Department for Business, Energy & Industrial Strategy

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Dame Meg Hillier
Chair of the Committee of Public Accounts
House of Commons
London
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[by email]

13 April 2022

Dear Dame Meg,

Many thanks for your further correspondence of 30 March requesting additional information about the operation of the Nuclear Liabilities Fund (NLF), following the oral evidence session on the Future of the Advanced Gas Cooled Reactors (AGRs) held on Monday 7 February and our subsequent exchange of letters.

We have responded to each of your additional questions below.

The rationale for transferring the AGR sites from EDF Energy to the NDA

"We would be grateful for a further explanation of why the Department agreed to transferring the sites back to the public sector. In recent years, this Committee has paid close attention to the work of the Nuclear Decommissioning Authority (NDA) and the very significant challenges it already faces.

Whilst we are aware of some of the reasons that have been put forward in favour of taking some of the decommissioning tasks away from EDFE, we still have a question mark over whether the Department has fully considered the capacity of the NDA to take on this huge task when this organisation already struggles to deal with its existing portfolio of very difficult sites including Sellafield and establishing the Geological Disposal Facility? We would be keen to understand the thinking that persuaded the Department that transfer was a good idea."

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As discussed during the evidence gathering session, the Nuclear Decommissioning Authority (NDA) is best placed to undertake the decommissioning of the stations after spent nuclear fuel has been removed given their extensive experience of decommissioning nuclear plants and facilities in the UK, as well as their extensive, well established decommissioning supply chain and obligation to deliver value for money for the Exchequer.

The transfer of the AGR stations to the NDA and the consolidating of the decommissioning missions will provide enhanced opportunities for realising synergies, sharing know-how and creating a coordinated and consistent strategy as well as maximising and coordinating competition through the supply chain, which will also allow for more efficient delivery. The potential cost savings associated with these opportunities are significant.

In developing and assessing the revised decommissioning arrangements, the Department carefully considered NDA and Magnox's capability to obtain a site license and to undertake the decommissioning of the AGR sites, we were assured based on the existing decommissioning organisation, and regulatory licences already in place at Magnox, and the previous success of transferring other stations to Magnox, such as the legacy UKAEA nuclear research sites Harwell and Winfrith.

The AGR stations are expected to start to transfer to Magnox from 2026 at the earliest and on a staggered basis over the next 10-12 years. This provides an appropriate planning horizon to help ensure a seamless transfer and one that will create value by allowing NDA to optimise the decommissioning of the AGR and Magnox stations under a single owner and licensee.

NDA is cognisant of the work required to ensure Magnox is ready to receive the stations and is fully committed to successful delivery of the revised decommissioning arrangements.

Magnox will not be building station-specific capability from scratch. Under contract and statute significant resource-capability, including all relevant staff employed at station, will transfer from EDF to NDA/Magnox to help ensure the seamless transfer of the management and operation of the decommissioning programme.

NDA, Magnox and EDF have already started working together to plan for a successful transfer of the stations and have made good progress. In its role as NDA sponsor, BEIS will continue to monitor NDA and Magnox's progress towards transfer. Departmental oversight will also be applied through a BEIS-chaired senior forum and through the regular review meetings I – as BEIS Permanent Secretary - will have with NDA's, Magnox's and EDF's CEOs. These fora were all established under the terms of a Cooperation Memorandum of Understanding agreed as part of the revised decommissioning arrangements.

This winter, the Department and the NDA wrote to the Committee outlining the changes to the NDA's operating model made over the last several years. These include a change in delivery structures and enhancement of the leadership structure and personnel. They also include a new approach to engaging with the private sector that minimises the barriers to progress that NDA faced with the previous Parent Body Organisation (PBO) model, for example the challenges that arise when contracting-out uncertain scope. NDA is now a stronger organisation, operating under a very different model and this new operating model will help ensure NDA is able - structurally, culturally, and commercially - to deliver the additional AGR scope.

The rationale for the rise of investment into the NLF

"Please can you explain the rationale why all new taxpayer cash injections into the Fund go into very low yielding deposits with the National Loans Fund?

Is there any intention to increase the proportion of assets invested in the Mixed Assets Portfolio so that a better return can be earned, thereby increasing the value of the Fund to meet decommissioning costs over the longer term?

Would this change in investment approach minimise the calls upon the taxpayer over the long term?

As set out in our previous letter, there is no cash fund which the government is accumulating to pre-fund the liabilities of the Nuclear Liabilities Fund (NLF). To date, when addressing a material shortfall in the NLF, as with the £5.61bn payment which was made in March, the government has credited the NLF with an additional deposit at the National Loans Fund, which increases its liabilities accordingly, but with no net effect on the overall government balance sheet position. No actual monies need raising, depositing or ringfencing since this deposit is funded by transfer from within the Exchequer. In line with the approach taken by the government to funding longterm liabilities, in cash terms any payments that will become due in the future from the NLF's National Loans Fund deposit will be funded through a mixture of future tax receipts and Exchequer borrowing.

As your letter notes, an alternative approach to meeting a material shortfall in funding in the NLF would be an additional investment in the MAP. As an investment outside the central Exchequer funds, this would require cash to be raised, increasing government debt at the point of investment, and resulting in different risk and return profiles on the assets acquired and the debt liabilities raised to finance them, exposing the taxpayer to increased risk. By contrast, the government's chosen approach of increasing the NLF's deposit with the National Loans Fund has zero net impact on the public sector balance sheet: the increased assets held in the NLF net out exactly against the increased liabilities raised to finance them. And because those assets are invested back into the National Loans Fund, all the interest payments and economic and financial risks attached to those assets are exactly matched by equal and opposite payments and risks on the liability side of the public sector balance sheet.

For these reasons, an additional deposit within the Exchequer, leading to precisely offsetting assets and liabilities, coupled with essentially zero transaction costs of undertaking this arrangement, makes the credit of further funds to the National Loans Fund the most cost-efficient way of meeting the sufficiency requirements of the NLF for the taxpayer.

If not, why maintain the Mixed Asset Portfolio at all and instead make taxpayer allocations to the National Loans Fund to pay for all the AGR Nuclear decommissioning?

Wouldn't the latter be much simpler to operate and be in line with Treasury thinking on how it manages the national balance sheet and debt?"

As set out in our previous letter, the MAP is a legacy of the restructuring of British Energy, which concluded in 2005. At that point the assets held in the NLF were considered sufficient to meet the then estimated liability costs. Subsequent identified shortfalls in the NLF have been addressed through adding to the NLF's deposit at the National Loans Fund rather than through additional investment in the MAP.

The Committee has raised the logical question of whether to go further and liquidate the existing assets already held in the MAP, with the proceeds reinvested into the National Loans Fund. As the Committee notes, this would bring the operation of the Nuclear Liabilities Fund more completely into line with the government's overall principles for balance sheet management. Any proposal of this sort would require the agreement of the trustees, who legally control the investments in the Fund. Given the size and nature of the MAP portfolio there would be value for money issues to consider, including the timing and cost of liquidating any more illiquid assets. The Treasury identified this issue as part of the Balance Sheet Review and intends to explore further with the trustees alongside the annual funding review.

The calculations underpinning the £4.6 billion corporation tax liability

"We are perplexed by the enormous corporation tax estimate accompanying the recent £5.6 billion request for a top-up given the size of the Fund assets. We would be grateful for a further explanation of how that figure has been compiled."

Of the c£5.6bn deposited in the National Loans Fund following this year's supplementary estimates, around £4.6bn is required to ensure the NLF is able to meet the incremental tax burden imposed by last year's corporation tax rate rise in the long term. As set out in our previous response to your question on how the tax increase was calculated, the fund grows as the investment return on the fund's assets, particularly its Mixed Assets Portfolio (MAP), is compounded and tax is due on the growth of the fund. The process NLF's fiduciary advisors, Aon, go through to determine any potential shortfall (including in respect of the corporation tax liability) in accordance with an agreement between BEIS, HMT and NLF, can be summarised as follows:

1. Obtain liability cashflow forecasts from EDFE[1] covering the period to 2125;
2. Apply inflation to these;
3. Model both the National Loans Fund interest rates (using Bank of England forward curves) and the target return on the MAP (currently 7.3%);
4. Calculate tax on the returns noted above;
5. Take into account projected EDFE contributions[2], fund expenses and tax payments;
6. If the net position of the fund is a material shortfall (more than £300m), a top up or transfer is required.

The NLF's liabilities will be paid for out of the National Loans Fund deposits in the first instance. This will provide the actively invested MAP with time to grow to meet the NLF's longer term liabilities. Once the National Loans Fund deposits have been fully extinguished (currently assumed to be in the mid-2040s), the NLF expects the MAP to have grown to c.£18bn. Since the annual liability payments are projected to fall significantly at around this time as the AGR stations enter the 'care and maintenance' stage of decommissioning, the MAP will continue to grow in order to meet projected liabilities for final site clearance at the beginning of the next century.

The NLF's assets will therefore increase significantly over a very long period and the tax payable will grow in proportion to the return on the fund's assets. The increase in the rate of corporation tax from 19 to 25% (a c.30% increase) means an additional tax burden on the fund.

The graph below shows the growth in the fund's assets required to meet the current projected liabilities over their lifetime on the blue line against the axis on the left, and the tax payable on the orange line against the axis on the right. The assets of the fund will peak at c.£200bn[3] and at that point around £3bn is forecast to be payable in tax annually. On this basis over the lifetime of the fund over £100bn tax will be payable in aggregate (all figures quoted in the monetary amounts of the day).

[1] Cashflows that reflect the latest decommissioning plans scrutinised and approved by BEIS's agent under the terms of the relevant legal agreement - the Nuclear Liabilities Funding Agreement (NLFA).
[2] EDFE contributions determined in accordance with the relevant legal agreement.
[3] Assuming a long-term CPI assumption of 2.2% this would discount to c.£25bn in today's money.

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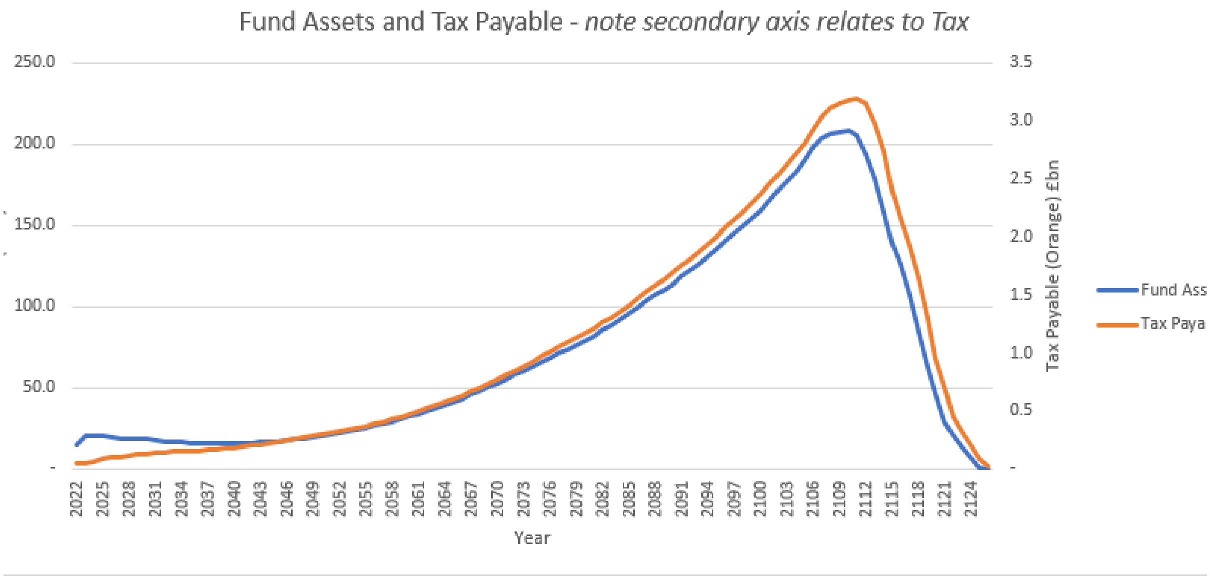
The funding assessment including the projected tax liability is based on various assumptions and is without prejudice to changes that may be made in the future to the way that the existing liabilities are funded, for example whether the future costs of decommissioning the AGR stations may be met out of the fund or taxation after those stations transfer to the NDA.



The transfer of land and buildings associated with the AGR sites

"We would be grateful to understand what precisely the Department has agreed with EDFE in terms of the land and buildings transferred to the NDA.

In particular, what would happen if the NDA and EDFE disagree on what should be transferred?

What is the position if the EDFE wants to retain part of the site to build one or more modular nuclear reactors, but the NDA needs the space for its decommissioning activities?

Could the necessary land be included in the transfer or would it have to be an additional purchase, if so on what terms?"

As the Committee is aware, a suite of legal agreements was put in place when British Energy was restructured in the mid-2000s and those agreements were restated on EDF’s £12.5bn purchase of British Energy in 2009. The restructuring and subsequent sale of British Energy have been considered by the NAO in VFM reports published in March 2006 and January 2010.

One of the suite’s legal agreements, the Option Agreement, included options for HM Government to take ownership of the AGR and the Pressurised Water Reactor (PWR) stations after each closes for the purpose of their decommissioning. The Option Agreement also provided a legal framework for the transfer of relevant assets and resources once a decommissioning option had been exercised.

Whilst the Option Agreement was revisited as part of the negotiations between BEIS and EDFE on the decommissioning arrangements - and was enhanced to take account of the simultaneous exercise of the decommissioning options for the AGR stations, to resolve some ambiguities and to provide further operational detail - its economic balance was maintained. The Option Agreement was supplemented by a new Cooperation Memorandum of Understanding (MoU) to help ensure close aligned working between EDFE and NDA, overseen by the Department, in the defueling of the AGR stations and their subsequent transfer.

Under the terms of the original Option Agreement the land required for decommissioning would be transferred by EDFE to the new licensee on completion of any exercised option. All other land would be retained by EDFE under the terms of its original purchase of British Energy. These provisions were not substantively modified in the revised ‘AGR Option Agreement.’ Any attempt to move the parameters of the 2009 sale in respect of EDFE’s land rights would have been strongly resisted by EDFE and jeopardised the enhancements agreed to the decommissioning arrangements.

In practice, the land required for decommissioning will be determined site-by-site, in accordance with technical, operational, and regulatory requirements. It may be, for example, that less land is required to decommission co-located Magnox and AGR stations than would be the case if each station were separately licensed and decommissioned. This would enable more land to be put to alternative use earlier.

Joint planning work between EDF, Magnox and NDA is identifying, prioritising, and addressing all station transfer matters through the workstreams set out in the NAO report (stakeholder engagement; people and know-how; land, estates, and sites; IP and records; IT and management systems; supply chain contracts; licencing and permissions; assets; decommissioning strategy). This work is progressing towards a detailed joint plan for transfer starting with Hunterston B by the end of the year.

Were disputes to arise in any of these areas, there are legally binding resolution procedures provided for under the suite of legal agreements governing the transfer of the sites and their decommissioning, including the AGR Option Agreement. There

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are also governance and escalation forums provided for in the MoU, up to CEO/Permanent Secretary level if required.

We trust that the above is helpful.

Kind regards,

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Director General, Net Zero Strategy and International

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Sarah Munby
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Tom Scholar

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