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Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
 Secretary of State
 Department of Energy
 Thames House South
 Millbank
 LONDON
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10 June 1985

AEA BILL: COVERAGE

Thank you for your letter of 9 May about the AEA Bill. I have also seen Norman Tebbit's letter of 24 May.

The possibility of AEA taking a minority stake in joint venture companies has been discussed by colleagues separately.

I think there is little between us on the desirability of facilitating partial privatisation in the medium-term. My preference would have been to take powers in the Bill for you to direct the disposal of activities unconnected with nuclear safety. But I see the Parliamentary problems that might involve. I am content to leave this out of the Bill on the understanding that the objectives of the Chairman and other Board members include the requirement (set out in your paper for E(NI) last October) to manage the AEA's affairs so as to create viable areas which could either become joint ventures with the private sector or be floated off in total.

I am content with your proposals for minor provisions. It is already common ground that the remaining indemnities to BNFL and shippers should be run down as far and as quickly as possible.

Our officials have been discussing the options for the AEA's capital structure. I understand the reason for your Department's inclination towards a solely debt-based system similar to the monopoly nationalised industries. Unfortunately our experience is that this creates difficulties in the longer-term, as the value of debt declines in relation to assets

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in real terms. The impending problems faced by the ESI becoming debt free are a classic example. It is significant that the Electricity Council itself has moved voluntarily towards wanting to pay dividends on its retained earnings rather than repay more debt as part of negative EFLs. It seems to me unsatisfactory to create capital structure for the AEA Trading Fund which we know at the outset would have a major defect. Accordingly I think we should plan on the basis that AEA will make dividend payments to the Exchequer on a regular basis from distributable profit, as the Government Trading Funds do. The amount would be derived from (ie not determine) the Financial Targets we will agree for the AEA, taking account of interest and any Corporation Tax payments due. My preference would be to enshrine such arrangements in the AEA Bill by providing explicitly for commencing equity to be created (on which dividends are payable) alongside commencing debt; and for powers to convert reserves into additional equity later. That could readily be presented as akin to the private sector practice. The Government does of course already have broad powers of direction over AEA's revenues and accounts already. There should thus be at most only small additions to the Bill; it may even be that Parliamentary Counsel will advise that none are needed.

It would be important to make clear both to the AEA and the House what was intended so that there were no misunderstandings later. If you are content I suggest that officials from your Department and Treasury draw up, with the AEA, a comprehensive statement of the proposed financial structure which would serve both as a record of what was intended and a basis for public presentation.

I am copying this letter to the Prime Minister, the Lord President, members of E(NI) and Sir Robert Armstrong.

Peter Rees

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