep anti-avoidance provisions, the Accelerated Decommissioning Contributions Amount and the unspent portion of any payments made to NNB for Designated Technical Matters, will be validly put in place in accordance with the terms of the FAP.
8. We assume that the provisions of the FAP which allow the Secretary of State to enforce her security interests in priority to the FDP Company will be exercised in line with the statutory obligations on the Secretary of State to exercise her statutory powers with the aim of securing that prudent provision is made for the financing of the decommissioning

and disposal of waste, and that the Secretary of State will act in line with these obligations when deciding whether and how to enforce her security interests.

9. We assume that, prior to the designation of any Project Finance Secured Documents and/or should there be a proposal for a further or replacement FDP Direct Agreement (as described in paragraph 5.14 in Annex 3, *Factual Background*) in addition to or in place of the Standstill Agreement, the Secretary of State will, if appropriate, seek the views of the Board or a similar body prior to entering into such an agreement as to the continued suitability of the FAP.

Section 46 Agreement

10. We assume that the Secretary of State will be satisfied that the Section 46 Agreement includes adequate provision for the modification of the programme in the event that the provision made by it for the technical matters (including the financing of the DTMs) ceases to be prudent.

NNB

11. We assume that NNB will act reasonably and in accordance with the spirit of the FAP at all times, in particular in relation to the fund investment rules, disbursement requests and the DWMP updating requirements.

Alternative waste disposal arrangements

12. If NNB wishes to enter into alternative waste disposal arrangements then we have assumed that, given the material nature of the modifications to the DWMP which would be required to give effect to such alternative arrangements, NNB would need to seek a statutory modification to the FDP to do so, which would, again, require the approval of the Secretary of State under the 2008 Act.

Operating life

13. We have assumed that HPC will have a technical expected economic life of 40 years.

ANNEX 7**FINANCING ARRANGEMENTS**

1. This Annex sets out a summary of the financing arrangements in relation to HPC currently contemplated as they have been presented to the Board. Given that the FAP is dependent, in a number of respects, on the financing arrangements for HPC, we recommend that the Secretary of State consider whether to defer her final approval of the FAP until she is satisfied that the final terms of the anticipated financing arrangements do not affect the validity of her conclusions on the FDP. The Board asks that the Secretary of State also refer to its assumptions regarding the financing arrangements set out in Annex 6, *Assumptions*.
2. The Board's understanding is that the Lords Commissioners of HM Treasury (**IUK**) are planning to commit a £2 billion guarantee in respect of NNB's debt financing of HPC. The guaranteed bonds will have a maturity date of December 2020 (i.e. prior to the date on which the first annual contribution to the FDP fund is due). NNB's shareholders are committed to providing £4 billion in equity financing to HPC prior to drawing any guaranteed bonds, although IUK is not mandating this. The Board understands that subject to the fulfilment of certain conditions precedent, and provided that the initial £2 billion debt financing is repaid, NNB will be able to request that the Guarantee covers up to £12.1 billion of long-term bonds. NNB may seek debt financing up to the permitted gearing level under the FAP through either IUK or another third party lender (for more details regarding the permitted gearing level, see paragraph 4 of Annex 5, *Life Cycle of the FAP*). The Board has not, at the request of the Secretary of State, and understands that OND also has not, reviewed any of the financing documentation entered into or proposed to be entered into between NNB and any finance party. As such, the comments made by the Board in its advice on the financing structure are limited to what was explained to the Board by its advisers and OND and what is set out in the FAP.
3. The issuance of any long term bonds will be based on a 'non-recourse' project finance structure, with adjustments to accommodate distinguishing features of the transaction, including the statutory requirements of the FDP and, where relevant, the presence of IUK.
4. It is proposed that as part of the package, a special purpose sister company of NNB (**Finco**) would issue bonds in the public markets and on-lend the proceeds to NNB. These bonds would not (where the guarantee structure is deployed) themselves benefit from security granted by any member of the HPC corporate group, but would be guaranteed by IUK.
5. The Board understands that it is contemplated that Finco and other companies involved in the financing structure, including NNB, will grant extensive security interests in favour of a security trustee acting in the interest of IUK (or other third party lenders), securing the aggregate value of the guaranteed funding obligations. This package of security will include, for example, security over the shares in NNB and rights under the intercompany loans that are to funnel the proceeds of the public bond through the capital structure. A common terms agreement will connect the various parties and documents.

ANNEX 8

LIST OF PARTIES CONSULTED BY THE BOARD

- a. NNB Generation Company Limited and its advisers (Herbert Smith Freehills and Deloitte)
- b. Office for Nuclear Development (OND)
- c. The Board's own advisers (Slaughter and May and KPMG)
- d. The Nuclear Decommissioning Authority (NDA)

ANNEX 9**INDICATIVE TIMELINE OF THE FAP**

Included on the following page is an indicative timeline of the FAP.

1. *This diagram is for illustrative purposes only and is not to be relied on without reference to the provisions of the FAP and other relevant documentation.*
2. *All of the CfD and FAP dates used in this timeline are assumptions as at the date of the Board's advice, and are subject to change.*
3. *This timeline should be read in accordance with the Assumptions set out in Annex 6, Assumptions.*