

# WORKING PAPER ON ISSUES NUCLEAR OPERATORS SHOULD CONSIDER WHEN MAKING PROVISION TO COVER THEIR THIRD PARTY LIABILITIES

## 1 PURPOSE

1. The UK Government is committed to ratifying the amendments made to the Paris Convention on nuclear third party liability and its supplementary Brussels Conventions.
2. The Conventions, which were established in the 1960s, make nuclear operators liable to pay third parties compensation for damage caused as a result of a nuclear incident. The Conventions were amended in 2004. The changes upgrade the existing regime and are intended to ensure that, in the event of a nuclear incident, an increased amount of compensation will be available to a larger number of claimants in respect of a broader range of damage than is currently the case. The amendments to the Conventions are not yet in force and will only become so when the EU signatories, who have agreed to ratify the amended Conventions at the same time, have done so. No agreed date has yet been set as countries are at varying stages of implementation into their national law, but we hope that ratification can take place in 2013.
3. In order for the UK to be ready to ratify the amended Conventions it needs to:
  - (a) Amend the national law to implement the amended Conventions; and
  - (b) Be satisfied that it will be possible for nuclear operators to meet their legal obligation<sup>1</sup> to have insurance or other appropriate financial security to cover their third party liabilities.
4. The Government intends to lay an Order in Parliament later this year which will amend the Nuclear Installations Act 1965 ("the 1965 Act") to implement the amended Conventions.
5. The purpose of this working paper is to initiate discussions with nuclear operators (or more precisely licensees and operators of disposal sites for the purpose of the 1965 Act) over the summer on their efforts to obtain insurance or other financial security to meet their obligation under section 19 of the 1965 Act. Under section 19 of the 1965 Act the Government's approval (with the consent of Treasury) is required for nuclear operator's insurance (or other financial arrangements) and it is important that the dialogue between Government and operators begins as soon as possible as we would like to receive proposals from this autumn.

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<sup>1</sup> The current requirement is set out in Article 10(a) of the Convention and is implemented in the UK by section 19 of the 1965 Act. The arrangements put in place by an operator (ie the nuclear site licensee) are required to be approved by the Secretary of State for Energy and Climate Change with the consent of the Treasury.

6. The working paper sets out in broad terms some of the issues that nuclear operators should consider when obtaining their insurance or other financial security. It also lists some of the evidence that the Secretary of State will expect operators to provide in order to be satisfied that their proposed arrangements are suitable for the purposes of section 19..
7. The paper is not intended to provide a definitive set of acceptance criteria or replace the need for operator's to obtain their own professional legal and financial advice.

## 2 BACKGROUND

8. Details of how the UK Government proposes to implement the changes have been subject to a public consultation. The public consultation was carried out between 24 January and 28 April 2011<sup>2</sup>. The consultation summary and the Government response<sup>3</sup> were published on 30 March 2012.
9. Nuclear operators will be financially liable for claim amounts up to a total the equivalent in Sterling of €700m rising to €1200m for standard sites (such as nuclear power plants and reprocessing plants), €70m for prescribed sites<sup>4</sup> and €80m for low-risk transport related claims. These amounts are required per incident and cover liabilities to pay compensation for:
  - (i) property damage,
  - (ii) personal injury and loss of life ("personal injury") up to 30 years after the event;
  - (iii) economic loss arising from (i) or (ii);
  - (iv) the costs of measures of reinstatement of the impaired environment;
  - (v) loss of income deriving from a direct economic interest in any use or enjoyment of the environment; and
  - (vi) the costs of preventive measures and consequential losses.
10. One of the central features of the Paris liability regime is the requirement on operators to maintain insurance or other financial security to cover their liabilities. **The aim of this requirement is to ensure that UK operators always have sufficient funds to meet claims for compensation.** This aim will underpin the Secretary of State's consideration of whether to approve provision proposed by an operator.

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<sup>2</sup> Implementation of changes to the Paris and Brussels Conventions on nuclear third party liability A Public Consultation <http://www.decc.gov.uk/assets/decc/Consultations/paris-brussels-convention-changes/1182-cons-implement-changes-paris-brussels.pdf>

<sup>3</sup> Implementation of changes to the Paris and Brussels Conventions on nuclear third party liability Summary of responses and Government response to consultation <http://www.decc.gov.uk/assets/decc/Consultations/paris-brussels-convention-changes/4874-parisbrussels-government-response-to-consultation.pdf>

<sup>4</sup> As defined by the Nuclear Installations (Prescribed Sites) Regulations 1983 (SI 1983/919)

11. Section 19(1) as amended by the Order mentioned above will require licensees and UK operators of disposal facilities to make such provision (either by insurance or by some other means) for sufficient funds to be available at all times to ensure that established claims under the 1965 Act or the law of another Paris Convention country<sup>5</sup> can be met up to the amount of the applicable UK liability limit(s) (see paragraph 9 above). Note an operator could have more than one liability limit - in respect of its installation, any higher-risk transport) and any low-risk transport.
12. The requirement is for the provision to be made in respect of certain “cover periods”<sup>6</sup> rather than on a per incident basis. The cover periods are the current cover period and certain old cover periods (see section 19(1)(b) and (c) – which will be amended by the Order).
13. When the Order comes into force the current cover period will come to an end and a new cover period will begin. Provision for the new and increased liabilities will need to be put in place for this new cover period but not the old cover periods (as only new “occurrences” will be subject to the new regime). However, provision in respect of the old liabilities for the required old cover periods<sup>7</sup> will still need to be maintained

### 3 INSURANCE OR OTHER FINANCIAL SECURITY

14. At the highest level, an operator, in seeking to make arrangements to meet the requirements under section 19 of the 1965 Act, has two options. Either it can obtain cover from a third party such as an insurer who undertakes to pay compensation on behalf of the operator for a charge ie a premium; or the operator can make its own provision with the necessary assurances that the funds would be available in the event of a claim.

**Table 1: Examples of liability cover**

<ul style="list-style-type: none"> <li>• Parental guarantees</li> <li>• Captive insurance company</li> <li>• National/international mutual insurance</li> <li>• Pooling</li> <li>• Insurance / Reinsurance</li> <li>• Bonds</li> <li>• Bank guarantees/Letter of credit</li> </ul>
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15. Of these two choices DECC’s preference would be for operator’s to obtain cover from a third party (e.g. an insurance company) rather than make

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<sup>5</sup> A claim could be brought against a UK operator in the court of another Paris Convention country if the incident for which they are responsible happens in the territory (including marine zones) of that country but the UK liability limits will apply.

<sup>6</sup> “Cover period” is defined in section 19(2).

<sup>7</sup> Required under the old section 19(1).

provision in house. We recognise however that at the start of the revised regime there may be elements of the liability which the market cannot cover and that operators should consider if appropriate in-house provision can be made with the necessary legal ring-fences.

#### **4 ISSUES FOR OPERATOR'S TO CONSIDER WITH REGARD TO THEIR INSURANCE/FINANCIAL SECURITY**

##### **4(a) Insurance or financial security provided by third parties**

16. Where the operator proposes to cover all or part of its liability via a third party such as an insurer or through some other financial security arrangement, such as bank guarantees, the operator should provide full details of how these arrangements would operate and provide a copy of the proposed relevant legal documentation along with a summary of their operation.
17. The operator should consider the following in assessing the suitability of an insurance product:
  - Nuclear operators should be able to satisfy themselves and demonstrate to Government that the liabilities are insured with insurance providers regulated for solvency purposes within the EU or in a jurisdiction which applies solvency standards of a similar level to the EU's.
  - Nuclear operators should be able to demonstrate how they propose to initially assess and subsequently monitor the financial standing of the provider of their security.

*Some specific requirements for policy wording.*

- Operators must demonstrate to Government how the insurance policy satisfies the requirements of section 19 of the 1965 Act and that compensation will be available when a successful third party liability claim is made.
- The insurance policy must not have any exclusions or other conditions that would significantly weaken the protection e.g. onerous claim reporting requirements.
- The definition of "event" and accumulation of risks should normally be such that the insurance policy cover is maintained even where the insured event happens. Where this is not the case, the company needs to explain how it has ensured that it remains covered in the event of a claim.
- A claim on one site should not reduce the cover available for other sites for which the operator is the licensee.

*Currency risk*

- Operators are required under section 19 to have cover up to their liability limit(s) for both claims brought in the UK and claims brought in other Paris Convention countries (under the Paris Convention rules on jurisdiction). The liability limits in the 1965 Act will be stated to be an amount in Sterling equivalent to a set amount in Euros and claims in the UK will be paid in Sterling. However, where claims are brought in another Paris country, they are likely to need to be paid in the currency of that country.
- The operator will need to ensure that the insurance policy has the facility to be able to make the necessary conversions without diminution in the overall level of financial cover.

#### *Consequences of insolvency of the nuclear operator*

- The nuclear operator must set out how the rights of third parties will be protected in the event of the nuclear operator's insolvency. This will apply to claims immediately upon a major incident and also claims that are reported in up to 30 years' time.

#### **4(b) The Operator's own insurance or financial security**

18. Nuclear operators and their advisors may come up with innovative financial security solutions which will be judged individually on their merits, just as will any insurance based solution. DECC, in assessing any non-insurance financial security arrangements, will need to be satisfied that the operator has demonstrated the following.

#### *Use of assets as financial security*

19. If the operator puts aside specific assets to cover potential future claims then:

- If the assets are invested with a third party, that third party should have a credit rating which is at least of a level of investment grade. In addition, the operator must demonstrate appropriate diversification so that the financial security arrangements are not overly exposed to the credit risk of any one institution.
- As with an insurance policy any such assets should be legally ring-fenced so that, for example, if the company becomes insolvent they cannot be used for any other purpose unless it is clear that they will not be required to pay claims.
- These assets need to be readily realisable e.g. not tied up in property or plant and machinery.
- The assets need to cover the liabilities and not be unduly exposed to the risk of this cover ceasing to be the case, for example not being exposed to market risk as a result of being invested in equities.

- These assets ought to be held in an appropriate jurisdiction, e.g. the EU, so that they can be easily realisable when required.
20. The nuclear operator must set out how the rights of third parties will be protected in the event of the nuclear operator's insolvency whenever this occurs. This will apply to claims immediately upon a major incident and also claims that are reported in up to 30 years' time.

## **5 EVIDENCE TO BE PROVIDED BY THE NUCLEAR OPERATORS**

21. The evidence that the company should provide is set out in the following sections. The evidence should be provided on an annual basis (i.e. when the cover is renewed) or whenever the nuclear operator makes a change in its insurance or financial security which means that the existing arrangements are no longer appropriate.
- The latest audited accounts for the legal entity purchasing the insurance and consolidated group accounts and any other relevant regulatory returns that nuclear operators have to produce. Details of existing insurance and any other financial security arrangements put in place by the nuclear operator to meet the requirements of the Paris and Brussels Conventions..
  - The nuclear operator's claims experience in respect of incidents that would be covered by the Paris and Brussels Conventions (including incidents where no claim was made against their insurer and incidents within the last 10 years where they may still be some latent personal injury claims to be notified). The nuclear operators' risk management policies.
  - Policy documents for any new insurance cover, including schedules and endorsements, if any, and proposal forms.
  - Examples of how the insurance and other financial security arrangements would cover large claims in a variety of scenarios.
  - Where insuring with a captive insurance company, the nuclear operator should provide details of the captive's reinsurance arrangements, underwriting committee papers and the report and accounts and the regulatory returns of that captive.
  - Where the nuclear operators puts aside specific assets to cover its potential liability, the nuclear operator should explain how they will meet the criteria set up in section 3 above.
  - In addition, the operator should submit a peer review of the proposal from an appropriately qualified independent expert (such as an established legal or brokerage firm) which was not involved in the development of the proposal, which is able to confirm that it is fit for

purpose and complies with the insurance company or other regulatory requirements

22. Nuclear operators are encouraged to provide any additional information in support of their insurance proposals.
23. Where a nuclear operator uses some other financial security arrangement, such as bank guarantees, parent company guarantees or catastrophe bonds, the nuclear operator ought to provide full details of how these arrangements would operate and provide a copy of the relevant legal documentation along with a summary of their operation.

## **6 NEXT STEPS**

24. We invite nuclear operators to get in touch with officials in DECC if they would find it helpful to discuss how they propose to meet their section 19 obligations.
25. In any case we would encourage operators to begin submitting to DECC their insurance proposals from this autumn

**DECC**

**August 2012**