



Abb
NBPN

Treasury Chambers, Parliament Street, SW1P 3AG

John Patten Esq
Minister for Housing, Urban affairs
and Construction
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

24 January 1986

Dear Sir

WATER PRIVATISATION: DRAFT WHITE PAPER

FILE WITH DRAW

Thank you for your letter of 21 January. I have now seen the revised draft covered by Kenneth Baker's letter to the Prime Minister of 22 January and am very content with the way in which the points I raised earlier have been handled.

Kenneth drew attention to a change in the reference in paragraph 3.9 to the public bodies which would assume responsibility for flood defence after privatisation. On the understanding that this leaves quite open our eventual decision on the precise type of body to be set up, I can support, and indeed would prefer, the new formulation.

I understand that our officials have agreed a number of small drafting points on this draft. Only one difficulty now remains to be resolved. In paragraph 4.17, "threat of takeover" is described as a spur to efficiency. Until our thinking is clearer on the circumstances in which we would regard takeovers as acceptable and those in which we would regard them as objectionable, I think that it would be wiser to drop this reference. It will, I feel, simply, raise the spectre of foreign takeovers and of diminished competition between authorities as a result of amalgamation which I do not think would be helpful until we are clearer about the appropriate riposte if indeed we decide in due course that takeover is desirable. It may also cause problems in relation to wider share ownership and employee involvement.

I am copying this letter to the recipients of Kenneth Baker's.

John Moore

JOHN MOORE

LOCAL GOVT
WATER
PT 3





PRIME MINISTER

WATER PRIVATISATION - WHITE PAPER

With my minute of 23 December I enclosed a copy of the draft of the White Paper on Water Privatisation. Your Private Secretary wrote in response on 13 January, and I have also had helpful comments from a number of colleagues.

Generally, we have been able to accept colleagues' points and I am writing to them individually to explain how we have handled the issues of substance which they have raised. We have also made our own revisions, to tighten the drafting and in particular to spell out more clearly the benefits which will arise from privatisation. The text is much improved.

I should draw attention to one point where I am now proposing to draw back from what we agreed in E(A), namely on the future arrangements for a public body to finance land drainage and flood protection. I believe we should keep our options open on this pending advice from officials in the Interdepartmental group on the Financing and Administration of Flood Defence, and have written to Michael Jopling accordingly.

We aim to publish the White Paper on Wednesday 5 February and delay must be avoided if we are to meet our timetable for legislating in the next session. I am circulating this revised text in the expectation that colleagues will not be seeking further changes. If they do, however, I must have them please by midday on Friday 24 January. If we do not hear by then, we will assume colleagues are content.

I am sending a copy of this to members of the Cabinet, John Wakeham, Bertie Denham, Sir Robert Armstrong and Brian Griffiths.

K.B.

K B

22 January 1986

Prime Minister 4

To note the two
parts marked below.

DES

24/1

cc:SG

✓
MD



Treasury Chambers, Parliament Street, SW1P 3AG

10th January 1986

The Rt Hon Kenneth Baker MP
Secretary of State for the Environment
2 Marsham Street
LONDON SW1

NRBM

Ken Kenneth.

WATER PRIVATISATION: WHITE PAPER

at Map

WITH DRN

Thank you for copying to the Chancellor your minute of 23 December to the Prime Minister and the draft of the White Paper. I agree with Norman Tebbit's view (his letter of 6 January) that it makes a good case for privatisation of the Authorities in their present form and that it meets very adequately the argument that privatisation would jeopardise the interests of consumers and the environment. I am also grateful for the efforts your officials have made in keeping my people here at the Treasury closely in touch during the drafting of the Paper.

I think that Chapters 2 and 3 read well and that the balance has been struck satisfactorily in explaining why there are limits on the extent to which further improvements can be achieved within the public sector without denigrating those very real achievements which have been made by the Authorities since the reorganisation in 1974.

I remain, however, slightly concerned by the extent to which we appear to be committing ourselves to an RPI - x type formula in Chapter 4. There is a great deal of work to be done on the nature of the regulatory framework following publication of the White Paper and the precise mechanism of the formula could easily be left more open, for example in 4.12 where there is a firm steer towards RPI-X.

Secondly, the reference to new committees (eg in paragraph 4.25) gives the rather misleading impression that there will be an elaborate new committee structure accompanying privatisation. The proposals, for consumer consultative committees at authority

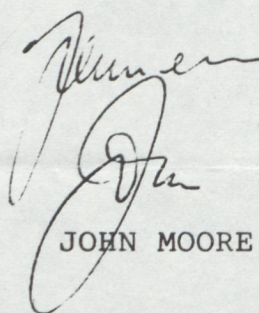
level which will replace the original divisional committees, for recreation and conservation committees and fisheries committees may be acceptable but I am sure that the structure should be kept as simple as possible and that this should be a stated aim.

Thirdly, it is proposed (paragraph 4.7) that the licence should require WSplcs to make an adequate contribution to R&D. This is an unusual licence condition and while I can understand your concern that underinvestment in research would, in practice, take place without such a licence requirement, I feel it may be unwise to include such a specific reference when so many details of the regulatory regime remain open. At the very least the reference to "contributions" could be dropped, so that the licence would require WSplcs "to maintain an adequate research and development capacity". This leaves the question slightly more open.

Fourthly, it is proposed in Chapter Five that the Secretary of State should retain a general power of direction with respect to their responsibility as pollution control authorities (5.10). I am not convinced that it is practicable or desirable for future Ministers to have such a power of direction over private sector companies. Whilst I quite appreciate the need for control, I do feel it would be more appropriate for it to be exercised through a proper statutory system or through a neutral third-party (eg the Director-General) rather than through ad hoc powers of Ministerial direction. The idea that future Ministers should have unconstrained powers of direction over future private sector companies makes me very uneasy.

I have annexed a number of more detailed drafting points which I think could usefully be incorporated and I would be grateful if our officials could agree how these should be handled.

Copies of this letter to go to recipients of yours.



JOHN MOORE

ANNEX

DETAILED COMMENTS ON DRAFT WHITE PAPER ON WATER PRIVATISATION

1.3. As the benefits listed do not relate exclusively to the consumer, as is now implied, the first sentence could be revised to "The Government believes that the nation will benefit from privatisation of the Water Authorities in the following ways:"

1.5-1.10. In a number of cases (eg environmental protection) it is probably worth mentioning improved arrangements under more than one heading as they benefit more than one group.

1.13. 2nd sentence, delete "also" as it is redundant.

2.11. It is rather unhelpful to refer to flood defence in the context of the importance of integrated management over the whole river catchment area, as it is not a function which will be retained by the WSplcs.

2.22. Last sentence. The reference to real profits is rather obscure. Amend to "since 1979, the Government has stimulated them to more effective management by requiring the authorities to achieve a rising real rate of return, more in line with that of the private sector as a whole."

2.25d. The statement about future levels of expenditure on flood protection and land drainage are more quantified and pre-emptive than for the other areas of expenditure discussed in this paragraph. As neither flood protection nor land drainage are being proposed for the privatisation cost this commitment seems unnecessary. The first two sentences should therefore be amended to read "The Water Authorities have planned to incur capital expenditure of £200-250m over the next 4 years to prevent flooding and there will be a continuing need for such work into the 1990s."

2-Tables. As chapter 2 concentrates on achievements since the 1973 Act, it would be appropriate for the tables to date from then. Table 3 does not state the year to which it refers.

3.4. Last sentence. Insert "WSplcs" before "articles of association".

3.9. The possibility of making the direct beneficiaries pay or developers contribute to expenditure on land drainage and flood protection is under consideration but the opening part of this paragraph rather gives the impression that there is a commitment to fund all expenditure from the public purse. It would be better to say "The Government proposes to reconcile these opposing ideals by new arrangements for the financing and co-ordination of"

4.2. Although it is correct to say that the water industry differs from Telecommunications and Gas in the extent to which competition is possible, it is similar in its local distribution networks. To this extent it is consistent to treat water similarly and it would be useful to make this point here.

4.3. and 4.13. Both give "consultancy" as main example of the scope for competition in services. This sells us short. There is scope for competition over a wide range of leisure services and 4.13 is more diffident than is necessary on the scope for competition on laboratory analysis, sewage treatment and competition for customers on authorities' borders.

4.19(ii). The reference to the various situations being reflected in their "flotation prices" may give rise to the misleading impression that the Government would be prepared to sell certain authorities at a larger discount than others.

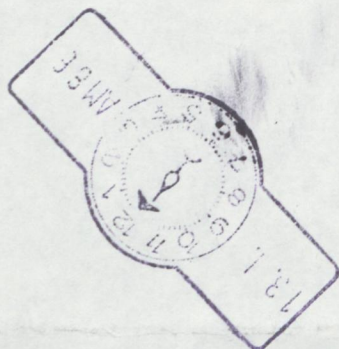
4.20. Delete reference to "the formula described" and insert "a price control formula of the type described".

4.23. This paragraph, which explains how the cost of services currently funded by the Environmental Service Charge will be met, is slightly opaque and gives over-heavy emphasis to the consultative process which the Director General would undertake in coming to a decision about the appropriate subsidy. Perhaps it could be revised to read "the Government will expect efforts to be made for the maximum possible recovery for those services currently funded by the Environmental Service Charge. Some areas of new enterprise could well be done on a profit making basis. However, it is accepted that some desirable activities may have to continue to be run at a loss and, as described in paragraph 3.15, WSpIcs will be able to meet the net cost of those services currently funded by the Environmental Service Charge from the Charges for their main services. The size of the contribution which is at present no higher than 2.5% in any part of the country would be determined, after appropriate consultation, but the Director General. There is no question of repealing obligations.....".

5.6. Last sentence: delete "and tradition of public service" as it may invite the comment that a better way of preserving this tradition would be to retain the authorities in the public sector.

LOCAL GOVT PTS

WATER INDUSTRY



CCBG



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NB 2 pp's

Minister for Housing,
Urban Affairs and Construction

My Ref: B/PSO/10278/86

21 January 1986

NBPM

WATER PRIVATISATION - DRAFT WHITE PAPER

Thank you for your letter of 10 January about the White Paper on water privatisation.

I think we have been able to meet all your points adequately. We will be circulating a revised text in the next day or two, and you will find that explicit reference to RPI-X is no longer a feature, although we do refer - as I think we must - to the fact that there are precedents for price control formulas in the Telecoms and Gas cases. I agree that a good deal more work needs to be done in working up a model appropriate to the water industry.

On committees, the draft now includes a sentence that our overall aim will be to keep the structure of WSPLCs as simple as possible. We no longer refer to separate recreation and conservation committees and I accept that we will need to look, interdepartmentally, at the arrangements for all the functions you mention to ensure that simplicity is, if possible, achieved.

On research and development, we think it is important (and we will be under a good deal of pressure in the House of Lords Select Committee on Science and Technology and elsewhere if we do not say this) that the WSPLCs should be able to carry out themselves, or to have carried out, adequate research and development to fulfil their responsibilities. We have dropped the reference to environmental and long-term issues, though there will be cases, undoubtedly, where work on such matters will be necessary.

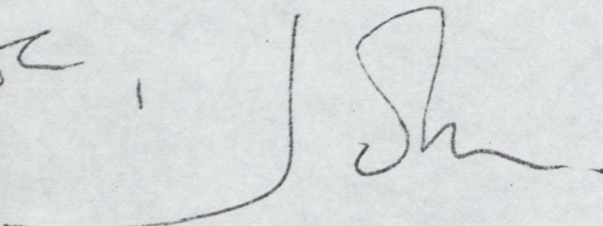
So far as directions are concerned, we will certainly need a mechanism for ensuring that EEC directives and pressing pollution control requirements arising in a national context, can be brought into effect. The Secretary of State will retain his environmental protection duties, including those laid on him by section 1 of the Water Act 1973, and he must have a means of discharging those duties in such a crucial area as water pollution. Nevertheless, I accept your point about the possible alarm which the exercise of direction

C O N F I D E N T I A L

powers by future Ministers might cause in the mind of potential investors. The revised draft is therefore couched in terms of powers subject to Parliamentary procedure and I hope that this will give the arrangements the protection you feel is necessary.

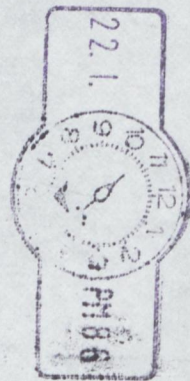
Officials have discussed your more detailed points and I believe that the Treasury is satisfied with the way we have handled them.

I am sending a copy of this letter to those who received yours.

Yr. ltr. 

JOHN PATTEN

LOCAL GOVT: water ind. Pt 3.



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PRIME MINISTER

WATER PRIVATISATION - WHITE PAPER

Following consideration in E(A) on 19 November of the memorandum on Water Authority Privatisation submitted jointly by Nicholas Edwards, Michael Jopling and myself, we now submit a draft White Paper for colleagues' approval. This has been drafted to provide a clear statement of our policy and to meet the various points raised during the E(A) discussion.

In developing and clarifying our views on the form of regulation, John Patten and I have had the benefit of a report from Professor Littlechild which it is my intention should be published at about the same time as the White Paper. Section 4 of the draft White Paper follows his lead in proposing a system of regulating prices and service levels together; and the management would be motivated to make profits by achieving both as efficiently as possible. Our proposals also take full advantage of the potential for competition between the ten authorities in the stock market and in all other possible ways.

Flood prevention and land drainage cannot be dealt with in this White Paper though paragraph 3.10 states the new context in which the administration and financing of these functions must now be reviewed. On pensions we cannot go beyond the statement on para 7 of Section 1 until we have had discussions with the water authorities and the Treasury; the statutory water companies' employees are in the same pension arrangements as the authorities' and careful negotiation will be needed when the broad shape of our proposals has been disclosed. Tax issues too cannot be resolved unambiguously before water authority asset registers have been reviewed, but we shall not be under immediate pressure to show our hands on taxation. The proposals in Section 5 should allay the inevitable misgivings of the environmental interests, with careful presentation. The investors will have to accept them if water authorities are to be privatised at all.

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On water metering, the White Paper does I hope reflect your views as expressed in your Private Secretary's minute of 9 December. In particular it makes clear our support for the extension of metering, the advantages of economies of scale in installation and the need for large scale trials.

In conclusion I would just like to mention the statutory water companies. They are already in the private sector, so they are not the main focus of our policy. However, we do see advantage in their agreeing to convert themselves into PLCs and to come within the same regulatory framework as that to be established for the WSPLCs; our bill will provide for this voluntary transition. I am pleased to report that the initial response to this suggestion from the Water Companies Association has been quite encouraging.

As our policy paper E(A)(85)64 made clear, our aim is to legislate for water authority privatisation in the 1986/87 session, to incorporate all water authorities as WSPLCs as soon as possible after Royal Assent, and to be ready during 1987 to begin a sequenced flotation of all the authorities. This is a very tight timetable, and to hold to it is essential for the White Paper to be published very early in the New Year. I would therefore ask all colleagues to let me have any comments on the draft White Paper by Monday 13 January at the latest.

I am copying this minute to all Cabinet Colleagues and to John Wakeham, Bertie Denham, Sir Robert Armstrong and Brian Griffiths.

SWenderson

for

K B

*Approved by the Secretary of State and
signed in his absence*
23 December 1985

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