

PO-CH/NL/0280

PART A

Part A

SECRET
(Circulate under cover and
notify REGISTRY of movement)

Begins : 6/6/86.
Ends : 31/12/87.


PO -CH /NL/0280

PART A

Chancellor's (Lawson) Papers:

NEW WATER POWER AND
CHARGES BILL TO PREPARE
FOR PRIVATISATION

Disposal Directions : 25 Years



18/10/95.

PO -CH /NL/0280
PART A

2 discuss with FST

CHANCELLOR

FROM: G E GRIMSTONE
DATE: 6 June 1986

WATER PRIVATISATION

Handwritten notes in red ink:
We spoke. I will have an early mtg with Mr. Moore & officials. Mr. Moore is to have a full brief on privatisation (1986 June) for Mr. Moore's work report.

You are having lunch at Thames Water on Monday and I have done the attached brief as an update on water privatisation both for you and the Financial Secretary.

2. You asked what would be the effect of postponing water. As far as proceeds are concerned, a separate note that Mr Moore is putting up to you today assumes receipts from water as follows:

<u>1987-88</u>	<u>1988-89</u>	<u>1989-90</u>
£1.5 bn	£1.2 bn	£1.25 bn

Handwritten notes in red ink:
Mr. Moore's work report. 5 June 2. Mr. Moore's work report.

This is a conservative assumption and, depending on the regulatory regime, total receipts should be in excess of £5 billion. As far as 1987-88 is concerned, we can substitute BP shares for water (and we have our BT pref shares in reserve). Both are our easiest shares to sell in a pre-Election period if the markets are nervous.

3. But I think that there is more to it than that. Over the period 1987-88 to 1990-91 we need water receipts at some point if the programme is going to bring in £5 billion a year (assuming Electricity if done will not be ready until 1991-1992). If you defer water legislation for a year, I think that there is a risk that you will lose it altogether. The reasons for this are:

Handwritten notes in red ink:
Mr. Moore's 1989-90 Why?

- (i) It will look like another loss of nerve
- (ii) Opponents of water privatisation (including some of your colleagues and their officials) will see deferral as a victory. They will gain heart from this.

SECRET

(iii) The water authorities themselves will lose their present apparently cohesive pro-privatisation stance (which although not fully real should not be under-estimated) and it will be very hard to corral them again.

(iv) Impetus will be lost.

4. Deferral also has implications for the Government's broader position and, for example, I understand that the Policy Unit are opening a campaign amongst Ministers (presumably on instruction) that water privatisation is a touchstone of the Prime Minister's policies and that to be seen as retreating will do general damage. Mr Hartley-Booth is coming to see the Financial Secretary about this next week.

5. It is not really for me to say but if Gas and subsequent sales are roaring public successes (and with some help they ought to be), if PEPs take off (as it looks they might), if the Prime Minister makes it clear in summer 1987 that there will not be an Election until Spring 1988, and if the market is reasonably confident of a Conservative victory, then a mega-Water sale in October 1987 with customer inducements and strong marketing might suit you very well. It would provide a strong focus for privatisation and you might rather enjoy tackling the Opposition head-on about renationalisation at that time.

6. This approach requires you and your colleagues to be confident and a lot therefore turns on Mr Ridley's attitude. DoE are keeping up to the mark at present and are still just about on course to get a Bill ready by the beginning of the new Session. They lost much valuable time early on through delay and incompetence but the work now has developed its own momentum (they have no less than around 30 people in DoE working full-time on water privatisation

SECRET

plus numerous advisers). Mr Patten is admirable in some ways but is strangely undecisive at times (eg nearly 3 months after the competition to appoint brokers he still cannot decide between Hoare Govett and de Zoetes) and has a knack of dodging the big decisions. Mr Ridley needs to drive hard if it is all to be done in time and he must be robust in public and in Parliament.

7. If you do decide to back off, I would do it quickly using as a justification the new Secretary of State and the lack of time to prepare the Bill. A commitment to bring the Bill forward in the first Session of the new Parliament would also be necessary. But, as set out above, my advice would be to press on provided this is done whole-heartedly.

g.e.g.

G E GRIMSTONE



Mr R supports this,

but has a

le ⁶⁷ ~~attaches~~ ^{Bill} ~~higher~~ ^{which} ~~priority~~

Oh

Mr Ridley is voting at 10.00pm. But he has a dinner before, and a meeting at 10.15pm.

He hopes to see you in your room at 9.50pm, but if he does not manage that he will certainly see you in the lobby.

I have had Gerry Grimstone's draft note typed up, with minor changes, in a form for you to hand to Mr Ridley (with a copy for you).

ANK

CHANCELLOR

FROM: G E GRIMSTONE
DATE: 30 June 1986

PS @ Gen

ch
See note at end -
do you want to put this
to Mr Ridley?
AMK
30/6

cc Chief Secretary
Financial Secretary
Mr Monck
Mr Moore

A good idea.
PS let me have a
personal note to hand a
in a week at no 10 pm
10th 1 private (check with
be was office with
MS

WATER PRIVATISATION: 1986-87 LEGISLATION

I understand that, following your discussion with the Secretary of State for the Environment, Cabinet are likely to be told this week that water privatisation legislation will be deferred. It has recently become clear that existing water legislation does not give water authorities sufficient vires to make all the preparations that are necessary for privatisation and it occurs to me that, if the main legislation is to be deferred, it might be attractive to substitute a short one clause Bill to resolve this.

2. The vires problem arises because existing water legislation was, of course, not drawn up with the prospect of privatisation in mind. The effect is that water authorities can provide comment and advice to the Secretary of State as part of the run-up to privatisation but cannot take executive decisions about preparations. For example, a water authority could not appoint a PR advisor to advise the board how best to improve the authority's corporate image in the run-up to privatisation. Water authority board members incur personal liability if they step outside their vires and this will, no doubt, make them very cautious about what they should and should not do.

3. Deferring water privatisation will be seen by some as further evidence that the Government is going soft on privatisation and you clearly need to minimise the effect of this. A short one clause Bill at the beginning of next Session that allowed authorities to prepare for privatisation but without any commitment to form or detail would mean that water privatisation could be included in the Queen's Speech and, in putting the Bill through, the Government would be demonstrating its commitment to privatise water authorities at a future date. I think that it would be seen by

Thames Water

From the office of the Chairman,
Roy Watts.

34 Smith Square,
London SW1P 3HF.
Telephone 01-222 4291

Date 15 July 1986

Ref: RW/CEV/5

The Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
11 Downing Street,
London, SW1.

STRICTLY PERSONAL

*Thank you - a note
Copy not clear X.
As you will be providing
look forward to the
early part of the
year.*

Dear Nigel

You may like to see my statement on our Annual results.

Regards

Roy

EMBARGO: NOT FOR PUBLICATION BEFORE 3.00 P.M. ON WEDNESDAY 16TH JULY 1986

STATEMENT MADE BY MR. ROY WATTS CBE, CHAIRMAN OF THAMES WATER

"The results of Thames Water are excellent and will be the envy of many companies in the private sector. In accounting terms Thames made a profit - after payment of interest - of £150 million on a turnover of £501 million. In cash terms Thames paid out of current income all its operating expenditure, all interest, the whole of its capital programme, and some £76 million to reduce outstanding debt, £30 million of which was repaid early.

The good results stem from two causes. First, the Authority beat all targets that were set. Secondly, in the opinion of the Authority, the financial target set by government, after a debate in the House of Commons, was too high and resulted in a price rise to customers higher than the Authority thought necessary. The owner, the Treasury, in my opinion, takes too much.

It remains the Board's view that, on this financial evidence, customer price protection would have come from privatisation, and for that reason alone the delay in privatisation is regrettable."

- Ends -

For further information contact:

Brigitte Daniels
or

Virginia Winther
01-222 1176

16th July 1986



Regulatory Bill
The Hon Mr Justice
with us just
or was it?
Pps A

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

The Rt Hon The Viscount Whitelaw CH MC
Lord President of the Council
Privy Council Office
Whitehall
LONDON
SW1

CH/EXCHEQUER	
REC.	18 JUL 1986
ACTION	FST
COPIES TO	PARLIAMENTARY CLERK

My ref:

Your ref:

18 July 1986

Dear Annie

now below: not originally copied to us

Thank you for your letter of 8 July about the possibility of a short bill next session to enable the water authorities to prepare for privatisation.

Since Cabinet discussed water privatisation, we have given further thought to the possibility of promoting such a bill. It seems to us on reflection that there are strong arguments against doing so. The first is that there is no immediate need to give the water authorities additional powers. The preparation of legislation, and the development of a regulatory regime, are the matters which we will be taking forward between now and the Election. These are matters on which we will need advice and comment from the water authorities, but they will not be expected to incur significant expenditure (certainly not, for our purposes, to employ advisers), and in our opinion all that we will be asking of them will be within their powers. That accords with the advice which they themselves have received.

Secondly, to promote a short bill now will mean having another debate on water privatisation next session which does not seem necessary from the legal point of view. For the reasons you point out, people may claim legal principles are involved, and that there may be inconsistency at a time when we are tightening up the powers of local authorities to advertise etc.

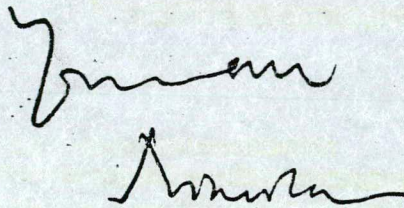
Thirdly, there are the possible implications for other privatisations, past, present and future. I know that Peter Walker is concerned about the position of British Gas, and that Michael Havers has also expressed his concern. We do not wish to cast doubt on what others have done, or may be doing. Leaving our legislation until lack of powers is about to have an inhibiting effect on things which water authorities must do to prepare for privatisation would minimise this risk.

On balance, it seems wiser to wait a little. We could bring this Bill forward in 1987/88 or in the first session of the new Parliament. We should introduce legislation immediately after the Election to deal with this vires point, in parallel with the main privatisation bill. The Vires Bill will be short and uncomplicated. Although dealing with two bills in one session is not ideal, opposition would be focused and would be much easier to handle.

It is also possible that we may need to return to this subject before the General Election if NALGO succeed in the action which they have brought against the Thames Water Authority, alleging lack of powers. However, we cannot be certain what NALGO's intentions now are, nor whether they will succeed, and I would prefer to defer any decision to introduce legislation at this stage unless there is a clear reasons.

Meanwhile, our commitment to water privatisation remains the same as before. We will need to seek alternative means to reaffirm this commitment. I will be writing to the water authority chairmen telling them of the timetable we are now working to and asking for their co-operation. We should seek other, more public means of underlining our policy.

/ I am sending a copy of this letter to the Prime Minister and other members of the Cabinet, the Chief Whips of both Houses, the Attorney General, first Parliamentary Counsel and Sir Robert Armstrong.



NICHOLAS RIDLEY

Thought we to be aware

CR 29/17

The practical possibilities for competition in water are clearly limited but they exist (eg green field industrial / housing developments)

It would seem bizarre to extend for HMG to rule them out statutorily

FROM T TARKOWSKI
DATE: 29 August 1986

- 1. MR GRIMSTONE
- 2. FINANCIAL SECRETARY

- cc Chancellor ✓
- Chief Secretary
- Sir P Middleton
- Mr Monck
- Mr Moore
- Mr McIntyre
- Mr Ross Goobey

WATER BILL

888
29/8
I'm afraid we couldn't find this evening

John Patten's letter of 17 June to Mark Roberts at the Welsh Office sought colleagues' agreement to proposals on a number of issues which the water privatisation legislation will need to cover. We initially delayed submitting a reply until we saw how other Ministers responded, and deferral of legislation into the next Parliament has since extended the timetable for resolving these issues, but we think it would now be helpful if you wrote to restate the Treasury's position on the points which are relevant to your interest.

2. Mr Patten raised three issues. From the Treasury's point of view the important issue is his proposal (page 4 of his letter) to exclude sewerage from the arrangements we envisage for introducing competition into the privatised water industry. His grounds for this are that:

- a) there is little likelihood of private sector interest in providing sewerage facilities
- b) it would provoke strong opposition (from the water authorities, and possibly from others on public health grounds, though Mr Patten does not elaborate)
- c) unlike water supply, where the statutory water companies provide a precedent for private sector involvement, there is no precedent for private sector provision.

I do not know that there is a lack of authority for sewerage responsibility & water privatisation

3. We do not accept these arguments. Sewerage is, in fact, the area in which the private sector has shown the largest interest to date. Anglian Water Authority's plan for a privately financed sewage treatment works at Peterborough ("Flag Fenn") aroused considerable interest, and there were negotiations with three separate private contractors before Anglian decided not to proceed with the option of private finance. In any case, even if there were in the event only a limited increase in private sector involvement, it will be important to demonstrate that the Government has done what it can to allow for the possibility. This is particularly important in an industry where the kind of efficiency gains which we would normally expect to flow from privatisation will be relatively limited.

4. The remaining issues can be very briefly summarised. They do not materially affect the Treasury's major interests.

Section 1, Water Act 1973: National policy for water

5. Mr Patten proposes that the general duty imposed on him by this section to formulate and promote a national policy for water jointly with the Minister for Agriculture Food and Fisheries should be abolished, given that the new legislation will place specific obligations for consumer protection, environmental protection etc. on the Secretary of State, the Director General of OFWAT and the Minister for Agriculture. Retention of the general duty, with its flavour of national planning, would be out of keeping with the general spirit of privatisation and we have no difficulty in agreeing this proposal.

Consultative arrangements

6. Consultative arrangements will have to be agreed for three separate interest groups - conservation, fisheries and recreation. Our main interest is to guard against a bureaucratic proliferation of bodies which would add to the industry's costs (or public expenditure) and worry potential investors.

7. DOE are well aware of the need for simplicity and Richard Luce, at MPO, who has overall responsibility for quango policy is also concerned, so our interest is already well covered. Mr Patten's detailed proposals amount to a considerable rationalisation of the existing arrangements in the industry, but his detailed proposals inevitably create difficulties with MAFF. We do not think it is necessary for you to become involved in this.

8. I attach a draft letter to Mr Patten.

Tanred Tarkowski
T TARKOWSKI

**DRAFT LETTER FROM THE FINANCIAL SECRETARY TO
MINISTER FOR HOUSING, URBAN AFFAIRS AND CONSTRUCTION**

WATER BILL

Thank you for sending me a copy of your letter of 17 June to Mark Robinson. I have also seen his reply of 25 July, and the comments from John Gummer, Richard Luce and Lord Lucas of Chilworth.

I am sure you are right to dispense with Section 1 of the 1973 Water Act. While I understand the use that could be made of this by the opponents of privatisation, its retention would not assist us in moving towards the kind of arms length relationship with the water industry which privatisation implies.

My main concern is with your proposals on competition. Our general aim must be to use the opportunity presented by privatisation to secure as much competition within the industry as can be achieved, and I think we would be open to reproach if we failed to do this.

I am quite sure that this principle should apply to the supply of water, and your proposals on this provide a convincing means of putting it into practice. However, I do not accept your arguments against extending competition to sewerage. There is a clear opportunity here which we should not pass by. The private sector is clearly interested in this area - as the Flag Fenn project demonstrates - and we should certainly not be seen to close off opportunities for competition in this area when our arrangements for the supply of water provide a clear model for how they might

be extended.

I am sending a copy of this letter to Mark Robinson, Richard Luce, John Gummer, Michael Howard and Alick Buchanan-Smith.

NORMAN LAMONT.



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

cc PS/CST
PS/FST
Mr Mondk
Mr Branganer
Ms DL J Moore

NO FURTHER COPIES TO BE TAKEN

17 February 1987

Dear Tim,

The Prime Minister yesterday discussed a range of Trade and Industry matters with your Secretary of State. This letter records action points which were agreed.

On competition policy, it was agreed that your Secretary of State should circulate to the small group of Ministers which discusses the affairs of the Rover Group from time to time, a paper about the results of the first stage of the review.

The meeting to discuss competition policy should also discuss the possible privatisation of the Post Office and the British Steel Corporation, in view of the particular sensitivities arising from what would be seen as threats to rural post offices and to Ravenscraig. No papers should be circulated before the meeting but, if necessary, a note might be handed round at the meeting.

On Airbus launch aid, a paper should be prepared and circulated at this stage only to the Chancellor of the Exchequer and the Chancellor of the Duchy of Lancaster.

I am copying this letter to Tony Kuczys (H.M. Treasury).

Yours,
David

D R NOROGROVE

Timothy Walker, Esq.,
Department of Trade and Industry.



FROM: A W KUCZYS

DATE: 25 February 1987

CHANCELLOR

1. Alex
 2. b/f with
 draft letter
 from B/FST
 (27/2) p

PRIVATISATION

The Financial Secretary has asked to see you briefly to mention two aspects of privatisation in the next Parliament which are worrying him.

2. The **first** is the **Post Office**: I think the FST feels that more ought to be being done on this, especially as Post Office Senior Management seem to be ready and willing (so long as the corporation is not broken up), and indeed assume that plans are already being laid within Government. You will have your own views on this, but you will remember that in discussion with Mr Channon recently, the Prime Minister was far from enthusiastic about privatisation of the Post Office. There is to be a meeting of the small group of Cabinet Ministers which usually discusses Rover Group (not yet fixed up) which will deal inter alia with the question of what we should say, over the coming months, about the Post Office and British Steel in the next Parliament.

3. The FST's **second** worry is over **water privatisation**. Apparently (we have not seen it) Mr Ridley has minuted the Lord President saying that he would not press for the Water Bill to be in the first session in the next Parliament. But if it slips to the second session, it will probably clash with the Electricity Bill (which Mr Ridley does not know about). The FST is concerned that two such complex and controversial Bills may not be manageable in one session.

A W KUCZYS

*papers below

Covering SECRET, CMO

1. MR D J L MOORE *DJM 27/2*

FROM: MRS M E BROWN
DATE: 27 February 1987

2. FINANCIAL SECRETARY

[Copy attached for the Chancellor]

Ch
Is this what you wanted?
Letter to issue?
AMK
27/2

cc Chief Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Moore
Mr Instone

PRIVATISATION: LEGISLATIVE PROGRAMME 1987-88

As Mr Heywood requested yesterday, I attach a draft letter from the Chancellor to the Secretary of State for the Environment stressing the importance to the privatisation programme as a whole of taking the main Water Privatisation Bill in the first Session of the new Parliament.

2. The reference to housing legislation has been agreed with LG Division. I understand that Mr Ridley is due to circulate a further minute about housing today, which will be discussed at a meeting with the Prime Minister next Wednesday (the same day as the next meeting of QL on the legislative programme as a whole). The implications for legislation are bound to be a key issue at the Prime Minister's meeting.

Mary Brown

MRS M E BROWN

SECRET ~~CMO~~ AND PERSONALP1 type 25
Chris 80g**DRAFT LETTER FROM THE CHANCELLOR TO THE SECRETARY OF STATE FOR THE ENVIRONMENT**

Copied to: The Prime Minister
The Lord President
Sir Robert Armstrong

LEGISLATIVE PROGRAMME 1987-88

Norman Lamont has ~~shown~~ ^{discussed with} me Willie Whitelaw's letter to you of 19 February, and your reply of 25 February. The issues raised are due to be discussed at QL Committee next Wednesday, 4 March.

I fully recognise the pressures placed on the legislative programme, and on your Department, by the number of major Bills you are due to bring forward after the Election. I must stress, however, that I attach the strongest importance to passing the main water privatisation Bill in the first main Session of the new Parliament. *We have already postponed ~~the Bill~~ in 1987 out, as it is.*

There are two consequences otherwise. We lose the momentum of the privatisation programme: deferring the water legislation to the second Session would mean that there were no primary privatisation sales after BAA this summer until late in 1989-90 - at least 2½ years. *Moreover,* we will I hope be bringing forward in the Second Session further major privatisation measures which are bound to be controversial and may well require complex and lengthy legislation. These privatisations, like water, will take time to implement: we cannot let them slip. And we need to leave room for further privatisation measures to follow them in subsequent Sessions. *He*

This would seriously damage two of the Government's major most important policies. Privatisation itself - the extension of popular capitalism. It could also cause problems for the public finances.

The legislation for
Unless water privatisation is completed in the first main post-Election Session, we will face the prospect of taking at least two major privatisation bills (together with any necessary Paving Bills) in the second Session.

I hope therefore that we can re-consider the programme for the first Session, with the object of including the main water privatisation legislation. *at least for the time being.* The implications for your other bills are of course very much a matter for you. *I realise the problem you have of too many major Bills jostling for a place in the first Session, and* As you know from our earlier discussion, I strongly support your objectives for change in housing policy. However, it is clear that a good deal of further work is needed in order to refine the options we are now considering and turn these objectives into precise legislative proposals. *We cannot get so sure that* I do wonder, therefore, whether

it is realistic to expect much of the housing package to be ready for introduction in Autumn 1987. We shall therefore, suggest, postpone a decision between water and housing until much nearer the time.

Finally, although I certainly do not underestimate the controversial nature of water privatisation, I do wonder whether this legislation will be quite as time consuming as QL was assuming when it met on 25 February. You have mentioned to me that you are currently considering some new ideas which could make the privatisation simpler and considerably less controversial. QL will also be considering further whether a Paving Bill is strictly necessary. I am not convinced, myself, that even if we do need a Paving Bill it must precede the main Water Privatisation Bill, rather than being taken in parallel with it up to Second Reading as has always been planned. I hope that, too, will be carefully considered by QL next week.

I am sending copies of this letter to the Prime Minister and *Willie Whitelaw,* ~~The Lord President of the Council~~ and to Sir Robert Armstrong.

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

16 June 1987



The Rt Hon Nigel Lawson MP
HM Treasury
Parliament Street
LONDON
SW1

CH/EXCHEQUER	
REC.	16 JUN 1987
ACTION	FST
COPIES TO	

Dear Chancellor,

WATER PRIVATISATION

I was grateful to see a copy of your Private Secretaries' letter of 15 June to the Lord President's Private Secretary in which you press for the main Water Privatisation Bill to be taken in the first session of the new Parliament.

I fully recognise the importance of maintaining the flow of proceeds from privatisation, and of keeping up the momentum in our privatisation programme. Water privatisation has a major role to play in both respects, which is why I am keen to press ahead with our paving legislation, on powers and metering, as quickly as possible. That Bill is drafted, and, subject to final policy clearance with colleagues, should be ready for introduction before the Recess.

The introduction of a main Bill in the first session however presents very significant problems. The decision to set up a National Rivers Authority and to privatise only the utility functions of the water authorities was not finally concluded until the meeting of E(A) on 7 May and we were not able to announce it before the election campaign. The change is of fundamental significance. It involves the disentanglement of functions previously carried out by the water authorities and their assignment to the NRA and the utility companies. This is a particularly delicate question in relation to water resources, where both sides will have a major interest; the utilities will need assurance that they have adequate access to water resources at all times, whereas the National Rivers Authority's interest is to plan, protect and conserve.

We cannot resolve the many questions which this gives rise to, for instance who is to own the river regulating reservoirs or how the costs of developing resources are to be paid for, within Government. We simply do not have the expertise. We need to consult people in the water industry and elsewhere, and a consultation paper is already being discussed between Departments, including Treasury, with a view to publication in July. We must then allow a reasonable time for people to comment.



Even if we were to draft the Bill in parallel with consultation we could have no confidence that we had got it right and, until the outcome of consultation we will be faced with last minute changes of major significance. It is essential however that we introduce this Bill with the policy on a proper basis if we are to retain the confidence of the city and to win the confidence of the water industry, and so pave the way for a successful privatisation.

When we were drafting the Bill on the previous model, our aim was to send Instructions to Counsel by June if we were to have a Bill for introduction not later than January. Although much of the work on instructions is now completed, we clearly cannot finalise them this month given the unresolved issues on resources. A January introduction would in any case be undesirable for a major bill of this kind, with over 200 clauses, many of them highly contentious.

1987/88 will in any case produce a heavy legislative workload even without a main Water Privatisation Bill. Main water privatisation would be a substantial extra burden; it might be very difficult to accommodate it without dropping another major bill. For the reasons I have outlined, however, I do not think it is in any case practical to think of our having the Privatisation Bill ready on a realistic timetable for 1987/88.

I am sending a copy of this letter to the Prime Minister and all members of the Cabinet.

Yours sincerely

JH Leonard

PP.

NICHOLAS RIDLEY

(Approved in draft by the Secretary of State and signed in his absence)



Ch/ See also note from Mary Brown (below) which deals, inter alia, with your earlier question

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

The Rt Hon Nigel Lawson MP
HM Treasury
Parliament Street
LONDON
SW1

CH/EXCHEQUER	
256	19 JUN 1987
ACTION	FST
COPIES TO	

19/6
My introduction will be to go along with
this, unless introduction is delayed
which is unlikely in W. case
or unless for better behaviour
of government vis P. 71.

Dear Nigel

WATER (POWERS AND CHARGES) BILL - POWERS TO PREPARE FOR PRIVATISATION, AND BILL TIMETABLE

I should like to raise with you and colleagues the provisions in the Water (Powers and Charges) Bill, which will confer powers on the water authorities to prepare themselves for privatisation. Since one of the main problems this gives rise to is on the handling of the Bill, I would like also to discuss this, in anticipation of QL's consideration next week of the legislative programme. I have now seen Paul Channon's letter of 17 June in which he argues for postponing the introduction of the Bill, and of course we discussed the legislative programme in relation to water at Cabinet this morning.

There is little difficulty with the powers clause in terms of what it seeks to achieve. Water authorities will be empowered to do anything they consider appropriate to help develop Government proposals for the transfer of their functions to other bodies. These would include the PLCs which inherit the utility functions of water supply, sewerage and sewage treatment and disposal, as well as the National Rivers Authority which will inherit the other functions. We have considered whether we need a power to direct the authorities to co-operate. This is undesirable for a number of reasons, not least that forcing a reluctant industry to co-operate in its privatisation will hardly engender confidence or assist the process of flotation. Nevertheless, if the reaction of the water authorities to our revised proposals is one of outright opposition we may have to return to this question.

The Bill contains no retrospective authorisation of what water authorities have already done by way of preparatory work. NALGO have brought an action against the Thames Water Authority alleging ultra vires activity last year, and this case is waiting to be heard. (It is unlikely to come to Court before the autumn.) We think that even if the action went against Thames the likelihood of individual Authority members being called to account is slim, and that it is unlikely therefore that any awkwardness would arise on that score. If however an adverse judgement did give rise to problems, the Bill could, if we thought it right, be amended in Parliament to protect the individuals concerned; or, if it had by then been enacted, the consequences could be dealt with in the main privatisation Bill. To introduce retrospective provisions now could be seen as prejudging the NALGO case, and must be undesirable.

The main questions for us are the relationship of this Bill with electricity privatisation, and the timing of it with reference to the BAA and electricity privatisations.

I understand that Department of Energy lawyers consider that the electricity industry has the same powers deficiency as the water authorities and that this will need to be made good. The question is when and how. One possibility would be to rely on a bill to restructure the electricity industry, in advance of its privatisation, but I understand that decisions on whether electricity is to be restructured, and whether there is to be a preliminary bill, have yet to be taken. Another possibility would be to add electricity to the water powers clause in this bill. I am advised that technically this would not be difficult to achieve, though I would have serious reservations about its desirability. It would significantly broaden the scope of the bill, and therefore allow amendments on a wide range of additional topics to be deployed, so causing delay.

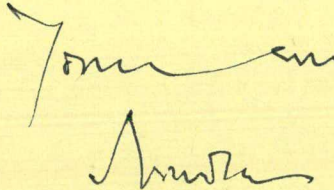
A further possibility would be a general, nationalised industry powers bill. This could take care of later privatisation candidates also (I understand that British Coal's powers might be in doubt, for example), though it would no doubt take a little longer to prepare the legislation. A suggestion for such a bill was made by Norman Lamont to QL earlier this year, and rejected by the Committee. A fourth possibility would be a separate electricity powers bill later this session.

As you know, I would like to introduce my bill as soon as possible, as an indication to the water industry that we mean business. Water privatisation has been around for more than 2 years now, and we have yet to take any firm, legislative steps. The bill is drafted and, subject to resolving the electricity point, could be introduced in July; indeed, I would like if possible to get Second Reading out of the way before the Recess. However, Paul Channon's letter indicates that this might pose difficulties for the BAA privatisation, which is timed for the second half of July. Even though BAA has been a PLC for almost a year, so that vires have not been in question during that time, there could be doubts about things done by the authority earlier than that. Even the existence of such doubts could cast a shadow over the flotation. Clearly that would be undesirable, but I believe we could distance the water industry's position from that of other privatisations by emphasising the fact that the NALGO case has been brought against Thames, thus creating a climate of uncertainty within the water industry which needs to be resolved. That is not the position with BAA, or indeed any other industry.

I would much prefer to introduce our powers and metering bill immediately, rather than wait another 3 or 4 months. July introduction would enable us to get a major part of our new programme before Parliament at the earliest opportunity. I would also prefer to introduce my bill dealing just with water, and leaving electricity to be sorted out later, either in a paving

bill or a separate, short powers bill. My aim is to put my bill to L Committee on 1 July, so early resolution of these matters is essential.

I am sending a copy of this letter to the Prime Minister, other members of Cabinet, the Attorney General, the Chief Whips of both Houses and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Nicholas Ridley', written in a cursive style.

NICHOLAS RIDLEY

CONFIDENTIAL

1. MRS. M E BROWN (seen in draft by Mrs Brown)

2. FINANCIAL SECRETARY

FROM: T TARKOWSKI
DATE: 22 June 1987cc Chancellor
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Moore
Mr M Williams
Mr Colman
Mr Bent

ch/ This crossed with your own comments. Content with advice at 'x'?
JK 22/6

no. any vires in an expression in my PS note of 22/6. It top priority is to press it to with water.

WATER PRIVATISATION: VIRES

Mrs Brown's minute to the ^{Financial Secretary} Chancellor of 18 June set out the background to the current correspondence on the timing of the water vires bill. The Treasury's interests are mixed, and it is not clear that either of the main options - introduction in July, or introduction in the Autumn, has a clear advantage. Our twin aims are to assist DoE to make progress as rapidly as possible with all aspects of water privatisation; and to secure vires for the electricity industry in England and Scotland during this session.

2. Mr Ridley has now written urging his case for introduction of the water vires bill this July. He argues that electricity vires should be dealt with separately.

3. It is necessary to balance the advantages, as regards water privatisation, of early introduction of the Bill, against the risks to the BAA privatisation of raising the issue before dealings begin. It is very hard to see what real risks to BAA arise in this area: there has been no hint of complaint that the former British Airports Authority exceeded their powers; it is very hard to see how, if such a claim was made, it could have a material effect on BAA plc; and the amount of money in question is relatively small (£200,000 or so). Nevertheless, having considered these points, the previous Attorney General took the view that there was some chance, however small, that an interested party might go to Court.

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If this were to occur before BAA's privatisation, there would be unwelcome publicity which would distract attention from the merits of BAA as an investment. Our conclusion is that the risk to the BAA sale is very small indeed, and is outweighed by the real advantages of being seen to press on with water.

X 4. We think it would be helpful for you to write back quickly to support Mr Ridley on early introduction, but to suggest that his Bill should be rapidly amended to include Electricity too. The alternatives - a separate Electricity Vires Bill or a general Vires Bill - are much less attractive from the Treasury's point of view and also that of the business managers.

5. If Mr Parkinson and Mr Rifkind maintain the view that there is insufficient time to insert Electricity into the Bill before the Recess, we will have to look again at the relative priorities. But for the moment it is worth trying to mobilise everyone into rapid action.



TT

T TARKOWSKI

CONFIDENTIAL**DRAFT LETTER FROM FINANCIAL SECRETARY TO:**

The Rt Hon Nicholas Ridley MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London SW1P 3EB

WATER PRIVATISATION: VIRES

Thank you for your letter of 18 June to Nigel Lawson.

There is a clear advantage in giving an early and unambiguous signal to the water industry that we mean business on privatisation. The introduction of a vires bill before the Recess would clearly achieve this presentational objective, and would at last remove the legal difficulties which have overhung the work on water privatisation to date. It would also, of course, somewhat ease the pressures on your own Department if we were able to make early progress on the Paving Bill, given the very tight timetable for work on the main legislation which has now been agreed by Cabinet.

I note Paul Channon's concern that introducing this Bill in July could stir up trouble for the BAA sale. There clearly is some risk here, but it seems to me to be very small, and not sufficient to outweigh the advantages of pressing ahead with water.

I am sure we should also move to secure similar vires for the Electricity industry in England and Wales and Scotland, although I have not yet seen the views of Cecil Parkinson or Malcolm Rifkind. Combining these powers with your own Bill on water powers would clearly be helpful both in terms

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of the pressures on the legislative timetable, and in avoiding an additional series of debates.

In my view, therefore, we should extend the scope of the vires bill to Electricity, and I hope that we can introduce it in July. With rapid agreement on all sides, I see no reason why this should not be possible.

I am copying this letter to recipients of yours.

NORMAN LAMONT



REC.	23 JUN 1987
ACTION	EST
COPIES TO	

PRIME MINISTER

WATER (POWERS AND CHARGES) BILL - METERING PROVISIONS

As you know, I am seeking to introduce at a very early date a Bill which will give the water authority powers to carry out work in preparation for their privatisation and facilitate the wider use of metering. I am consulting colleagues separately about the privatisation provisions. This minute deals with the metering proposals. I am also minuting you about the future of domestic water charges more generally in the light of rates abolition. (below)

Our policy on metering was considered in correspondence last year, following the recommendations of the Watts Committee. We agreed last March:-

- that there should be a series of controlled large-scale experiments to establish where and how we could get good value out of metering. These would, for example, test the effects of charging by measure on demand, and thus on water undertakers' longer term investment needs; and the costs and benefits of different metering technologies and tariff structures;
- that we should legislate to remove legal doubts about, and otherwise facilitate, compulsory metering trials and the extension of metering generally;
- that we should provide for all new dwellings to be constructed to enable simple meter installation.

The decision to legislate was announced in our privatisation White Paper.

Subject to one modification which I suggest below, this still seems to me the right approach. Since metering is greatly preferable in principle to unmeasured charging, I would in an



ideal world prefer to dispense with trials and proceed straight to the phased introduction of compulsory metering 'for real'. But the cost and scale of the operation, and the uncertainty as to its effects on demand and revenue, are such that I must reluctantly accept the case for trials. My City advisers, too, have warned me that the flotation prospects of the proposed Water Services PLCs would be seriously affected if we were seen to be forcing upon the industry the general adoption of metering before its consequences had been fully assessed and without regard to the undertakers' own commercial judgment.

I am determined however that where, whether for a particular part of its area or type of property or more widely, an undertaker is already persuaded of the case for metering it should be free to proceed. As regards new connections, indeed, I believe it would be right to take a bolder approach than we did last March. Meters are relatively cheap. It is the adaptation of existing plumbing to accommodate them that costs the money. It makes sense, then, to put in the meter and the surrounding pipework together when a connection is first made. I would like therefore to enable the undertaker to insist, as a condition of making a new connection to the mains, not merely (as we originally proposed) that the plumbing should be such as to facilitate meter installation at a later date but alternatively, if the undertaker preferred, that a meter be installed at the outset.

There has however been no opportunity to consult the housebuilding industry on this proposal. I am therefore inclined to omit it from the Bill on introduction, and to table an appropriate amendment, following consultation, at Committee stage.

The note annexed outlines the provisions I consider it appropriate to make in support of our policy. They have the following main elements:



- the statutory water companies, which have at present a variety of more or less restrictive charging powers in their own local Acts, will be given access to the wider powers on which the water authorities mainly rely. These allow the authorities to fix their charges as they see fit, provided that they have regard to cost and do not discriminate unduly between different classes of customer, and subject to a power of Ministerial direction which it has not so far proved necessary to use.

- a special regime will be established for metering trials schemes. Because of their experimental character they will be exempt from the normal requirements to have regard to cost and avoid undue discrimination. Instead they will be subject to approval by the Secretary of State.

- the existing law on metering and charging by measure will be clarified and extended in a number of ways which are designed to facilitate the introduction of metering on a large scale. These include (in addition to the arrangements for new connections described above), provisions requiring the occupier of metered premises to notify the undertaker if he moves house; adjustments to water undertakers' powers of entry for purposes of preliminary surveys, meter installation, maintenance and reading; provision for meter installation etc costs to fall on the undertaker whenever charging by measure is imposed on properties already connected to the mains; provisions on tampering with meters; a duty, where the water and sewerage services are provided by different undertakers (a common situation, since the statutory water companies provide water supply only) for the water undertaker to make meter readings available to the sewerage undertaker so that they can be used, if required, to charge for sewerage as well; and provisions for arbitration in cases of dispute between the undertaker and other parties. There is also a regulation-making power for the Secretary of State to make supplementary provision on these and other matters, such as the siting of meters.



These provisions need not in themselves entail any significant increase in public expenditure. The water companies are outside the public sector. Water authorities' metering costs would normally fall to be met from their charges to customers, or from borrowing within their approved EFLs. The administrative costs to my department would be unlikely to exceed around £30,000 per annum. However, you should know that I consider it important that there should be a centrally co-ordinated programme of trials to ensure that the costs and benefits of metering are assessed in a variety of different local circumstances, that lessons of general application are drawn from individual undertakers' experience, that there is no unnecessary duplication of effort, and that clear evidence should be available in the prospectuses of the WSPLCs that a sound basis is being provided for their decisions about the future basis of charging following rates abolition. Preliminary discussions with the industry suggest a total cost for such a programme of around £6.5m spread over 3 years starting in 1988-89. I would propose to offer a contribution from my Departmental Research Programme. This contribution would be made under separate existing powers and is therefore of no direct relevance to the Bill. I mention this proposal, however, since it is likely that I will be asked about my intentions as regards the trials programme during Second Reading and it will be necessary to agree with John Major the terms of any statement I make. I may wish to make an associated bid in the Public Expenditure Survey. My officials are consulting Treasury officials separately about the details.

I should be grateful to know by close of play on 29 June whether colleagues have any comments to make on these proposals.

Copies of this minute go to members of E(A), and to Sir Robert Armstrong.

N R

23 June 1987

**WATER (POWERS AND CHARGES) BILL: PROPOSED PROVISIONS ON CHARGING
AND METERING**

Clause 2 Empowers statutory water companies to fix their charges as they see fit and demand and recover these from their customers, subject to later provisions of the Bill. Charges may be fixed by means of a scheme or by agreement. This power (identical in essentials to the charging power under s.30 of the 1973 Water Act on which water authorities chiefly rely) is additional to, rather than a replacement for, water companies' other charging powers (mostly in local Acts).

Clause 3 This governs the fixing of charges by water companies under Clause 2 and by water authorities under s.30 1973. It restates the key principles previously provided for in s.30:-

- undertakers may generally fix their charges by reference to such matters, methods and principles as they consider appropriate; and may make different charges for the same service in different cases
- however, in fixing their charges they must have regard to the cost of performing the service in question and ensure that no undue preference is shown to, and that there is no undue discrimination against, any class of persons
- they must also comply with any directions given by the Secretary of State to them, individually or collectively, as to charging matters, methods and principles.

In addition, the clause makes provision for liability for charges, when these are fixed wholly or partially in relation to volume, on change of occupier. If the old occupier fails to give two working days' notice of his departure, he will remain liable for water charges on the property until either i) 28 days after notifying

the undertaker or ii) the next normal meter reading day or iii) the new occupier telling the undertaker he has taken up residence, whichever is the earliest. This draws on precedents in gas legislation.

Clause 4 This clause makes special provision for charges schemes which are declared to be made for purposes of metering trials, or of amending such schemes. The purpose is to remove legal inhibitions on experimentation which the undertakers might otherwise feel, while ensuring adequate protection for the consumer. The special feature of trials schemes is that they are not subject to the provisions requiring charges to be cost-related, or prohibiting undue discrimination/preference. Such latitude is considered necessary for purposes of experimentation, not least since costs will not be known in advance, one important aim of the trials being to ascertain how charging by volume affects costs, and since undertakers may want to try out a variety of different tariff structures. In return for this concession, however, undertakers must submit these schemes to the Secretary of State in draft for his approval (which may be conditional). In considering draft schemes, the Secretary of State must have regard to the interests of customers affected and to whether appropriate provision has in his view been made on a variety of matters, including the way charges are to be calculated, the selection of locality and premises, the duration of the scheme, consultation arrangements and the handling of representations. He may himself have regard to costs in considering draft schemes, so that he can refuse to agree to charges proposals which seem out of line with any reasonable hypothesis as to what costs might be. He may, too, require a scheme he has approved to be amended or revoked should adjustment or abandonment prove necessary in the light of experience; or make the change himself if the undertaker fails to comply. In order to encourage undertakers to submit proposed trials schemes quickly, there is a provision enabling the Secretary of State to refuse to consider schemes submitted to him after 1 April 1989.

Clause 5 Provides for the detailed provisions of Schedule I (see below) to have effect, and empowers the Secretary of State to make supplementary provision in regulations (negative resolution procedure) on such matters as meter location, the proving of meter readings, adjustment of charges where the meter appears to be faulty etc. The power is widely drawn, with the aim not only of meeting immediately foreseeable requirements but also of ensuring that any practical problems of general application which come to light during the trials programme or experience with metering generally, can be dealt with.

Clause 6 and 7 are supplemental and interpretative. Amongst other things, they enable the Secretary of State to modify by order any existing local Act provisions on charging by volume.

Schedule I makes provision for the following:-

a) power to impose conditions of new supply.

(These provisions may be omitted from the Bill on introduction, pending consultation with the housebuilding industry). Undertakers may make it a condition of making a new connection for purposes of domestic water supply, even if they have no immediate intention of charging by volume, either that

- i) a meter has been installed and connected in accordance with approved specifications or
- ii) the plumbing complies with specifications approved by the undertaker (locally, nationally, or for the particular case) with the aim of facilitating installation of a meter at a later date.

b) powers of entry for installation etc of a meter

Drawing where relevant on existing water and gas legislation, these provisions extend water undertakers' existing powers of entry so as to cover the following purposes, when undertakers have either fixed volume - related charges for the premises concerned or given notice of their intention to do so:-

- preliminary surveys to establish the practability of installing a meter and how it can best be done
- installation and connection, inspection, repair, disconnection and removal of meters
- meter reading

Provision is made for the giving of due notice of intended entry; entry on the authority of a justice's warrant where necessary; and offences of unauthorised disclosure of information gained in the course of entry, and obstruction of authorised persons making an entry.

c) expenses of installation etc

The undertaker is normally to bear the whole costs of meter installation, repair, removal etc. Exceptions are where:-

- i) meter installation, or particular plumbing specifications, have been required by the undertaker as a condition of new supply under a) above
- ii) the undertaker has not imposed a volume related charge but the customer has exercised an option to be charged by volume
- iii) the occupier asks the undertaker to locate the meter in a position other than the one proposed by the undertaker, in which case the occupier may be required to bear the excess costs.

The undertaker must also pay for any damage caused in the exercise of his power of entry.

d) offences of tampering with meters etc

Deliberate interference with a meter, or carrying out work which will affect the operation of the meter or require its disconnection is to be an offence, unless the work is carried out with the undertaker's consent. A procedure is laid down for seeking the undertaker's consent, and for the undertaker itself to carry out the work if it wishes (at the occupier's expense). These provisions replace broadly similar ones in existing legislation.

e) duty of undertakers to inform other undertakers of meter readings

It is customary, where water is charged for on the basis of meter reading, for the sewerage charge also to be based on this reading (since the quality of effluent is likely to be closely related to the volume of water supplied). The two services will sometimes be in the hands of different undertakers. It is proposed that, in these circumstances, the undertaker which has made the meter reading should be under a duty to pass it to the other undertaker concerned, where the parties have reached an agreement as to costs.

f) arbitration

Provision is made for arbitration between water undertakers and other parties in cases of dispute as to eg the allocation of expenses incurred in metering, or specifications for the metering of properties to be newly connected.

Schedule II and III provide for consequential amendment and repeals.

Y SWYDDFA GYMREIG

CHEQUER
GWYDYR HOUSE 23 JUN 1987

WHITEHALL LONDON SW1A 2ER

Tel. 01-270 3000 (Switchboard)
01-270 0538 (Direct Line)

Oddi wrth Ysgrifennydd Gwladol Cymru

The Rt Hon Peter Walker MBE MP



WELSH OFFICE

GWYDYR HOUSE

WHITEHALL LONDON SW1A 2ER

Tel. 01-270 3000 (Switchboard)
01-270 0538 (Direct Line)

From The Secretary of State for Wales

23 June 1987

WATER (POWERS AND CHARGES) BILL - BILL TIMETABLE

I have seen Nicholas Ridley's letter to you of 18 June and Paul Channon's letter to Nicholas Ridley of 17 June on the same subject.

If we are to introduce the main privatisation legislation in the first session of this Parliament it is essential that the Vires Bill is laid before the House before the summer recess. The water industry will need this so that they can make a start on the very large areas of privatisation work for which their current powers are inadequate, secure in the knowledge that we will be remedying any deficiency in their powers.

However, as you know from my letter to you of 17 June I do not believe that it is either sensible or practical to rush water privatisation legislation and have argued for introduction in November 1988. The later introduction for main legislation would allow us to defer the Vires Bill until the autumn, thus removing the worries that Paul Channon has expressed over the BAA sale. On balance I favour introduction of the Vires Bill after the summer recess with the concomitant deferral of the main Bill to November 1988.

Nicholas' concern about the need to convince the water industry of our serious intentions on water privatisation will be met to some extent by publication of the paper detailing our proposals for the National Rivers Authority. We should aim to do this in July.

I agree with Nicholas that adding electricity vires into a bill which deals with a range of water issues apart from vires will only compound the difficulties of getting the water legislation through Parliament. I understand that there is no certainty as to when the electricity legislation will be ready and that there may be complications with its extension into Scottish legislation and all that that might entail. Thus I think electricity vires should be handled as a separate issue.

/ Copies of this letter go to the Prime Minister, other members of Cabinet, the Attorney General, the Chief Whips of both Houses and to Sir Robert Armstrong.

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer



CH/EXCHEQUER	
REC.	24 JUN 1987 ✓
ACTION	FST
COPIES TO	

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

24 June 1987

Dear Chancellor

TIMING OF THE WATER (POWERS AND CHARGES) BILL

I am grateful to Paul Channon and to Nicholas Ridley for copying to me their letters of 17 and 18 June. (Ch: still with you?)

My main concern is that we should make early progress on electricity privatisation. To do so, we will need a considerable input from the industry itself, including early expenditure. In order to undertake this work, the industry will need clearer statutory powers to prepare for privatisation than it presently has. I appreciate and sympathise with Nicholas' difficulties - it is important to the Government that water privatisation is well prepared and successfully carried through - but I do not want electricity to be held back. We have no Department of Energy legislation this Session, and I therefore have a strong preference for the inclusion of the necessary single clause provision in the Water (Power and Charges) Bill after the Summer recess. The alternative of having two separate bills covering much the same ground in the same session does not seem to me to be an economical use of ministerial or parliamentary time.

Naturally I would prefer to delay introduction of the Water (Powers and Charges) Bill until the autumn to ensure we have sufficient time to prepare provisions covering England, Wales and Scotland. I am glad that Peter Walker agrees that introduction in the autumn would be acceptable. However, if colleagues are convinced that we must seek the presentational advantages of introduction before the recess, I hope they will also agree that we should still add our clause on electricity. We are giving this task priority and should be able to complete instructions to counsel this week. So I believe it should be possible for counsel to complete clauses in time for QL to consider a revised Bill on 1 July, although I recognise this would leave little time to circulate it in advance of the meeting.

*The amount ✓ need ✓
to do with ✓ to take
this into privatisation.
to your note
Bob must*

*24 June 1987
Summer recess before
can be done with
an electric clause
added, I am
prepared to
consider it.
There is
an
priority
for that
Glee.
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John
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Am it
will have
Frank*

*Ch
You wanted to
see this straight
away ✓ done*



I am very ready to take part in a discussion, perhaps in E(A), of how to proceed, if others believe that would be helpful.

I am copying this letter to the Prime Minister, other Cabinet colleagues, David Waddington, Bertie Denham and to Sir Robert Armstrong.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'Cecil Parkinson', written in a cursive style.

top

CECIL PARKINSON

(Approved by the Secretary of State and signed in his absence)

CONFIDENTIAL

FROM: T TARKOWSKI
DATE: 29 June 1987

- 1. MRS BROWN
- 2. FINANCIAL SECRETARY

- Chancellor
- Chief Secretary
- Sir P Middleton
- Mr F F R Butler
- Mr Monck
- Mr Moore
- Mr Hawtin
- Mr Turnbull
- Mr Burgner
- Mr Bonney
- Mr Instone
- Mr Lyne
- Mr Parr
- Mr Tyrie

(I am content with the first two pages (with no deletion) but think it has 150 1/2 of that page & I am with 2: 1 do not delete the 2 1/2). contact with the Chancellor encourage the flood (no more a lot) but for a handsh... do so. incidentally, how can the PM also be involved in this point?

ch
FST content with draft letter below (except for one deletion, marked) but wd welcome your agreement
ch

WATER PRIVATISATION: DOE POLICY PAPER - THE NATIONAL RIVERS AUTHORITY

Mr Ridley circulated a draft policy paper, under his minute of 23 June to the Prime Minister, which he aims to publish in early July. He asked for comments by Tuesday 30 June. His minute of 26 June proposed a series of further amendments, designed to widen the scope of consultation. I attach a draft reply. You are holding a meeting to discuss tomorrow.

2. In general, we are now content with the substance of the paper (as amended), most of which apart from the amendments has been subject to extensive discussion between officials. The only aspects of policy on which it represents a development from the position agreed at E(A) are:

- (a) water resources: this is an area on which the paper is wholly consultative, rather than making firm proposals;
- (b) consultative arrangements: where E(A) did not finally resolve disagreement between MAFF, DOE and MPO about the appropriate structure;
- (c) the new suggestion, in Mr Ridley's second minute, that the National Rivers Authority might contract out the implementation of

significant tranches of its functions to the privatised utilities.

These are covered below.

Presentation

3. As far as presentation is concerned, the paper represents an enormous improvement over the previous drafts. We have insisted that every opportunity should be taken to present the proposals in a positive light, and that defensive or apologetic material should be eliminated or pared to the minimum. We have also succeeded, to some extent, in reducing the emphasis DOE wanted to put on the consultative elements in the paper, so as to give it a more purposeful tone. Mr Ridley's second thoughts have extended the area on which he is prepared to consult, tending to counteract this, but not, ^{in our view,} ~~incur~~ disastrously.

4. We think the final result is acceptable (subject to a number of relatively minor suggestions attached to the draft reply), though it is still not as crisp or up-beat as we would have wished. However, DOE have argued that it must be directed primarily to the expert audience in the water industry, and must satisfy their expectations by providing a full discussion of the finer details, and must also set out the background to the decisions which have been taken. They accept, however, that a simpler, more up-beat presentation will be needed for the press and other interests. It would be useful if your reply could underline the importance of getting the presentation right.

5. One aspect of this is how we handle the main objection that has been raised, particularly by the water authorities themselves. This is that the new proposal destroys "integrated river basin management", which was acknowledged in the 1986 water privatisation White Paper to have been recognised world-wide as a good and cost-effective model for the industry's structure, and was adopted as the corner-stone of the earlier proposals. Roy Watts has argued strongly against the new policy on the grounds that it will damage the industry's standing overseas and reduce its foreign earnings potential.

6. We have argued that this objection should be tackled head-on in the policy paper. The draft reply takes up the point, and suggests the line

we might take on this in public.

Water Resources

7. As Mr Ridley made clear at E(A), one policy area on which consultation with the industry is essential, before policy can be settled is water resources. There are three main issues with significant implications for the Treasury:

(a) who owns water resource assets (eg, reservoirs): There are significant maintenance and operating costs associated with ownership.

(b) who builds new assets: new reservoir construction is relatively rare - there are only 2 major water resources projects planned for the rest of the century. But they are expensive.

(c) How the costs of (a) and (b) should be shared among the various beneficiaries.

8. Our preference would be for the privatised water companies to take all water resource assets with them into the private sector, and to be responsible for all new construction. The White Paper makes this clear. Under this option, the National Rivers Authority (NRA) would shoulder only minor administrative costs (plus, possibly, the relatively small cost of re-imbursing reservoir owners for the costs of contributing to the NRA's environmental objectives).

9. However, some reservoirs are constructed for primarily environmental reasons, to regulate river levels. It seems likely that in these circumstances the NRA would be obliged to take these over from the water authorities on privatisation. This would increase the NRA's net costs, which we would otherwise expect to whittle down to around £40 million a year under our preferred option. (In the unlikely extreme, where the NRA owned all water resource assets, the annual net cost would be the £130 million which DOE originally suggested when the new policy was first discussed). All options would require elaborate systems of payment between the NRA and the private companies, where both benefited from an installation.

This is the point at 7(c) above. This too would have implications for public expenditure.

10. In practice, we expect the water industry to want to take as many of their assets with them as possible. Given this coincidence of interest, the public expenditure issues may well not arise. Moreover the policy paper makes no irrevocable commitment to any particular solution. In this part of the paper, as elsewhere, there is also a suitable emphasis on the importance of cost-recovery. However, if our preferred option proves unworkable, after consultation, we will need to return to the public expenditure issue. The draft reply flags this issue.

Consultative Committees

11. Arrangements for the committee structure were not resolved by E(A). Mr Heywood's minute of 25 June records that you wish to discuss this with us.

12. The background is described on pages 2 and 3 of Mr Ridley's minute. Briefly, there will be two quite separate sets of issues in each Region:

(a) customer issues: relating to the service provided by the privatised utilities, and their charges.

(b) environmental/amenity issues: relating to the way in which the NRA discharges its duties, and the impact of the activities of the privatised companies, as well as local industrialists, farmers and others, on the environment.

13. DOE and we believe that these sets of issues should be kept quite separate. The first set of issues would be looked at by a committee of the utilities' customers, who would report to the regulator - the Director General. As with previous privatisations, there would be no contact with Government.

14. The second set of issues would be dealt with by a committee representing all the interest groups, and would report to the NRA. Its purpose would be to resolve conflicts of interest and to advise the NRA on how to carry out its essentially "public good" duties.

15. Fisheries belong naturally with the second set of issues. However, MAFF are reluctant to give up their separate, statutorily independent, committees. And they cannot be accommodated within the upper limit of 2 committees per Region which the Prime Minister asked for at E(A). The compromise proposed is that they should be retained as sub-committees of the main environment/amenity committees. We think this is acceptable.

16. The other dispute is who should appoint them. If MAFF ministers, as at present, they are caught in the quango count (and lines of accountability are confused). If by the NRA (which will appoint the main environment/amenity committees, and itself has MAFF appointees who could exercise oversight) they escape the quango count (and accountability is clear). We support the latter option (also preferred by DOE and MPO).

17. The draft reply supports this solution.

Contracting Out

18. Mr Ridley's new proposal, which has not been discussed with us, is that the NRA should be obliged to contract out all the operational and management functions for which it is responsible, (while retaining responsibility for policy, and finance). He also floats the possibility that the privatised utilities should have the right to contract for the work for an initial (say 3 year) period.

19. This idea has come from the water authorities themselves, who are clearly anxious to retain as much of their existing empires as possible. Mr Watts is opposing the establishment of the NRA altogether, for these reasons. But the other authorities have recognised that the Government is committed to the principle of the NRA, and have adopted this subtler defence.

20. Contracting out is, superficially, an attractive idea. The potential advantages are:

(a) that it could secure efficiencies through competition, thus reducing NRA's costs

(b) it might secure the industry's goodwill for the new proposals

(c) Mr Ridley also argues that it could avoid some disruption in the industry, and allow for the benefits of ~~paid~~^{past} rationalisation through integrated management to be preserved. We doubt this could be done without undermining regulatory independence.

However, the potential disadvantages should not be underestimated:

(d) too close a relationship between the NRA and the privatised companies could easily lead to regulatory capture, or accusations of it, frustrating the very purpose for which we are setting the NRA up. Any extensive contracting out would be viewed with considerable suspicion by other interest groups.

(e) Much of the NRA's activities will be entirely regulatory in character (eg granting discharge consents) or advisory (eg advising the Secretary of State on disputed environmental/amenity issues), and thus will be unsuitable for contracting out.

(f) The suggested 3 year monopoly right for the utilities to supply contracted out services would be viewed with particular suspicion. It would do nothing to secure new efficiencies, and could be justified only in terms of smoothening the transition. It would mean that long-term arrangements were once again in the melting-pot at, or shortly after, flotation. This is clearly to be avoided.

21. The NRA has responsibilities in six areas:

- (i) water resources
- (ii) environmental quality and pollution control
- (iii) land drainage and flood protection
- (iv) fisheries
- (v) conservation and recreation
- (vi) navigation

22. In practice the ~~main~~ benefits likely ~~from~~ contracting out are likely to come from land drainage (iii). This will be the bulk of the NRA's budget,

and since there is relatively little regulatory content, we believe this is worth exploring.

23. Water resources (i) is discussed in paragraphs 7 to 10 above. Under our preferred solution all significant operational responsibilities will go the private sector anyway. But if this proves impractical, contracting out arrangements might be part of the solution adopted.

24. Pollution control and environmental duties are largely regulatory and we see little scope for contracting out (other than, eg work in clearing up accidental discharges).

25. The remaining functions are very small. They too are largely regulatory or policy/advisory in character. But there may be some fisheries work or navigational maintenance work that could be contracted out without undermining regulatory independence.

26. The likely benefits of contracting out, other than in the land drainage are thus few. However land drainage is estimated to account for as much as half of the 7,000 NRA employees envisaged in Mr Ridley's E(A) paper, and there could well be scope to contract out a significant proportion of this work, much reducing the NRA's manpower.

27. It seems worth exploring what can be achieved, if this would help win over the support of the industry, provided we make it clear that we will ensure against regulatory capture. With the slight changes we propose, we think ~~the~~ amendments achieve this without significantly weakening the paper presentationally, or committing us to contracting out any specific operational duties.

28. The attached draft reflects this advice.

This should save NRA's overhead costs. And competitive tendering could promote efficiencies within the water undertakings. M.S.

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DRAFT LETTER FROM THE FINANCIAL SECRETARY TO MR RIDLEY

**PRIVATISATION OF THE WATER AUTHORITIES: ESTABLISHMENT OF
A NATIONAL RIVERS AUTHORITY**

Thank you for sending me copies of your minutes to the Prime Minister of 23 and 26 June.

In general I am content with the policy paper (as amended by your second minute) subject to a number of detailed drafting points which I attach.

It is of course vital that our new proposals are presented in as positive a light as possible. We have already had to abandon our earlier proposals, incurring substantial delay, and we must clearly do all we can now to avoid any general impression that we remain unclear about what we are proposing.

I accept that your paper must be aimed primarily at the expert audience in the water industry, and that this means that your proposals cannot be presented in quite the same way as one would wish to do for a wider audience. This makes it all the more important that any accompanying notices and statements give a clear message to that audience that we mean business, and that we are now moving ahead confidently, and in the right direction.

Turning to a specific aspect of the way the proposals are presented, I wonder whether there might not be some advantage in tackling head on the argument that we have turned our backs on integrated river-basin management. This is something on which your paper is entirely silent. But it is a subject on which there has already been press comment. A possible line we might take, if you thought it helpful, is included in the attached drafting suggestions.

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Turning to the subjects on which you commented specifically in your 23 June minute, I note that the results of consultation on the question of water resources could have very large implications for the costs of the National Rivers Authority, and public expenditure. I am content that your paper urges that, as far as possible, water resource assets should go into the private sector with the privatised utilities, and that it makes no irrevocable commitment to any particular solution. However, if our preferred option remains unworkable, after consultation, we will need to look very carefully at this issue, bearing the public expenditure implications in mind.

You also mentioned the question of the appropriate arrangements for consultative committees. I am quite sure you are right that the committees dealing with consumer issues (ie. the services and charges of the utilities), which will have to report to the Director General, should be kept quite separate from those dealing with environmental and amenity issues, which will exist to advise the NRA. The former should, as for British Telecom and British Gas, have no direct contact with Government. The latter will advise a central government agency, responsible to your Department, on what are essentially "public good" issues.

[I share the general desire to restrict the number of committees we set up to the minimum. Although E(A) recognised a case for separate arrangements for fisheries distinct from those dealing with environmental and amenity issues generally, I remain unconvinced that fisheries could not in fact sensibly be dealt with within the water amenity committees (WACs).

[However, if it is considered essential that these have an identity separate from the WACs, they should clearly be sub-committees of them. I very much agree that it would be preferable, both in terms of the quango count, and in securing clear lines of accountability, that they should be appointed by the NRA, rather than by Ministers.]

FST wd
delete
this
dx

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Turning to your minute of 26 June, I am glad to hear that the majority of the authorities have decided against opposing the establishment of a National Rivers Authority. However I am concerned that their intention, in urging that the NRA should be obliged to contract out its operational responsibilities, reflects a desire not to lose parts of their existing empire, rather than a public-spirited concern with public sector efficiency.

The main objection to their proposal is the risk of regulatory capture. Clearly there will be large areas of the NRA's functions, particularly on the environmental side, which will be quite unsuitable for contracting out. In practice, I suspect that the main benefits from contracting out will be in land drainage and flood defence, though there may be some minor opportunities in fisheries and navigation and in clearing up pollution incidents. I confess to some scepticism about the practicality of maintaining multi-functional divisions in their present form without severely undermining regulatory independence. We can expect other interest groups to be intensely suspicious of any proposals to contract out NRA responsibilities to the privatised utilities, and to be ready with accusations of regulatory capture. This would frustrate the very purpose for which we are setting up the NRA - which is to be seen to have established effective safeguards.

However, I am prepared to agree that you should explore the possibilities, without commitment, if that will assist in securing the industry's co-operation. However we should make it abundantly clear at the same time that we will not risk regulatory capture, or be seen to undermine the NRA's effectiveness.

I am afraid I am not attracted to your suggestion that the privatised utilities have a 3-year monopoly right to supply the contracted-out services. This would do nothing to secure new efficiencies, and would mean that long-term arrangements were back in the melting pot at, or shortly after, flotation.

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This is clearly to be avoided.

I am copying this letter to the Prime Minister and other members of E(A).

[N L]

DRAFTING AMENDMENTS

- (i) Paragraph 1.6 line 2: delete "... are well founded, and that they ...".
- (ii) Insert, after paragraph 1.6, a new paragraph along the lines:

"Integrated River Basin Management

We said IRBM had proved a success. This is true. The essential advances on the pre 1973 arrangements were rationalisation of 1,600 undertakings into 10, resulting economies of scale, elimination of unnecessary and wasteful duplication, concentration of expertise, clarification of responsibilities etc. ... Believe these advantages will not be lost by creating one additional agency. Indeed, they will be strengthened by making choices more explicit, introducing greater transparency, increasing accountability, recognising the independence of social from commercial objectives, and providing centrally for the resources necessary for the former. Will also allow for development of an effective national policy towards our rivers and water resources.

- (iii) Paragraph 2.1 (b) line 2: delete "and where necessary" and insert "or".
- (iv) Move last 2 sentences of paragraph 2.1 "The transfer of Statutory functions ..." to insert, in paragraph 2.4, after second sentence.
- (v) Paragraph 3.8, second sentence: Delete "If accepted" and continue "It would also provide a basisassets, following the principle that where the public interest is adequately secured there is no need for public ownership." In the fourth sentence replace "way

in which" with "method by which" for clarity. Amend following sentence, to read "These are not simple issues, and the ...".

- (vi) Paragraph 4.1, line 4 "maintenance or enhancement".
- (vii) Could "might" in line 3 be replaced by "can"?
- (viii) paragraph 4.5 "... responsibilities, will mark a major advance in environmental enhancement and protection".
- (ix) Paragraph 4.6. The penultimate sentence should make clear that the cost implications for the WSPLCs will be considered by the Director General.
- (x) Paragraph 4.13, final sentence to read: Each will have distinct role. It is envisaged that a working relationship between HMIP and the NRA will develop within this framework."
- (xi) Paragraph 5.1: amend final 2 sentences to read: The Committees will discharge their responsibilities within the regional structure described in section 2. The new arrangements proposed will be built on the foundations of the existing organisation.
- (xii) Paragraph 8.1 second sentence should, for accuracy, read "...in respect of these functions."
- (xiii) Paragraph 11.2: in the fourth sentence, "....the PLCs to be responsible for operational or management aspects of some of the NRA's functions, provided such arrangements do not prejudice the independence of the NRA in discharging its regulatory responsibilities. Such arrangements could allow the PLCs to maintain a measure of multi-functional working"

(xv) Paragraph 13.2 penultimate sentence: delete "a major question" and replace with "questions".

CH/EXCHEQUER	
REC.	29 JUN 1987
ACT	FST
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✓ 29/6

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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

29 June 1987

Dear Robin,

WATER

Your Secretary of State has sent the Prime Minister four minutes about water privatisation. (Not attached: v. bulley - you have seen)

N.B.

Your Secretary of State's minute of 23 June discussed the future of water charges after the abolition of the domestic rate. The Prime Minister believes that the proposals on this are particularly important and bound to be controversial and she would like to discuss them at a meeting. This will be arranged as soon as possible.

The Prime Minister is content, subject to the views of colleagues, with the metering provisions for the Water (Powers and Charges) Bill described in your Secretary of State's minute of that title, also of 23 June.

The Prime Minister is also content, subject to the views of colleagues, with the draft consultation paper attached to your Secretary of State's third minute of 23 June: Privatisation and the Water Authorities: Establishment of a National Rivers Authority. The further minute, of 26 June, of the same title proposed amendments to the consultation paper, among other things to invite views on the possibility of contracting out certain functions of the National Rivers Authority to the water authorities. The Prime Minister agrees, subject to the views of colleagues, that it would be reasonable for the NRA to be allowed to contract out, but she believes it would be inadvisable, having brought these functions into Government for a specific reason, to introduce any possibility of compulsory contracting out, especially at this stage.

I am copying this letter to the Private Secretaries to the Members of E(A) and E(LF) and to Trevor Woolley (Cabinet Office).

David Norgrove

DAVID NORGROVE

Robin Young, Esq.,
Department of the Environment.

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CONFIDENTIAL and
PERSONAL



PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

No copies to be taken

H/EXCHEQUER	
CLC.	01 JUL 1987
TO	Mrs Brown
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	PS/FST
	NK MOORE

1 July 1987

Dear Nigel

Ch
 Hd Whitelaw's office wonders if you wd prefer a bilateral with him tomorrow, without Mr Ridley? (I wd have thought better to have Mr Ridley present, as planned - it's his Water Privatisation Bill, after all.) Either way

Make it a bilateral, as suggested by Low

I thought it might be useful if I sent you this short note before we have a word about this tomorrow evening.

this does not look hopeful
1/2

The general position is that our legislative programme this Session is exceptionally large and controversial. In particular, it contains three controversial Bills - Abolition of Domestic Rates, Housing, and Education - each of which is very large and complex. Norman Lamont will doubtless have told you that when QL met this week they were very anxious about getting such a programme through. The obvious risk is that we might run into quite uncontrollable congestion in the tail end of the Session.

QL will therefore ask that everything possible should be done to get the main Bills into Parliament as soon as possible after the Recess, and they also decided to recommend to Cabinet that the contents of the Housing Bill should be tailored to the parliamentary time available. I shall be reporting all these conclusions to Cabinet for discussion on 9 July.

The proposition that we should also include a main Water Privatisation Bill has to be seen against all this background.

?

I am advised that the Bill could not be ready before the end of January, and even if all the other considerations were favourable, that would be a dangerously late start for such a massive, complex and controversial measure. Now that QL and I have looked into the position in some detail, however, we are quite clear that the existing programme stretches both our drafting resources and parliamentary time to the limit.


The Rt Hon Nigel Lawson MP

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In the light of all this I do not think that QL had any option but to conclude that the only way in which a main Water Bill could be accommodated would be by forthwith dropping Abolition of Domestic Rates, Housing or Education in order to free both the necessary drafting capacity and parliamentary time. The choice seems to me to be quite inescapable.

I am sorry to have to describe the situation in such stark terms, but I do believe that the time for a final decision is now running out very quickly. A realistic main Water Bill would soon need to occupy appreciable time of Parliamentary Counsel and there are simply not enough draftsmen to take on an additional task of this magnitude alongside the disturbingly large programme that we already have on the stocks. I am afraid, therefore, that keeping open the option of a main Water Bill as a contingent possibility will just simply divert resources we need critically elsewhere and I shall have to ask Cabinet to take a clear decision next week.

I do, of course, entirely accept all that you have said about the general desirability of proceeding swiftly with Water Privatisation. At the end of the day, though, this has to be seen as a matter of priorities. My task, on QL's behalf, is simply to expose the nature of the choice to our Cabinet colleagues.

Manu
Waller


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CHANCELLOR

FROM: MRS M E BROWN
DATE: 1 July 1987

Ch

I have not included
all the many recent
papers on water privatisation,
but can send them across
if you want
D.W.K.

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Hawtin
Mr Moore
Mr Scholar
Mr Colman
Mr Williams
Mr Bent
Mr Tarkowski

**WATER PRIVATISATION: MEETING WITH LORD WHITELAW, THURSDAY
2 JULY**

You are seeing Lord Whitelaw tomorrow (Thursday) evening. Lord Whitelaw has written to you today saying that he considers it impossible to introduce the main Water Bill in the coming Session, unless one of the three other major bills is dropped. These are Housing, Rates and Education. None of these Bills would be likely to reach the Lords until after the Easter recess. Since water could not be introduced in the Commons until end-January at the earliest, it would compound the pile-up.

2. Cabinet will consider the legislative programme again on 9 July. Lord Whitelaw proposes to say then that a firm decision on Water must be taken now, not left open until January as agreed at Cabinet on 18 June. (minutes attached)

3. You may have to accept that the Water Bill must be postponed to the 1988-89 Session. But you could first put the following points to Lord Whitelaw:

(i) Privatisation programme

One of Government's highest priorities. Prime Minister said at Cabinet on 18 June that early water privatisation was a considerable prize to be won.

Postponing Water Bill means first sale(s) not until Spring/Summer 1990. Electricity sales likely to begin Autumn 1990. Excessive demand on market. Real danger that two major primary privatisations of this Parliament would not be completed before next Election.

[See also Mr Moore's minute of today on privatisation proceeds; and annex to this minute on timetable]

(ii) Priorities

Housing: no higher priority than Water. Have already queried inclusion of clauses on Housing Action Trusts. — or, indeed, anything except private rented sector — in the first Housing Bill.

(iii) Business management problems

- possibility of introducing one Bill (eg. Housing) in Lords? [Lord Whitelaw's Office think not - too controversial].

- really impossible to introduce Water as well as other 3 Bills - especially if Housing Action Trusts omitted from Housing Bill?

- how confident at this stage that all major medium-sized Bills will be prepared in time for introduction this session? Why not stick to Cabinet's conclusion (18 Junc) that preparations on Water should continue, in case gap in legislative programme appears?

Timing of water sales if legislation deferred

5. If the Water Bill is postponed to the Second Session, you will want to secure Cabinet agreement that

(a) DoE will still press ahead as rapidly as possible with their preparations.

[If there is a loss of momentum now, there is a danger that DoE will pull scarce resources out of the water privatisation team, and fail to maintain the pressure on the water authorities to tighten their management and finances. I am concerned that DoE's commitment to water privatisation - fragile in some quarters already - will weaken, and be difficult to revive];

CH
ELSEWHERE
IN YOUR BOX
dw.

(b) DoE should move much more rapidly to the first flotation(s) following Royal Assent.

[DoE say they need 6-9 months after Royal Assent to set up the National Rivers Authority; and then at least 3 more months before the first flotation(s). Thus Royal Assent in July 1989 implies flotations in Spring/Summer 1990. If you wanted the first sales brought forward to the 1989-90 financial year, they would have to occur by November 1989: budget disclosure problems rule out a later date. You might press Lord Whitelaw on the possibility of securing Royal Assent for the Water Bill by March 1989, so that the NRA could be set up by early Autumn, with first flotations in November. But that is a tight timetable, and Mr Ridley may well say it is impossible.]

Mary Brown

MRS M E BROWN

WATER PRIVATISATION: ALTERNATIVE TIMETABLES

	<u>Legislation in 1st Session</u>	<u>2nd Session</u> (Present assumptions)	<u>2nd Session</u> (Accelerated)
<u>1988</u>			
Jan/Feb	Water Bill introduced		
Autumn	Royal Assent	Water Bill introduced	Water Bill introduced
<u>1989</u>			
Spring	NRA established		Royal Assent
Summer	<u>1st Water sale(s)</u>	Royal Assent	
Autumn	<u>2nd Water Sales</u>		(1) NRA established (2) <u>1st water sale(s)</u>
<u>1990</u>			
Spring		NRA established	
Summer	<u>3rd water sales</u>	<u>1st water sales</u>	<u>2nd water sale(s)</u>
Autumn	[1st electricity sale]	[1st electricity sale]	[1st electricity sale]



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
LONDON
SW1

CH/EXCHEQUER	
REC.	03 JUL 1987
ACTION	FST
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3 July 1987

Dear Nigel,
in the light of
(and) from the X
is now clear
that we
cannot get the
water from
the section. I am
now writing to Parkinson
accepting the June

WATER (POWERS AND CHARGES) BILL

I have seen Nicholas Ridley's letter of 18 June to you and colleagues' subsequent correspondence in particular Cecil Parkinson's letter of 24 June.

Like Cecil I am concerned that the apparent lack of powers on the part of the electricity industry to prepare for privatisation is remedied as soon as possible. I therefore support his suggestion that the relevant part of Nicholas' Bill is expanded also to cover the Electricity Boards both in England and Wales and Scotland and that the expanded Bill be introduced at the earliest opportunity.

I am copying this letter to the Prime Minister, other members of Cabinet, the Attorney General, the Lord Advocate, the Chief Whips of both Houses and Sir Robert Armstrong.

MALCOLM RIFKIND

Ch
NB also papers below,
esp. Mr Parkinson's letter
of 2 July
JDR/K

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- 1. MR MOORE
- 2. CHIEF SECRETARY

FROM: MRS M E BROWN
 DATE: 23 July 1987

*I am sure this is right.
 The 10 WAs are very different in
 character and prospects & we ought
 to look at them separately
 irrespective of privatisation, and
 certainly with it coming.*

- cc Chancellor
 Financial Secretary
 Sir P Middleton
 Mr F E R Butler
 Mr Monck
 Mr Turnbull
 Mr Houston
 Mr Lyne (or)
 Mr Tarkowski
 Mr Parr
 Mr Sharp

JW 23/7.

*18 July 87
 make in final
 contact with
 P...
 Waterhouse,
 who are
 doing a
 grant a
 this with
 Authority
 & New
 privatisation
 Mr*

WATER AUTHORITIES: INVESTMENT AND FINANCING REVIEW (IFR) AND FINANCIAL CONTROLS

We are having difficulties with DoE at official level over

(i) our request that, when they submit their TFR bid (equivalent to the departmental PES bids) at the end of July, they should explain how the bid fits in with privatisation plans for each authority;

(ii) the financial controls which the Government should exercise over the water authorities between now and privatisation.

2. It would be helpful if you could write to Mr Ridley, emphasising that all decisions about the authorities' finances from now on must be taken in the light of privatisation; and that the Treasury will accordingly need to take a closer interest in the finances of the 10 authorities individually than it has done in the past. A draft letter is attached.

Background

(i) IFR information

3. The draft letter is largely self-explanatory. We wrote to DoE officials in June, asking DoE to summarise, as a

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supplementary paper to their IFR bid, their privatisation strategy for each authority and explain how the IFR bid would contribute to that, and how proceeds could be maximised. DoE declined to offer the paper we requested. They said that we were familiar with projections of the authorities' finances after privatisation (true: but these are based on current performance and make no allowances for improvements which could be made before privatisation). They also said that in the IFR they would be arguing that the authorities need more investment, but that charges must be held down. They failed to explain how this scenario would affect the authorities' individual privatisation prospects. They refused to discuss how proceeds could be maximised. Copies of the correspondence are attached.

4. A particular difficulty behind all this is that by unwritten but established practice, the Treasury has, until now, been mainly involved in controlling the water industry in aggregate. But work on privatisation inevitably focuses on the 10 authorities individually, since they will be sold as separate businesses. It seems inevitable that Treasury (at least at official level) must now get involved in decisions about the individual authorities which are taken in the IFR. The 1987 and 1988 rounds will be the key (and for some probably the last) opportunities to get the authorities in best possible shape for privatisation.

5. DoE officials are due to send us their revised IFR bid for the water authorities at the end of July. (The timing and procedures for nationalised industry bids are different from those for departmental PES bids). The draft letter accordingly presses Mr Ridley to ensure that the information on privatisation we have requested is provided in support of the bid.

(ii) Financial controls

6. As explained above, the IFR discussions have in the past taken place on an aggregate basis. The figures have then

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been allocated amongst the individual authorities by DoE with only minimal consultation with Treasury.

7. After last year's IFR agreement we became concerned that there were considerable discrepancies between the control figures which DoE set for the individual authorities (notably the financial target - ie. operating profit as a percentage of net assets - and investment), and the figures which had been common ground in the Ministerial IFR discussions. We were also concerned that a number of authorities had been consistently over-achieving against their financial targets. We suspected that the financial targets being set were not sufficiently demanding, and that, partly as a result, it was too early for some individual authorities to raise an additional slice of revenue and use it for extra investment without proper authorisation. Your predecessor accordingly agreed with Mr Ridley that officials should review the way in which the financial targets and other aspects of the control system were operating.

8. The review has progressed slowly. DoE spent a long time arguing that financial targets should be abolished in favour of a simpler system such as dividend control (which would have involved a major financial reconstruction for each authority). We explained that the present control system is the one which Ministers have collectively agreed should apply to all nationalised industries, and that this has always included those being prepared for privatisation. Controlling dividends or borrowing alone is not sufficient: it leaves the Government with insufficient influence over levels of pricing or investment.

9. We then examined the way in which the present financial control system operates. We (ie Treasury) have identified various weaknesses in the present system, and the main changes we would like to see. The changes are:-

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- tighter control of investment. Unlike other industries, DoE do not set the individual water authorities formal investment allocations. As a result monitoring and control is largely undermined;
- set financial targets at realistic levels - ie. generally at, or above, those achieved in the previous year.
- abolish the system of "balances". An authority which achieves a level of operating profit in excess of its financial target is allowed to carry forward the excess as a notional balance, and set it against the financial target in the following year. Many authorities have simply been accumulating larger and larger balances from year to year. But those which under-achieve against the financial target escape penalty because they can make up the difference by drawing on their balances;
- closer Treasury involvement in the process of setting financial targets, investment allocations and EFLs for each authority individually.

10. We are now ready to put these proposals to DoE. I plan to do that initially at official level. But I expect to make little headway in getting agreement, and we may need to ask you to discuss the proposals with Mr Ridley - preferably before the IFR. I have therefore included a brief reference to the review of financial controls in your letter to Mr Ridley, in order to forewarn him.

Mary Brown

MRS M E BROWN

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DRAFT LETTER FROM THE CHIEF SECRETARY TO THE SECRETARY OF
STATE FOR THE ENVIRONMENT

cc The Secretary of State for Wales

1987 IFR and privatisation

The 1987 and 1988 Investment and Financing Reviews will provide a key opportunity for us to influence the financial position of many of the water authorities before privatisation.

I am sure you will agree that from now on we will need to take all our decisions about the authorities in the light of our privatisation strategy. We want sales which are perceived to be successful; which maximise proceeds; and which contribute to our objective of widening share ownership. We will, of course, be selling the ten water authorities in England and Wales as separate businesses, so our decisions must make sense in relation to each of them.

Against this background, my officials have asked yours to supplement the revised IFR bid (due at the end of this month) with information relating specifically to privatisation. They have asked for your Department's assessment of the present flotability of the different authorities, the steps needed to improve the position of those not at present considered to be viable, and the options for maximising proceeds from all the authorities. They have also asked for your department's assumptions about the possible order of flotations, since that is clearly germane to our plans. My officials have suggested that these questions should be discussed with the City advisers, although they must obviously not be drawn into the IFR negotiations per se.

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I am surprised to learn that your officials have declined to provide the paper requested. They have taken the view that there is no more to add to the work which has been done so far by a DoE-Treasury group on the water authorities' finances. They have specifically declined to discuss how proceeds may be enhanced. This does not seem to me satisfactory. The financial work so far has, I understand, been concerned with projecting the authorities' finances after privatisation. In the IFR, we will be concerned with their finances before privatisation. I do not see that you and I can have a sensible discussion in the IFR without considering our privatisation strategy - which must clearly be built on a separate strategy for each authority - and how your IFR bid fits in with that.

In particular, we need to consider what must be done to get the weakest authorities into a flutable state, and the probable timescale. I understand that the modelling work confirms that some authorities are now in a flutable state. But I understand also that your officials consider that additional investment may be needed in the water industry. If you feel such a proposal is justified, I will of course need to know how it would affect flutability and proceeds. I will also want to discuss how you propose to maximise proceeds from this privatisation. In this respect we should consider in particular the position of authorities which are likely to be sold first. Quite apart from our common goal of privatisation at an acceptable price, you will appreciate that the timing of individual sales will have a significant effect on their public expenditure provision, which I shall have to take account of.

I hope, therefore, that the additional information which my officials have requested will be provided either at the time the revised IFR bid is submitted, or as soon as possible thereafter.

Review of financial targets

You agreed with John MacGregor after last year's IFR on a review of the operation of the financial target and other

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aspects of the financial control framework. My officials are writing to yours with proposals arising from this review. They have a bearing on the forthcoming IFR, since they suggest some tightening of the way the present control operate. I hope we can reach agreement on them in good time before our IFR discussions in the Autumn.

I am sending a copy of this letter to Peter Walker.

J M

CONFIDENTIAL



Department of the Environment

Room A421

Romney House 43 Marsham Street London SW1P 3PY

Telex 22221

Telephone Direct Line 01-212 6100

Switchboard 01-212 3434

GTN 212

Mrs M Brown
HM TREASURY
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

26 June 1987

Dear Mary,

IFR 1987 AND WATER PRIVATISATION

Thank you for your letter of 9 June.

2. I am glad you see this coming IFR round as an important opportunity to influence the authorities' financial and trading position in the run-up to flotation. We do too, and we have had privatisation considerations very much in mind from the earliest stages of our thinking about this year's IFR. For instance, the paper on the financial target system which we prepared earlier this year drawing on the views of our privatisation advisers, pointed out that the traditional approach to the setting of targets would at best be of limited relevance to investors on flotation: and it is a pity that our exchanges with you following that paper did not make more headway.

3. I think however that subsequent work in the Financial Assessment Committee (a draft report on which is now with Martin Lyne for comment) has largely confirmed the view we took at the time of the way in which the markets would assess the prospects of the WSPLCs. This would be based on the projected movement of operating profit and dividends with an eye also to gearing ratios and interest and dividend cover and looking beyond the accounting numbers, to factors such as quality of management, potential future obligations on the undertakers, the extent to which existing obligations were being complied with, and what could be ascertained or guessed about the intentions of the regulator.

4. Two potentially problematic categories of authority have been identified on the basis of necessarily simplifying and artificial assumptions: those with an excessively high ratio of investment to turnover which would unduly depress starting levels of profit and dividend (North West, South West, Wessex) and those with an embarrassment of surplus cash for which the market would be disinclined to give full credit, either because it was judged unlikely to be allowed to persist or because the company was

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thought unlikely to be able to put it to best use (Northumbrian, Severn Trent, Thames and Welsh). We noted also for further analysis another potential difficulty: a sharper divergence than might have been expected between the HCA and CCA numbers for certain authorities.

5. Some of the forms of corrective action which it will be open to us to take fall outside the scope of the IFR. In particular, and subject to a variety of constraints, it will be possible to differentiate between the individual WSPLCs in terms of their initial capital structure and their permitted level of charges increase for the first quinquennium; and action to strengthen management is being pursued separately. Other matters, again, are largely outside our control: prospects for growth or decline in demand and investment requirements arising from past neglect of the asset base or existing or impending statutory obligations (though we can and will continue to encourage the development of systematic and cost-effective strategies for dealing with these). Other things being equal, however, we would wish to take advantage as far as possible of this and the next IFR rounds (and a third, if there is one, completed before flotations can begin) to redress some of the present financial imbalances between the authorities.

6. As we have argued before, we consider the way that the system of financial targets has operated in the past to be positively unhelpful in this regard. Investors will not be interested in the undertakings' rate of return on CCA net assets, as opposed to the return the expected dividend stream will offer them on their own money; and use of the former measure ignores the wide differences in indebtedness between authorities which are of crucial importance to their financial health. For as long as it is retained, we are left with an unpalatable choice between a policy of 'convergence' between the targets set for each authority, which would serve only to widen the differences between their financial profiles, and a policy on differentiation in the interests of reducing present financial imbalances, which would be extremely difficult to explain and defend in public and to Parliament. I very much hope that we can now persuade you of this.

7. As regards investment our room for manoeuvre is limited, as I have explained. As it happens, the latest corporate plans already show some substantial differences between authorities' medium term intentions and the figures assumed for purposes of the FAC modelling work: on this basis, Wessex in particular looks to be a more easily flutable proposition and Severn Trent now appears less likely to generate an embarrassingly large cash surplus. But of course the plans need critical appraisal. They are to some extent in the nature of bidding documents and there are certainly, as usual some items in this year's crop of plans for which the authorities have failed to make a convincing case.

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8. On the other hand, there is disturbing evidence that, in the interests of keeping their charges down, authorities are neglecting aspects of their existing statutory obligations to which they believe their customers attach low priority. This applies in particular to discharge consents. By the end of the plan period, authorities seem to envisage that large numbers of their sewage treatment works would still be in breach, despite the fact that many consents were revised quite recently in the light of the performance the works in question were judged realistically capable of achieving. This cannot be a defensible position for prospectuses, and the successful prosecution of Thames for breaching the terms of their consent for the Aylesbury Works (which post-dated authorities' 1987 plans) has set a precedent which could be followed many times. Nor do we think authorities are yet taking sufficiently seriously and urgently our recent re-interpretation of our obligations under the Bathing Water Directive. I believe we have to get the authorities first to show that they have the finances to get out of these difficulties, in the shortest possible timescale: no other scenario is going to be tenable in the run up to privatisation.

9. We cannot come to any conclusions until the end of the corporate planning round and even these will be subject to further adjustment in the light of the longer-term projections we have commissioned for submission with next year's plans. But our present feeling is that, in aggregate, authorities are under-stating rather than over-stating the investment required to put their houses into demonstrably good order in the run-up to flotation.

10. As regards the level of charges, there will of course be a political judgment to be made as to the right balance between customer interests and the maximisation of proceeds for the Exchequer. But some authorities already look to be perfectly flodable with charges at their present real level, or even below it, while a further real increase would be one means of helping to get others into a readily marketable state. Some of the authorities concerned, and indeed Ministers, may however be reluctant to contemplate this after the sizeable increases of recent years, particularly where the quality of service currently provided falls some way short of the standards which have come to be expected elsewhere and we should bank on securing only very modest steps in this direction within any one year.

11. I do not think it would be either practicable in the present state of knowledge or appropriate to the nature of the IFR exercise and to the role of the Treasury in that process for us to prepare a paper for you on the lines you suggest. But it is already clear from the FAC work which authorities, on the assumptions used, are the strongest and the weakest flotation candidates; the corporate planning round will enable us to adopt more realistic assumptions for the first few years and thus to refine that assessment;

and it will be possible, subject to what I say above about financial targets to differentiate helpfully between the authorities in the decisions we take. I have no reason to think that it will be impracticable to bring any of the authorities to a flutable state within any realistic timetable for completion of the exercise, through our decisions in successive IFR rounds and, where necessary, the other measures open to us.

12. I think I must decline also your invitation to consider 'the most practicable options for enhancing proceeds above the 'flutable' level'. The policy of privatisation will not be defensible to parliament and the public if it is seen to entail an increase in charges to the customer, before or after flotation, going well beyond the level required to sustain the viability of the undertakers in the private sector; besides, the indications from Schroders work so far are that the law of diminishing returns would soon set in.

13. I am copying this letter to Len Taylor.

*He - -
He
at bank
charge
after
Mistaken*

Yours ever,
John

J A L GUNN



MES

Mr Moore
Mr Houston
Mr Tarkowski
Mr Lyne
Mr Parr
Mr Sharp

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-270 3000
Direct Dialling 01-270.....4640

J A L Gunn Esq.
Department of the Environment
Romney House
43 Marsham Street
London SW1

9 June 1987

Dear Mr Gunn

IFR 1987 AND PRIVATISATION: WATER AUTHORITIES IN ENGLAND AND WALES

We have received Tim Roberson's letter of 26 May enclosing the initial bid for the water authorities, for which many thanks.

2. If a Conservative Government were returned after the Election, Ministers would want to consider the authorities' spending plans in the light of

(i) their commitment to privatise the authorities as soon as practicable in the next Parliament; and

(ii) overall public expenditure policies and constraints.

3. As I mentioned to you last week, it would help us if you could let us have your thoughts on the strategy required to prepare each authority for privatisation, and how the IFR bids fit in with this. Clearly an exercise of this kind is beset with uncertainties. Some (eg. the timing of privatisation) should be resolved in the next few weeks. Others (eg. capital investment requirements) will continue for many months. But a good deal of modelling and financial assessment work has now been done, and this must be put to the best possible use in the coming IFR discussions. For at least some of the authorities, the 1987 and 1988 IFR rounds could well be the Government's last opportunity to guide their financial and trading position before privatisation.

4. I attach a note of the points we would like you to cover. I fully appreciate the difficulty of answering some of them at this stage. On the other hand, we had, until Easter, been

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planning to float the first authority or authorities in November/December 1988; and Ministers will be entitled to expect the thinking about IFR changes to be meshed in very closely with thinking about the privatisation of each authority. We must, I am sure, have a view - however preliminary - on each of the points indicated.

5. It would seem sensible to involve Schrodgers (and possibly Touche) in the preparation of the paper: indeed, they have already done a good deal of the ground work in assessing each authority's present readiness for flotation. We would like to have Schrodgers' views on how best to use this year's IFR to progress each authority towards privatisation. At the same time, we must clearly avoid compromising the advisers' objectivity by allowing them to become involved in the IFR bidding process itself.

6. Perhaps the best way forward would be for you to prepare an initial paper, which we could then discuss with the advisers in a sub committee of the FAC. I would see the paper being the basis for further work beyond the IFR, as our financial information and modelling is refined.

7. On timing, revised IFR bids are due at the end of July and we should clearly have the final version of your paper as a supplement to your revised bid. I should like to suggest that you let us have an initial draft by the first week in July (if necessary focussing on the privatisation strategy for each authority, with revised IFR numbers only so far as is possible). We can then discuss it with you and Schrodgers before it is finalised and before people disappear on summer holidays. This is a tight timescale, but since you will no doubt have been giving thought to these questions yourselves in preparation for the IFR, it should not be impossible.

8. Do let us discuss if you would like to.

9. A copy of this letter goes to Len Taylor at the Welsh Office.

Yours sincerely

B. Kitchener
MRS M E BROWN

ee

CONFIDENTIAL

R 1987 AND PRIVATISATION: WATER AUTHORITIES

GUIDELINES FOR DoE PAPER

Assumptions

1. The privatisation objective for each authority is to achieve the perception of a successful sale and to maximise proceeds within the agreed timescale, consistent with Ministers' policies for wider share ownership;

2. Timing: in case the timing of water privatisation is not rapidly resolved, it may be necessary to prepare the paper on two alternative assumptions:

(a) first flotation(s) summer 1989; last flotation(s) December 1990;

(b) first flotation(s) summer 1990; last flotation(s) December 1991.

3. "Flotability": FAC discussions of how flotability is defined are still in progress. You will probably want to rest on Schrodgers' advice on what constitutes basic flotability, whilst recognising that steps can be taken to boost proceeds above this level.

4. Other financial assumptions: the best currently available including a 50:50 debt equity ratio (although we recognise the many shortcomings at present);

Individual authorities

We would like information on the following points in relation to each authority:

1. On present projections is the authority flutable within the timescale assumed?

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2. If not, what do you see as the main options for adjusting real charges, operating costs and investment in order to make the authority flutable within the timescale? What would be the consequences for external finance?
3. In the light of (1) and (2) would you regard the authority as a candidate for privatisation early, mid-way or at the end of the suggested 18 month period in which flotations will take place?
4. For each authority, what do you consider to be the most practicable option(s) for enhancing proceeds above the "flutable" level implied in (1) and (2) above?
5. What does the IFR bid contribute to achieving flotability? (Please indicate as specifically as possible how proposed changes in particular items, including operating costs, investment and charges, affect the assessment of flotability).
6. Do you foresee any major changes in the authority's financial position being proposed in the IFR rounds beyond the present one (eg. for metering) which would significantly affect the flotability assessments? If so, could you indicate (however broadly) what further adjustments might be needed, and when, to ensure that the authority was still flutable by the target date.
7. Are there any other particular factors affecting this authority which Ministers should bear in mind during the 1987 IFR discussions?

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ASB/c.c. Chancellor

FST



Sir Peter Middle

Mr Butler

Mr Monk

Mr Scholar

Mr Moore

Treasury Chambers, Parliament Street, SW1P 3AG Mrs Brown

Mr Tarkowski

Mr Parr

Mr Sharp

Mr Cropper

Mr Tyrie

The Rt Hon Nicholas Ridley AMICE MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London
SW1P 3EB

19th November 1986

Dear Nicholas,

WATER AUTHORITIES: RETURN ON ASSETS ORDER

Thank you for your letters of 11 and 18 November.

As you know, I was surprised to learn that the financial targets proposed in your letter of 11 November implied an average rate of return for the water authorities in 1987-88 of about 1.8 per cent and a likely increase in charges averaging about 2.5 per cent in real terms. It had been common ground between us in the IFR bilaterals that your bid implied an average rate of return of 1.9 per cent and a real increase in charges of 3 per cent. I understand that you have relaxed these assumptions, in part at least, by reducing the proposed levels of investment by the water authorities below the levels indicated by the EFL which we agreed in October.

I am glad that our officials have now been able to identify a means of restoring the financial target close to the level we had previously assumed. I am content with the revised proposals in your letter of 18 November, averaging 1.875 per cent. However, I share your concern that the present targets policy is operating in a less than satisfactory manner, and has apparently ceased to provide the real incentive and discipline which Parliament and the public expect. My agreement to the targets this year is accordingly conditional on the thorough review of the present system for setting the water authorities' financial targets, including the carry-forward of surplus balances between

on this we agreed on your proposal has reported is!

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financial years. This should be completed before next year's
11R.

I am also concerned about the effect which the present system may be having on the authorities' approach to budgeting and capital investment. I have asked my officials to take this into account when they consider with your officials the performance aims for 1987-88 and the following two years, and in monitoring actual performance against the aims. We also need to ensure that the authorities maintain a disciplined approach to capital investment. I understand that you are currently expecting investment to be around £960 million in 1987-88, though we have still to agree on firm investment plans. It is important that the water authorities should not exceed these plans unless specifically authorised to do so by the issue of revised capital expenditure approvals, and I trust that your Department will be keeping a careful eye on this. I think this is also an area which our officials should look at in the review which you have proposed.

Finally, I understand your reluctance to be seen to impose substantial price increases on the water industry in the run up to an election. Nevertheless, in order to prepare the authorities for privatisation some tough decisions will need to be taken on charging levels. (For instance, your officials asked us to make clear in the paper on ERDF receipts which I have just sent to the Prime Minister that the North West Water Authority will need real price increases of about 10 per cent to make it floatable - and more if ERDF receipts ceased after privatisation). Assuming the most rapid timetable, there could be only one more round of price increases after 1987-88, before the first water authorities were floated. I take it, therefore, that you are prepared for charges increases in 1988-89 to be as high as the requirements of privatisation indicate, and to recoup any of the ground lost this year. I should be grateful for your confirmation on this point.

I am copying this letter to Nick Edwards.

Yours etc,
JH

JOHN MacGREGOR



A328

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:
Your ref:

The Rt Hon John MacGregor
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1

CHIEF SECRETARY	
DATE	18 NOV 1986
FUNCTION	Mr Tackowski
COPIES TO	CX FST St Peter Middleton
	Mr Butler Mr Anson
	Mr Mowbray Mr Hartley
	Mr Mans Mr Scholier

18 November 1986

Mr Turnbull Mrs Brown
Mr Norton Mr Pirie
Mr Cooper Mr Tyrrie

Dear John

WATER AUTHORITIES: RETURN ON ASSETS ORDER

Since I wrote to you on 11 November, there have been discussions between our officials about your desire to see a higher average target rate of return than I had proposed for the water industry as a whole.

I must emphasise that I am not prepared to do anything which would result in higher increases in charges than those mentioned in my previous letter. Nevertheless by calling on the balances available to particular authorities, (these are a result of past, over-achievement), it is possible to raise the average of the targets from just over 1.8% to 1.875%, at the cost of a wider spread. The individual figures are then as follows:

Anglian	2.10%	South West	1.95%
Northumbrian	2.05%	Thames	1.85%
North West	1.75%	Wessex	1.75%
Severn Trent	1.95%	Yorkshire	1.70%
Southern	1.75%	Welsh	1.95%

Your officials have intimated to me that such a package would be acceptable. I propose therefore to incorporate them in the Order and aim to ensure that it can be laid early next week.

It is quite clear to me, from this episode, that the present targets policy is operating in a less than satisfactory manner. I hope that you will agree, therefore, that as soon as the present Order is laid our officials should get together to prepare proposals for a different approach to financial targets in future years. They will need to bear in mind our privatisation policy, and the need for targets which are compatible with the financial viability required for flotation purposes.

/ I am copying this letter to Nicholas Edwards.

Yours ever
Nicholas

NICHOLAS RIDLEY

M, Thanks.
I expect the ex would value
a sight of this.

FINANCIAL SECRETARY

A. 23.11.

67.30/9
FROM: MARK CALL
DATE: 22 SEPTEMBER 1987

cc Mr Moore
Mr Tarkowski
Mr Cropper
Mr Tyrie

ECONOMIST CONFERENCE ON WATER PRIVATISATION

I attended the Economist Conference on privatisation of the water supply industry on Friday, 18 September. This was a well attended conference at which most of the industry participants were represented, and adequate time was given for questions and discussion in addition to set piece speeches. Press coverage of the conference unfortunately failed to separate self-interested staking of ground by, for example, the Water Authorities from discussion of principles. I certainly believe we could put over positive aspects of the National Rivers Authority more effectively.

Issues raised

2. To give you a feel for the kind of debate we can expect of water privatisation, I list below some of the issues raised at the conference.

Should the WS plc's have the freedom to act commercially abroad? (Raised not surprisingly by Roy Watts of Thames Water).

Will the mechanism for reviewing and approving price increases be designed so as not to discourage WS plc's from improving profitability and hence raising share price?

Is the "RPI minus x" formula the right one, and if so, what would be in the "basket"?

How good is the information on the condition of underground assets?

2/34

19/200

Are the current levels of charges sufficient to meet future capital expenditure requirements?

Will tight regulation on dividend policy continue to be necessary to ensure WS plc's invest in a long term programme of asset renewal? (Perhaps necessary to stop a short term acquiror buying a WS plc, stopping capital expenditure to boost dividends and hence share price, and then cashing in).

Would WS plc's be allowed to introduce economic tariffing, charging more in areas of high cost, thus correcting the current cross-subsidisation there is in the universal tariff structure?

Would WS plc's be required to maintain a universal service provision within their territories, or could they sell off or cease to supply deficit making areas?

Should "customer shareholders" be favoured in share allocations when the Water Authorities are privatised?

Can effective measures of levels of customer service be devised and systems for monitoring these over time be developed?

What would be the extent of the liability of the WS plc's in the event of a cut of supply and consequent damage caused to customers?

What recourse would WS plc's have in the event of damage caused to them by negligence on behalf of the NRA in monitoring the environment?

Mc

MARK CALL

Wf. with other ppl
30/9

FROM: MARK CALL
DATE: 24 SEPTEMBER 1987

FINANCIAL SECRETARY

*This has a
strong
regulation
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or*

cc Chancellor
Mr Moore
Mr Tarkowski
Mr Cropper
Mr Tyrie

*RPL-2,
or some
how complex?*

ECONOMIST CONFERENCE ON WATER PRIVATISATION

You refer to my note on the issues raised at The Economist Conference on water privatisation, and query the suggestion that dividend control might be necessary to ensure WS plc's invest in the long term replacement of underground assets. I noted the question as one raised at the conference rather than my own concern. I believe that dividend control would negate many of the beneficial effects of privatisation and would therefore be most undesirable. In this note I develop the argument underlying the point raised at the conference a little further in answer to your query.

2. If price based regulations (such as RPI minus x) are introduced to prevent the abuse of local monopoly power, a WS plc can only boost profitability by reducing costs. In that it is encouraged to reduce operational costs, this is good. It may also be tempted to cut back on capital expenditure costs, so reducing the depreciation burden. It is here that the problem arises in some people's mind.

3. The crux of the matter is the difficulty in assessing the condition of underground assets and the long replacement cycle. If it is difficult for the water supply companies themselves to gain an accurate picture of the condition of these underground assets, it is virtually impossible for an external observer to gain such information. Thus a WS plc may be tempted to cut back on renewal of underground assets to boost short term financial performance, thereby burying a problem of heavy future capital investment requirement. This has potentially damaging implications

for both consumers and those companies wishing to acquire a WS plc.

4. Lets assume that the effects of deteriorating underground assets on quality and customer service levels can be measured and corrections/containment enforced by regulation. However, such deterioration in service would not become apparent for many years due to the long investment cycle, leading to concern voiced at the conference of the potential misbehaviour of a predator company. The argument goes that a company buys a WS plc, cuts back on capital expenditure in order to boost dividends, the share price rises accordingly and the company sells out at a profit, the premium effectively robbing the new owners of the amount equivalent to the underinvestment. In other words, the acquirer would have paid over the odds given the condition of the assets, the value of which he was unable to determine with any accuracy. My own view is that the principle of "buyer beware" should operate here as elsewhere, and that methods of monitoring the condition of underground assets and the resulting databases will improve to meet this need.

5. Accordingly, WS plc's and others in the water supply industry should be trusted to behave responsibly and regulations should focus on safeguarding standards of service to customers. The risk of the above problem arising would be reduced if the WS plc's had significant local shareholders, whether companies or customer shareholders.

6. It might be interesting to know whether any problems of this type were experienced in the United States.

Mc
MARK CALL



Handwritten signature

FROM: J M G TAYLOR
DATE: 7 October 1987

PS/FINANCIAL SECRETARY

cc Mr Moore
Mr Tarkowski
Mr Cropper
Mr Tyrie
Mr Call

ECONOMIST CONFERENCE ON WATER PRIVATISATION

The Chancellor has seen Mr Call's minutes of 22 and 24 September. He has commented that the issues raised in Mr Call's minute of 24 September have a bearing on the regulation formula used: ie whether it should simply be RPI - x, or something more complex.

Handwritten signature

J M G TAYLOR

Thames Water

From the office of the Chairman,
Roy Watts.

Date 14th October, 1987.

34 Smith Square,
London SW1P 3HF.
Telephone 01-222 4291

Ref:

cc: P3/F35
Mr Monk
Mr Moore
Mrs Brown
Mr Tarkowski

Rt. Hon. Nigel Lawson, MP,
Chancellor of the Exchequer,
H. M. Treasury,
Parliament Street,
London,
SW1P 3AG.

Handwritten in red ink:
Roy Watts, no copy - psk.

Dear Nigel

In view of your interest in the proposed privatisation of the water authorities we thought you might like to have a copy of Thames Water's response to the Government's consultation paper proposing the establishment of a National Rivers Authority (NRA).

There have been a number of reports in the press of an alleged divide between the water industry and the Government over the privatisation proposals. We believe that it is very important to emphasise that the Board and professional staff of Thames Water are totally committed to privatisation. They believe that not only will the industry benefit, but more importantly, the consumer will see continued improvement.

Whilst we wholeheartedly agree the industry will need proper regulation we do believe that the proposed managerial and operational functions of the NRA will prove both costly and unnecessary as they are already being performed effectively by each authority. A breakup of the current system would reduce the quality of service to all its customers. We hope in the coming months to continue our constructive dialogue with the Department of the Environment.

If you would like any further information please do not hesitate to contact us.

Rayan
Ran



Thames Water

**THE GOVERNMENT'S PROPOSALS FOR A
NATIONAL RIVERS AUTHORITY**

THE THAMES RESPONSE

Thames Water

**THE GOVERNMENT'S PROPOSALS FOR A
NATIONAL RIVERS AUTHORITY**

THE THAMES RESPONSE

**THE GOVERNMENT'S PROPOSALS FOR A
NATIONAL RIVERS AUTHORITY**

THE THAMES RESPONSE

THE THAMES RESPONSE

1. The Board of Thames Water has considered the Government's Consultation Paper dated July 1987 which proposes the establishment of a National Rivers Authority to be responsible for the functions of:-

Water Resources
Environmental Quality and Pollution Control;
Land Drainage and Flood Protection;
Fisheries;
Conservation and Recreation;
Navigation;

these functions currently being the responsibilities of Regional Water Authorities (RWAs). In doing so, it has had the benefit of advice from the Regional Land Drainage, Regional Fisheries Advisory and Consumer Consultative Committees. The comments of these Committees are summarised in **Appendices 2 & 3.**

The conclusions expressed in this paper represent the unanimous views of the Board reached at a special meeting on Tuesday, 6th October 1987.

2. Although many of the issues raised by the Consultation Paper are common to all RWAs, the Board has concentrated on the impact the proposals would have on Thames. It has approached the matter from the standpoint of its customers, its employees and shareholders of a prospective Thames Water Plc. In particular, the Board places overriding emphasis on service to and protection of customers in what is and will remain a monopoly.
3. Thames Water manages its services in a highly integrated manner. Not only do the functions ascribed to the proposed National Rivers Authority interlink with each other, but individually and collectively they are also deeply interwoven with the primary service of water supply, dirty water disposal and the protection of the environment. This total integration in Thames is effective and efficient. It gives a good service to individual customers, to special interest groups and to the community at large. Integration is of specific significance to Thames Water because of its dependence on a single trunk river system, from which it derives some 70% of its drinking water for London.



4. Integrated river basin management is the unique feature of the water industry. Any break up will make Thames Water Plc substantially less attractive to shareholders on flotation. This view is supported by our Merchant Bankers, who state that share-ownership will be less wide in a narrow, utility-based Plc, and the timing of flotation will be put at risk. It is also their view that Thames' overseas commercial prospects will be adversely affected.
5. The Board's view is that any break up of the currently integrated system will reduce the quality of service to all its customers, and will raise the cost of such services both directly and indirectly. For that reason a minimum position of the Board is that it should remain statutorily responsible for those management and operational activities which the Government proposes to transfer to a National Rivers Authority. The Board is convinced that any break up of the integrated system will produce sub-optimal solutions, and will be significantly less effective, in both planning and operational terms, and particularly during emergencies such as flooding and drought.
6. The Board has analysed the various public interest concerns which appear to have led the Government to depart so radically from its original White Paper proposals, but does not consider that the break up of the industry is necessary to meet them. In its view, the fundamental issues of monopoly power, third party rights and public accountability can be met in a responsible manner by a carefully constructed regulatory framework.
7. This analysis of public interest concerns has identified those responsibilities and activities that should remain in the public sector. In the Board's view, the responsibility of a National Rivers Authority should be confined to regulatory oversight of river related functions. In this form, an NRA would address the public concern about monopoly power, and would have a key part to play in setting and enforcing standards and in determining applications for licences by third parties. It should be concerned with the Water Plcs' objectives and standards and the auditing and monitoring of their performance, and should have power to seek sanctions. But it would have no management or operational duties. Those would remain with the Water Plcs. The Board's view is that a National Rivers Authority, in the form Government proposes, confuses regulation with operation and begs the question as to who will protect the customer against the operational activities of such a body.
8. An alternative Thames model is set out in detail in the attached paper, together with an account of the thinking on which it is based. Attached as Appendix 1.

9. Within the regulatory machinery proposed in the Thames model - in which the DoE/MAFF, the National Rivers Authority and the Director General will each have a distinct role to play - there will be every assurance that a Thames Water Plc will act responsibly in its dealing with other bodies. It will be in its own self interest to do so. Moreover, the move to the private sector will bring with it a sharpening of accountability, not least the requirement to satisfy its shareholders in general meeting.

By contrast, a narrow utility-based Plc, as proposed by the Government, would be less sympathetic to the wider interests of water as a whole. Indeed, in a very real sense, the whole concept of the water industry as an entity would be dead.

10. If the Government cannot accept the Thames solution, the Board urges Government to review its decision to privatise the water industry.
11. The Board adds another recommendation. It urges Government to review the divided responsibility for water-related matters between two departments of government, namely MAFF and DoE and, as part of that, urges a review of the financing of land drainage, which would remain a responsibility of Thames Water Plc in the model proposed by the Board.

Thames is by far the largest land drainage authority in the Country and raises one-third of the total precept in England and Wales. It carries out extensive flood alleviation for urban areas, both from fluvial and tidal flooding as well as agricultural drainage management. Thames adopts a progressive approach to land drainage management requiring close integration with related functions. Consistent with its response to MAFF's Green Paper, Thames believes land drainage should be financed direct through the water bill in the same way as the other statutory services.

12. If, however, the Government decides - with or without a review - to proceed with privatisation on the lines envisaged in the Consultative document, then it should frankly acknowledge the extent of the separation it will be introducing into what has hitherto been a fully integrated system. In that event, the Board take the view that a Thames Water Plc would wish to be free-standing in the duties of water supply and disposal, and would see little or no advantage in contracting for activities for which it is currently responsible in the National Rivers Authority area. Contracting back some of the activities in what is now an integrated system would not be in the interests of Thames employees, whose future would be uncertain. Nor would it necessarily be in the interests of a Thames Water Plc, which would wish to use its resources of capital, skills and manpower to its best commercial advantage.

13. On that basis, therefore, if the Government proceed with their proposals, they should work on the assumption that the staff currently attributed to those functions in Thames - including their associated support staff in Head Office functions e.g. Finance, Computers and Personnel - must be transferred wholly to the National Rivers Authority. The number is estimated at 1,400. In such a situation, the staff will need to be counselled, locations established, and terms and conditions set. This will inevitably take time and will cause considerable disruption. There is a danger of a significant decline in employee morale and efficiency resulting from the break up of an Authority in the midst of gearing itself for privatisation.
14. The Board remains a supporter of the privatisation of water. It can claim to be the earliest and most vocal advocate. But it believes, notwithstanding other advantages, that there must be a demonstrably better deal for customers in what is a basic monopoly. The Board has concluded that the Government's proposals will downgrade service to customers, will reduce the attractiveness of the flotation to prospective Thames Water Plc shareholders and will cause major disruption for staff. It is for that reason that it opposes them.
15. It remains firmly of the opinion that the widely acknowledged benefits of the integrated system can be retained within an incisive and effective regulatory framework. In that way, service to customer can be enhanced and not diminished. The onus of proof rests with Government to demonstrate that the benefits of the integrated system are an acceptable casualty of privatisation. No such proof has been forthcoming.
16. The Board recommends to Government its proposals for an integrated approach to privatisation, set out in Appendix 1. It is anxious to work with Government to achieve such a constructive solution that will maintain the highly successful structure of our industry. The Board remains convinced that an effective and successful privatisation, fully supported by the industry, is within grasp.

ROY WATTS
CHAIRMAN
14 October 1987

THAMES WATER: PROPOSALS FOR AN INTEGRATED APPROACH TO PRIVATISATION

1. INTRODUCTION

Thames Water believes that a monopoly statutory service must be regulated in the public interest. In order to exercise that control Government needs to create a regulatory machinery. That is not in dispute. The job of the regulator is to control the activities of those who provide the services, not to undertake them itself. That is in dispute.

In turn a PLC requires a number of fundamental freedoms if it is to operate successfully in a commercial environment. They must allow the freedom to manage in the interests of the customer, in the interests of the employee, and in the interests of the shareholder. If the controls of the regulator remove those basic freedoms privatisation becomes pointless.

Secondly the control system must be as clear and certain as is possible, such that PLCs can manage their affairs that impact on the public interest with the minimum of ambiguity. In order to meet the criteria for commercial freedom Government controls need to be based on the principles of price control, pre-defined quality standards, post-audit and stiff sanctions. But what of the wider public interest?

Thames Water believes that the proper and responsible protection of the public interest across the water services is compatible with the required freedom of management action for Plcs, without eroding the range of activities for which the RWAs are currently responsible. The Government's present proposals cannot reconcile that situation, and in consequence break up the industry as a cohesive entity.

2. THE PUBLIC INTEREST

Public interest in relation to a privatised water industry derives from the following areas of concern.

- MONOPOLY POWER - exercised in relation to specified statutory services for which a natural monopoly cannot be denied.
- POACHER : GAMEKEEPER - the RWA exercises controls over the interests of other water users and commercial interests, and to an extent regulates its own activities.
- PUBLIC ACCOUNTABILITY - the provision of community services from 'community based charges' requires an ultimate public accountability.
- COMMERCIAL SELF-INTEREST - a WSPlc will have to take account of the expectations of its shareholders, this may lead to 'conflict' in the exercise of its public service obligations.

The first three factors are recognised in the exercise of Government controls over the activities of RWAs today. The introduction of commercial self-interest demands that the public control framework is both clear and certain.

An analysis of the areas of public interest condense to the following primary concerns:

- PRICE - This arises from the exercising of a monopoly position in relation to a package of basic community services.
- QUALITY - The comment is the same. The services include public health obligations, and wider community service and environmental implications.
- KEY ASSETS AND RESOURCES - The industry has an extensive network of long life assets, many of which are 'out of sight'. The community cannot allow these to be run down in the interests of shorter term profit.
- UNDUE INFLUENCE - RWAs control the interests of third parties in relation to a number of water rights. They also have powers to police these rights, inspect premises etc.
- COMMUNITY PRIORITIES - RWAs take decisions (usually through consultative processes) on the level of investment and priorities for a range of public good services, for which no direct customer choice can be expressed (eg land drainage, environmental improvement, recreational provision etc).

3. THE THAMES MODEL

The following approach seeks to reconcile the fundamental requirements for commercial freedom with the need to safeguard the public interest. The model places a number of specific duties, or obligations, on the new WSPLCs and requires that bodies in the public sector should:

- (i) set key statutory objectives (eg for river water quality), and act as the competent authority for EEC purposes
- (ii) ensure that costed plans on prescribed community and environmental activities are prepared by WSPLC (eg for Water Resources)
- (iii) set objectives and agree standards which are necessary in the public interest for the protection or improvement of the environment and other community matters. [The Director General Water would be required to take the cost of these into account when considering the financial price control.]
- (iv) oversee WSPLCs performance against such objectives and statutory obligations. [Audit powers backed by sanctions.]
- (v) confirm statutory powers over third parties (eg compulsory purchase orders, byelaws). They should also determine licences for abstractions and discharges, determine prosecutions and continue to arbitrate on appeals

The model set out on the following pages allocates these responsibilities between the existing central government departments (DoE and MAFF), and a new regulatory body, the National Rivers Authority (NRA). It also identifies the role of the Director General (DG).

The model concentrates on those functions which are the subject of the Government's NRA proposals, viz

- Water Resources
- Water Quality/Pollution Control
- Land Drainage
- Navigation and Recreational Facilities
- Conservation Responsibilities

The framework could readily be extended to include the utility services, with statutory objectives (eg for potable water quality), agreed customer standards of service, safeguards relating to long life underground assets, and price control being the essential elements.

WATER RESOURCES

Public Sector

1. Duty to ensure that WSPlcs make proper plans for the conservation, redistribution or augmentation of water resources, having particular regard to:
 - a) the needs of all users equitably,
 - b) the longer term conservation of the resource (NRA)
2. The power to require amendments relating to points a) and b) above (NRA)
3. The power to determine water abstraction licences (on recommendation of WSPlc) (NRA)
4. Determination of appeals on water abstraction licences (DoE)
5. Power to prosecute in cases of over abstraction (NRA)
6. Control of WSPlc expenditure through price control (DG)
7. Confirmation of compulsory purchase orders (DoE)

WSPlc

1. Duty to consult interested parties and to prepare plans for the conservation, redistribution or augmentation of water resources (including water quality considerations)
2. Duty to develop, manage and operate water resources
3. Duty to take all reasonable steps to make water available to statutory water companies to enable them to meet the foreseeable demands on consumers
4. Ownership of water resource assets (land and structures)
5. Duty to make technical appraisal of, and carry out consultations on, all applications for water abstraction licences, and to advise the NRA on them
6. Power to set abstraction charges and to collect them
7. Power to investigate and to recommend on prosecutions
8. Powers of entry for operational purposes
9. Compulsory land acquisition (with ministerial confirmation)

WATER QUALITY, POLLUTION CONTROL

Public Sector

1. Duty to determine statutory natural water quality objectives, having regard to the cost implications (DoE)
2. The power to specify sampling regimes to monitor the quality objectives (NRA)
3. The power to determine discharge consents (on recommendation of WSPlc) (NRA)
4. Determination of appeals on discharge licences (DoE)
5. Power to prosecute for failure to meet discharge consents (NRA)
6. Power to carry out technical auditing of WSPlc, including powers to monitor, sample etc (NRA)
7. Power to interpret and require compliance with EC Directives (DoE/NRA)
8. Control of WSPlc expenditure through price control (DG)

WSPlc

1. Duty to secure compliance with the statutory natural water objectives
2. Duties and powers to prevent and control pollution to include:
 - sampling
 - monitoring
 - analysing
 - inspection
 - taking measures to deal with pollution emergencies
 - the investigation and recommendation upon prosecution
3. To carry out routine sampling to monitor compliance with statutory natural water objectives
4. Duty to make specified data on natural water quality available for public inspection
5. Power to set and collect consent charges (covering planning, consents and monitoring - as with abstraction charges)

LAND DRAINAGE

Public Sector

1. To set national objectives and priorities for grant (MAFF)
2. Duty to ensure that WSPlcs make proper plans for the land drainage and flood defence requirements of its region, having particular regard to:
 - a) the needs of all interested parties equitably,
 - b) national objectives and priorities (NRA)
3. The power to require amendments relating to points a) and b) above (NRA)
4. Duty to audit compliance with approved plans (NRA)
5. Power to determine classification of main river (MAFF)
6. Control of WSPlc expenditure through price control (DG)
7. Confirmation of Land Drainage Byelaws (MAFF)
8. Power to investigate and prosecute for breaches of 1976 Act and Byelaws (NRA)
9. Confirmation of Compulsory Purchase Orders (+ Appeals) (MAFF)

WSPlc

1. Duty to plan and keep under review the land drainage and flood defence requirements of its region
2. Duty to consult interested parties to prepare plans for the land drainage and flood defence requirements of its region
3. Power to carry out 1976 Act powers in relation to main rivers, and default powers
4. Duty to provide flood defence warning systems
5. To design, build and maintain land drainage works
6. Ownership of operational assets
7. Power to recommend on the definition of 'main' river
8. Power to levy a general services charge and to supplement it with direct charges on beneficiaries
9. Power to investigate and prosecute breaches of 1976 Act and Byelaws
10. To determine land drainage licences (subject to appeal to courts)
11. To advise local planning authorities on land drainage issues

NAVIGATION AND RECREATIONAL FACILITIES

Public Sector

1. The power to confirm navigation byelaws (DoE)
2. The power to provide guidelines on the provision of recreational facilities, on water and land adjacent to it (DoE)
3. The duty to audit compliance with national guidelines (NRA)
4. The power to set and monitor customer standards of service (DG)
5. Control of WSPlc expenditure through approval of direct charges (eg boat licences) and setting of deficit financing contribution (DG)

WSPlc

1. The statutory duty to maintain, manage and operate a public navigation
2. To design, build, maintain and own fixed assets for recreational purposes
3. To enforce navigation byelaws (Appeal through courts)
4. To register craft and collect licence fees
5. To determine applications for river structures
6. Duty to put own water rights to best recreational use
7. Power to secure use of water and associated land for recreational purposes
8. Duty to consult on plans for the discharge of navigation and recreational functions

FISHERIES

Public Sector

1. The duty to specify overall objectives and spending guidelines for the improvement and development of fisheries (MAFF)
2. The duty to audit compliance with national objectives and spending priorities (NRA)
3. The power to confirm fishery byelaws (MAFF)
4. Power to investigate and prosecute for breaches of the Act and byelaws (eg serious poaching offences) (NRA)
5. To determine fishery licences (NRA)
6. The control of WSPlc expenditure through approval of direct charges (eg rod licences) and setting of deficit financing contribution (DG)

WSPlc

1. Duty to plan, manage and operate fishery management services consistent with MAFF guidelines, and to consult with interested parties
2. Power to design, build, maintain and own fishery assets
3. Power to investigate and prosecute for breaches of the Act and byelaws
4. To issue rod licences and to recommend on fishery licences

CONSERVATION

Public Sector

1. Power to issue guidelines + codes of practice on conservation matters (DoE)
2. Duty to audit compliance with national guidelines (NRA)

WSPlc

1. Duty to comply with Section 22 of the Water Act 1973
2. To comply with national guidelines + codes of practice
3. Duty to prepare local guidelines and codes of practice

4. CONCLUSION

The allocation of public sector responsibilities within this model is broadly as follows:

- DoE and MAFF - to determine statutory objectives and national standards and spending priorities; to determine appeals, and confirm byelaws and compulsory purchase orders (broadly the existing position).

- NRA - to oversee water resource plans and the exercise of water quality powers, including the determination of abstraction licences and discharge consents and powers of technical audit. To ensure the preparation of proper plans by WSPlcs to discharge their river function obligations, including audit powers; and to oversee and handle enforcement issues arising from river management. The power to seek sanctions (through the DG) would complement these responsibilities.

- DG - to determine price controls and to oversee customer service standards, and to impose sanctions for failure.

In this proposal the water quality role of HMIP has been subsumed within the NRA. The interface and management of those activities is a matter for Government to determine but it is believed that two separate bodies with responsibilities for water quality would confuse the essential clarity of guidance that is required.

The various duties to consult placed on the WSPlcs could be coordinated through committees similar to those currently existing, namely regional land drainage committees, regional fishery advisory committees, regional recreation and conservation committees and consumer consultative committees.

The model provides a balance between the public interest concerns and the need to maintain essential management freedoms. It provides a clear statutory framework within which to act. It retains the practice of integrated river basin management within the Plcs whilst acknowledging the need for high level public accountability. These are the essential ingredients for a successful privatisation of the water industry.

The Views of the Regional Land Drainage and Regional Fisheries Advisory Committees on the Government's proposals for a National Rivers Authority

1. Regional Land Drainage Committee

In considering the Government's Consultation Document on the National Rivers Authority the Regional Land Drainage Committee took account of a paper (Annex "A" hereto) setting out the implications for land drainage.

The Committee agreed to inform the Board as follows:-

"The inclusion of land drainage is fundamental to the maintenance of integrated river basin management. The proposal to place land drainage in a National Rivers Authority has no advantages and many disadvantages for the land drainage service. If this is the only way Government were prepared to consider privatisation, then we must be against it."

2. Regional Fisheries Advisory Committee

The Regional Fisheries Advisory Committee, having considered the Government's proposals, advised the Board that:-

- (a) They continued to have major doubts that privatisation was the way forward for fisheries.
- (b) Whilst there was, in principle, support for the concept of integrated river basin management there were many reservations as to the way water authorities had carried out their responsibilities in relation to fisheries, abstraction and pollution. Experience of common control of sewage disposal and pollution had demonstrated a conflict of duties.
- (c) There was agreement that any "watchdog" body should have effective teeth, and that such a body must be answerable to Government in holding the balance between the public and the PLCs.
- (d) On the question of whether integrated river basin management with a proper "watchdog" body was preferable to split management between the National Rivers Authority and utility PLCs, the majority of the Committee were in favour of split management.

THE NATIONAL RIVERS AUTHORITY : IMPLICATIONS FOR LAND DRAINAGE

1. INTRODUCTION:

The Government's proposals would result in the transfer of the Land Drainage function to a newly created National Rivers Authority. If literally interpreted this would involve the transfer of all land drainage assets, employees, etc. This would have far reaching consequences for the Land Drainage function and these are summarised in paragraphs 2 to 5.

2. OVERALL MANAGEMENT OF THE FUNCTION:

2.1 Regional management of land drainage will remain but the membership of the new Regional Flood Defences Committee will be more widely drawn than at present and their relationship with the NRA will be different to that currently existing with the Thames Water Authority. For example, the NRA will be empowered to give directions to RFDC's where planned works are likely to have an effect on the N.R.A's other river management activities. In general terms this additional influence could infer a much more rigorous national control over work than has been experienced hitherto.

2.2 The NRA will be a body primarily existing to exert regulation and protection over the River systems. Its membership will reflect a minority land drainage interest (probably one member out of twelve) and will almost certainly be biased towards environmental protection. Land Drainage is essentially an operational function and its activities fit in well with Thames Water, which is also fundamentally an operational outfit. Under an NRA regime it is likely therefore the land drainage function could suffer in terms of the importance attached to it and its future development.

2.3 Significant changes in the way the Water Cycle is managed are proposed in the Consultation Paper. However, there are no proposals which actually take the Land drainage function forward. The 1985 Land Drainage Green Paper looked to the possibility of widening current powers to enable work to be undertaken beyond the present 'main river' limits. It also made fundamental and progressive proposals for financing the service and suggested ways of streamlining Committee structures. All these progressive proposals seem to have been forgotten in the latest consultation paper.

3. OPERATIONAL MATTERS:

3.1 Perhaps the greatest dangers inherent in the Government's proposals are that they will 'break up' the practice of integrated river basin management. This will disadvantage all the functions currently managed by Water Authorities and will have a direct bearing on Land Drainage. Some examples of the effects of the proposed break up on the Land Drainage function are as follows:-

- telemetry - there are many common telemetry systems in Thames Water, all of which feed into common computers providing a range of information. The great benefit of these common databases will be lost.
- Land Drainage currently benefits from all the large telecommunications and computing equipment used by Thames Water. If these are lost on privatisation, it is extremely doubtful that an NRA would be able to replicate them with equipment etc. of similar quality.
- in Thames Water's Rivers Division we have a Control Room which controls the River for the purposes of land drainage, water abstraction and navigation. It also makes a major input into general Authority-wide emergencies. This integrated response would be lost on privatisation.
- flood and other emergencies currently involve an Authority-wide response if there are major incidents. Regional transport, the region-wide direct labour force, can all be mobilised at short notice. This extremely important response capability will be lost as a result of the proposals in the consultation document, and emergency communication lines will be further stretched with all the inevitable consequences.
- Thames Water employees, whether they be manual or non-manual, are all responding well to the commercial culture which is developing in the Authority. We are introducing Staff Performance Review systems, paying people by results, introducing better bonus schemes, getting business from outside, etc. There is a great danger all this good work will be lost with employees isolated in a national quango with no Industry-wide cross fertilisation taking place.
- At the moment the Land Drainage function in Rivers Division is supported by first rate 'support services'. These embrace accountants, computer experts, scientists, lawyers, etc. It is most unlikely an NRA could offer and afford such a high level of support and the function, if administered in this way, would therefore suffer.

- 3.2 The consultation paper does contain some very loosely defined proposals for contracting NRA work to the Water Supply Public Limited Companies. These proposals refer to the winning of contracts and NRA discretion as to how much etc. should be awarded. Under these circumstances such arrangements would fall far short of retention for land drainage of the advantages of integrated river basin management. They would also mean, a greater use of contractors generally on riparian owners land with all the attendant problems this has always caused.

4. PLANNING AND STRATEGY:

- 4.1 The way forward in Land Drainage lies in undertaking catchment studies so as to enable us to fully understand the natural drainage of a catchment. This has benefits not only in the preparation of capital schemes, but also in day-to-day operations and on the statutory planning front.
- 4.2 In order to carry out such studies, it is essential to have full knowledge of other operations in a catchment which might affect the natural drainage. In particular, the construction and operation of reservoirs, sewerage systems, abstractions and on-line storage. All these activities are currently controlled by Thames Water. This important strategic link will inevitably deteriorate under the regime defined in the Consultation Paper.
- 4.3 Planning advice on third party applications is also well on its way to being totally integral in Thames Water. The close links between the sewer system and natural drainage channels have been strengthened. Greater separation will inevitably result in sub-optimal decision making.

5. IMAGE:

- 5.1 Concerted efforts have been made in Thames Water over the last few years to promote an image of Land Drainage as a 'progressive, modern, forward looking function'. Customers are becoming more aware of its existence and naturally relate its activities with Water Authorities. The new proposals could change this image of land drainage, making it more remote and less outward looking in its future development.
- 5.2 Integrated river basin management is the envy of the world's water industries and land drainage clearly benefits from this concept.

A Summary of comments made by the consumer consultative committees on the Government's proposals for a National Rivers Authority

1. SUMMARY

(a) The Issue of Privatisation

Although not unanimous, the general feeling among members of the CCCs was that the water industry is an inappropriate candidate for privatisation. South London and Western considered there to be no evidence of advantage to the customer in moving away from the present publicly-owned water authorities. The privatisation of British Telecom and Gas had not provided encouraging precedents. Northern supported Western's resolution that privatisation was not in the interests of the consumer or the environment.

South London considered there to be disadvantages to customers in the need for the Water Services PLCs to raise money to pay dividends to shareholders and that customers would only receive by way of services what they were prepared or able to pay for.

Support was also expressed by Eastern and Southern for continuation of the present organisation of the water industry. South London and Western were particularly concerned about privatisation of a total water monopoly and the absence of alternatives; monopolies did not produce a better deal for customers.

(b) The Proposal for a National Rivers Authority

There was support from both Eastern and Southern for the Board's view that the National Rivers Authority as proposed would be a large and costly quango. North London however recorded its general support for the Government's proposals and believed the arguments in favour of these proposals to be more convincing than those against. Some members of Northern suggested that the Board was overreacting in its response to the Government proposals, and questioned Thames' estimates of cost and size of the proposed NRA.

South London believed that the costs of the NRA would be out of all proportion to the benefits to the consumer and that the organisation itself would add a further layer of bureaucracy. Western was of the opinion that the NRA proposal would give scope for buck passing and duplication. The NRA would have functions which were too far-reaching and would carry an

enormous workload. Fears were expressed by Southern and Eastern that the establishment of the NRA would lead to a reduction in accountability to consumers.

Members of South London saw little positive purpose in having a NRA except in accommodating environmentalists' objections. There was however support in most CCCs for a smaller regulatory body, perhaps along the lines suggested by the Board. Water quality and pollution control were particular areas where a need was identified for a public regulatory body should the industry be privatised.

(c) Integrated River Basin Management

With the exception of North London, the CCCs were in favour of retaining integrated river basin management and passed resolutions to this effect. In the case of North London, the arguments in favour of retention of integrated river basin management were not felt to be completely convincing.

The implications of loss of integrated river basin management on Thames Waters' overseas consultancy were discussed by most CCCs. Western did not believe that there was a need to move to growth business and suggested that overseas activity could be covered by existing consultants.

(d) Consumer Representation

Concern was expressed by Southern that the proposed customer service committee would represent even larger areas than at present, while Northern considered it to be doubtful whether sufficient consumer input would be obtained under the present proposals. North London also believed that the local management structure of the NRA would be ineffective in responding to local consumer and environmental needs and interests, and urged that the new CSCs should be more localised to allow a more effective input by local consumer bodies, industrial users and local authorities. Northern also stressed that representation should be kept as close to the consumer as possible. The proposal for CSCs to be allowed to consult each other was welcomed by North London so as to make for a more effective nationwide consumer voice.

Several CCCs raised the question of local authority representation on the CSCs. Southern commented that if each local authority were not to have a representative on the CSC then a valuable link with the consumer would be lost and accountability of Water Services PLCs reduced. Both Western and Northern in their resolutions stated that local authorities collectively should retain the right to recommend a significant proportion of the membership of CSCs. They further believed that CSCs would acquire a role of much increased importance and should be given stronger powers.

(e) Land Drainage and Non Profit-Making Activities

The role of land drainage and other potentially loss-making functions were considered by the CCCs. Members of Western

considered that it was particularly inappropriate to privatise land drainage and concern was expressed that non-revenue earning functions were likely to fall casualty to profit in the absence of a strong, independent, public regulatory body. Southern supported the retention of certain aspects of the water industry's activities in the public sector. Areas specified included flood relief and drainage, sewerage and sewage treatment, and schemes benefiting large sectors of the community such as the Thames Barrier.

North London CCC urged that the Government should legislate to encourage Water Services PLCs to retain local authority sewerage agency agreements. The NLCCC also believed that in the case of civil emergencies and drought regulations affecting water provision and sewerage, the NRA should be empowered to lay down priorities for Water Services PLCs.

2. REGIONAL RECREATION AND CONSERVATION CONSULTATIVE COMMITTEE

The views of the Regional Recreation and Conservation Consultative Committee are attached as Annex A hereto.

3. FORMAL RESOLUTIONS

The formal resolutions of the consumer consultative committees are attached as Annex B hereto.

**Comments made by the Regional Recreation and
Conservation Consultative Committee on the
Government's proposals for a National Rivers
Authority**

- A. Points made during discussion at the meeting of the committee included:
- (a) concern over the profit motive of WSPLCs and the adverse effects on recreation and conservation interests and that the Government's present proposals were therefore an improvement on their earlier ones;
 - (b) the feeling that Thames Water's proposals were unworkable; the difficulties in setting standards for conservation and other interests was instanced;
 - (c) reference to the relationship between the navigation and water supply functions of rivers; the deficit on navigation accounts could probably be eliminated if water supply costs were properly taken into account;
 - (d) the view that the poacher and gamekeeper role of water authorities had not been particularly effective because the latter aspect had been starved of funds;
 - (e) a general strong feeling that the NRA was in the best interests of conservation, fisheries, navigation and other recreation interests; the unanimous support of all angling organisations for the NRA was mentioned;
 - (f) the view that the NRA would provide a national framework for regulatory functions; more precise information was required as to the impact of regional recreational organisations on the NRA and how the NRA was to work;
 - (g) some members felt too much importance was being attached to integrated river basin management (IRBM) and reference was made to the bad record of water authorities on pollution notwithstanding IRBM;
 - (h) reference was made to land drainage and a view was expressed that IRBM, though not perfect, did in fact work and that it might be better to leave things as they were;
 - (i) the good relationship between Thames Water executives and the RRCCC was voiced;

(j) the general feeling was that privatisation would happen whether or not it was supported; accordingly it was felt that Thames Water should stop fighting the proposals and concentrate on giving constructive advice as to how best to make the NRA work; a strong, effective NRA, with adequate resources was required (a "Rolls Royce" and not a "Morris Minor" model) and Thames Water's objections might have the effect of watering down its effectiveness.

B. The following resolutions were passed:

I. "In the event of the privatisation of the water industry, the RRCCC entirely supports the concept of a National Rivers Authority provided

(i) that it is adequately funded

(ii) that it controls fisheries, conservation, navigation and recreation functions of the present regional water authorities and

(iii) that it maintains the present system of integrated river basin management.

II. The RRCCC urges Thames Water to play a part in the shaping of the National Rivers Authority.

III. The RRCCC agreed that the foregoing resolutions should be sent to the Board of Thames Water and the Department of the Environment."

SUMMARY OF RESOLUTIONS PASSED BY CCCs

EASTERN CCC

"This CCC supports the Board of Thames Water in its attempts to retain integrated river basin management."

NORTHERN CCC

"This CCC has not changed its view that the privatisation of the water industry is not in the interests of the consumer or the environment.

If privatisation proceeds Northern CCC would advocate the retention of the integrated river basin management concept but supports the Government's view that there should be statutory control over the privatised industry's operations. The Northern CCC could however only support a small independent statutory body to do that.

CSCs would acquire a role of much increased importance and should be given stronger powers. The Government appeared to have taken account of many suggestions previously made by CCCs. Local Authorities collectively should retain the right to recommend a significant proportion of the membership."

NORTH LONDON CCC

"While the CCC remains irreconcilably divided for and against Privatisation in general and of Water in particular, on the assumption that H.M. Government will introduce legislation to Privatised Water, it records its general support for the current proposals as outlined in the POLICY AND CONSULTATION PAPER circulated under cover of the Minister's letter of 16th July 1987. It finds the arguments in favour of these proposals more convincing than those against.

It acknowledges that some minor modifications to H.M. Government's proposals may be necessary and asks that responsibility for the safeguarding of the many documents and artifacts of historic interest, at present held by Water Authorities and Companies, be passed to the National Rivers Authority.

We consider the local management structure of the NRA to be ineffective in responding to local consumer and environmental needs and interests, and urge that the new Customer Service Committees be more localised so that local consumer bodies, industrial users and local authorities can have a more effective input. These localised CSCs should also be empowered to discuss, and be consulted on the performance of local WSPLCs and Statutory Water Companies, as well as that of the NRA, in their area. We welcome the proposal for CSCs to be allowed to consult each other, and organise themselves, so as to make for a more effective nationwide consumer voice in responding to the national policies and operation of the NRA.

We believe that in the case of civil emergencies, and drought regulations, which affect water provision and sewerage, the NRA should be empowered to lay down priorities for local water public limited companies.

We also urge that the Government issue legislation to encourage WSPLCs to retain local authority sewerage agency agreements."

SOUTHERN CCC

"This Committee rejects the whole privatisation package if it includes the current proposals for a National Rivers Authority. The package should preserve integrated river basin management, but should also include an independent regulatory body."

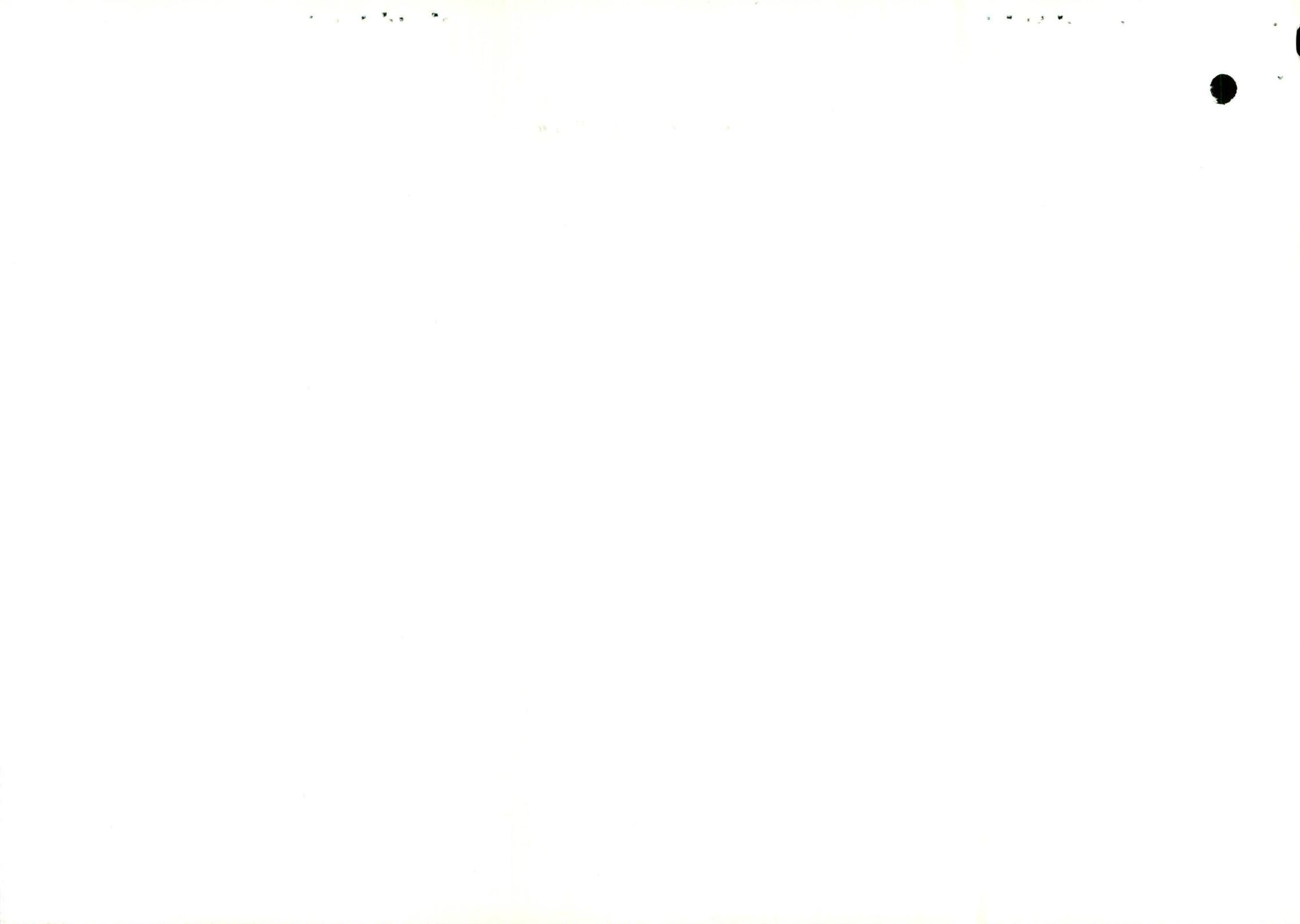
SOUTH LONDON CCC

"The case for privatisation has not been made. If it goes ahead then the version proposed in the 1986 White Paper is to be preferred to the current proposals. South London CCC is consequently opposed to a National Rivers Authority and wishes to see the concept of integrated river basin management retained."

WESTERN CCC

"This CCC has not changed its view that the privatisation of the water industry is not in the interests of the consumer or the environment.

If privatisation proceeds Western CCC would advocate the retention of the integrated river basin management concept but supports the Government's view that there should be statutory control over the privatised industry's operations. The Western CCC could however only support a small independent statutory body to do that."



RESTRICTED

Bf 30/10



FROM: J M G TAYLOR
DATE: 27 October 1987

MR TARKOWSKI

cc: PS/FST
Mr Monck
Mr Moore
Mrs Brown

WATER PRIVATISATION

You should have seen a copy of Mr Watts' letter of 14 October to the Chancellor, enclosing a copy of Thames Water's response to the Government's consultation paper.

The Chancellor would be grateful for a draft acknowledgement (which should give no comfort).

CR
PP J M G TAYLOR

FROM: T TARKOWSKI
DATE: 28 October 1987

CHANCELLOR

*Ch/Content?
OK 28/10*

cc PS/FST
Mr Monck
Mr Moore
Mrs Brown

WATER PRIVATISATION

Mr Taylor's 27 October minute requested a non-committal acknowledgement of Mr Watts' 14 October letter to the Chancellor. I attach a draft.

2. The terms of the attached have been cleared with DOE officials, but there would be no harm in your private secretary checking with Mr Ridley's office that he is content.

Mr Ridley's office said they thought this was OK. (But we could easily drop the second sentence altogether without harm). J

Tancred Tarkowski
T TARKOWSKI

SA3.035.SS

DRAFT LETTER FROM: CHANCELLOR

TO: ROY WATTS

Be type / 2/3

Thank you for sending me a copy of Thames' response to our consultation document on the National Rivers Authority.

[As Nicholas Ridley has made clear, constructive discussion on the right division of responsibilities between privatised water utilities and the National Rivers Authority is welcome.]

[N L]



Paul

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

2 November 1987

Roy Watts Esq
Thames Water
34 Smith Square
LONDON
SW1P 3HF

Roy

Thank you for sending me a copy of Thames' response to our consultation document on the National Rivers Authority.

NIGEL LAWSON

Nigel Lawson



*Bf with advice
or 17/11*

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:
Your ref:

The Rt Hon Nigel Lawson MP
HM Treasury
Parliament Street
LONDON
SW1

CH/EXCHEQUER	
REC.	3 NOV 1987
ACTION	FST
COMES TO	

3 November 1987

Dear Nigel

WATER PRIVATISATION: TIMETABLE

When the Cabinet considered the legislative programme on 9 July, I was invited to consider ways of shortening the period between a water privatisation main bill's Royal Assent in the 1988/89 Session and the first flotation(s). The object was to achieve the latter in the 1989/90 financial year having regard to your own requirement for proceeds, and the need to avoid excessive bunching with the electricity privatisation programme.

I am not yet able to discharge this remit. We are thinking our way carefully through some of the difficult issues involved. Chief of these is to secure a division of the authorities between the new National Rivers Authority and the utility PLCs, as well as taking the steps necessary to float the latter, in the short period available to us after Royal Assent, which we are assuming will be in July 1989. A quick flotation was achieved for example in the case of British Gas, but that did not involve the restructuring which we are proposing for water.

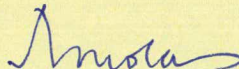
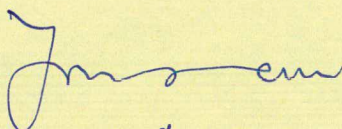
There is one point within your own province which I should register. We understand that you have been advised that no flotation should be undertaken between January and the Budget because of the possible need to disclose in the flotation prospectus budgetary provisions, if they affected companies generally, or the flotation candidate in particular. Allowing for Christmas, and the normal timing of the Budget, this effectively means that no flotation is possible between early December and late March.

We have considered, with assistance from our financial advisers and from Treasury officials, the possibility of a flotation after the Budget, at the end of March. This would be theoretically possible, but it would be undesirable, because the pathfinder prospectus, which will be particularly important in the case of a novel privatisation such as water, would have to be published

before the Budget. Unless we could be sure that the Budget had no implications for the flotation, such a pathfinder could be misleading. I am advised that even including a disclaimer in the pathfinder does not overcome all the legal difficulties. And besides that, the timetable for the closing stages of the flotation, assuming a budget in mid-March, is undesirably compressed.

So we are looking - and I must emphasise this - most carefully, at whether we can so anticipate the work of dividing up the water authorities, vesting assets and functions, and otherwise preparing for flotation that it is possible to privatise part of this industry by early December 1989. That is the main focus of the work we are doing on this at present and I expect to be able to report on it in the next few weeks.

I am sending a copy of this letter to the Prime Minister, other members of Cabinet and to Sir Robert Armstrong.



NICHOLAS RIDLEY



Ch 'X' is wrong. We can, of course
privatise in January (vide BA)

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

The Rt Hon Nigel Lawson MP
HM Treasury
Parliament Street
LONDON
SW1

FINANCIAL SECRETARY
REC - 3 OCT 1987

My ref:
Your ref:

Handwritten notes:
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Sutton!

3 November 1987

MRS Brown
PBS CST
Sir P. Middleton
MR FER Butler Mr Manck
MR D. Moore Mr Bent
MR IGAROWSKI Ms C. Evans
Mr Cropper Mr Tyrie

Dear Nigel

WATER PRIVATISATION: TIMETABLE

When the Cabinet considered the legislative programme on 9 July, I was invited to consider ways of shortening the period between a water privatisation main bill's Royal Assent in the 1988/89 Session and the first flotation(s). The object was to achieve the latter in the 1989/90 financial year having regard to your own requirement for proceeds, and the need to avoid excessive bunching with the electricity privatisation programme.

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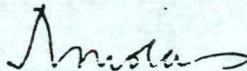
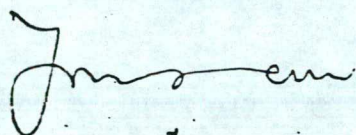
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before the Budget. Unless we could be sure that the Budget had no implications for the flotation, such a pathfinder could be misleading. I am advised that even including a disclaimer in the pathfinder does not overcome all the legal difficulties. And besides that, the timetable for the closing stages of the flotation, assuming a budget in mid-March, is undesirably compressed.

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I am sending a copy of this letter to the Prime Minister, other members of Cabinet and to Sir Robert Armstrong.



NICHOLAS RIDLEY



FROM: J M G TAYLOR
DATE: 5 November 1987

MRS M E BROWN

cc PS/Chief Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr D J L Moore
Mr Bent
Mr Tarkowski
Ms C Evans
Mr Cropper
Mr Tyrrie

WATER PRIVATISATION: TIMETABLE

The Chancellor has seen Mr Ridley's letter to him of 3 November.

2. He has commented that the reply should make clear that it is possible to privatise in January (vide BA). The period is fraught with difficulty, and best avoided if possible, but not unthinkable.

3. He has further commented that, nevertheless, early December 1989 - subject to the views of officials - would be very much better.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR

CONFIDENTIAL

FINANCIAL SECRETARY

FROM: MRS M E BROWN
DATE: 9 November 1987cc Chancellor
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Moore
Mr Colman
Mr M Williams
Mr Lyne
Mr Bent
Mr Tarkowski
Ms C Evans
Mr Call**WATER PRIVATISATION: TIMETABLE**

Mr Ridley was asked at Cabinet on 9 July to consider whether the first water sale(s) could take place in 1989-90. He has sent the Chancellor an interim reply, sounding him out on the possibility of a post-Christmas flotation, and promising a substantive reply in the next few weeks. I recommend you to reply pressing for a pre-Christmas date if possible, but making clear that privatisation plans for 1989-90 and beyond have yet to be firmed up.

2. There are two main considerations: the water privatisation timetable itself; and how it fits in with other privatisations - notably electricity.

Water privatisation

3. The main Bill is due to be introduced in November 1988, with Royal Assent in July 1989. The Gas Bill received Royal Assent in July 1986, and was followed by privatisation in November. However, DoE think this is a very tight timetable for water, because of the need to split each of the 10 water authorities into a utility company (to be privatised) and an environmental agency (to remain in the public sector), and

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then to merge the latter into the new National Rivers Authority. Although the ground can be prepared in advance, much of this has to happen between Royal Assent and the first flotation. DoE's present thinking is that a November 1989 sale may be possible - but they are still working through the detailed logistics. One way of speeding things up would be to complete the legislation before July 1989. We are not sure how seriously DoE have addressed this, and I suggest you ask Mr Ridley about it in your reply.

4. Mr Ridley raises the possibility of an end-March 1990 sale. Treasury Solicitor agrees that we must scotch this: it would mean publishing a pathfinder prospectus before the Budget, which might need to be revised after the Budget. Mr Ridley also asks about a January slot. We have been taking the line with DoE officials that the January-March period should be avoided because of budget disclosure problems. However, the Chancellor has commented that a January slot would not be impossible, and I understand that Sir Peter Middleton agrees with this. But a pre-Christmas date would be safer, and I recommend you to steer Mr Ridley to that if possible.

Privatisation programme

5. We need to know whether a 1989-90 flotation date for one or more water authorities is possible, in order to start piecing together the total privatisation programme in 1989-90 and beyond. But a number of other pieces of the jigsaw also have to be fitted in, and we cannot yet tell DoE firmly that there will be a water sale that year.

6. As Mr Moore reported in his minute to the Chancellor of 8 October, we have proceeds of nearly £3 billion in the bag for 1989-90 (assuming no complications in collecting instalments from BP). The estimate of total proceeds for that year published in the Autumn Statement is £5 billion. The extra £2 billion or so will need to be found from one or more of the following: BT, Steel, Water or Electricity. We are looking further at the options for the timing of the BT sale. Whether it were

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in 1988 or 1989 there could be very large receipts from instalments in 1989-90. Sales of one or more electricity area boards, or possibly of the Scottish Electricity industry, might be possible in 1989-90 depending on the extent of the restructuring of the industry, and assuming legislation in the 1988-89 Session. But it seems more likely that electricity privatisation will start in 1990-91. That being so, it is likely - but by no means certain - that we will want one or more water sales in 1989-90. This could help meet the proceeds target. But, perhaps more important, it would also help to spread out water and electricity sales, which will be competing for slots in the following years. Planning would, however, be complicated if it were not possible to do either BSC or BT in 1988-89. We could then be faced with finding room for BSC, BT and Water sales between summer 1989 and January 1990.

7. It will be useful to ask Mr Ridley how many water authorities could be ready for sale in 1989-90, and what the broad order of magnitude of proceeds might be. Once you have his reply, you will clearly need to have more detailed discussions with DoE Ministers over the coming year on the candidates for early flotation. Work so far suggests one or more of Severn-Trent, Anglian, Southern and (possibly) Yorkshire. We can also consider further how the Water options fit in with those for other sales.

Conclusions

8. Mr Ridley promises his conclusions on timing in the next few weeks, when further work on setting up the National Rivers Authority has been completed. A draft reply is attached, indicating that a late-November impact date would be the safest target, and asking Mr Ridley whether one or more of the authorities could be ready for flotation by that time.

Mary Brown.

MRS M E BROWN

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DRAFT LETTER FROM FINANCIAL SECRETARY TO SECRETARY OF STATE
FOR THE ENVIRONMENT

WATER PRIVATISATION: TIMETABLE

Thank you for your letter of 3 November to Nigel Lawson about the possibility of one or more water sales in the 1989-90 financial year.

I agree that we should not contemplate a post-Budget flotation at the end of March 1990. Turning to pre-Budget slots, we do as you say run into possible prospectus disclosure problems arising from the Budget preparations from January onwards. At this stage I do not think it out of the question to go for a January flotation; but it would be safer to aim for a pre-Christmas date. That effectively means an Impact Day no later than about 20 November, since we have to ensure that the posting of Renounceable Letters of Allotment, following the end of the offer period, is not disrupted by the Christmas post.

On wider considerations, we have as you know published in the Autumn Statement proceeds estimates of £5 billion for each of the next 3 years. We will need to firm up our plans for 1989-90 and subsequent years over the next 12 months. The possible timetables for water and electricity, and how they interact, will be central to this. Irrespective of the contribution to proceeds, it might be useful to have at least one water sale in 1989-90 in order to reduce the risks of a log jam of water and electricity sales in 1990-91.

It will therefore be very helpful to have your conclusions on timing in the next few weeks. In that connection, I wonder if there is any possibility of achieving Royal Assent for the

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main privatisation Bill before July 1989? It would also be helpful to know how many authorities (if any) could be floated in 1989-90, and what might be the very broad order of magnitude of proceeds. This information will greatly help us in planning the privatisation programme and in considering the options.

We will of course need to discuss your conclusions in more detail once they are available.

I am sending copies of this letter to the Prime Minister and other members of the Cabinet, and to Sir Robert Armstrong.

NORMAN LAMONT



CC: PPS
 Sir P. Middleton
 Mr. F.E.R. Butler
 Mr. Marsh
 Mr. Moore
 Mr. Colman
 Mr. M. Williams
 Mr. Lyne
 Mr. Bent
 Mr. Takewski
 Ms. C. Evans
 Mr. Call.

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley AMICE MP
 Secretary of State for the Environment
 Department of the Environment
 2 Marsham Street
 LONDON
 SW1P 3EB

16 November 1987

Dw Nick

WATER PRIVATISATION: TIMETABLE

Thank you for your letter of 3 November to Nigel Lawson about the possibility of one or more water sales in the 1989-90 financial year.

I agree that we should not contemplate a post-Budget flotation at the end of March 1990. Turning to pre-Budget slots, we do as you say run into possible prospectus disclosure problems arising from the Budget preparations from January onwards. At this stage I do not think it out of the question to go for a January flotation; but it would be safer to aim for a pre-Christmas date. That effectively means an Impact Day no later than about 20 November, since we have to ensure that the posting of Renounceable Letters of Allotment, following the end of the offer period, is not disrupted by the Christmas post.

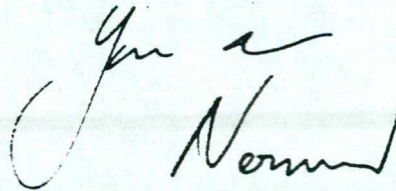
On wider considerations, we have as you know published in the Autumn Statement proceeds estimates of £5 billion for each of the next 3 years. We will need to firm up our plans for 1989-90 and subsequent years over the next 12 months. The possible timetables for water and electricity, and how they interact, will be central to this. Irrespective of the contribution to proceeds, it might be useful to have at least one water sale in 1989-90 in order to reduce the risks of a log jam of water and electricity sales in 1990-91.

It will therefore be very helpful to have your conclusions on timing in the next few weeks. In that connection, I wonder if there is any possibility of achieving Royal Assent for the main privatisation Bill before July 1989? It would also be helpful to know how many authorities (if any) could be floated in 1989-90, and what might be the very broad order of magnitude of proceeds. This information will greatly help us in planning the privatisation programme and in considering the options.

CONFIDENTIAL

We will of course need to discuss your conclusions in more detail once they are available.

I am sending copies of this letter to the Prime Minister and other members of the Cabinet, and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read "Norman Lamont". The signature is written in a cursive style with a large initial "N" and a long, sweeping underline.

NORMAN LAMONT

PPS. pl.



REQUER
19 NOV 1987/11
F-51

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

18 November 1987



Dear Nicholas

I have seen a copy of Norman Lamont's letter of 16 November to you in which he asks if there is any possibility of achieving Royal Assent for the main water privatisation Bill before July 1989.

I can quite see the sense of Norman registering his concern with you early on but there are of course far too many imponderables for any firm assessment to be made, not least what other Bills are to be in the programme in that session and when it will start. The business managers would certainly use their best endeavours to secure Royal Assent on whatever target date was operationally necessary but I have to say that a precondition of those endeavours would be that the bill was ready for introduction at the start of the Session.

I am sending a copy of this letter to the Prime Minister, the members of the Cabinet, the Financial Secretary, Treasury and Sir Robert Armstrong.

V. imp.
A. J. H. H.



LF
miss
H. H.
J. H. H.

Yours
L. H. H.

The Rt Hon Nicholas Ridley MP



FROM: J M G TAYLOR *JMG*
DATE: 23 November 1987

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Mr F E R Butler
Mr Monck
Mr D J L Moore
Mr Colman
Mr M Williams
Mr Lyne
Mr Bent
Mr Tarkowski
Ms C Evans
Mr Call

WATER PRIVATISATION: TIMETABLE

The Chancellor has seen the Lord President's letter of 18 November. He has noted, in particular, the Lord President's view that a pre-condition of the business managers' best endeavours would be that the Bill was ready for introduction at the start of the Session. He has commented that we must press DOE on this urgently: this is very important indeed.

JMG

J M G TAYLOR



CHIEF SECRETARY	
REC.	30 NOV 1987
ACTION	Mr Tarkowski
COPIES TO	AST, CX, Se PM, Mr Moore, Mr Moore, Mr Treasury, Mrs Brown, Mr Sargent, Mr Lyne, Mr Park, Mr Call

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Mr Anderson, Mr Moore,
Mr Moore, Mr Treasury, Mrs Brown
Mr Sargent, Mr Lyne, Mr Park,
Mr Call

My ref:

Your ref: 2

27 November 1987

Dear John

WATER AUTHORITIES IFR

Following our discussions in September, we agreed that the water authorities' external finance limit for DOE services in 1988/89 should be £-10m. This was sufficient to allow investment of £1089m but would necessitate an average increase of 6.6% in charges.

Our discussions on the IFR were based on information obtained from discussions with water authorities about their Corporate Plans over the period from May to July. As your officials are aware the actual allocations to individual authorities have to await the information obtained in October submissions. These submissions update the figures in the Corporate Plans to take account of latest expectations.

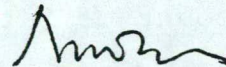
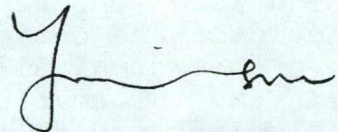
The submissions this year have revealed, I am pleased to say, that revenue is more buoyant than had been expected and that authorities are also doing well with asset sales, with reducing interest charges, and generally with increasing internal resources. They have also done some more work, as we requested following meetings on Plans, to investigate the potential for speeding up compliance with discharge consents. My officials' paper supporting the original DOE/Welsh Office bid explained that some allowance had been made for speeding compliance with the Control of Pollution Act, but that further expenditure could arise if authorities could show that more rapid progress was practicable. Authorities have also been proceeding with the surveys of asset condition which are so important as a preparation for flotation. As a result of this extra work, the authorities have suggested in their October submissions that the correct level of investment should be £1156m. These "Bids" have been examined and there are some instances where the case for extra investment is strong. For example, Southern Water now need to build a new surface water sewer to accommodate the drainage requirements of the Channel Tunnel, a scheme which will be financed by capital contributions by the developers. I also think it desirable to speed up investment on sewage works where this has been shown to be feasible. Yorkshire Water have also shown that it is possible to speed up compliance with their service standards generally. That should certainly help improve their flotation prospects.

After giving due consideration to the figures, I propose to allow authorities to increase capital spending in 1988/89 to £1119m. This can be more than accommodated with the EFL, but I propose to adhere to the average increase in charges of 6.6% which we earlier agreed and to the charges for individual authorities which were given to your officials in October.

This all means that, at present, I shall not need to allocate all of the EFL available to individual authorities. However, I am aware that I am probably going to need to come back to you again to raise investment levels further when we have a clearer view of the impact of the enforcement of EC Directives. I do not wish to allocate the increased investment which will be necessary at this stage, because I shall be anxious to ensure that any extra capital is directed precisely where it is needed. Needless to say, I shall seek to absorb as much within the existing EFL as I possibly can.

To summarise, I hope you will agree that we should allow capital expenditure of £1119m in 1988/89, with corresponding increases to £1199m in 1989/90 and £1312m in 1990/91.

NICHOLAS RIDLEY



CONFIDENTIAL

file ASIS

FROM: T TARKOWSKI
DATE: 3 December 1987

1. MRS BROWN
2. CHIEF SECRETARY

cc Chancellor
Financial Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Scholar
Mr Turnbull
Mr Instone
Mr A M White
Mr Bonney
Mr Lyne
Mr Parr
Mr Call

The present EC standards for drinking water are unacceptably high. It is unfortunate that DOE signed up to these in 1980, and they will now try to relax them. But time is short before privatisation, and considerable extra investment may be needed.
MEB

3/12

Ms Wheldon T Sol

WATER AUTHORITIES: ARTICLE 169 PROCEEDINGS BY THE EUROPEAN COMMISSION

This note reports recent developments which threaten substantial additional costs on the water industry and/or problems when we come to write sale prospectuses. For the time being no action by Treasury Ministers is necessary, but difficult decisions may be needed in the New Year.

The problem

2. The Commission have begun proceedings against the UK by issuing an "Article 169" letter alleging breaches of the Drinking Water Directive (adopted in 1980) on 4 separate counts (details at Annex). Legal advice, now confirmed by the Law Officers, is that the allegations are well founded and would almost certainly be upheld if the matter went to the European Court.

3. The costs of compliance, however, would be very substantial. DOE estimate that the total bill for improving drinking water treatment and supply would be around £1½ billion spread over anything up to 20 years. And although it appears that the legal arguments all point to compliance, there seems to be little or no case on any other grounds. UK drinking water supplies are generally of a higher quality than in a number of other EC countries. There are no medical grounds

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for concern. And no other EC country has complied in full, though the Commission's action has singled the UK out for particularly draconian treatment.

The UK response

4. The obvious response is:

(a) To try to get the Directive changed. DOE are undertaking an urgent study of how the Directive is working elsewhere in the Community in order to gather support; and

(b) To try to persuade the Commission to modify or drop their action.

5. However, both these will take time, which we may not have. It will be essential to have this action out of the way well before the final run-up to privatisation. Defeat in the European Court, or a last minute climb-down would both be seriously damaging to sales.

6. The immediate need is for an initial response to the Commission from DOE. With support from Cabinet Office and the FCO we have persuaded DOE that immediate panic concessions are not necessary, and DOE will now send a response focussing mainly on specific illegalities in the way the UK has implemented the Directive, rather than on the question of practical compliance (see Annex for details).

7. On legal advice, however, DOE will now have to withdraw their current guidance to the authorities on the sampling methods used to test compliance. It will be necessary to agree revised sampling standards, which will inevitably require additional investment. DOE are exploring with the water authorities whether compromise standards might mitigate at least some of the £1 billion or so which compliance with the Commission's strict interpretation would mean. But even if a compromise can be devised, the Commission may not be prepared to accept it.

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Next steps

8. It remains to be seen how far the Commission is satisfied with this response. There will almost certainly be pressure for more action in the New Year. However the Commission respond, we will need to act to remove the substantial uncertainties surrounding the issue. By then, DOE should have a clearer idea of the options open to us, but it remains very likely that additional expenditure, possibly substantial, will be inescapable.

9. We will keep a careful watch on developments and keep you and other Treasury Ministers informed. If it appears that DOE need further prodding we may need to invite you to write to Mr Ridley.

Tancred Tarkowski
T TARKOWSKI

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ANNEX

ARTICLE 169 PROCEEDINGS: DRINKING WATER

Non-compliance has been alleged in four respects. Of these, (c) and (d) are the important ones. The Law Officers have confirmed DOE legal advice that the Commission's complaints would almost certainly be upheld by the European Court.

(a) Legislation is not available to apply the Directive to private supplies

Ministers have already agreed collectively to remedy this in the main privatisation Bill in 1988-89. This is explained in the reply to the Commission. The letter will offer sight of the draft clauses as soon as they are ready. There are costs to the private sector (£10-15 million capital plus £1.5 million running costs) and enforcement costs on local authorities of perhaps £2 to £3 million.

(b) Lead levels in supplies in many parts of Scotland exceed permitted levels. Programmes for improvement must be put forward before the Commission can agree to a delay.

The reply will include a detailed programme and timetable for full compliance. The costs, falling on the local authorities, are expected to be relatively modest. Under the new burdens policy, the Treasury would expect to see them offset within the Scottish block.

(c) The UK has illegally granted derogations for nitrates to exceed permitted levels

The reply will simply note the Commission's view that no derogations can be granted, and say that the UK intends to withdraw them where they can't be legally justified. No commitment will be made on the timescale. The reply also notes that policy on nitrates is currently under review, and that conclusions will be reached in the New Year. Compliance

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would cost an initial £50 million, with a further £150 million over 20 years plus running costs rising to around £ million a year. Action on prevention at source, rather than water treatment, could reduce these costs (by transferring the burden to farmers). The review of policy on nitrates, led by MAFF, may be helpful, but some cost to the Government is almost certainly inescapable.

(d) The UK has issued incorrect guidance on the interpretation of the maximum levels of impurities (etc) permitted. DOE have applied the limits to 3-monthly or 12-monthly averages. The Commission are insisting that they apply individually to every single sample.

The reply will say that DOE are withdrawing their guidance. This will leave the authorities in considerable uncertainty which cannot be prolonged beyond a few months. The costs of full compliance with the Commission's interpretation would be enormous, between £1.1 and £1.6 billion in extra investment over perhaps 15 years, plus higher operating costs of up to £50 million a year. It seems clear that on the Commission's interpretation the standards set by the Directive are impossibly high. DOE do not believe that they are met anywhere in the EC, but the differing constitutional positions of other national water utilities make it harder for the Commission to pursue them. The reply stresses the unworkability of the Directive and calls for an urgent review. But that will at the least take time, and may prove fruitless, and in the meantime we will be under pressure to agree a substantial acceleration in spending.

MR GUNTON

*mgp*FROM: T TARKOWSKI
DATE: December 1987cc PPS ✓
PS/CST
PS/FST
Mr Anson
Mr Monck
Mr Moore
Mr Burgner
Mr Turnbull
Mr R I G Allen
Mrs Brown
Mr Bonney
Mr Lyne
Mr Parr
Mr Call**WATER AUTHORITIES: EC DRINKING WATER DIRECTIVE**

You may have seen that last Sunday's Observer reported the EC's threat to take the UK to court unless we complied with the EC drinking water directive at an alleged cost of £6 billion. It claimed that over 900,000 (Friends of the Earth estimate 4 million) consumers are exposed to health risks including stomach cancer. The Independent of 8 December followed the story up today (copies of both attached). We have agreed the following line with DOE.

Line to take

2. Reports exaggerated. No health risk in any UK drinking water supplies (endorsed by Government's Chief Medical Officer and Commons Environment Committee). UK is investing substantially (over £400 million this year) to improve standards further, in line with the very high standards of the directive, and all water authorities have already made their plans public. Substantial increases in planned investment were agreed this Autumn. Government is in parallel considering further action to reduce pollution from agricultural sources. [IF PRESSED: UK like other Member States is in discussion with the Commission on detailed interpretation of the Directive. Conclusions have not yet been reached but HMG is withdrawing existing guidance. Costs quoted by press are wildly exaggerated].

Tarkowski
T TARKOWSKI

Consumer calls for fair BT contracts

NATIONAL Consumer is added its voice to the demands that British be made contractually if it fails to provide service or to correct faults in a period. Chairman, Sally Oppenheimer, said that the telephone contracts customers are re-cept when they have a line installed are a disgrace. Contracts stipulate that you be obliged to install your promised date or to pairs within a stated Oppenheim-Barnes

believes that instead of its own conditions, a telephone service, dependent of BT, such policies and Mergers or the director-general-telecommunications, are responsible for BT's contracts are stomer.

made its comments in a letter to OfTel, the telecommunications regulator, which has issued a paper on contracts BT.

Ryan Carsberg, director of OfTel, is determined to reduce some form of flexibility and is studying submissions to the

aid that since BT is not a monopoly, consumers must accept what is imposed by BT or the potential for a clearly dem-terms set for cus-it said.

Trode QPR 7.6m

by Kane Staff

TRODE, who has a list of football fans, has announced plans to demolish the old football ground, pouring Queens £7.6m deal.

owns up the way to ensure complex hit City, west would lead to the are offering. aid yesterday: at the general supporters will

Sub-standard water will cost billions to improve

By Jeremy Warner Business Correspondent

THE GOVERNMENT has conceded it has been breaking an EC directive on drinking water quality with the effect that the water industry will have to spend billions of pounds on improvements in the run up to privatisation.

The Water Authorities Association confirmed yesterday that it has been asked by the Department of the Environment to draw up an estimate of the amount of additional spending needed to fall into line with the directive. A spokesman said the new spending programme would have to run to "several billion pounds".

It is almost certain ministers will decide to pass on the extra costs in the form of higher water charges. These are already set to increase sharply in the next two years because of tough new financial targets imposed by the Government on the water authorities to improve their performance before privatisation.

The Environment Secretary, Nicholas Ridley, has decided, after taking legal advice, that the term "maximum admissible

concentration" in the EC drinking water directive should relate to individual samples and not the average over a period of three months which is currently used by water authorities. The directive covers maximum permissible levels for a wide range of pollutants which exist in drinking water.

Mr Ridley made the announcement in reply to a parliamentary question last week but the full implications have only just begun to sink in among industry chiefs. The WAA said the change would require a huge programme of mains pipe refurbishment and improvements to water treatment works.

It also said it had now become essential that the Government give active support to stronger measures to combat nitrate and pesticide pollution from the farming community.

The EC threatened the Government last August with legal action for failure to implement the

drinking water directive after complaints from a number of environmental groups including Friends of the Earth.

Friends of the Earth yesterday lodged another complaint with the EC which claimed that some 49 sources of drinking water have exceeded their legal limit for nitrate since the directive came into force in August.

This is on top of the 46 areas exempted from the legal nitrate limit "because of the nature and structure of the ground". FoE has already complained that these areas have been wrongly exempted and that their high nitrate levels are caused by chemical-intensive agriculture.

Environment ministers are considering a number of initiatives for strengthening and extending water pollution controls. Mr Ridley is expected to make a statement on the new measures before Christmas when he will also be spelling out in more detail the Government's plans for the creation of a National Rivers Authority.

Retail sales rise to record level

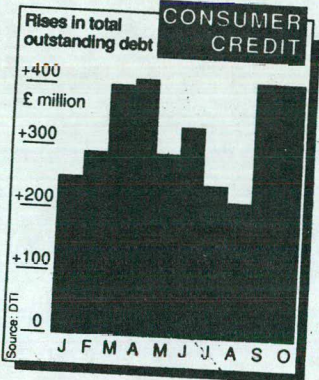
By Steve Levinson Economics Correspondent

CONSUMER confidence has so far been unaffected by the stock market collapse according to Government and retail industry figures published yesterday.

In October retail sales rose by 0.9 per cent to a record level, while credit extended to consumers also rose strongly. More up-to-date information from store group John Lewis showed that in the last week of November the value of sales was 9.2 per cent higher than a year earlier, while food sales were 13.1 per cent up.

The government figures showed that in October the volume of sales was at record levels in food, clothing and footwear, and in mixed-retail outlets. The 0.9 per cent increase in October took the level above the previous peak in August. In the three months August to October sales were 2.9 per cent higher than in the previous three months, and 6.5 per cent higher than a year earlier. In value terms sales in October were 8.6 per cent higher than a year earlier.

Although the Government figures refer to a period which included Black Monday, there is no sign of any slowdown in spending. The demand for credit was also



little changed. The amount of debt outstanding to consumers rose in October by £412m, the same as in September. New credit advanced fell slightly from September's record level but still showed a 6 per cent increase in the latest three months.

Any significant impact from the crash, however, is more likely to show in November's figures. There are as yet no Government figures for this period, but John Lewis reported yesterday that at the end of November sales were brisk. Its returns showed that department store sales in this current financial year were 9.9 per cent higher than last year, against a budget of 9 per cent. Food sales have increased by 12.1 per cent as against a target of 9.5.

SIB extends talks on unit trusts

By Susana Antunes City Staff

THE Securities and Investments Board and the Department of Trade and Industry have met demands from the unit trust industry that the consultation period over rules for the pricing of units be extended beyond one month.

Initially, the DTI will make the rules to ensure that the timetable for implementing the Financial Services Act is adhered to. The DTI can make rules faster than SIB, which would have to go through the lengthy process of drawing up another set of draft regulations.

In essence it proposes that all dealings in units should be done on a future price, which is calculated after an order is received.

Despite industry exhortations that such a system would be unfair to the consumer and difficult to implement, during the first days of the market crash, many managers resorted to forward pricing as they sought to protect their own positions.

The extension will enable a detailed look at "the practical and operational considerations... and give the industry as much notice as possible of the changes it will have to make."

New to

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Be say

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Peter Earl of... nancial advisers... terminated the B... terday passed... opportunity to... deal under the... takeover code.

The terms will... Storehouse accep... falls subject to... Earl said.

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Cocoa

COCOA prices col... day to their lowest... after the Intern... Organisation talks... intervention range... early hours of Sat... which went long on...

U-turn plunges water industry into £6bn crisis

GEOFFREY LEAN ■ Environment Correspondent

ENVIRONMENT Ministers have been forced to capitulate to EEC pressure to cut pollution in water drunk by millions of people in Britain.

Their U-turn will cost Britain's water industry billions of pounds and plunge it into its greatest-ever financial crisis on the eve of privatisation.

Mr Nicholas Ridley, the Environment Secretary, conceded defeat, dismissing it as 'a technical point,' which 'does not have health implications.' In fact he is being forced to reduce the levels of a chemical suspected of causing cancer in the drinking water of four million people, in the face of legal action from the European Commission.

This marks a major victory for Friends of the Earth, which has been pressing the Commission to take action, and removes a cornerstone of Ministers' policy to minimise clean-up action.

It will also compel Ministers to admit far more people are drinking water polluted above the official limits than they have acknowledged.

The issue centres around the interpretation of 'maximum admissible concentrations' for a wide range of pollutants in drinking water, laid down in an EEC directive.

The Commission insists the

pollution should never exceed these levels; but Britain has argued for the past five years that higher pollution is acceptable from time to time, provided concentrations stay beneath the limits when averaged over a three-month period. The EEC has threatened to take Britain to the European Court to force it to comply.

The Government's biggest problem is nitrates, which some scientists suspect set off a chain reaction in the body leading to stomach cancer. The chemicals, mainly from artificial fertilisers used in agriculture, are gradually building up in drinking water.

Nitrate rules

So far the Government has said 'only' about 900,000 people receive water containing more than the EEC's limit, which was set partly to avoid the cancer risk. But now they have to acknowledge the problem is even greater.

Friends of the Earth estimate that another four million people have to drink water which strays above the limit from time to time, and it will now have to be purified. The water industry does not contest the estimate.

The industry says it will cost up to £6 billion—15 times its present annual capital investment in water resources and supply to comply with the new rules over nitrates and other pollutants.

Ministers have made their U-turn because their lawyers told them they were likely to lose the legal action to the EEC.

This could in turn endanger the privatisation programme, because it would have been likely to have come to court just as the first water authorities were being prepared for flotation.

They preferred to concede now and incur the massive costs involved, than to leave the City worried by the uncertainty.

Mr Andrew Lees, of Friends of the Earth, said yesterday: 'The Government is caught between the rising tide of public concern about polluted tap water, a jittery City, and the European Commission's determination to enforce EEC law.'

But the Government, and the privatisation programme, still face grave difficulties over the supplies of the 900,000 people the Government has always admitted receive nitrates above the EEC limit.

The Government has tried to exempt these from the EEC standards. But the EEC insists that this too is illegal and has initiated legal action over them as well.

If it is forced to clean up these supplies, the water industry will have to spend several billion pounds more, casting an even greater shadow over the financial attractiveness of the privatisation package.

Mine of information: Vol...

Call for

A FORMER British military intelligence officer is heading a South African anti-sanctions campaign in London.

Mr Robert Swain, a captain in British Army intelligence until 1984, was recently appointed the director of the South African coal industry office here.

A Labour MP, Mr Richard Caborn (Sheffield Central), yesterday called on the Home Secretary to investigate the operations of the office. 'Swain admits he is closely monitoring the sanctions campaigns of the Anti-Apartheid Movement and the National Union of Mineworkers, and I regard this as spying,' he said.

The South African coal industry set up its first overseas bureau in London last September, only a week after the end of the South African miners' strike. The office is funded by a group of mining

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CHIEF SECRETARY

FROM: MRS M E BROWN
DATE: 9 December 1987cc Chancellor
Financial Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Bonney'
Mr Lyne
Mr Tarkowski
Mr Parr
Mr Sharp**EC DIRECTIVE ON DRINKING WATER**

Mr Tarkowski's minute of 3 December reported on the very considerable additional investment in the water industry which could be required in order to comply fully with EC drinking water standards. The current position is that the Commission have formally alleged that the UK is breaching the Drinking Water Directive. DoE are about to reply, saying that current guidance to the water authorities on water sampling procedures is being withdrawn, and that the water privatisation legislation will give full legal force to the Commission's interpretation of the Directive.

2. It is important that DoE do not give any more ground than they need to. Although there seems no alternative to recognising the Directive in principle, we are pressing the Department to play for time in indicating how they will comply in practice, and to make maximum use of the argument that other European countries seem to get away with less than full compliance.

3. We were rather alarmed to see an Oral Answer by Mr Ridley last week (attached) which was not cleared with the Treasury, and went further than we would have expected. We are writing to DoE officials to stress the need to keep Treasury closely involved in this issue, and asking for information about the proposals which they plan to put to the water authorities about revised water sampling standards.

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4. It would be very helpful if you could write a brief letter to Mr Ridley at the same time. A draft is attached.

May Brown

MRS M E BROWN

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DRAFT LETTER FROM THE CHIEF SECRETARY TO:

The Secretary of State for the Environment

cc Prime Minister
Foreign Secretary
Secretary of State for Trade and Industry
Secretary of State for Northern Ireland
Secretary of State for Scotland
Secretary of State for Wales
Sir Robert Armstrong

EC DIRECTIVE ON DRINKING WATER

When you wrote to me on 27 November you mentioned the action which the European Commission is taking against the UK on the Drinking Water Directive. I have seen the Oral Answer which you gave on this on 2 December. I will be replying separately to your letter of 7 December about nitrate standards.

I know that our officials are in touch about the next steps to be taken, once you have replied formally to the Commission. Since there are potentially very heavy expenditure implications, I should be grateful if you would keep me closely informed of developments, and in particular if you would ensure that I and my officials are consulted before any proposals (for instance on revised guidance on water sampling) are put to the water authorities. As I understand it, your reply to the Commission will indicate that the present guidance is being withdrawn, that the Government intends to withdraw Nitrate derogations and that our privatisation legislation will incorporate the Commission's interpretation of the Directive in principle; but at this stage you will not be offering any practical concessions.

I should add that I think it important that in dealing with this issue we exploit to the full the argument that 100 per cent compliance with the Directive is pretty well impracticable, and

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that other European countries, which also fall short of perfection, are not being pursued by the Commission in the same way. I am sure we must resist giving any commitment to the Commission, or entering any new arrangements with water authorities, which imply that we accept unequal treatment for the UK on this matter.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe, David Young, Malcolm Rifkind and Peter Walker, and to Sir Robert Armstrong.

JOHN MAJOR

capitalised repairs. That is a route that councils such as Bolton should follow. They should also have a look at their rents because they are below the north-west regional average and well below the national average.

Mr. Robert G. Hughes: While the Housing Bill is going through its stages in the House will my hon. Friend look at the possibility of well-organised tenants' associations being given powers to look after their own maintenance and financial delegation in the same way as those powers are given by the Education Reform Bill to governing bodies?

Mr. Waldegrave: That suggestion is very positive. The right of tenants' choice that we are putting forward will give them exactly that kind of capacity. They will be able to organise secondary co-operatives, for example, to do exactly that sort of work. That is one of the attractions of the proposals.

River Pollution

3. **Mr. Allan Roberts:** To ask the Secretary of State for the Environment what action he is taking to reduce the levels of nitrate and nitrite pollution in Britain's rivers.

The Secretary of State for the Environment (Mr. Nicholas Ridley): I am considering a number of initiatives for strengthening and extending water pollution controls and expect to make a statement on the Government's policies in the near future. In due course the National Rivers Authority will be responsible for maintaining river water quality.

As to drinking water quality, I have decided, after taking legal advice, that the term "maximum admissible concentration" in the European Community drinking water directive should relate to individual samples and not to averages over a period. This is a technical point. It concerns the appearance of water supplied and does not have health implications.

Mr. Roberts: I do not accept the Secretary of State's last remark about this being a technical point. It is about the quality of drinking water and this question is about river quality. Will the Secretary of State confirm that over the past few years river quality in Britain has deteriorated because of pollution from sewage, animal slurry and nitrates and nitrites, mainly from agriculture? As well as getting into drinking water and being linked to stomach cancer, these pollutants flow via the rivers into the North sea, over-fertilise the photo plankton, de-oxygenate the North sea and create conditions in which fish cannot live. Will he act on the recommendation of the Select Committee on the Environment and on the recommendation in the final draft declaration of the recent North sea conference of Ministers, to which he was a signatory, to declare nitrate protection zones, or is the Minister of Agriculture, Fisheries and Food still holding up that declaration?

Mr. Ridley: The hon. Gentleman's question is about nitrate levels in Britain's rivers. Nitrate levels in most rivers have remained fairly constant over the past 10 years. Very few water supplies with raised nitrate levels come from river sources. The hon. Gentleman asked about the progress of the North sea conference that I chaired last week. I can tell him that we agreed on a substantial reduction in inputs of nutrients, which include nitrates, in those coastal and estuarial waters where nutrients are a

serious problem. That means the shallow waters off Denmark and Germany and to some extent off Holland and not, on present evidence, British coastal waters. I am certainly considering whether to create nitrate protection zones and I expect soon to come to a decision.

Mr. Budgen: Does my right hon. Friend agree that this is yet another example of the environmental disadvantages of the common agricultural policy? Does he further agree that if farm products were priced at a lower level farmers would no longer find it economically justified to put very large quantities of nitrogen upon their crops?

Mr. Ridley: I am not sure that my hon. Friend is right. I certainly do not think that this is a question with which to put into doubt our membership of the Community, which seems to be what my hon. Friend was doing. As farm incomes decline, I think that the farmer will be tempted to use more nitrates to try to bring about increased production at reduced cost.

Mr. Dalyell: Is the legal advice to which the Secretary of State refers any better than that which is usually given to him?

Mr. Ridley: It is all impeccably good.

London Docklands

4. **Mr. Alexander:** To ask the Secretary of State for the Environment if he will make it his policy to publish a report on the London Docklands Development Corporation's work on regeneration of the London Docklands.

Mr. Trippier: The LDDC itself publishes reports on an annual basis. It is required by statute to lay the annual report before Parliament. The reports have shown tremendous success which has been achieved within the London Docklands area.

Mr. Alexander: Is it not the case that, had it not been for the London Docklands Development Corporation, areas of otherwise very poor and derelict land would largely have remained so—thanks to the inactivity of the various councils that were administering them at the time? Does not the success of the LDDC since then point the way towards the regeneration of many other areas of our inner cities?

Mr. Trippier: That is correct, and it is why I was surprised to hear the amazing statement of the right hon. Member for Bethnal Green and Stepney (Mr. Sheehy) during a debate in the House a few weeks ago to the effect that the massive development in Docklands would have taken place had a Labour Government been in power, which is stretching credulity to breaking point.

Mr. Simon Hughes: Will the Minister ensure that the next LDDC report explains the extraordinary behaviour of the Secretary of State in sacking the vice-chairman of the LDDC, when the main target has gone completely untouched? Will the report explain how it is that 10 weeks ago people such as Mr. Martin Berney could be convicted of the offence of being an unlicensed estate agent in Docklands? Is he aware that the fraud squad is investigating property transactions and sales in Docklands and all sorts of matters which do not feature in the annual report? It does not disclose the sordid money-ma-

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MP

Ch Mr Ridley has now written - see enclosed folders

FROM: T TARKOWSKI
DATE: 9 December 1987

- 1. MRS BROWN (Main letter is behind his 'personal' letter to you) cc
- 2. FINANCIAL SECRETARY *JK*

- Chancellor
- Chief Secretary
- Sir P Middleton
- Mr Anson
- Mr Monck
- Mr Moore
- Mr Hawlin
- Mr Burgner
- Mr Turnbull
- Mr Instone
- Mr Bonney
- Mr Lyne
- Mr Bent
- Mr Parr
- Mr Graydon
- Mr Sharp
- Mr Call

Mr Ridley will be writing shortly to seek quiet clearance for his NRA proposals. This is advance notice. We are generally content, but have pressed DOE to indicate more clearly that they favour maximum contracting-out of NRA work. You may need to take this up if the draft is still woolly.

*Mary Broom
10/12.*

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WATER PRIVATISATION: NATIONAL RIVERS AUTHORITY

Mr Ridley wishes to make a public statement before the Recess on the outcome of consultation on the July consultation paper on establishing a National Rivers Authority. We have now seen the attached draft memorandum which DOE officials expect him to circulate to colleagues formally later this week.

The Proposed Announcement

2. The draft confirms that the Government will go ahead on the basis of the July paper:

- A new National Rivers Authority (NRA) would take on environmental responsibility for river management, including resource planning, fisheries, navigation and flood defence.
- It would be a national body with an executive presence in each region.
- Advisory committees in each region will continue to bring together the interested parties to advise the regional officers of the NRA, but (apart from land drainage) they will have no executive powers. There will be no net increases in the number of committees (but no reduction either: the tally is three per region).

Illegal for them to collect in

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- The regional land drainage committees will continue, as now to have an executive role.

- The NRA will be encouraged to contract out operational and management work whenever appropriate. The document envisages that it will take about 5 years for fully competitive arrangements to be instituted across the whole range of its contracted-out activities.

- Reservoirs (both existing and new) will be for the utilities to build, own and manage.

3. The statement qualifies or elaborates this broad outline in a number of ways noted below. We have already suggested some further improvements which we expect to be reflected in the version to be circulated later by Mr Ridley.

4. On a number of key questions notably contracting-out, and the size of the NRA, DOE's progress has been disappointing, and the statement will not much advance matters. We have suggested ways of strengthening the way these points are handled, but there is bound to be criticism in some quarters that the policy still lacks detail.

Making Progress: a shadow NRA

5. In spite of this, we believe a statement now is essential to further progress. Energies in the water authorities are at present devoted to contesting the allocation of responsibilities, and the role of contracting out. A clear decision confirming the basic principles should re-focus minds and allow DOE to get on with negotiation with the authorities on the detail.

6. This work is now urgent. Establishing the NRA will be a complex operation. The internal structures of the 10 water authorities differ considerably, and in many the "NRA" functions are highly integrated with utility functions. But in Summer 1989 it must be possible to pluck the NRA functions (and staff) out of each authority, and weld them into a new whole, ready to assume instant responsibility for a mass of complicated contractual relations with the 10 utilities, and to assume its statutory responsibilities.

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7. DOE believe that intensive preparatory work must start early next year. We agree. Each authority will need to split out the two sides of its operation, and identify which of its staff and assets will transfer to the NRA. At the same time, the contractual arrangements which will govern the relations between the PLCs and the NRA on abstractions and discharges, the operation of reservoirs and other assets used for more than one purpose will need to be negotiated.

8. It is important that the Government side has sufficient resources to negotiate satisfactory arrangements with the water authorities for setting up the NRA (eg on contracting-out). Because the authorities hold all the detailed information about the work which is to be transferred to the NRA, there is a danger that they will have too much discretion in drawing up the re-organisation blueprint. Government must also take a keen interest in administrative matters such as staff contracts. There will also have to be sufficient consistency in the staffing and structural arrangements in each authority for the merger to create a sensible NRA.

9. For all these reasons a "shadow" NRA will be essential, as in other major re-organisations. The convention is that such shadow bodies are appointed when the legislation gets its Second Reading. DOE believe, and we agree, that this will be much too late if the NRA is to be established immediately after Royal Assent in Summer 1989, with a first sale a few months later. Accordingly they propose to appoint a "shadow shadow" authority in the next few months, though it will formally be only an advisory body. Officials are still considering the details, but it is expected that it might comprise perhaps 8 would-be Members, say 4 Chief Officers (Chief Executive, Personnel, Finance and Legal) and a handful of support staff totalling perhaps 20 in all. We will be consulting the Chief Secretary when DOE have put forward detailed proposals. They would be carried on DOE's books and receive DOE support. Their task would be to enter into substantive discussion with each of the water authorities immediately after the Vires Bill, now in Committee, receives Royal Assent around Easter 1988. These intentions are spelled out in the "Next Steps" section of DOE's Memorandum (paragraphs 34-40).

Other issues10. (a) Contracting out

DOE are confident that the NRA will be able to contract-out a significant amount of its operational work. This judgement is based on the nature of the work. But the terms on which it could be achieved cause difficulty. The water authorities have taken the line that they will only be interested in cosy 25 year contracts. And alternative contractors are unlikely to be available in the short-term. DOE believe it would seriously weaken their hand with the authorities if the Government committed itself now to full contracting-out from the outset, given the absence of a competitive market yet. For credible negotiations, they argue, the NRA will have to retain the possibility of initially doing the work in-house. A second problem is that it may take too long to unscramble some highly integrated operations in time to insist on fully competitive contracting before, or at the time that, the NRA is established. Accordingly, DOE propose that all contracted-out work should be done on a fully competitive basis within 5 years. We have proposed that the document should also say that although there will be no initial requirement to contract work out, we will expect the NRA to make progress as the market in its services develops, and the Government would have the right to require contracting-out if it was dissatisfied with the rate of progress in any area.

(b) Reservoirs

The Water PLCs will take over all existing reservoirs and the presumption is that all new reservoirs will be commissioned by those who need them (ie, the utility companies or, possibly, other private industries). They would charge the NRA for some services, but the costs would be fully recovered through the NRA's charges. This is in line with our preference among the proposals in the July paper. DOE now want two small caveats:

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(i) The NRA should have power to build reservoirs, for the purpose of river management, if no-one else has sufficient motive.

(ii) The NRA would be able to own an existing reservoir in the event that no satisfactory operating agreement could be reached with a PLC owner.

We think this is a very satisfactory outcome, compared with the earlier fear that the NRA would have to assume substantial responsibilities for reservoirs. The draft document makes it clear that use of either power would be exceptional. It will be in the interests of PLCs to control their costs directly, by owning and managing reservoirs themselves. The use of either power would be subject to agreement by the Secretary of State, after a full planning enquiry in the case of new Reservoirs, so we believe the Exchequer will be adequately protected.

(c) The regulatory framework

There has been comment on the number of regulatory agencies. The document confirms that there should be a complete separation between the Director General, whose role is to protect water consumers, and the NRA which will protect the water environment and its users. It is weakest on the interface between the NRA and the newly established Pollution Inspectorate (HMIP) who will operate on similar lines to the factory inspectorate. Further detail is promised in another paper on pollution, which DOE need to produce in response to the Environment Committee and developments on nitrate pollution. We have asked for the present draft to make it clear that the NRA and HMIP will collaborate closely at the casework level, to prevent double regulation of industrialists and eliminate duplication.

(d) Finances

The present draft is weak. The issue of contracting-out will not affect the responsibilities for which the NRA will have

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to foot the bill. It will only impact on the efficiency with which they are carried out. Otherwise, the costs are already known so we believe that this weakness can be satisfactorily remedied, avoiding the public confusion generated by the July paper. We have asked that the next draft should support the point in paragraph 31 that the NRA will have essentially the same sources of income as the water authorities for the services it provides, subject to the exceptions discussed by a detailed annex reconciling existing flows with those envisaged under the new regime.

(e) Manpower

Because the extent of contracting-out is unsettled, it is still not clear how large the NRA will be. We have insisted that estimates of the range must be included. DOE's view is that the upper limit is around 6,500 (compared with their earlier estimate of 7,000) if there is absolutely no contracting-out. We have pressed DOE for a broad estimate of how far this might potentially be reduced, for inclusion in the Memorandum, but have had no response yet. Even if DOE will not publish estimates of how much smaller the initial NRA establishment might be, we think there should be an indication of how many jobs could be contracted-out eventually.

11. Mr Ridley will consult formally in the next day or so. In the meantime we are of course ready to discuss if you would find it helpful.

Tancred Tarkowski
T TARKOWSKI

Any



Ch
Make pps behind
(attached to F57)
27/12

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

EXCHEQUER	
11 DEC 1987	
COPIES TO	

My ref:

Your ref:

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
SW1P 3AG

11 December 1987

Dear Nigel

✓

THE SIZE OF THE NATIONAL RIVERS AUTHORITY

Gordon Jones has told me that when you met at the dinner for the Nationalised Industry Chairmen, you were surprised when he mentioned to you that the NRA might employ as many as 5,000 employees.

I have tried to make clear in the covering letter to the attached memorandum that 5,000 is a higher estimate than others made by co-operative water authorities for the size of the NRA nationally even if all its work were done in-house, and that in any event we would expect the number of people directly employed by the NRA to be significantly less than this as the result of contracting out.

It is also worth making the point that on any estimate at least 45,000 jobs will be transferred to the water authorities on privatisation, and that a workforce of 5-6,000 would not be unreasonable for a body like the NRA with national responsibility for water resources, land drainage and flood protection, pollution control, fisheries and the other functions that are transferring to the NRA.

Our own estimate is in the range 2,500 - 4,500

Johnson

Nawra

NICHOLAS RIDLEY

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley AMICE MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London
SW1P 3EB

For Nick,

11th December 1987

EC DIRECTIVE ON DRINKING WATER

When you wrote to me on 27 November you mentioned the action which the European Commission is taking against the UK on the Drinking Water Directive. I have seen the Oral Answer which you gave on this on 2 December. I will be replying separately to your letter of 7 December about nitrate standards.

I know that our officials are in touch about the next steps to be taken, once you have replied formally to the Commission. Since there are potentially very heavy expenditure implications, I should be grateful if you would keep me closely informed of developments, and in particular if you would ensure that I and my officials are consulted before any proposals (for instance on revised guidance on water sampling) are put to the water authorities. As I understand it, your reply to the Commission will indicate that the present guidance is being withdrawn, that the Government intends to withdraw nitrate derogations and that our privatisation legislation will incorporate the Commission's interpretation of the Directive in principle; but at this stage you will not be offering any practical concessions.

I should add that I think it important that in dealing with this issue we exploit to the full the argument that 100 per cent compliance with the Directive is pretty well impracticable, and that other European countries, which also fall short of perfection, are not being pursued by the

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Commission in the same way. I am sure we must resist giving any commitment to the Commission, or entering any new arrangements with water authorities, which imply that we accept unequal treatment for the UK on this matter.

I am copying this letter to the Prime Minister, Geoffrey Howe, David Young, Malcolm Rifkind, Peter Walker, and to Sir Robert Armstrong.

John Major

JOHN MAJOR



The Rt Hon Nigel Lawson MP
 Chancellor of the Exchequer
 HM Treasury
 Parliament Street
 SW1P 3AG

CH/EXCHEQUER	
REC.	11 DEC 1987
ACTION	EST WITH ATTACHMENT
COPIES TO	

112 2 MARSHAM STREET
 LONDON SW1P 3EB
 01-212 3434

My ref:

Your ref:

11 December 1987

Dear Nigel

THE NATIONAL RIVERS AUTHORITY

The period for comments on the July consultation paper on the National Rivers Authority ended in October, and I am anxious to announce the Government's conclusions on the functions of the NRA.

An early announcement before Christmas is important as the Water Authorities do not yet seem to have come to terms with the concept of a National Rivers Authority properly responsible for and accountable for its functions. Until we have made it absolutely and definitively clear in public that a purely regulatory NRA, with all operational functions still carried out by the privatised utility companies, is unacceptable, progress with authorities on the necessary preparations for privatisation and restructuring will be delayed. In view of your requirements that we should be ready for the first flotations of the utility companies in the autumn of 1989, the earliest possible start needs to be made on the major reorganisation that each water authority needs to undertake in preparation for privatisation and restructuring. That is why I have promised the Water Authority Chairmen, and said in Parliament, that a statement will be made in December.

What I propose is that I should place in the Library of both Houses a memorandum outlining the Government's conclusions on the consultation exercise, at the same time that the public responses are placed there. I attach a draft of this memorandum, together with a draft covering PQ and Answer.

The memorandum makes clear that the NRA must be fully responsible for and accountable for its functions. I hope that it will be able to contract out a lot of its operational work, although, as you will know, the water authorities are currently saying that they do not want to tender for work unless they can be assured that they will have and retain work for the full 25 years of their licence. As the Prime Minister has pointed out, such compulsory contracting out would not be acceptable when we have taken the decision that the functions of the NRA must be retained in the public sector. As the memorandum makes clear, contracting out of work will be encouraged, but the terms of contracts will need to recognise the nature of the work involved, and that, at least at first, there may be no alternative to work being carried

out by the privatised utility companies. But it is also necessary to allow for the possibility that we may end up with more work than we wish being done in-house by the NRA, with the consequence that the NRA could be larger than we would like, according to some estimates employing as many as 5,000-6,000 people nationally although separate estimates by individual water authorities of an NRA employing either 2,500 or 4,500 people nationally even if all its work were done in-house seem to me a more realistic range. I am confident that we can avoid this by the use of flexible contract terms, which will recognise the operational difficulties of the PLCs in some areas. But it is important that we do not concede to the water authorities at this stage the idea that there is a maximum size of the NRA that we can accept. Otherwise, they will put the NRA in an impossible bargaining position, which will enable the utility companies to set conditions for carrying out essential work that go against the standards of open competition that are essential for a properly accountable public sector body. We may face some criticism at this stage that the NRA will be larger than we want. This is, in my view, preferable to ending up with an NRA that is seen to be incapable of setting and maintaining standards in a way that is independent of the utility companies.

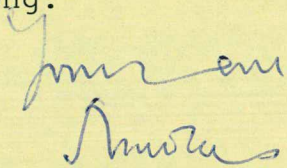
I should also mention the arrangements for consultative committees. At the time the text of the consultation paper was agreed, the Prime Minister expressed concern about the number of advisory committees proposed, and we were asked to review the fisheries advisory arrangements in considering the responses to the document. One issue which emerged very clearly from the consultation exercise was the importance attached to the need for strong local representation. The Country Landowners Association, for instance, proposed that the fisheries committees should have executive rather than simply advisory functions. We are not proposing to accede to that. However, to reduce the number of committees proposed would inevitably be seen as weakening arrangements which many do not regard as being strong enough. To go some way towards meeting demands for strong local representation, we are proposing to replace the original recreation and conservation committees with Regional River Advisory Committees (RRACs). These will cover a broader remit, covering the interests of all river users. They will therefore help to focus input from outside bodies, which was one of the earlier concerns. We are not, of course, proposing any increase in the total number of committees either over our previous proposals or indeed over those existing at present.

Finally, you will see that the memorandum proposes the establishment of a special advisory committee to advise on the arrangements for reorganisation put forward by each water authority. This seems to me essential to ensure that the NRA-side of their business is not treated as subordinate in the preparations within the water authorities. There are a number of matters to do with the arrangements for this committee, and its support staff on which I still need to consult you. But I hope

that you will agree to the announcement of this committee now, on the basis that the detailed Vote implications can be resolved between us early in the New Year. I do see this committee as essential to ensure that the necessary arrangements are made in the water authorities in 1988 to enable us to keep to the target of the first flotations in the autumn of 1989. This committee, which will have only a limited life during the reorganisation within the water authorities in 1988, will not be a 'shadow' NRA; it is no more than an Advisory Committee designed to advise Ministers on the preparations for privatisation and restructuring that need to be undertaken, and for which the water authorities will be empowered by the paving Bill currently before Parliament. There can be no question of creating a 'shadow' NRA until after the Second Reading of the main legislation, that is, about a year from now, though I would not exclude the possibility that some people on the Advisory Committee may subsequently serve as members of the NRA.

I should like to lay this memorandum on Thursday of next week. I should therefore be grateful for any comments you and colleagues may have by close of play on Tuesday 15 December.

I am copying this to the Prime Minister, the Lord President, members of E(A), Richard Luce, David Waddington and Bertie Denham and Sir Robert Armstrong.

A handwritten signature in blue ink, appearing to read 'Nicholas Ridley', is written above the printed name.

NICHOLAS RIDLEY

Draft PQ

To ask the Secretary of State whether he is in a position to announce his conclusions on the policy and consultation paper on the National Rivers Authority which was published in July.

Draft Answer

There were nearly 350 responses to the Government's consultation paper from a wide range of organisations and environmental interests. The proposal to create a National Rivers Authority to take over water authorities' regulatory and river basin management functions after privatisation of their main functions was widely welcomed.

I have today placed in the Library of both Houses copies of the responses of those who agreed their responses could be published, together with a memorandum which sets out the Government's decisions on the issues raised in the consultation paper.

The memorandum reaffirms our commitment to the creation of a National Rivers Authority. We consider it essential that the regulatory functions of the water authorities remain in the public sector, together with the broader range of river functions. These functions - water resource planning and control, land drainage and flood protection, the protection of the water environment, and the improvement and development of fisheries, and navigation, where it applies - must be the responsibility of a public body, answerable to Ministers and to Parliament.

The National Rivers Authority will have full statutory responsibility for these functions, including responsibility for operational work. The Government does not consider it is

appropriate for the NRA's role to be limited to a purely regulatory or auditing role. However, it is not necessary for all the operational work associated with the NRA's functions to be carried out by the NRA's own employees. The Government anticipates that a significant amount of work will be contracted out by the NRA on the basis of fully competitive contracts. The NRA will be required to ensure that as much of its work as possible is done on the basis of competitive tendering. The basis of the contracts for such work will have to take full account of the market conditions and the nature of the work. It will be open to the privatised utility companies to compete for such work, but it would not be acceptable for the NRA to be dependent on the privatised utility companies for the carrying out of such work as part of their conditions of appointment or licence, though, in the short term, special transitional arrangements between the NRA and the privatised utility companies may be required in some areas in respect of some functions.

The NRA will be separate from the Director-General of Water Services, and will be a non-Departmental public body, with a Board of up to 12 members. The Chairman and 8 members will be appointed by me; two by my RHF the Minister of Agriculture, Fisheries and Food, and one by my RHF, the Secretary of State for Wales. Details of the organisation, and the arrangements for the representation of regional interests are outlined in the memorandum.

The NRA will be constituted immediately after the main legislation to allow for the privatisation of the water authorities has received Royal Assent. Before then, substantial preparations are needed within each Water Authority. The Public Utility Transfers and Water Charges Bill, currently before Parliament, will give water authorities express powers to prepare themselves for privatisation and restructuring. I am asking each Water

Authority to prepare a scheme of organisation, and to submit it to me within a month of Royal Assent to the Public Utility Transfers and Water Charges Bill.

In order to advise on each authority's proposals for reorganisation, my RHF's and I propose to appoint an advisory committee, to be called the National Rivers Authority Advisory Committee. The terms of reference are to advise us on the implications for the water authorities of the reorganisation needed to provide a separate organisational structure for their water and sewerage functions, and the functions that will be performed by the new National Rivers Authority; to advise on the acceptability of the scheme proposed by each water authority; and to ensure that it will enable the NRA adequately to fulfil the tasks proposed to be allocated to it. I shall make a further announcement about the Chairman and other members of this Committee as soon as possible.

I am confident that these arrangements will enable Water Authorities to start soon on the necessary preparations for privatisation and restructuring so as to provide for the successful transfer to the private sector of the vast majority of the jobs in the water industry, together with the transfer of the regulatory and river basin management functions of water authorities in an important new national authority in the public sector.

The National Rivers Authority

Introduction

1. The Government has considered the responses to the policy and consultation paper on the National Rivers Authority published in July 1987. Nearly 350 responses were received, and there was widespread welcome for the proposal for a national body which will retain the water authorities' regulatory and river basin functions in the public sector after the privatisation of the water authorities' main functions. A summary of the main issues raised in the consultation is at Annex A.

2. On the basis of this response, the Government reaffirms its commitment to the creation of a National Rivers Authority. This will be done in the same Bill which will transfer the utility functions of the ten water authorities in England and Wales, that is water supply and sewerage, to utility companies constituted as public limited companies under the Companies Act 1985. These will subsequently be offered for sale to private investors.

3. It is the Government's view that the regulatory functions of the water authorities must remain in the public sector, and that the broader range of river functions is inextricably linked with regulation. These functions - water resource planning and control, land drainage and flood protection, the protection of the water environment, and the improvement and development of fisheries, and navigation where it applies - are carried out not simply for the benefit of individual customers but to meet more general purposes, including the protection of the environment. These activities cannot all be financed exclusively from charges; at present, they are supported by the authorities' environmental services charge, and - in the case of land drainage - by precepts on local authorities and capital grants from central government. The NRA will be encouraged to recover as much of its costs as possible directly from users, but it will continue to depend to a significant extent, on support from public funds. An estimate of the expenditure of the NRA is given in Annex B.

4. It is therefore necessary that these functions should be the responsibility of a public body, so constituted that it can be subject to Governmental policy control, and answerable to Ministers, for the way they are carried out. They will become the responsibility of the National Rivers Authority.

5. The transfer of the statutory functions of river management to the NRA means that the NRA must be fully accountable for these functions. It must have responsibility for deciding what work is

done, and the power to ensure that the arrangements satisfy the requirements of value for money in the public sector. It would not therefore meet the requirements of public accountability for the NRA to be wholly dependent on the privatised utility companies for the execution of these functions as part of their conditions of appointment or licence. This rules out the possibility of an NRA limited to a purely regulatory or auditing role.

6. However the Government does not consider it necessary for the work involved always to be carried out by the NRA's own employees. On the contrary, the Government is committed to the principle that public bodies should pursue efficiency by the fullest possible use of competitive tendering and is confident that there is scope for the NRA to contract out a significant amount of its operational work. The provisions of such contracts are likely to vary depending on the nature of the work, and the market conditions relevant to contracting for the type of work. For example, the effects on a contractor of losing a particular contract must be a consideration in his acceptance of whatever terms of contract may be on offer. Equally, the NRA cannot be expected to agree terms which permit the contractor to get away with poor performance. The general principle is that the NRA must be in a position to specify what it needs to be done, and there must be appropriate provision for variations to meet changing circumstances. To that end, contracts will need to be awarded on a competitive basis, as the principle of competitive tendering is

an important means of promoting efficiency in public bodies. Once established the NRA will be expected to ensure that an increased proportion of its work is contracted out.

7. It will, of course, be open to the privatised utility companies to compete for such work if they wish. But, like any other accountable public sector body, the NRA must be free to employ the contractor who provides the best value for money for the work it requires to be done. The Government also recognises that the way some functions are presently organised in some regions may mean that it is not possible for the work to be offered on a competitive basis immediately the NRA is formed. In these circumstances, the NRA may enter into special arrangements for the carrying out of the work by the privatised utility companies. The period of contracts in these circumstances would vary according to the type of contract, but would need to take full account of the interests of the contractor, and the achievement of value for money.

8. The fact that the precise arrangements for contracting out work may vary from function to function and region to region mean that it is not possible to give any precise estimate of the number of staff who will be directly employed by the NRA until further detailed analysis has been done in each region. But the Government is anxious to ensure, through contracting out and

other means of securing efficiency, that the NRA is no larger than necessary to ensure the efficient and effective execution of its statutory duties.

NRA Organisation

9. The NRA will be a completely separate organisation from the Director General of Water Services, as the NRA's responsibilities are related to environmental matters and involve controls over all who use rivers and other natural waters, whereas the Director-General is concerned with economic regulation of the utility PLCs. The NRA and the utility PLCs will become statutorily responsible for their respective functions on the same day, and flotations of the PLCs will follow.

10. The NRA's status will be as a non-Departmental public body, and it will have a Board of up to 12 members, of whom 2 will be appointed by the Minister of Agriculture, Fisheries and Food, and one by the Secretary of State for Wales. The Chairman, and the remaining members will be appointed by the Secretary of State for the Environment. The intention will be to appoint members with knowledge relevant to the functions of the NRA.

11. As a national body covering England and Wales, the NRA will have a head office, with a Chief Executive and senior officers with responsibility for the NRA's main functions, and personnel,

finance, legal and other support services. This will inevitably be the forum for negotiation and discussion with Government Departments, the EC, and for dealing with a wide variety of other national interests.

12. But the main activities of the NRA will take place in the regions, as it will inherit from the existing water authorities responsibilities for river basin management of individual catchments. The structure of the NRA will reflect this. It will have the same regional boundaries as the existing regional water authorities, based on river catchments, and the regional management structure, under a regional manager in each region, will be strong enough to deal with the range and magnitude of activity in each region, taking full account of the needs of all river interests. Many of the NRA's staff at the regional level will come from the existing staff of water authorities, already working on activities related to what will become the NRA's functions.

13. The consultation paper acknowledged the need for the retention of specialist committees at a local level. On land drainage, the present Regional Land Drainage Committees will remain as committees reporting to the NRA, though renamed Regional Flood Defence Committees to reflect their present emphasis on flood protection. In addition, the Regional Fisheries Advisory Committees will continue in their present form, though they will report to the NRA.

14. The consultation paper proposed that the regional recreation and conservation committees, which presently report to the 9 English Water Authorities, should in future be the responsibility of the NRA, with the NRA making appointments to the Committees. However, in response to concern about the importance of taking account of local river interests in regional decision taking, the Government proposes to expand each RRCC into a wider committee, the Regional River Advisory Committee (RRAC), which would represent the main interests concerned in both using and conserving the rivers, ie conservation, recreation, industry (including the water supply industry), agriculture and local government. These committees, which would be appointed by the NRA, would advise the NRA on their river basin management functions. They would typically have between 15 and 25 members. The RRACs would be responsible for advising on all aspects of river basin management, but would have no direct involvement in the handling of the regulatory responsibilities of the NRA. Apart from the RLDCs, which would continue in essentially their present form, and the RFACs, both of which would retain their present roles in their own areas of responsibility, the new RRACs would be the major focus for consultation by the NRA about matters affecting river catchments at the regional level. All major river interests would be represented on the RRACs. Because of the RRACs' concern for water-based recreation, they will be the

appropriate body to continue the RRCCs' role in respect of recreation on reservoir and the other recreational resources of the utility PLCs.

15. In Wales, the recreation and conservation functions are currently combined with the customer service functions by the Local Consumer Advisory Committees, but a new RRAC will be established along the lines of the RRACs in England. Response to the consultation paper did not indicate a need for a separate NRA in Wales. Nevertheless, a special committee will be formed to advise the Secretary of State for Wales on Welsh issues. This committee will be chaired by the Secretary of State for Wales' appointee to the NRA, and its membership will include the chairmen of the RRAC, the RFAC and the RFDC.

Water resources

16. Water resources, and planning that adequate supplies of water are available, is a central function of the utility PLCs and the NRA. It will be for the utility companies to forecast demand and take the necessary steps to ensure that adequate supplies are available for their customers. The NRA will have the responsibility for safeguarding water resources for public water supply and all other uses. An important part of this role is the licensing of abstractions and impoundments. The existing licensing framework contained in the Water Resources Act 1963

will be retained, including the right of applicants to appeal to the Secretary of State against the NRA's decisions. It will be a statutory requirement for the NRA to consult the privatised utilities and statutory water companies about the applications it receives. In determining applications, the NRA will be required to have particular regard to the duty that water undertakers have to provide public water supplies.

17. The main assets involved in providing water resources are reservoirs. The water authorities' existing reservoirs were built primarily for public water supply, even in cases where they regulate flows to support abstractions further downstream. As proposed in the July paper, ownership of existing reservoirs will be transferred to the utilities. In cases such as regulating reservoirs where the public interest needs to be safeguarded by means of agreements between the NRA and the utilities, a basis for payment is still to be worked out. Subject to that, and the preparation of suitable agreements, the need for the NRA to take any existing reservoirs into ownership should be avoided.

18. The NRA will pay the utilities for the service they provide in regulating river flows, and will recover these and other water resource costs through abstraction charges. Authorities' existing charging schemes have been devised to allocate costs appropriately between the water supply side of each authority and all other abstractors. They will continue in operation while the

present water authorities have statutory responsibility for water resources. Any review of such schemes will be a matter for the NRA, once it has been established.

19. The NRA will generally look to the utilities and other abstractors, to create the new sources which they need. In such cases, it may be that the general needs of the river make it necessary for the NRA to require a larger reservoir than planned. In such a case, the utility would be reimbursed for this either by a direct contribution by the NRA, or through the charge it paid the utility for operating the reservoir. As the utility would effectively be meeting a large part of the NRA's costs through abstraction charges, this will provide appropriate incentives to ensure that costs are minimised. Given its overall responsibility for ensuring that adequate resources are available, it will be necessary for the NRA to be given the powers necessary to enable it to build a reservoir itself, though no circumstances are currently envisaged where it would be likely to do so. In any event, no major new resource projects are planned before the end of the Century.

Flood Defence

20. The NRA will inherit the land drainage and flood protection functions which the water authorities perform under the Land Drainage Act 1976. In this capacity, it will be answerable in

England to the Minister of Agriculture Fisheries and Food and in Wales to the Secretary of State for Wales. This includes responsibility for flood defences in some 40,000 kms of main rivers and defences against tidal flooding.

21. Water authorities also have responsibility for supervising the activities of other public bodies with drainage responsibilities including local authorities who have permissive powers to carry out works in non main rivers and internal drainage boards which are constituted as public bodies under land drainage legislation. All water authorities have precepting powers at a local level, and are eligible for Exchequer grant in support of capital projects.

22. The NRA will discharge these functions through Regional Flood Defence Committees (RFDCs). These will be based on the same areas as the existing Regional Land Drainage Committees, and will be constituted on similar lines. Members will, however, be drawn from a wider field than at present, reflecting the importance of urban flood defence and of environmental considerations.

23. RFDCs will assess the needs of their area, decide on a medium term and an annual programme of capital works and maintenance, determine the sums needed, and make recommendations about the precepts to be raised to the NRA, who will be responsible for these functions, and can decide on the best

methods of discharging these statutory duties. As now, substantial use will be made of outside contractors for capital works, and in some regions the NRA may also contract out maintenance work. As a principle for flood defence and other purposes, all river-operational assets at present owned by water authorities will be vested in the NRA. This is necessary to ensure that the NRA is properly accountable for its statutory duties. The assets include flood barriers, sluices, weirs, pumping stations and river banks and sea defences that water authorities currently own. The Government recognises that in practice some assets and facilities serve several purposes, but local arrangements for the operation of these assets should be able to take account of this under NRA ownership.

Pollution Control

24. The NRA will be the regulating authority with the central responsibility for protecting and enhancing inland, coastal and underground waters, and it will have the necessary powers and resources for these purposes. Determining the quality objectives and standards to which waters are maintained and improved will be the responsibility of Ministers but in doing so they will draw upon the assistance and advice of the Authority. The NRA will be required to have regard to these quality objectives and standards in discharging all its functions and to achieve the objectives so far as it can through the exercise of

its powers. It will take over the water authorities' present responsibilities for issuing discharge consents and monitoring observance of them by industrial and other discharges and for following up and avoiding pollution from all sources. It will also take on the Governmental responsibility for consenting water authorities' own discharges. The NRA will have new powers to charge for pollution control and monitoring.

25. In the control of pollution, as in the control of abstractions it would be unacceptable from the point of view of other interests if a privately owned company had a prerogative in granting licences and consents or the responsibility for policing work and preventing if necessary those responsible for unauthorised incidents causing damage to a water resource.

26. However, even in the pollution control function, the Government believe there is scope for contractual arrangements with the private sector. Provided that the pollution control authority - the NRA - is in a position to direct these activities from day to day and to ensure that they are seen publicly to be carried out impartially, the collection and analysis of water samples or the processing of water monitoring data can be contracted to any firm that can offer these services competitively and reliably. But the real business of protecting the water environment is intimately bound up with other aspects

of river management and, in lowland areas, especially with flood protection and land drainage. All these activities need to be carried out under the same direction in the public sector.

27. The respective roles of the NRA and Her Majesty's Inspectorate of Pollution (HMIP) were described in the policy and consultation paper. They are determined by the basic principle that the NRA is concerned with the water environment, whereas HMIP is concerned with the best practicable means of dealing with discharges from industrial processes by all disposal routes and by alternative methods. The details of the distinctive roles of NRA and HMIP and the arrangements for relationships between them will be subject to some further consultation in the New Year.

Hydrometric Network

28. The hydrometric network, measuring rainfall, groundwater and river flows, is needed both by the NRA and the utilities. It is important for water resource planning, land drainage and pollution control. At the moment, the systems in many authorities are highly integrated between different functions, and the aim in separating off the NRA functions will be to avoid unnecessary duplication. It is proposed that wherever possible, the utilities and the NRA should exchange information which they each require to collect for their own purposes anyway. Other

information required by the NRA could be obtained directly, or by other agents, including the utilities, on its behalf. Detailed arrangements will need to be decided in the light of local circumstances.

Fisheries

29. As was made clear in the July paper, the NRA will take over the responsibilities of the water authorities under the Salmon and Freshwater Fisheries Act 1975 for maintaining, improving and developing fisheries, for regulating fishing, and for consulting affected interests about the manner in which they discharge these duties. The NRA will be charged with improving sport fisheries, both by enhancing water quality and the river environment, and by positive fisheries management policies, including a strong attack on illegal fishing. The regional fisheries advisory committees (RFACs) will be maintained as committees of the NRA, and will continue to play a valuable role in advising regional management on these issues.

Conservation, Recreation and Navigation

30. The NRA will have the same duty as the water authorities to have regard to the conservation of the natural environment and to exercise their functions so as to further conservation. They

will also have a statutory duty to make land and any waters in their ownership available for recreation, so far as is reasonably practical. The policy and consultation paper published in July made clear the importance the Government attaches to these duties, and this has been welcomed.

31. Navigation is also an important operational function, and the NRA will take over the responsibilities for navigation which certain water authorities have. There can be a close connection between the maintenance of rivers and other waterways for navigation and their maintenance and operation as land drainage channels.

Finances

32. The NRA will have essentially the same sources of income as the water authorities for the services it provides. The exceptions are its new power to recover from dischargers the costs of administering pollution control and enforcement and the fact that the NRA will not levy an environmental service charge. It will be encouraged to seek the maximum possible recovery of its costs from direct charges such as licences. Additional support will be made available to the NRA through Exchequer grant-in-aid, but the present Environmental Services Charge will cease. The environmental services for which the NRA is unable to recover its costs directly are provided for the benefit of the

community as a whole. It is right, therefore, that they should be met from central funds, rather than covered by a charge levied on the utilities and ultimately their customers. It is anticipated that the charging principles currently embodied in s.30 of the Water Act 1973 will apply to the NRA as well as to the utilities. The Government will ensure that the NRA, while efficiently run, has the resources necessary for its task. More details of expenditure on the NRA's activities is given in Annex B.

NRA's employment policies

33. The employment policies of the NRA will be a matter for it to determine, both at national and regional levels. These can be developed only after the NRA has been established, and after appropriate consultation. In the first instance, all existing water employees who transfer to work for the NRA at the same level will be employed on the terms and conditions in their contracts at the time of transfer. Other appointees, whatever their present employment, will be offered terms and conditions based on those current at the time of transfer in the water industry.

34. On pensions, it will also be for the National Rivers Authority to determine an appropriate scheme. But, for existing employees of water authorities who are in the local Government

Superannuation Scheme on the date of transfer to the NRA, the Government can give an assurance that any new scheme that may be introduced will be an option, and, on transfer, such employees will be able to remain in a scheme with the same benefits, and requiring the same contribution, as the Local Government Superannuation Scheme.

The next steps

35. The functions of the National Rivers Authority are at present functions of the Water Authorities. The aim is to constitute the NRA immediately after the main legislation has received Royal Assent, and to transfer these functions to it at the earliest possible date. The legislation will provide for this to be done by Transfer of Functions Order, including provision for the transfer of staff and of assets appertaining to these functions.

36. To meet that timing, substantial preparations must be made, starting as soon as possible. The Public Utility Transfers and Water Charges Bill, currently before Parliament, will give water authorities express powers to prepare themselves for privatisation and restructuring.

37. Each Water Authority will be required to draw up a scheme of organisation, under which the authorities' functions will be carried on until vesting day - the day when the NRA is formed, and when the rest of the authority is reconstituted as a public limited company. Each authority's scheme of organisation should anticipate, as envisaged in the Public Utility Transfers and Water Charges Bill, the arrangements which will pertain after vesting day. So it must provide, if necessary by stages, for the formation of a viable regional component of the future NRA. The intention is that the NRA's regional structure should correspond to the regional boundaries of the present Water Authorities.

38. Each authority will be asked to submit its scheme of organisation to the Secretary of State within a month of Royal Assent to the Public Utility Transfers and Water Charges Bill.

39. In order to advise them on the appropriateness of each water authority's proposals for reorganisation, the Secretary of State for the Environment, together with the Minister of Agriculture Fisheries and Food, and the Secretary of State for Wales, will be appointing an advisory committee, called the National Rivers Authority Advisory Committee. It will have the following terms of reference:

"To advise the Secretaries of State and the Minister of Agriculture, Fisheries and Food on the implications for the water authorities of the reorganisation needed to provide a separate organisational structure for their water supply and sewerage functions, and the functions that will be performed by the new National Rivers Authority; and to advise them on the acceptability of the scheme proposed by each Water Authority, and to ensure that it will enable the NRA adequately to fulfil the tasks proposed to be allocated to it."

40. Subject to guidelines issued by Ministers, the National Rivers Authority Advisory Committee will scrutinise the proposals from each water authority, and advise on their acceptability. The differences in the character and topography of the regions mean that it is not expected that the authorities will necessarily follow a uniform pattern. Nevertheless, the ten schemes of organisation must be compatible, and the NRAC with its preparatory team will report to Ministers on whether the regional schemes taken together will result in a public body which, managed from a small head office, is effective from the outset in all its functions.

41. Each regional scheme of organisation will provide for a separation of the management and professional structure for the NRA functions from that which will run the functions and activities eventually vested in the utility companies. It is

appreciated that this will be a substantial reorganisation, affecting many employees in water authorities. Alterations will be required to job definitions, and accommodation and facilities for the NRA functions will need to be identified, and activities will need to be relocated in all regions. Assets and facilities will need to be allocated either to the utility PLC or to the NRA, including new arrangements for common services for both the PLC and the NRA. Each authority will be expected to consult its employees and its trade unions, in order to minimise any problems which could arise.

ANNEX A

The National Rivers Authority

Responses to consultation paper

1. The deadline for responses to the paper outlining the Government's proposals for a National Rivers Authority published in mid-July was mid-October. In fact, comments continued to be submitted well beyond this date. By the end of November, a total of 349 responses had been received. Of these, 179 supported the establishment of a National Rivers Authority, and 39 opposed it; the remainder (131) expressed no view for or against the National Rivers Authority, but offered comment on aspects of its operation. Copies have been laid in both Houses of Parliament of responses by all those who have agreed that their comments may be made public.

2. The issue of most concern to respondents was the presence which the Authority would have in the river-basins under its control. Interest centred on the nature of the Authority's regional organisation, on the relationship between the Authority's centre and its regional elements, and on the relationship between the regional elements and river-basin users. In

particular, many commentators were concerned with the arrangements to formalise the representation of users' interests in the new Authority's regions.

3. Respondents also commented extensively on the degree to which the new Authority should handle the operational aspects of the functions which it will take over from the water authorities. The July paper raised the possibility that the Authority might make contractual arrangements with other bodies on operational matters, and this drew a range of responses. There was general recognition that any such arrangements must not impair the impartiality of the regulatory decisions which the Authority would have to make. Some respondents argued that this precluded any contracting-out of work, but a greater number accepted that the Authority could appropriately make use of third parties at least in non-regulatory areas of work.

4. A third major theme for respondents was the need for clarity in the division of responsibilities between the regulatory bodies to be concerned with water matters. There was little dissent from the view that the National Rivers Authority would have a distinct role, and should therefore be a separate body, from the Office of the Director-General of Water Services (OFWAT), which is to be set up to deal with the economic regulation of the privatised water utilities. The point was however made that there would need to be co-ordination of the different types of regulatory impact, since the NRA's decisions could well have

significant cost implications for the utilities which should be borne in mind by OFWAT in its decisions on the charges made by the utilities. There was less of a consensus about the separation between the NRA and Her Majesty's Inspectorate of Pollution, however, and concern to avoid overlapping responsibilities expressed itself particularly strongly over the demarcation between these two bodies.

5. Much informed comment was also received about detailed aspects of the performance of the different functions to be exercised by the new Authority. It was the major institutional questions described above, however, which figured most in responses.

6. One other issue raised was whether the Statutory Water Company model would be a more appropriate model for the utility companies than the PLC model. The Government recognises that the statutory water companies have a long tradition of providing service to the public to a high professional standard. At the same time the statutory water company model contains too little incentive to efficiency, and it allows companies to charge customers whatever is necessary to pay their dividends after covering whatever costs they may incur. Under the PLC model, the discipline of providing dividends to shareholders within a price controlled regime is a permanent stimulus to the most efficient use of resources. The Government considers that, with the

appropriate safeguards it will be proposing, the objective of ensuring that standards of service to customers are adequately protected, can be fully secured under the PLC model as proposed.

ANNEX B

NATIONAL RIVERS AUTHORITY: FINANCES

1. The following is an estimate of the NRA's annual expenditure on the functions transferred to it from the water authorities.

	£M		
	Expenditure	Income	Deficit
Water resources	114.3	114.3	-
Pollution alleviation	4.4	-	4.4
Water quality regulation	18.1	0.3	17.8
Recreation and amenity	6.9	2.8	4.1
Fisheries	8.6	4.4	4.2
Navigation	4.7	1.8	2.9
Flood Defence/land drainage	89.7	89.7	-

The figures are based on the authorities' 1985/86 accounts.

2. These are not new costs, but expenditure that will in future be carried out by the NRA rather than the water authorities. At present, the deficit is met from the environmental services charge, levied by water authorities on rate-payers within their

area. In future, income from direct charges will be increased, with additional support through Exchequer grant-in-aid to the NRA.

3. The figures include an allocation for overheads. Some additional costs may arise from loss of economies of scale enjoyed by the water authorities and the need to set up a small central office for the NRA. On the other hand, there is likely to be scope for reducing costs by means of contracting out.

*JP*

FROM: J M G TAYLOR

DATE: 14 December 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Hawtin
Mr Burgner
Mr Turnbull
Mrs M E Brown
Mr Instone
Mr Bonney
Mr Lyne
Mr Bent
Mr Tarkowski
Mr Parr
Mr Graydon
Mr Sharp
Mr Call

WATER PRIVATISATION: NATIONAL RIVERS AUTHORITY

The Chancellor has seen Mr Tarkowski's submission of 9 December. He has also now seen Mr Ridley's letter and enclosure of 11 December.

2. He has noted the points which Mr Tarkowski makes about contracting-out. But he has commented that, despite these, we could surely contrive major contracting-out on a competitive basis from an early stage. The NRA is a national, not a regional, body, and it can invite tenders from a number of water authorities. It must surely be illegal for them to collude.

A handwritten signature in dark ink, appearing to be 'JMG'.

J M G TAYLOR

CONFIDENTIAL

FROM: T TARKOWSKI
 DATE: 15 December 1987

1. MRS BROWN ¹⁵/₁₂
 2. FINANCIAL SECRETARY *OK*

cc Chancellor
 Chief Secretary
 Sir P Middleton
 Mr Anson
 Mr Monck
 Mr Moore
 Mr Hawlin
 Mr Burgner
 Mr Turnbull
 Mr Bonney
 Mr Instone
 Mr Lyne
 Mr Bent
 Mr Graydon
 Mr Sharp
 Mr Call

Chy
 Comment for FST to
 write in these terms? (It is surely right
 to press Mr Ridley on numbers - the points
 in his "personal" letter to you of
 11 December don't seem to justify the
 proposed size of this grant at all).

TF
 15/11

THE NATIONAL RIVERS AUTHORITY

We discussed Mr Ridley's 11 December letter and enclosure, my 9 December submission, and the Chancellor's comments (Mr Taylor's 14 December minute) at your meeting this morning.

2. You agreed that we could not insist on obligatory contracting out across the full range of the NRA's functions:

(a) Because of the risk to the NRA's regulatory independence (the same point was made by the Prime Minister in July); and

(b) Because of the impossible further burden it would place on the shadow NRA, which will already have a mass of detailed negotiating to do in the few months between its establishment and the first sale(s),

but that we should insist on maximum competitive tendering on land drainage functions (which employ perhaps 3,000 people) from the outset, and that the public statement will make it clear that the Government will insist on further rapid progress in contracting out.

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3. I attach a draft response on these lines.
4. DOE need a reply by close today so that the Memorandum can be printed in time for the planned statement on Thursday.

Tomasz Tarkowski
T TARKOWSKI

CONFIDENTIAL

DRAFT LETTER FROM FINANCIAL SECRETARY TO:

Secretary of State for the Environment

December 1987

THE NATIONAL RIVERS AUTHORITY (NRA)

Thank you for your letter of 11 December addressed to the Chancellor, on whose behalf I am responding.

I agree that it is important to make rapid progress now, and that a public statement on the results of consultation is now essential. I am content with the proposed parliamentary question and the Memorandum, subject to a few points. Specific amendments reflecting these points are attached.

My main concern, which the Chancellor shares very strongly, is that we should not, as Roy Watts and others have alleged, create a quite unnecessarily substantial quango. I have to say I am disturbed by the very large numbers you are prepared to contemplate as direct employees of the NRA. I am surprised that you do not now envisage that a significant role for contracting out can be contrived when the NRA is first established. The NRA will be a national, not a regional body, and it can invite tenders for its operational work from a number of water authorities, as well as other contractors. Perhaps half of the 6,000 - 7,000 people who would become direct NRA employees if

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there were no contracting out are engaged on land drainage and flood protection, and we could surely insist that in this area, at the least, there is fully competitive tendering from the outset. No risk to the independence of the NRA's regulatory functions is involved. And ^{if} the water industry are not interested in competing for this work others, for example construction companies, presumably would be. The attempt by the industry to insist on 25 year operating contracts as the price of co-operation is totally unjustifiable, and we should call their bluff.

On the other functions of the NRA, for example in monitoring water pollution, I accept that an initial requirement to contract out might undermine, or be seen as undermining, its independence from the privatised companies. There is also, I accept, a risk of overloading the NRA within its first few months, and the key priority must be to ensure that we are fully ready to begin privatisation sales in Autumn 1989. But we should make it clear that the Government will insist on further progress in contracting out in all areas of the NRA's work. My amendment is designed to do this.

My other major concern centres on the planning for re-organisation which we will now be asking the water authorities to begin. It is clearly essential that we do not let the initiative in this pass to the water authorities, and the amendment I have proposed reflects this point.

The suggested amendment on co-operation between the Pollution Inspectorate and the NRA is self-explanatory. We must obviously avoid wasteful or burdensome duplication in our regulatory regimes, and we should state clearly that this is our intention.

I am copying this letter to the Prime Minister, the Lord President, members of E(A), Richard Luce, David Waddington, Bertie Denham and Sir Robert Armstrong.

[NORMAN LAMONT]

AMENDMENTS:

(i) **DRAFT PQ** (page 6, line 1) "... each water authority to prepare outline proposals for a scheme of organisation, on the basis of guidelines which will be issued by my department, and submit it to me"

Draft Memorandum

(ii) (Paragraph 6) delete final sentence. (Paragraph 7) Add, at end, "For these reasons there will initially be no absolute requirement on the NRA to contract out all operational and management aspects of all the functions for which it will be responsible, except in the area of land drainage where no risk to the independence of the NRA arises, and where a range of potential alternative contractors already exists. The NRA will be expected to continue to make progress as the potential scope for contracting out increases, and the Government will have the right to require contracting out if it is dissatisfied with the rate of progress in any area."

(iii) (Paragraph 27) Insert, at end, "The NRA and HMIP will be expected to collaborate closely at the casework level, to prevent wasteful and burdensome duplication in the practical application of the regulatory regime to individual businesses."

(v) (Paragraph 39) Amend remit of the National Rivers Authority Advisory Committee as in (i) above.

pmp

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH



From the Minister

The Rt Hon Nicholas Ridley MP
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

CHIEF SECRETARY	
REC.	18 DEC 1987
ACTION	Mr Bowen / Mrs Bevan / Mr Inis
COPIES	to Mr P.M.G., Mr Anson, Mr Kemp Mr Flower, Mr Burgess, Mr Edwards Mr Horton, Mr Crabb, Mr Cranston Mr T... .. Mr Call

17 December 1987

See Mr...

NITRATE IN WATER

Thank you for your letter of 7 December about the need for an announcement of the Government's policies on nitrate pollution of drinking water.

I accept that your decision to inform the EC Commission that nitrate derogations will be reviewed and are all likely to be withdrawn may necessitate a public statement about the decision. I do not, however, consider that it would be wise at this stage to announce, as you suggest, a "programme of action for complying with the nitrate parameter". As I understand the conclusions of Cabinet Office discussions at official level on the response to the Commission, it was agreed that no indication of the concrete steps to be taken should be given, so that we could be left free to decide our strategy in the light of the results of the desk studies now under way. These should give us invaluable pointers to the relative merits of different options and I think it would be a mistake to announce measures now, in ignorance of those results.

I also doubt the wisdom of saying too much at this stage in response to the House of Commons Environment Committee Report. I understand it was agreed earlier that a response was close to completion which would be quite positive on most major points but would give a holding reply on nitrate pollution. That still seems to me the right course in spite of the further delay in delivering the response, for which no doubt your Department had good reasons unconnected with the nitrate issue.

As to the Commission's proposals on wider nitrate inputs to water, I am not aware of any moves within the Commission likely to result in a very early presentation of draft proposals. I agree that, until we know our own strategy more clearly, we cannot do too much to influence Commission thinking. But that does not seem to me sufficient reason for us to take decisions in advance of receiving the desk study results.

/As you know, my ...

As you know, my reluctance to announce the setting up of trial protection zones is based upon the very great uncertainties we face on where such a step might lead us, and the expectations and fears which would be raised by such a move. I am convinced we must prepare the ground thoroughly before taking any such decision, which is why we must have the desk study results first. I note that John Belstead has recently said as much in a letter to the Chairman of Severn-Trent Water Authority.

As to the steps being taken to educate and advise farmers, John Gummer will be making an announcement to the farming world shortly about our new joint initiative, which should raise considerably the awareness and understanding which farmers have of the problem.

There is clearly some potential for our extensification scheme to help farmers out of cereals in nitrate sensitive areas, and I hope many will take up the offer when it is made next year. But the scheme must aim above all to reduce farm surpluses and I doubt that it can offer more than a small part of the answer to the nitrate problem. Nonetheless this point is covered in the consultation document on the extensification scheme which we have just issued. It would not therefore be necessary to include it in any statement.

To conclude, I recognise the need for some statement on the review of nitrate derogations, but I doubt the wisdom of going very much further until we have the desk study results. I certainly could not agree to the inclusion in your statement of the element listed at c of your penultimate paragraph. Moreover, I am a little surprised at your wish to include item d in your statement: I had understood that your decision to review nitrate derogations would probably lead some Water Authorities to invest in de-nitrification processes in the near future. On e, we shall, as indicated above, be making an announcement shortly. I suggest we decide at that time how this might be related to any announcement you will be making.

≠ I am copying this letter to the recipients of yours.

JOHN MacGREGOR

CONFIDENTIAL

CC-CX-FBI
Sir P. M. DOOLEY, Mr. Anson

Mr. Mawer, Mr. Burgess

Mr. Hawtin, Mr. Moore

FROM: CHIEF SECRETARY

DATE: 18 December 1987

Mr. Bonner, Mrs. Brown

Mr. Inyang, Mr. Grayson

Mr. Tarkenton, Mr. Carr

PRIME MINISTER

WHITE PAPER ON WATER QUALITY AND THE WATER ENVIRONMENT

I have seen Nicholas Ridley's proposal for a White Paper in February (his minute to you of 11 December).

2 I appreciate Nicholas's wish to make a positive policy statement on the water environment. But I am very wary of rushing into commitments which may have major expenditure implications. Three issues concern me particularly.

3 First, problems on ground water. The European Commission has criticised nitrate levels in drinking water, and is likely to press for considerable extra investment by water authorities to remedy the position. We need to negotiate toughly on this: the Environment Select Committee has recommended that we should try to get the EC standards changed. I fear that a commitment to publish a White Paper would put pressure on us to say too much too soon.

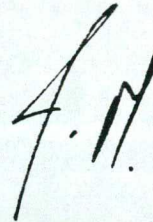
4 Second, drinking water quality. The EC is pressing for stricter interpretation of its standards on drinking water generally. Taken literally, this could require new capital expenditure on water treatment and water pipes of £1-2 billion or more. Negotiations with the Commission are just beginning and again we will want to challenge the present Directive. It would be premature to make any public proposals for compliance.

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5 Third, reducing sewage pollution at seaside resorts. The EC have threatened action against the UK, but I understand that they have recently suggested a compromise programme of capital investment. Measures to clean up beaches are already in hand, and we need to assess the new proposals, and the cost implications, most carefully. I have no idea at this stage whether we would have anything to announce in February.

6 It might be useful to meet to review the various issues covered in Nicholas Ridley's minute, and how best to present our policy on them.

7 I am copying this minute to Willie Whitelaw, Nicholas Ridley, Tom King, Peter Walker, Malcolm Rifkind, David Young, John MacGregor, John Moore, David Waddington, and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to read 'J. M.', is positioned above the typed name.

JOHN MAJOR



2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon Norman Lamont MP
Financial Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

4/5

CH/EXCQUEUR	
REC.	04 JAN 1988
ACTION	FST
COPIES TO	

3) December 1987

Dear Norman

WATER PRIVATISATION: TIMETABLE

Thank you for your letter of 16 November. You will already have seen Willie Whitelaw's letter to me of 18 November, covering the possibility of achieving Royal Assent for the main Privatisation Bill before July 1989. We have of course secured advance drafting authority for the Bill, and the first tranches of instructions have been sent to Parliamentary Counsel. So we expect to have a Bill ready for introduction at the start of the next Session, and would hope to be able to achieve Royal Assent to the main Privatisation Bill by July 1989, though this must remain subject to the imponderables of the Parliamentary Timetable.

The main thrust of our flotation strategy must be to ensure that all authorities are capable of being floated, at prices which will secure an acceptable return to the Government. This was, of course, the principal theme in this year's Investment and Financing Review. To ensure flotability, action has to be taken on a number of fronts. In some cases authorities are financially weak, and charges have to rise. We are politically constrained from pushing up charges unless the increases are fully justified, and even where higher charges are justified, there are constraints on the rate at which they can be increased. Action is also necessary to ensure that investment levels are sufficient to meet level-of-service objectives and statutory requirements, and to provide adequately for maintenance and renewal of assets. All authorities are still refining their projections of long-term investment needs which we have requested for the end of March 1988. The flotation prospects of individual authorities will depend in large part upon the outcome of that exercise, on the successes of management over the coming months in meeting financial objectives, and on external factors such as the impact of new obligations arising from actions in Brussels. The largest and most difficult is the outcome of the currently threatened legal proceedings on drinking water.

You will remember that the Financial Assessment Committee used the financial model, WATMO, last summer to take a first look at the flotability of individual authorities. You discussed the results with Lord Belstead in September. The results suggested



that three authorities appeared flutable as they stood, four presented some problems because they were cash rich, and the remaining three were investment heavy. These results now need refinement, in the light of the latest financial position, the action taken in the IFR, and the forthcoming assessment of investment needs. The model will also need some modification. This should give us another set of results in the Spring. It will not be until the Autumn that we are able to produce a set of results which takes account of the need to split the NRA from the utility companies.

The need to separate out the National Rivers Authority, its functions, responsibilities and assets, from the existing water authorities soon after Royal Assent, is another major factor. My earlier letter touched on this. It will be necessary to have completed this task for all water authorities, regardless of their position in the flotation queue by a common date, so that the NRA can assume its functions and the new PLCs, still under Government ownership, can assume theirs on a single day, probably in September, 1989. We should not under-estimate the complexity of this task, work on which will have to start very soon, well in advance even of establishing the NRA in shadow form. And the more requirements we impose on the NRA when it is established, or on water authorities in preparing for that, the more likely we are to upset the whole applecart. My officials are in touch with yours, and with OMCS, about the manpower and expenditure implications of this.

The ultimate flotation strategy will also have to take account of market conditions once the authorities have been vested. Events over recent weeks have served to illustrate that it is unwise to make assumptions too far in advance.

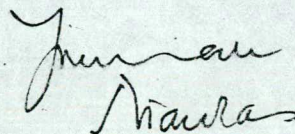
Given that we have advance drafting authority for the Bill, and that a start can be made early next year by the water authorities and by ourselves on the separating-out of the NRA following our recent announcement, I would hope to achieve Royal Assent by July, 1989, with the opportunity for one flotation at the end of November, 1989. Even so, as you will have gathered, the timetable would be extremely tight. We would then have to wait until after the Budget for further flotations. Hopefully, it should be possible to float all of the other nine authorities in the financial year, 1990/91. However, this working assumption, (I do not think it should be called a plan) will have to be reviewed in November, 1988, in the light of the latest financial assessments, and of progress with preparing for the NRA.

The consideration of receipts introduces yet more uncertainties. Your officials played a full part in the work of the Financial Assessment Committee, and are aware both of the range of possible totals of sale proceeds which emerged in that work and the qualifications which must be attached to them. The proceeds will also be heavily dependent on market conditions at the time of flotation, and in present market conditions the FAC figures would

be significantly too high. Much depends on financial developments in the meantime, as emphasised in the second paragraph of this letter. As a working assumption it might be reasonable to assume proceeds of £1bn in 1989/90 and £5bn in 1990/91. I would attach a wide range of uncertainty to these figures, perhaps £0.5bn - £1.5bn in 1989/90 (if one flotation can be achieved) and £2.5bn - £7.5bn in 1990/91.

In the light of all of the uncertainties which were clear in your discussion with Lord Belstead, I do not think it would be productive to attempt any more detailed analysis at the present time. We must now proceed with our preparations of all authorities, and take stock of the position at key points in the timetable, such as July, after reviewing water authorities' Corporate Plans, and particularly in November, after the IFR, and in the light of progress on separating out the NRA activities. In the meantime, I hope that the guidance in this letter will be of some help to you.

Copies of this letter go to the Prime Minister and other members of the Cabinet, and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Nicholas Ridley', written in a cursive style.

NICHOLAS RIDLEY