



House of Commons
Committee of Public Accounts

Risk management: the nuclear liabilities of British Energy plc

Thirty-seventh Report of
Session 2003–04

*Report, together with formal minutes,
oral and written evidence*

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The Committee of Public Accounts

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Rt Hon Alan Williams MP (*Labour, Swansea West*)

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Mrs Cheryl Gillan MP (*Conservative, Chesham and Amersham*)
Mr George Osborne MP (*Conservative, Tatton*)

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The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at http://www.parliament.uk/parliamentary_committees/committee_of_public_accounts.cfm. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Nick Wright (Clerk), Christine Randall (Committee Assistant), Leslie Young (Committee Assistant), and Ronnie Jefferson (Secretary).

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Summary

Introduction

British Energy is the largest electricity generator in the United Kingdom, with an annual turnover of over £2 billion. Its eight nuclear stations generate approximately 20% of the electricity used in England and Wales, and half of that used in Scotland. The 1996 privatisation raised £2.1 billion for the Government, and British Energy accepted responsibility for all its nuclear liabilities, including the disposal of spent nuclear fuels and decommissioning of power stations. These liabilities were valued at £5.6 billion on a discounted basis to take account of the long period over which they were expected to mature.

Following a period of sustained falling prices for generating electricity, in September 2002 British Energy declared that it might no longer be able to meet its liabilities as they fell due. The Government granted a £410 million credit facility to provide working capital and to allow British Energy to stabilise its trading position. In October 2003 British Energy formally agreed a restructuring deal with its key creditors and the Government. Under the deal the Department of Trade and Industry has assumed £1.7 billion of British Energy related liabilities and is ultimately exposed to British Energy's remaining £3.9 billion liabilities.

In 1998 when reporting on the privatisation, this Committee raised concerns about the taxpayer's potential exposure to British Energy's large nuclear liabilities, because the Government is ultimately responsible for ensuring the safe management or disposal of spent nuclear fuel and for decommissioning nuclear stations.¹ We recommended that the Department should monitor carefully British Energy's ongoing ability to meet its liabilities in full without recourse to the taxpayer. The Department accepted the need to monitor these risks² and, as regards British Energy's financial position, took comfort from the dividend payments made to shareholders after privatisation, including the £432 million special dividend payment made in 1999.

On the basis of a Report from the Comptroller and Auditor General,³ we took evidence from the Department and British Energy on the extent to which risks originally transferred have been accepted back and the adequacy of the Department's monitoring of British Energy's viability.

1 5th Report from the Committee of Public Accounts, *Department of Trade and Industry: The sale of British Energy* (HC 242, Session 1998–99)

2 Treasury Minute (Cm 4335) on the 5th Report from the Committee of Public Accounts, *Department of Trade and Industry: The sale of British Energy* (HC 242, Session 1998–99)

3 C&AG's Report, *Risk management: The nuclear liabilities of British Energy plc* (HC 264, Session 2003–04)

Conclusions and recommendations

1. **Despite retaining, under international treaty obligations, the large residual liabilities associated with nuclear power, the Department treated British Energy after privatisation as just another company.** But the Government's formal residual liability implied that British Energy was in a different situation from any other company and the Department needed to behave as a prudent business would in managing the residual risk. The Department failed, however, to put in place any proper risk management arrangements to protect the taxpayer from these risks as set out in our predecessors' Report.
2. **The Department assumed that privatisation obliged it to distance itself from British Energy's potential problems, but that constraint was to a large extent self imposed.** At privatisation the Department had prepared a risk analysis, which could have formed the basis of continuing risk management, but it failed to update this analysis, and omitted British Energy from its work underpinning the 1998 White Paper on energy for power generation.⁴
3. **The Department placed too much emphasis on British Energy's dividend payments, particularly the £432 million special dividend, as an indicator of its financial position.** Dividend payments are not necessarily a good indicator of a company's financial health and departments should not rely on them. In the private sector financial institutions will make arrangements to prevent companies leaking value through paying dividends and other fees to investors where underlying performance is poor. The Department should make arrangements in the restructured British Energy to avoid the risk that the Company might be weakened by excessive distributions to its shareholders.
4. **The Department did not have access to definitive information and in the critical two years to early 2002, it was left to British Energy to bring matters to its attention.** In future where departments are exposed to potential liabilities, they should equip themselves with rights of access to company information similar to those obtained by financial institutions in a comparable position.
5. **The Department failed to establish a credible overview of British Energy's deteriorating financial position, and did little more than gather information.** Its inaction was compounded by split responsibilities for monitoring British Energy and the design of the New Electricity Trading Arrangements. In designing and coordinating energy policy it failed to consider the taxpayer's potential exposure. The Department should establish effective oversight of British Energy's financial position, drawing on information from outside and within British Energy and resolving any inconsistencies in information at the time they arise.
6. **British Energy executives may receive bonuses as a result of improvements in the company's finances accruing from restructuring funded by the taxpayer, including the Government's £410 million credit facility.** The Department should

4 Conclusions of *The review of energy sources for power generation*, Government Reply to 4th and 5th Reports of the Trade and Industry Committee, Session 1997–98 (Cm 4071)

require that financial improvements brought about through its support for restructuring are excluded when considering directors' remuneration and bonuses. One way such an exclusion could be achieved might be through a memorandum of understanding regarding the terms of directors' contracts overseen by the appointment of a partnership director on the remuneration committee.

7. **British Energy's management did not respond effectively to the changes in the electricity market and the Department did not challenge the company's strategic direction.** British Energy's failure to invest in domestic electricity supply significantly contributed to the company's eventual difficulties. Where departments may have to bear residual liabilities from private companies, they should undertake strategic benchmarking of the company against its major competitors and seek explanations for significant variations as a matter of course. In future where departments face significant risks reverting back to them, they should consider whether a Public Private Partnership, with its closer relationships between departments and the private sector and scope for joint risk management, would provide a more appropriate arrangement than privatisation.

1 The extent to which risks originally transferred have been accepted back

1. British Energy was privatised in 1996. Through a combination of share sales and debt repayment by British Energy, the Government received £2.1 billion. As part of the privatisation process the Government transferred £5.6 billion of nuclear liabilities from the taxpayer to the private sector (**Figure 1**). The liabilities are expected to mature over a long period with power stations having lives of 40 years or more. If these liabilities were to crystallise earlier than expected, they would cost more – possibly as much as £14 billion. International law requires that the Government must bear the responsibility and hence meet the costs where no third party under its domestic law can discharge its obligations in respect of nuclear safety.⁵

Figure 1: The nuclear liabilities of British Energy plc

	As at 31 March 1996	
	Undiscounted £bn	Discounted £bn
Fuel costs		
-reprocessing and storage of spent fuel and related by products	8.4	4.6
-management of intermediate and high level waste	1.4	0.3
Sub total	9.8	4.9
Decommissioning		
-station decommissioning	3.4	0.6
-management of intermediate and high level waste	0.8	0.1
Sub total	4.2	0.7
Total	14.0	5.6

At privatisation British Energy took on liabilities valued at £5.6 billion which are due to mature over a number of years. The liabilities would be valued at £14 billion if they matured tomorrow.

Source: C&AG's Report, Figure 4

2. To finance the liabilities for decommissioning nuclear power stations, at privatisation the Government established the Nuclear Generation Decommissioning Fund, through an initial payment of £228 million from the state owned predecessor companies to British Energy. To meet the full £3.4 billion cost of station decommissioning,⁶ the Fund will depend on investment returns and contributions from British Energy. The Fund is currently worth between £300 million and £400 million.⁷ British Energy was to meet all other nuclear liabilities such as nuclear fuel costs from its operating cash flows.

3. As a result of changes in the electricity markets and a sustained period of falling prices for generating electricity, British Energy faced serious financial difficulties. In 2002 British Energy's financial problems came to a head. In May 2002 it warned the Department of its difficulties and in September 2002 it announced that it might no longer be able to meet its liabilities. The Department took back £1.7 billion of nuclear liabilities⁸ as part of ongoing

5 C&AG's Report, para 1.1

6 This cost is based on the current planned closure dates of British Energy's stations.

7 The exact value changes with the day-to-day changes in the value of its investments; Q 84

8 Q 3

restructuring of all nuclear liabilities in the UK from British Energy, British Nuclear Fuels and the Ministry of Defence. All liabilities will be transferred to a new public body, the Nuclear Decommissioning Authority. If British Energy were to become insolvent and station closures occurred sooner than planned, all the liabilities would mature earlier. The cost of nuclear liabilities, less the value of the Nuclear Generation Decommissioning Fund, would then fall to the Government.

4. As part of its support to British Energy, in September 2002 the Government provided a £410 million Credit Facility Agreement. Extending credit facilities has provided breathing space, enabling British Energy to plan its restructuring but there is a risk that improvements flowing from Government support might be used to calculate bonuses for directors.⁹ To avoid such a situation occurring, a memorandum of understanding could be drawn up requiring British Energy to insert appropriate terms into its directors' contracts. The memorandum might also require British Energy's board to consider explicitly the performance of directors in addition to the benefit arising from Government intervention. Such work could be led by a partnership director, similar to those established at the time of the public private partnership for National Air Traffic Services Ltd.¹⁰

9 Qq 148–149

10 C&AG's Report, *The public private partnership for National Air Traffic Services Ltd* (HC 1096, Session 2001–02) para 4.7

2 The adequacy of the Department of Trade and Industry's monitoring

5. When we examined the sale of British Energy in 1998,¹¹ we raised concerns about the taxpayer's financial exposure to British Energy's nuclear liabilities. We recommended that the Department should monitor carefully the company's ongoing ability to meet its liabilities without recourse to the taxpayer. In the Treasury Minute response the Department accepted our recommendations (**Figure 2**).

Figure 2: Summary of the Committee's previous recommendations

PAC	Treasury Minute
<p>In 1998 the Committee recommended that the Department:</p> <ul style="list-style-type: none"> • monitors carefully the company's ongoing ability to meet its liabilities without recourse to the taxpayer; • should monitor the progress of the nuclear industry in developing its technologies for undertaking decommissioning; • maintains communication with the key parties responsible for monitoring the level and financing of nuclear liabilities: British Energy, The Nuclear Installations Inspectorate and the Nuclear Generation Decommissioning Fund's Trustees. In this way, the Department can assure itself that all parties are focused closely on the best means of managing nuclear uncertainties and financial risks. 	<p>The Department responded:</p> <ul style="list-style-type: none"> • The Department will continue to monitor carefully as recommended the company's ability to meet its liabilities and the development of technologies for the disposal of waste. • The Department notes the Committee's conclusions. The Department already maintains close communications with British Energy, the Nuclear Industries Inspectorate and the trustees of the Nuclear Decommissioning Fund with a view to ensuring this and other objectives.

Source: 5th Report from the Committee of Public Accounts, *The sale of British Energy (HC 242, 1998–99)*, and the *Treasury Minute to the Report (Cm 4335)*

6. Given the Department's commitments and the size of its potential exposure, we would have expected the Department to undertake a significant amount of risk management activity. Since privatisation, however, the Department has treated British Energy no differently to any other company.¹² The Department took a narrow view of monitoring. Before the New Electricity Trading Arrangements¹³ were introduced, it stood back from the company. Part of its rationale for this was the size of British Energy, which represents 87% of the nuclear sector.¹⁴ The Department also considered that support of the nuclear sector might be construed as state aid to British Energy.¹⁵

7. As part of the privatisation the Department had developed a financial model of British Energy's future revenues to 2035 and compared these revenues with the then best estimates of the size and timing of liabilities. After privatisation, however, the Department considered it inappropriate to conduct ongoing analysis of the ability of British Energy to

11 5th Report from the Committee of Public Accounts, *Department of Trade and Industry: The sale of British Energy (HC 242, Session 1998–99)*

12 Q 37

13 The New Electricity Trading Arrangements, introduced in March 2001

14 C&AG's Report, Figure 3

15 Q 51

generate sufficient cash to be able to meet its future liabilities and abandoned its modelling work.¹⁶ The Department also omitted British Energy from its analysis for its 1998 energy White Paper,¹⁷ despite its forecasts showing a 50% fall in the power generation industry's profits.¹⁸ The White Paper considered that nuclear fuel would play a decreasing role in energy generation. The Department did not address the implications this would have for British Energy's ability to fund its nuclear liabilities and the risks of these liabilities returning to the taxpayer.

8. In the decisive period between 2000 and 2002, the Department relied on publicly available information. Some analysts considered that British Energy could face difficulties.¹⁹ Others were more upbeat, pointing to profits from overseas ventures and the potential for a recovery in prices. The Department did not come to its own view on the potential impact for British Energy and only attempted to establish the true state of British Energy from its internal information when prompted by an invitation from the company in early 2002.²⁰ The Department did not put in place the formal access rights and regular reporting which financial institutions insist on when facing similar potential liabilities.²¹

9. Between 1998 and 2000 British Energy made a number of unsuccessful offers for domestic electricity supply companies. On two occasions it was outbid by Electricité de France. This inability to achieve vertical integration significantly contributed to British Energy's eventual difficulties.²² Whilst it was unsuccessfully trying to purchase a supply business, British Energy returned £432 million to shareholders through a special dividend and purchase of shares.²³ In May 1999 British Energy signalled the special dividend. The arrangement was that registered shareholders in August 1999 would receive payment in October. During the period from May to August, British Energy's share price fell by 13% (**Figure 3**) compared with the 3% fall in the FTSE. But for the special dividend, British Energy's share price might well have fallen further.²⁴

16 C&AG's Report, para 2.1

17 Conclusions of *The review of energy sources for power generation*, Government Reply to 4th and 5th Reports of the Trade and Industry Committee, Session 1997–98 (Cm 4071, Chapter 10)

18 Q 139

19 Qq 74, 104–105

20 Q 113

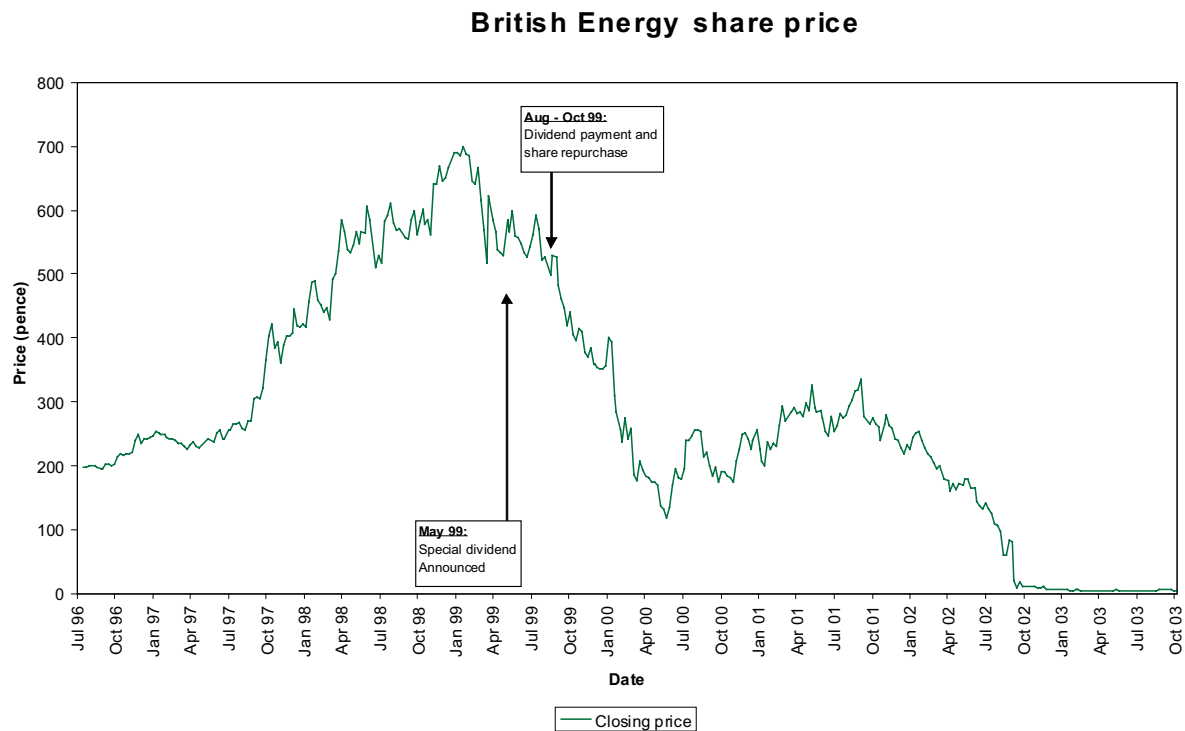
21 Qq 37, 50, 66, 70, 74–77, 112

22 C&AG's Report, para 2.18

23 Q 10

24 Qq 10–18

Figure 3: British Energy's share price 1996–2003



The special dividend of 1999 did not significantly affect British Energy's share price.

Source: British Energy

10. The Department took significant comfort from British Energy's payment of dividends.²⁵ Dividends are set for a number of reasons, however, such as meeting expectations of investors, and are not in themselves necessarily a good indicator of a company's state of financial health. In the private sector financial institutions exposed to a company will have arrangements such as guarantee agreements to ensure that dividends do not damage the overall health of the company.²⁶ The Department's distancing from British Energy meant that it was not in a position to question the company and protect the taxpayer's position.²⁷

11. Had the Department undertaken strategic benchmarking of British Energy against its competitors it would have known that other generating companies were acquiring supply companies. It could then have questioned closely British Energy's strategy. A Public Private Partnerships arrangement, with its closer relationships between departments and the private sector and scope for joint risk management, may better facilitate such work and may be more appropriate in future transactions where there are significant risks to the taxpayer.²⁸

25 C&AG's Report, para 3.21

26 *ibid*, para 3.28

27 Q 135

28 Q 136

12. After privatisation the Department split responsibilities for monitoring British Energy and developing the New Electricity Trading Arrangements.²⁹ Because the Department was not effectively managing the risk to the taxpayer of its exposure to British Energy,³⁰ it did not bring its exposure to the attention of other departments whose actions impacted on the electricity industry.³¹ The New Electricity Trading Arrangements, together with a new rating regime³² and the Climate Change Levy,³³ were therefore introduced without full consideration of their impact on British Energy and the possible consequences for the taxpayer.³⁴

29 C&AG's Report, para 3.3

30 Q 123

31 Q 80

32 Q 125

33 Q 122

34 Q 52

Formal minutes

Monday 28 June 2004

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Allan	Mr Frank Field
Mr Richard Bacon	Mr Brian Jenkins
Mrs Angela Browning	Jim Sheridan
Mr David Curry	Mr Alan Williams
Mr Ian Davidson	

The Committee deliberated.

Draft Report (Risk management: the nuclear liabilities of British Energy plc), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 12 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report, as amended, be the Thirty-seventh Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

Adjourned until Wednesday 30 June at 3.30 pm

Witnesses

Wednesday 11 February 2004

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Sir Robin Young KCB, Department of Trade and Industry, and **Mr Adrian Montague CBE**, British Energy

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Second Report	The new electricity trading arrangements in England and Wales	HC 63 (<i>Cm 6130</i>)
Third Report	The Sheep Annual Premium Scheme	HC 64 (<i>Cm 6136</i>)
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Fifth Report	Warm Front: helping to combat fuel poverty	HC 206 (<i>Cm 6175</i>)
Sixth Report	Department of Trade and Industry: Regional Grants in England	HC 207 (<i>Cm 6155</i>)
Seventh Report	Progress on 15 major capital projects funded by Arts Council England	HC 253 (<i>Cm 6155</i>)
Eighth Report	The English national stadium project at Wembley	HC 254 (<i>Cm 6155</i>)
Ninth Report	Review of grants made to the National Coalition of Anti-Deportation Campaigns	HC 305 (<i>Cm 6175</i>)
Tenth Report	Purchasing and managing software licences	HC 306 (<i>Cm 6175</i>)
Eleventh Report	Helping consumers benefit from competition in telecommunications	HC 405 (<i>Cm 6191</i>)
Twelfth Report	Getting it right, putting it right: Improving decision-making and appeals in social security benefits	HC 406 (<i>Cm 6191</i>)
Thirteenth Report	Excess Votes 2002–03	HC 407 (<i>N/A</i>)
Fourteenth Report	Inland Revenue: Tax Credits	HC 89 (<i>Cm 6244</i>)
Fifteenth Report	Procurement of vaccines by the Department of Health	HC 429 (<i>Cm 6244</i>)
Sixteenth Report	Progress in improving the medical assessment of incapacity and disability benefits	HC 120 (<i>Cm 6191</i>)
Seventeenth Report	Hip replacements: an update	HC 40 (<i>Cm 6271</i>)
Eighteenth Report	PFI: The new headquarters for the Home Office	HC 501 (<i>Cm 6244</i>)
Nineteenth Report	Making a difference: Performance of maintained secondary schools in England	HC 104 (<i>Cm 6244</i>)
Twentieth Report	Improving service delivery: the Veterans Agency	HC 551 (<i>Cm 6271</i>)
Twenty-first Report	Housing the homeless	HC 559
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Thirty-seventh Report	Risk management: the nuclear liabilities of British Energy plc	HC 354

The reference number of the Treasury Minute to each Report is printed in brackets after the HC printing number

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 11 February 2004

Members present:

Mr Richard Allan
Mr Richard Bacon
Jon Cruddas
Mr Brian Jenkins

Mr Siôn Simon
Mr Gerry Steinberg
Mr Alan Williams

In the absence of the Chairman, Mr Alan Williams was called to the Chair

Sir John Bourn KCB, Comptroller and Auditor General, National Audit, further examined.

Mr Rob Molan, Second Treasury Officer of Accounts, HM Treasury, further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL: Risk Management: The Nuclear Liabilities of British Energy plc (HC 264)

Witnesses: **Sir Robin Young KCB**, Permanent Secretary, Department of Trade and Industry, and **Mr Adrian Montague CBE**, Chairman, British Energy, examined.

Q1 Mr Williams: The hearing today is on the risk management of the nuclear liabilities of British Energy plc and our principal witness is Sir Robin Young and may I congratulate you, Sir Robin, on having such enormous pulling power; you have clearly developed star status because we never normally attract an audience of this size. Would you care to introduce your colleague.

Sir Robin Young: Adrian Montague is the Chairman of British Energy and he is the other witness here today.

Q2 Mr Williams: Sir Robin, one of the objectives of privatisation is risk transfer. How far down the path are we now of the risk transfer that we thought had been undertaken at the time of privatisation now being transferred back to the Government?

Sir Robin Young: Something obviously depends on whether the restructuring that has been proposed by the company and which the Government announced they have accepted does actually happen and that is dependent on agreement by the European Commission, as we will come on to discuss during the session. The intention and the expectation was that all the assets and liabilities were to be privatised and that was a discussion that was had at this Committee when you looked at the NAO Report on the privatisation of British Energy and it was concluded that the Department at that time had done all it could to make sure that the liabilities would stay in full in the private sector where they were meant to be. Subsequent to that, as this Report demonstrates, things did not work out as expected and, in 2002, we did have the offer of a restructuring by the company which we have accepted. The risks are then split differently and some of them indeed have returned to the public sector where they were to begin with.

Q3 Mr Williams: Am I right in saying that the £3.7 billion that we thought had been transferred at the time of privatisation is now down to £2 billion and that the Department now, as shown in its resource accounts, has an exposure of £1.7 billion?

Sir Robin Young: I think those figures are right. I cannot vouch for the absolute accuracy but that order of thing, yes.¹

Q4 Mr Williams: It is quite a reversal.

Sir Robin Young: Yes.

Q5 Mr Williams: It might not end there either, I suppose.

Sir Robin Young: No. The restructuring is conditional on the company proving viable and staying viable.

Q6 Mr Williams: Which is a fascinating philosophical conjecture at this point in time.

Sir Robin Young: Yes.

Q7 Mr Williams: So, conceivably, you are potentially open to the maximum risk of taking back the full responsibility.

Sir Robin Young: That is the maximum risk we face, yes.

¹ *Note by witness:* The discounted estimate of £3.7 billion at the time of privatisation as the cost of discharging nuclear liabilities has not substantially changed. It is therefore not correct to say it has been reduced to £2 billion. The £1.76 billion to which Mr Williams refers represents the Department's estimate of its current exposure to BE's nuclear liabilities discounted at 6% as recognised in its Consolidated Resource Accounts for 2002–03.

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Q8 Mr Williams: We made recommendations to you in a previous report referred to in paragraph 1.12. At the time, in the Treasury Minute, the Government and you, the Department, paid lip service to the recommendations we made, but really most of those have not been carried out or followed through.

Sir Robin Young: I do not think that is fair and it is certainly not what the Report says. As regards the monitoring in particular, which was the first one in paragraph 1.12, we did indeed monitor and the Reports sets that out. So, if I refer you, in summary anyway, to paragraph 15 on page 5, that is where the degree of monitoring which we carried out, exactly as requested by your Committee, happened. So, broadly speaking, the extent of monitoring obviously was influenced by the likelihood of action that that monitoring could lead to.

Q9 Mr Williams: Yet you have taken a very narrow view of monitoring. You produced yourselves in 1998 your Review of Energy Sources for Power Generation. In that review, remarkably, you omitted British Energy which is the very company that probably gave you the most danger in terms of risk exposure. Why on earth was it not even included in the review?

Sir Robin Young: We consulted British Energy, by that stage the privatised company, on that review and they had every opportunity, and no doubt took it, to make their own case. So, it was not a question that they were ignored. We consulted very, very, very widely throughout the energy sector in 1998 and it was for the company of course to respond to that consultation, which they did.

Q10 Mr Williams: Can I come to you on this, Mr Montague. In paragraph 3.21 on page 27, it is pointed out that you, in 1999, paid a special dividend of £432 million. That was a fairly massive distribution. Why?

Mr Montague: In the previous year, the Chairman at the time had given, I think informal assurances, but quite clear assurances to the shareholders, predominantly the city shareholders, that, if it was felt that the company had surplus capital at the time, we would return it to shareholders. So, the dividend payment that was made at that time was in discharge of those assurances.

Q11 Mr Williams: How would it compare with the normal dividend in your experience? In May 2002, there was what was described as a full dividend and that was just £31 million.

Mr Montague: Yes. It was clearly a return of capital to the shareholders; it was much more substantial than you would expect in the case of an ordinary dividend.

Q12 Mr Williams: It was more than 14 times the normal dividend.

Mr Montague: Yes.

Q13 Mr Williams: Was it not irresponsible?

Mr Montague: No, I do not believe that it was irresponsible.

Q14 Mr Williams: Did it not artificially alter the share price?

Mr Montague: One of the difficulties that certainly I face in this situation is that I am trying to transpose myself back in time to June 1999 when, as I said, the company had a different Chairman, and I think that we have to try to view that decision in the context of the circumstances at the time.

Q15 Mr Williams: Are the consequences not that you gave the existing shareholders 14 times the normal dividend, you therefore inflated the market value of their shares and thereby induced other future shareholders to pay inflated prices for shares that eventually were to slump in value. They were deceived, as the Department was deceived, by that handout.

Mr Montague: I do not believe that that is the case because, as I said earlier on, this was a payment which had been signposted the previous year.

Q16 Mr Williams: That would be reflected in your share price, would it not?

Mr Montague: I believe it was—

Q17 Mr Williams: Would it or would it not?

Mr Montague: I think it would certainly have been reflected in the share price.

Q18 Mr Williams: Therefore, the outcome of that was that members of the public who subsequently purchased were deceived by a false impression of the financial position of the company.

Mr Montague: No. I believe that the dividend was, as I say, clearly signposted. It reflected and was seen to reflect a different set of circumstances than those that subsequently developed. I do not believe that future shareholders were misled because the payment of that dividend was reflected in the price and in fact, at the time—

Q19 Mr Williams: I am sorry, that just does not make sense. Look at paragraph 3.21 of this Report where it deals with the special distribution and the normal distribution. “Both the Department and British Nuclear Fuels plc concluded from this that British Energy’s situation was not as serious as the Company was claiming.” You are claiming a serious situation and, at the same time, you were dispersing money with the largesse that is beyond comprehension and therefore you really misled people, in subsequent periods, into paying inflated prices for the shares.

Mr Montague: No, I do not believe that is the case, with respect.

Q20 Mr Williams: Try and explain how it cannot be. How can it be anything else?

Mr Montague: Can I draw your attention to the timing of this because the special dividend was declared in May 1999. This was at a time well before the new trading arrangements for the electricity market, which were the cause of many of the company’s difficulties and before those new trading arrangements had been introduced. So, at the time,

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this was a dividend that reflected the way in which the company had developed its operations in the years before the new trading arrangements. Therefore, I think that you cannot draw the inferences which I believe you were trying to draw that we had produced a dividend that was misleading to future shareholders. It was clearly signposted.

Q21 Mr Williams: Sir Robin, do you think that the structure in your Department was appropriate to ensure that you had an adequate degree of monitoring throughout these crucial early years?

Sir Robin Young: Yes, I do. If I can refer you again to paragraph 15, there were three periods, as it were, of this: the period immediately after privatisation up to early 2000, then 2000 to 2002 and then after 2002. So, what we did was, when the company was generating a lot of cash in the way you have just referred, we monitored it quite lightly and did not set up any special unit to monitor the company because the company was generating cash. Then, when the first storm cones were erected, as it were, in May 2000 when the then Chairman wrote in warning us that things were looking less good, we then started forming teams and finally we formed a special unit after March 2002. In other words, we responded organisationally to the financial circumstances of the company.

Q22 Mr Allan: Just to pick up on Mr Williams's point, at paragraph 3.21 we are told, "British Energy had seriously considered cutting the 2002 dividend. However when the Company had cut its 2000 dividend by 50%, its share price had fallen by 15% in a single day." It does look like there was a period of perhaps two years in 2000 and 2002 where British Energy was pulling all the corporate tricks it could to sustain the share price at the same time as going cap in hand to the DTI saying, "We are nearly bankrupt" and that does seem to have ended up resulting in the taxpayers' liability. Early action could have been taken had that strategy not been followed. Do you now think that was mistaken?

Mr Montague: I think that you need to view these things, as I say, in the context of the circumstances at the time.

The Committee suspended from 3.47 pm to 3.54 pm for a division in the House.

Q23 Mr Allan: Mr Montague, I was hoping that you were going to explain the strategy of the company telling the market that everything was fine from one side of its mouth while telling the Department that everything was terrible out of the other side of its mouth between 2000 and 2002.

Mr Montague: I think you chose the start of this question in 2000. I think you need to put 2000 in the context of what had happened before then because, in 2000, the new trading arrangements were coming into force. The price of power in the wholesale markets had already started a significant decline, a decline which was initially forecast to be just 10% but, in the event, turned out to reach a maximum of 40%. So, the company was in distress in the same

way as other generators in the marketplace were in distress. This was a much greater than expected decline in prices. So, the company at the time spoke to the DTI, the Chairman wrote to the DTI, to start a process of discussing with the DTI the implications of this fall in prices for the company. Life had to go on as normal; we had nuclear power plants to operate; we were trying to reduce the costs in those plants; and we were trying to increase production. There was an international strategy to become a nuclear operator in nuclear plants overseas. So, life was going on as normal. I do not recognise your description of tricks or saying one thing to one party and one thing to another. I think there was a consistent presentation to the Government side of the difficulties the company faced throughout this period.

Q24 Mr Allan: I gained my impression from the Report itself. In paragraph 3.19, it tells us, "In contrast to generally positive analyst statements, British Energy's representations to the Department focused much more on the threat from falling wholesale electricity prices." In gentle speak, that is saying that the company was saying to the Department it had a serious problem.

Mr Montague: Indeed.

Q25 Mr Allan: And saying to the market that it did not and I can understand why it would want to do that.

Mr Montague: No.

Q26 Mr Williams: Can I just take you up on one point given in answer which is not correct. You said that you expected 10% but, in paragraph 7, it makes it clear that the Department considered that the price reductions was of at least 10% to 15%, 10% being the lower parameter, so at least 10–15% were likely, not just remotely possible but were likely, and yet you talk about the lower figure as if that was the maximum you had to contemplate where clearly it could have been way above 15%.

Mr Montague: I think it was the general expectation, not just of the DTI but also of Ofgem who were quoted at the time of expecting around 10%. That, I think, was the broad consensus in the market at this stage. It is true that the Report refers to a band between 10% and 15% and I am sure that that is correct. The point I was trying to draw was that there was a contrast between expectations of 10% and 15% and the eventual decline of 40%.

Q27 Mr Williams: Why was the Department right in thinking 10% to 15% and you wrong thinking of only 10%? It does not make sense. The Department was slightly more realistic than you were.

Mr Montague: No, I am not suggesting to you that there was a difference of opinion within the industry. I think there was a general consensus at the time that the prices were likely to take a reduction of 10% or 15%. That was the expectation. I am contrasting that small reduction with the serious collapse that eventually ensued.

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Q28 Mr Williams: Following on, Sir Robin, you signed up to this document.

Sir Robin Young: Indeed.

Q29 Mr Williams: Your colleague is trying to disassociate himself with what you signed up to here. The Department—and these are the words you are signing up to—considered that reductions of at least 10% to 15% were likely. Were you not alarmed that an industrial consensus seemed to be way, way below what you were expecting to be the least?

Sir Robin Young: I do not think that is what Adrian Montague was saying. There was a consensus that there were going to be reductions. We did indeed estimate it at that time as 10–15%. I think Adrian Montague was saying that it was within that range, I suppose hoping that it would be at the lower end of that range.

Q30 Mr Williams: Right at the bottom of that range.

Sir Robin Young: If that is what it was.

Mr Montague: I think that, contrasted with a 40% collapse, the difference between 10 and 15, although significant, is not so startling.

Q31 Mr Williams: That is a statement of the obvious but you still were manifestly at least 15% wrong even on the Government's assessment. The minimum was 10%, the maximum they regarded as likely was 15% and you have gone for the very lower figure.

Mr Montague: No, I do not think I suggested that. I said there was a general consensus that there would be a reduction in prices of around 10%. If I neglected to include 10% to 15% as a band of around 10%, then I am sorry. I think it was clear that a relatively small reduction in prices was likely to ensue.

Q32 Mr Allan: When did the scale of the price levels become clear to you and that you were heading to 20%-plus? At what point did you start to revise your opinions?

Mr Montague: If you look at what actually happened in the wholesale market, if we can turn perhaps to the charts you will find on page 19 of the Report, you will see then that the decline was progressive after the new trading arrangements were introduced in March 2001 and they had come down from a peak under the old system which was arrived at in October 1999, and can I point out, just to come back on a point that Mr Williams mentioned earlier on, that that was a significant period after the first large dividend, to which reference has been made here. So, that dividend was paid at the time when prices were high. Prices started their decline when the shape of the new trading arrangements became apparent. That decline accelerated after the introduction of those arrangements in March 2001. That was the point at which discussions with the DTI, prompted by British Energy, were already under way.

Q33 Mr Allan: If I can turn to the Department's role because, in a sense, that is where we are really interested because, unlike TXU or somebody, when British Energy has problems, the taxpayer has

problems. We are told quite clearly in paragraph 3.18 that British Energy originally approached the Department in Spring 2000 but that the Department continued to rely mainly on publicly available and market information. In other words, it was believing the analysts who, as we have seen from other cases, often have a vested interest in talking up companies beyond their actual status. It does seem very peculiar that civil servants who are supposed to be guarding the taxpayers' interests were relying on market information rather than doing anything more fundamental when a company which carries huge taxpayer liability came to them. Can you explain that.

Sir Robin Young: Certainly. During that second period of monitoring, we were having much more regular discussions with the company, that is between May 2000 and early 2002, so it was not that we were purely relying on the market, we were actually talking to the company much more frequently. As the Report sets out, the company was asking us to do two or three things which are set out in the Report earlier in part 3. So, we were not getting the impression, nor was it the case, that it was an immediate collapse that was just around the corner at that stage. They were asking us for particular things—and it is quite common for companies to ask the DTI for particular things—involving lower taxation, one local taxation and one national taxation. Those were the things they were asking for. That was the discussion we were having with the company and it was a perfectly good discussion and there is nothing wrong with a company asking for that sort of help and there is nothing wrong with us taking it up with the relevant department. That was what was going on.

Q34 Mr Allan: It looks much more stark because it speaks of the year 2000 in particular, so it is being highlighted by the C&AG. "In particular the Department made use of brokers' investment analysis as a source of information regarding British Energy's financial health." This is following the initial approach in 2000 and all the way up to 2002. In 2002, we are told that, because of this payment of the dividend, the Department concluded that British Energy's situation was not as serious as the company was claiming. In other words, it missed a critical window of two years when these other strategies like building the retail market and so on could have worked. The Department seems to have been pretty deaf as to what was going on and simply picked up the analysts' reports and these paragraphs seem to spell that out in terms.

Sir Robin Young: We were the ones hearing what the company was saying and the company was not saying at that time, nor did it have the evidence so to do, that collapse was imminent. Whereas, when it did start saying that, which was early 2002, we responded very differently. So, when they said certain things to us, we responded and, when they said other things to us, namely, "Can we have these three bits of help?" we responded by looking at those three bits of help or whatever number of things they wanted. Of course, it is relevant to what the market

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was saying because remember that the risk we are looking at is them not having enough money to meet their liabilities and the fact that they did have enough money to pay dividends and that the marketplace was at least divided on it was relevant to us because it meant that they had enough money to meet their liabilities. That is the risk I am looking at, not anything about the future. I am concerned that they are paying for their liabilities and they were paying for their liabilities at that time.

Q35 Mr Allan: To follow on this matter, if you flick back to paragraph 2.1—and having read through the Report, there is a thread running through it—that paragraph tells us, “The Department did not update or revisit the modelling work it had assembled at the time of privatisation in the light of these changes.” These are predicted changes in the electricity market for which the Department is responsible. “The Department considered it would have been inappropriate to have undertaken ongoing modelling of a private company.” This is not any private company. This is not TXU or Centrica, this is a private company with liabilities that fall back on the taxpayer. Again, we seem to see a trend throughout of the Department, which from our point of view is the guardian of taxpayers’ money and who were supposed to be doing the work, appearing very reluctant to engage in the serious work that was needed.

Sir Robin Young: I do not think that is right and it is not what the Report says either. If you look at paragraph 3.15, we consulted, amongst others, British Energy about the changes that were envisaged and, if I can quote from paragraph 3.15, “British Energy’s stance was not to oppose the changes but to question their timing . . .” etc. “As late as December 1999 British Energy still expressed confidence . . .” etc “...could cope with the reduction of 10–20% . . .” to pick up a wider range. So, we were consulting with the company which had all its modelling capacity available to it and we were consulting lots of others and, of course, this Committee has just looked into the way in which we introduced the new electricity trading arrangements and, as recently as four months ago, this Committee’s report praised us really for the way in which we brought in the trading arrangements and its complaint, if I remind you, was really that the price reductions did not come through to the domestic sector as much as it did to the others.

Q36 Mr Allan: There was not a team sitting there in the DTI specifically saying, “British Energy are different.” We can talk about the generality of the market, but what was different here was this eventual liability and it strikes me that—

Sir Robin Young: There was a team bringing in the arrangements which consulted widely in the sector including British Energy. As the Report again made clear, there was nothing inevitable about the new arrangements leading to the eventual collapse of the company. That was not inevitable at all as the Report makes clear.

Q37 Mr Allan: The thread throughout the Report seems to be that the DTI was treating British Energy just like any other energy company and that is the part which subsequent events have shown was incorrect, in a sense. To treat them just like any other company was irresponsible in the sense that the liabilities that potentially would come from British Energy were of a wholly different order from any that would come from the collapse of any other energy company.

Sir Robin Young: You are quite right that we had given the company the assets and liabilities and they were their assets and their liabilities and therefore it was for them to model and prepare their response to the emerging picture—that was our view—and for us to second guess them and second guess the various strategies which the Report sets out they did try to adopt to avoid what actually happened, would be, I think, wrong. This was a privatised company; we had given them the responsibility of taking these decisions; it was not for us to say, “Go to America” or “Don’t go to America”, “Try and buy up some retail” or “Don’t try and buy up retail.” That was not our job as we saw it and nor as the privatisation had it.

Q38 Mr Steinberg: Sir Robin, the whole privatisation has been a complete disaster, has it not? It has been handed absolutely disastrously by your department.

Sir Robin Young: I think that is very unfair and—

Q39 Mr Steinberg: No, it is not unfair and I will tell you why. What amazes me about permanent secretaries who come here is that they seem to have a different interpretation of the reports that we get—is it not funny that my line of questioning is exactly the same line of questioning as Mr Allan’s; I follow exactly the same line and will follow it—and yet you see it in a completely different way. I find it amazing. Sometimes I wonder whether we get the same reports.

Sir Robin Young: The reason that I said it was unfair was because—

Q40 Mr Steinberg: If you read this Report, it is a disaster and you are responsible, or your department is, for making such a disaster.

Sir Robin Young: The reason that I say it was unfair is that, in paragraph 2, it refers to the NAO Report on the privatisation of British Energy and it “recognised that the Department created British Energy as a robust company, obtaining a high degree of assurance that British Energy would have the capacity to meet its nuclear liabilities . . .” That was the NAO Report, this Committee considered it and no one said that we had, as it were, done privatisation wrongly. That is all I was saying. I am of course not saying that it is—

Q41 Mr Steinberg: It is a little bit different saying that you did the privatisation correctly but how you actually then carried out, in the ensuing years, your relationship with British Energy clearly shows how you cocked it up, to be quite honest with you. Mr

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Montague, you are a busy man, are you not? You are Chairman of British Energy; you are Deputy Chairman of Network Rail; you are Chairman designate of Infrastructure Investors; you are leading the Government's review of Crossrail; you are Chairman of Michael Page International; and you are a non-executive director of CellMark AB. How many days a week do you put into British Energy?

Mr Montague: About two or two-and-a-half.

Q42 Mr Steinberg: So, there are about 12 days in a week!

Mr Montague: I am a non-executive chairman.

Q43 Mr Steinberg: How much do you get paid for doing the job?

Mr Montague: I get paid a basic fee of £150,000 a year. During the reconstruction period where, on many occasions, I have been working seven days a week, I get—

Q44 Mr Steinberg: Do you not think you should be the full-time Chairman of British Energy?

Mr Montague: I think that the Chief Executive and I have an arrangement under which he is very much full time and I am there whenever the company needs me.

Q45 Mr Steinberg: How much is the taxpayer putting into British Energy at the moment?

Mr Montague: At the moment, the taxpayer has, through the Department of Trade and Industry, advanced a loan to the company which was originally a maximum of £410 million.² At the moment, it has been reduced to £200 million and our drawings on that loan, the actual money we have had from taxpayers at the moment, are very small. I do not have the exact figure.

Q46 Mr Steinberg: I think it is important that we know.

Mr Montague: I think it is at the moment zero.

Q47 Mr Allan: So, you have not borrowed anything?

Mr Montague: Not at the moment.

Q48 Mr Steinberg: Do you intend to borrow anything?

Mr Montague: This is a loan which is due to expire when our reconstruction is completed. At the time the reconstruction becomes effective, we will have the new arrangements with Government under which some of these liabilities will be taken back on

to the Government balance sheet, but we do not expect any ongoing financial support from the Government.

Q49 Mr Steinberg: Mr Williams asked you about dividends paid presumably before you were there under the old regime. What dividends have been paid our recently? When was the last dividend paid out?

Mr Montague: The last dividend was in May 2002 before the collapse. There have been none recently.

Q50 Mr Steinberg: Sir Robin, getting back to what we are talking about originally, you were quoting paragraph 15 to Mr Williams. However, you did not continue to quote the paragraph because, if you had quoted the second little point, you will see that it says, "The period from Spring 2000 to early 2002, when the Department, uncertain in the face of mixed messages from the Company therefore increased its monitoring of the risks, trying to understand the real extent of the Company's difficulties from outside, and decided to 'wait and see.'" That is a different sort of impression than you have given certainly me, I do not know about the rest of the Committee. That was a little like an ostrich putting its head in the sand hoping that somebody else would solve it, but nobody else did solve it, did they? They had to come back to you, did they not? Just look at the appendix 2 on page 39 and if we look from March 2000, "31 March 2000 Chairman of British Energy advises Ministers of a major reverse to the fortunes of the Company, due to a 20% fall in prices and the difficulty of finding further cost reductions given an 'increasingly tough line' by safety regulators." Then, "28 April 2000 British Energy Directors obtain meeting with Departmental officials, and highlight British Energy's need for concessions on the Climate Change Levy and in the cost of services from British Nuclear Fuels . . ." Then we go on to, "May 2000 British Energy Chairman formally raises Climate Change Levy . . . is a matter for Treasury . . ." who have a lot to answer for as well—I hope he is not sitting there hiding behind his Report! Perhaps he could tell us why they did not do something about it as well—" . . . declining to become directly involved . . ." Then, "June 2000 Department concludes from review of brokers' reports that British Energy 'might be overdoing the gloom.'" It just reads like a disaster. Anybody with any sort of knowledge or anybody with any commonsense would have looked at this and thought, bloody hell, something is wrong here, but you did not, you just sat in your department, buried your heads in the sand and let British Energy get into more and more trouble, even though you were being warned that there was going to be a catastrophe, that there was going to be a disaster. Why?

Sir Robin Young: That is not a description that I recognise from this Report. As I said, between May 2000 and early 2002, we had hugely upped our monitoring and discussions with the company. The company asked for three or four things including things to do with local taxation and national taxation and, as I was saying in reply to Mr Allen,

² *Note by witness:* A Credit Facility Agreement of £410 million was originally extended to British Energy on the 9 September 2002. This loan facility, repayable with interest, was put in place to cover working capital requirements and cash collateral for trading. On 26 September 2002, this facility was increased to £650 million, which was reduced down to £200 million on 7th March 2003 following the sale of BE's Canadian assets. The CFA was raised temporarily on the 27 November 2003 to £275 million, but then reverted to £200 million on the 23 December following the sale of BE's US assets. There are currently no drawings under the CFA.

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those are discussions we took up with the relevant departments. This was not an emergency, it was not, in our view or in the view of most of the people in the market place, inevitable that the company was at that stage going to go bust. You will remember also that we cannot, as a department, intervene on behalf of a single private company, it is not policy and that would be unfair—

Q51 Mr Steinberg: This is not a normal private company, is it? It is a nuclear company which could have disastrous effects on the general public not only in terms of what might happen if anything went really, really wrong, but in terms of the actual amount of money that it is costing. It is not Marks and Spencer, I agree with you, but you treated it as though it was Marks and Spencer or an ordinary private company, that is the whole point.

Sir Robin Young: That is the point. It is set up as a private company. We are not allowed to give it state aid without getting permission from the European Commission and, if we do help in any way, the first people to complain would be its competitors. We have set up a marketplace for energy supply as this Committee knows because it has done the NETA report, the New Electricity Trading Arrangements Report. It was deliberately set up as a market which means that the Department cannot intervene on behalf of a single firm. It just cannot.

Q52 Mr Steinberg: Do you not feel as though you have a responsibility to say to, say, Ofgem, the Treasury, the Deputy Prime Minister's Office and the Health & Safety Executive, "Look, we are treating this company as an ordinary private company and, frankly, they are not." Even when they came along, as I work it out from the Report, they were not being treated as an ordinary private company. For example, the Report says that other energy companies get rate relief. When they came along and asked you for rate relief, you referred them to John Prescott's Department and it was refused. You then referred them to the Treasury Department as far as Climate Change Levy relief was concerned and they refused. What was going on here is quite incredible. Here is a company going down the drain. It would probably not have cost more to the taxpayer in the long run for you to have given them some sort of refund on climate energy at the Treasury, but you did not. Quite honestly, it makes an incredible story of incompetence.

Sir Robin Young: I am surprised at this line of questioning. This was a company which—

Q53 Mr Steinberg: You are surprised!

Sir Robin Young: This was a company which was a private—

Q54 Mr Steinberg: Can I have a look at your report to see if we have the same report.

Sir Robin Young: This is a private company which is still paying out dividends. You are suggesting, frankly, that the Department or the Government

should intervene and pay it a special thing, which would be a subsidy from the taxpayer straight to the shareholder. That is really what you are suggesting.

Q55 Mr Steinberg: No, I am not—

Sir Robin Young: And, if I may say so, that is the wrong policy.

Q56 Mr Steinberg: Mr Williams questioned you on the payment of dividends. It was quite outrageous that they paid a dividend in the first place considering that they were going down the drain and here they were paying out a dividend bigger than they had ever paid before. I am not for one moment suggesting that they should be paying out dividends, what I am suggesting is that you should have been seeing that in fact the company was being run properly, which clearly it was not and it was going down the drain. It was millions of pounds in the red.

Sir Robin Young: Just to pursue my earlier point, you were suggesting that earlier Government intervention by way of payment from the taxpayer to this private company should have happened earlier. I was arguing that that is a straightforward subsidy from the taxpayer to the shareholder which I would expect this Committee to criticise—

Q57 Mr Steinberg: No, it was not because you would not pay the dividend—

Sir Robin Young: . . . and I am also arguing—

Q58 Mr Steinberg: Who said anything about paying dividends? I did not mention paying dividends, you did.

Sir Robin Young: The company to whom you are suggesting we should have made early interventions and payments from the Exchequer was a company which, at that time, was paying out dividends. That is a factual statement.

Q59 Mr Steinberg: Right.

Sir Robin Young: So, it would have been the case that—

Q60 Mr Steinberg: Wrongly.

Sir Robin Young: Rightly or wrongly, so the taxpayers' money would be a straight subsidy to the shareholder. Moreover, it would have admitted that the company was going under and produced a distorting Exchequer subsidy to a particular company, which is illegal under the State Aid Regulations.

Q61 Mr Steinberg: But you have done it now.

Sir Robin Young: We have done it under Rescue and Restructuring, which is subject to the European Commission and of course have had the complaints from other competitors in the marketplace of unfair special treatment to this particular company.

Q62 Mr Williams: Following up on this point about that incredible dividend of £432 million, you indicated that was under pressure from the year before from your investors, but what you are saying is that you capitulated to the institutional investors

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and you bled money to the fat cats in the city instead of keeping it where it should have been as working capital within the company.

Mr Montague: No, I do not think that is at all a fair representation of events, if I may say so. The dividend was paid well before any of the changes were introduced that gave rise to the difficulties. There had been specific undertakings given to shareholders generally. We were not preferring any class of shareholder over any other shareholder—

Q63 Mr Williams: It was just that the ones who got the most and kept the most were the institutional investors.

Mr Montague: If you invest more than another shareholder, you expect to get a proportionate return.

Q64 Mr Williams: We understand the system but we are not sure that you do.

Mr Montague: I am doing my best!

Q65 Mr Williams: You do not seem to understand what we are saying.

Mr Montague: I am doing my best!

Q66 Mr Jenkins: Like other members of this Committee, I have difficulty because, like Mr Allan, Mr Williams and Mr Steinberg, I have the same report which I have read and we go through it without having the benefit of the departmental expertise in picking up the right phrases and the right words to support the Department. All we are trying to do is understand exactly what role the Department had in overseeing this situation. Quite clearly, when you get a privatised industry like the nuclear industry, we knew it was very difficult from the start because of the potential liabilities and, because of that potential liability, the Government decided to act almost as underwriter and put themselves in the front line, that is the taxpayer in the front line, if anything went wrong with the industry, as I understand it, and therefore your department had the responsibility to monitor, not aid, not finance and not in any way to support by the way of large sums of money but merely to monitor the situation. If I can take you to page 5 and to something to which we have already referred in paragraph 15, “The Department’s management of the financial risks, to the taxpayer, from British Energy’s nuclear liabilities evolved during three main phases.” The first phase was quite easy. When the industry was privatised, it went off very well, made large profits within a very good price for its product and therefore it says at the bottom, “The Department considers that monitoring was proportionate given the apparent success of the privatised Company during the period.” So, if monitoring was proportionate, what monitoring did you do that was deemed to be proportionate in that period?

Sir Robin Young: We had regular meetings and discussions with the company, we checked that they were paying into the Nuclear Generation Decommissioning Fund, which is the thing

mentioned on page 14, which is where the other bit of insurance that the privatisation brought in was to advise the company to pay into that fund, which of course it was doing. If you look at the description of the liabilities on page 12, we were satisfied—and it was the case that and the Report confirms that—that it was paying both into the decommissioning fund for the bottom half of the table of liabilities on table 4 and it was meeting the liabilities at the top of that table from its profits.

Q67 Mr Jenkins: So, we have now established that the Department was meeting the company?

Sir Robin Young: Yes.

Q68 Mr Jenkins: The privatised company and were in discussions with that privatised company as to its financial well being to ensure that no liabilities would have to come from the taxpayer; is that right?

Sir Robin Young: It was checking—

Q69 Mr Jenkins: It was not in breach of any European legislation.

Sir Robin Young: It was checking that the company was paying for its liabilities in the way that the privatisation set out.

Q70 Mr Jenkins: In the second phase “. . . from Spring 2000 to early 2002, when the Department, uncertain in the face of mixed message from the Company therefore increased its monitoring of the risks, trying to understand the real extent of the Company’s difficulties from outside, and decided to ‘wait and see.’” Wait and see for what exactly?

Sir Robin Young: To see whether the company was in as great a difficulty as some people were saying. Most people were saying that the company was not in so much difficulty that departmental intervention was needed. Remember, we can only intervene under EC law if a firm is in serious difficulty or what the Report calls “publicly evident distress”.

Q71 Mr Jenkins: I am not asking you to intervene in contravention of EC regulations. What I am asking you to do is to ensure that you yourself and your department went in, discussed with the company and established the level of uncertainty, clarified the messages and therefore could assess the risk to the taxpayer.

Sir Robin Young: Okay. I give you that assurance today.

Q72 Mr Jenkins: You decided to wait and see.

Sir Robin Young: Yes and I give you that assurance and that is what the Report says. So, we did indeed monitor, in the second period in paragraph 15, just in the way you say. Now, we decided that there was not evidence—

Q73 Mr Jenkins: This is where I go wrong—I do not have my rose-tinted glasses on—because “. . . trying to understand the real extent of the Company’s difficulties from outside, and decided to ‘wait and see.’” You were not inside the company, you were

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not establishing the full facts from inside the company, you were stood outside the company and, from what I can see, juggling mixed messages.

Sir Robin Young: No, I do not think that is right. We were meeting the company at all levels, ministerial level and various official levels, so we were with the company on a monthly or nearly monthly basis. So, we were with the company and speaking with the company about their prospects. So, we were going to the company and asking about their prospects and we were discussing with them the two or three things that they wanted from us.

Q74 Mr Jenkins: Let us take the third phase because the third phase is “. . . from March to September 2002, when the Department’s advisers”—correct me if I am wrong here—“having for the first time looked inside British Energy . . .” That is “. . . having for the first time looked inside British Energy . . .” Is this report wrong or have you been misleading me?

Sir Robin Young: Certainly not.

Q75 Mr Jenkins: You told me just now that, in the second phase, you were looking inside the company, you were looking with the department.

Sir Robin Young: I hope I said that we were meeting the company on a regular basis at ministerial level and various official levels. So, we were with the company on a monthly basis or nearly monthly basis. I hope that I said that.

Q76 Mr Jenkins: What is the step change from ‘wait and see’ to looking inside the company?

Sir Robin Young: The information coming from the company is then much more urgent. So, at this stage, the company tells us, “This is now imminent collapse.” This is now where a firm is in publicly evident distress. Therefore, the firm is in difficulty and that was the time where intervention was possible and likely and that is why we stepped up our act.

Q77 Mr Jenkins: You stepped up your act?

Sir Robin Young: Yes because they told us it was an emergency.

Q78 Mr Jenkins: The company was in a highly vulnerable position due to falling prices. This leads to a catalogue of three steps. The first step is that you were very much in the hands of the company in what they told you and what they said to you. The second step is that you actually did ask the company a few questions. The third step is that when the company was in serious difficulties and asked you to come in and they invited you inside the company to look at the books and see what was possible.

Sir Robin Young: I think that is it. That seems to be entirely right. I do not see why you think it is not.

Q79 Mr Jenkins: I think it is not because, if I were responsible for ensuring taxpayers’ money, I would have wanted certainly a memorandum of operation and authority and to go inside the company and ensure for myself that the operations were robust and, in the second phase, I would have wanted a

much more robust investigation to flag up the liabilities and the difficulties because, on the previous page where it says in the last paragraph of section 12, “The Department in discussions with these other agencies whose policies affected British Energy, did not specifically draw their attention to the risks posed to the taxpayer by British Energy’s nuclear liabilities.” The Department did not inform the other agencies, “Look, we have a problem here. We had better start dealing with it.” You did not talk to them.

Sir Robin Young: We certainly did regularly talk to all these agencies.

Q80 Mr Jenkins: And you flagged up the liability and risk?

Sir Robin Young: No because, at that stage—

Q81 Mr Jenkins: That is your job.

Sir Robin Young: Because, at that stage, in our view, the liabilities were not of sufficient risk for them to be flagged up.

Q82 Mr Jenkins: So, you totally miscalculated the liabilities.

Sir Robin Young: This line of questioning is making it look as if it was clear to everybody that the company was going under at that early stage. This report does not say that. It is not my view that that was the case. So, it is not right that it was clear, inevitable and unavoidable at this early stage that the thing was going under. Does that make it clearer? We were trying to establish at what stage the company was in publicly evident distress and that is why we were meeting the company more and more and that is why the company finally told us at the beginning of 2000 that it was urgent that we put in our own person in order to get the reconstruction arranged.

Q83 Mr Jenkins: Mr Montague, I see the decommissioning fund on page 14 at figure 5 where the fund value has decreased in the last year. Is this because some of the fund was tied up in the marketplace and, as the market values went down, so the fund suffered like everybody else in effect?

Mr Montague: That is correct.

Q84 Mr Jenkins: If the market comes back and if we get over the magic 5,000, will the fund be looking more robust?

Mr Montague: The fund has already recovered to the tune of a large amount of the deficit. The deficit has more than halved in the last six months.

Q85 Mr Jenkins: So, the market will go up and rescue your fund.

Mr Montague: I think the difficulty is that we are trying to provide for 100-year liabilities, liabilities accruing in 100 years, with assets of a much shorter duration.

Q86 Mr Simon: It is interesting that you should have been talking just now about the 100 years. Sir Robin, is it the case that, shortly before BE paid its special

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dividend of £432 million in 1999, it moved rather quietly the provisioning date for repository from 2015 to 2115, effectively in which case moving the company's long-term commitment by a century in order, very shortly thereafter, to pay short-term cash out to shareholders?

Sir Robin Young: I cannot answer that question. I do not know whether Adrian can.

Mr Montague: I think I am going to struggle. Perhaps I can take some advice and come back to it a little later on.³

Q87 Mr Simon: I think it is quite an important question. It seems to me that creating this 100 years you have just talked about by moving arbitrarily your provisioning date by a century, it is in fact exactly what enabled you or part of what enabled British Energy to pay £432 million of dividend only three years before it is demanding £410 million worth of credit from the Government.

Mr Montague: I must say that my knowledge is slightly limited in time because I took over this job about 15 months ago. My colleagues have given me a note which I am not sure I follow entirely.

Q88 Mr Simon: Perhaps we can move on and if you can indicate . . .

Mr Montague: I will send you a note.⁴

Q89 Mr Simon: During the privatisation in 1996, the HMG documentation states that the Government's view was that a segregated fund was the most robust mechanism to ensure adequate coverage of future liabilities, but this is not the case with the new NDA in the Energy Bill which will be financed by a segregated account with actual cash assets contained in the consolidated fund. So, what has happened to account for that difference in approach? Is that effectively recognition that the BE fund is not robust? This is more directed towards Sir Robin who has more of an overall view.

Mr Montague: Can I describe the previous Nuclear Decommissioning Fund (NGDF). There were then assets held separately in a trust that I believe did not form part of the consolidated fund. They were, if you like, assets dedicated to the application of decommissioning.

Q90 Mr Simon: And the new NDA is going to be in the consolidated fund. Is that recognition that the BE fund is not robust? Is that why the NDA is going to be in the consolidated fund?

Mr Montague: That probably is—

Q91 Mr Simon: I am asking Sir Robin.

Sir Robin Young: As I understand it, it is a statistical change. The Office for National Statistics has decided that these things should be public sector, so

the NDA has been statistically defined as in the public sector. It does not mean that the funding is not robust.⁵

Q92 Mr Simon: No more than a statistical difference, it is a difference between a segregated fund and part of the consolidated fund, it is a government current account effectively. It is either ring-fenced or it is not and it used to be and now it is not.

Sir Robin Young: Going back to the second part of your question, the NGDF as on table 5 at page 14, is fine. Now that the market has come up again, the fund is—

Q93 Mr Simon: Sticking with the NGDF, you are now saying that the market has come up. When the next review comes in 2006, are you confident that the fund will be okay without the contributing level having to be increased?

Sir Robin Young: That would be for the trustees to discover. As you can see we have set it up so that every five years the trustees review it. The last time they reviewed it they gave it a clean sheet.

Q94 Mr Simon: If there is a shortfall and BE cannot pay it who is going to pay it?

Sir Robin Young: The Government.

Q95 Mr Simon: The Government.

Sir Robin Young: If the restructuring goes through.

Mr Montague: It may be helpful to add that of course these are liabilities which will fall in in 80 or 90 or years' time, they are quite a long distance away.

Q96 Mr Simon: I understand that. The fund is measured in comparison against the projected future costs of decommissioning effectively. If you just bear with me, the rate of investment growth assumed by the fund according to the BE accounts suggests 3.5% real return per annum which compared with the rate of 2.5% for index-linked government gilts therefore implies a risk-based element to the investment return targeted by the fund. Given the nature of the fund, ie to guarantee sufficient resources to discharge future liabilities, does that risk element not run fundamentally counter to the *raison d'être* of the fund? I am directing that to Sir Robin.

Sir Robin Young: You are criticising the arrangements made at the time of privatisation. This was the way of meeting liabilities which was considered by the previous NAO/PAC and found to be robust. That was part of the privatisation deal. That was the way in which it was deemed to be right at that time, it is some time ago, obviously, of dealing with the decommissioning costs. The fund

³ Ev 17

⁴ Ev 17

⁵ *Note by witness:* The Nuclear Decommissioning Authority (NDA) is a public sector body which will be set up to deal with public sector liabilities. It will be funded directly by Government through grant in aid from the Consolidated Fund. The NGDF was established as a segregated fund in the private sector, to deal with British Energy's long-term decommissioning liabilities following recommendations in CM 2919. The creation of the NDA is therefore completely unconnected with the robustness of the NGDF.

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was set up independently and is seen to be working fine by the trustees. I do not quite know what else I can say, it was part of the privatisation deal.

Q97 Mr Simon: It is quite clear that the privatisation deal has gone wrong, has it not?

Sir Robin Young: It certainly is.

Q98 Mr Simon: Saying, that is the deal we did it does not seem to be a very dynamic response to what you do with a deal when the deal goes wrong?

Sir Robin Young: I beg your pardon, the restructuring that has been proposed and agreed, subject to the satisfaction of a number of conditions, including EC's agreement, sets out a whole new way of dealing with it. That is what I suppose the next NAO Report, if restructuring goes ahead, will look into. Details of the complete new deal as a result of the decision taken in September last year have been published. If it goes ahead, that reopens everything.

Q99 Mr Simon: Are you truly confident that the DTI's management of the costs associated with the risk and the cost of the risk in the nuclear industry has been as rigorous and effective as it could have been? Is the whole nuclear area not just a big black spot, a black hole? What about BNFL Inc, which I am told has lost untold hundreds of millions of pounds of taxpayers' monies through all kind of different incompetencies?

Sir Robin Young: The Report and the previous PAC report say that of its time the privatisation was fine. NETA was fine and here it sets out fairly our monitoring effort. However, since you ask the question, I think if I refer you to the recommendations page of this Report, page 7, I think we would not do it like that again. Indeed it has become, as this recommendation page sets out, clear in the light of experience that privatising things pure and simple is not the way and now we are more likely to consider PPP-type arrangements. If you look at recommendations five and six I think those are the lessons which we would learn as a result of experience with this one amongst others.

Q100 Mr Simon: I have one last question. Future cash flows demanded by decommissioning are inherently uncertain. The adequacy of the decommissioning fund is measured against BE's future discounted liabilities, should the liabilities be incurred earlier than expected the effect of discounting would itself be reduced, which implies that more needs to be set aside now to meet those liabilities. BE have assumed a very long time scale for long-term waste management disposal, much longer than BNFL or UKAEA, if long-term waste management and disposal comes earlier than BE assumed there will *habeas paribus* be bound to be a shortfall in the fund, will there not?

Sir Robin Young: That is something for the trustees to advise us on. That is why the trustees were set up.

Q101 Mr Simon: I have to say, and I do not mean to sound impertinent, but I think we are all getting the impression that the one thing we are learning certainly is that whoever's fault it is, whatever it is it is not yours, is it?

Sir Robin Young: That is certainly not how I mean to sound. I am saying that in hindsight, these days we would not do a privatisation like this. We would follow the advice of this Report, which I agree with, particularly at numbers five and six, that is the lessons we have learned. All I am trying to do is explain how the Department has coped with the privatisation which occurred.

Q102 Mr Simon: There seems to be a theme of consistent circularity, going back to the big picture of the dividends, we say, "why are you giving all of these dividends away?" You say, "They were allowed to give dividends because we had no reason to believe the business was doing badly". We say, "why did you think the business was doing badly?" You say, "You could tell they were all right because they were still paying the dividend".

Sir Robin Young: You do appreciate we could not stop them paying a dividend, it was set up as a private limited company over whose dividends we have absolutely no control. I hope you do appreciate that. We could not stop them under any circumstances.

Q103 Mr Simon: On the other hand it is not just some random private company, it is a private company you have now given a credit facility of £410 million.

Sir Robin Young: That is true. It was set up and we could not stop them paying the dividends, that is the only point I am making.

Mr Simon: Thank you.

Q104 Jon Cruddas: I am going to stay with the chronology of events, as far as I see it in 1998 Ofgem brought forward its proposals for reform. The dividend was issued in 1999, yet in 1999 both the Department and British Energy accepted there was a loss of between 10% and 20%, yet the new electricity trading arrangements did not come in until 26 March 2001. On the appendix that Mr Steinberg was talking about earlier, Appendix 2, page 39, given those assumptions about what was likely to happen that existed through to 1999 despite that fact neither you or the Department lobbied Ofgem about them. It says here, just after the Utilities Bill was introduced in the House, it was over a year before it passed. The next line says, "the decline in the level of forward prices for electricity". The next line "some analysts predict that market prices might dip below British Energy's generating costs". At the time—as I look in terms of the graph on Figure 6, page 18—of that statement, firstly, and I am not a financial analyst, was that a theme in the market as a whole, Sir Robin? "Some analysts predict that market prices might dip below British Energy's generating costs".

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Sir Robin Young: The theme of falling prices and the effect on generators was being discussed by analysts, yes.

Q105 Jon Cruddas: “Below British Energy’s generating costs”. You were talking about a 10% to 20% cut, as was the company, as I see it, and correct me if I am wrong, in terms of the graph on page 18, at that stage, January 2000, the cost was about £32 per megawatt hour, or whatever the unit is, what is the actual British Energy’s generating costs level at which it becomes uneconomic? That is greater than the 10% to 20% fall you were assuming in the Department at the time.

Sir Robin Young: Indeed. Perhaps I can make some introductory comments and then if you want, Adrian can talk about the company’s response. If you look on page 19, Figure 7, which I think is probably the more relevant wholesale electricity prices, you will see that when NETA was introduced it was £23.6 roughly, it then fell to the trough in April 2002.

Q106 Jon Cruddas: That is 2001 you are talking about, I am talking about over a year before.

Sir Robin Young: Okay.

Q107 Jon Cruddas: It says, some analysts predicted that market prices might dip not by 10% to 20% but below British Energy’s generating costs, which is a much more significant fall than either the Department or the company had assumed. The analysts were actually assuming it at the time.

Sir Robin Young: Indeed. Then there were various strategies which British Energy took to try and avoid that danger, they are covered in the rest of chapter two. You are right to paint the picture that people were talking about various ranges of price reductions and the lower the bottom of the range the more trouble it was for the company with high fixed costs. If that is the point you are making I think you are entirely right.

Q108 Jon Cruddas: Just to take that further, on graph six, and I am barely numerate, from what I can see at that time it was about £32, the operating costs level in the Report it says it is about £17.5 per megawatt hour, that is about a 40% cut to get to the generating cost level, and some analysts—and I do not know how many analysts, again I was not looking at this at the time—were predicting at the time precisely the level of fall that would produce over a year and a quarter later the sort of precipitated decline in the company. Is that a misreading of this? That is how I would look at that.

Mr Montague: Shall I try to help? I think it is very helpful to look at this in chronology because these events did not all happen on the same day, you are right to put distance into this. If you go back to the original Government White Paper on Energy, October 1998, there I understand that the Government stated that they expected reductions of at least 10%. Let us say, because the Report reflects it, 10% to 15%. Ofgem concurred with that in July

1999 when the details of NETA were first published. I think you are correct before the formal implementation of NETA—

Q109 Jon Cruddas: A year before.

Mr Montague:—there were a combination of circumstances which did drive the price temporarily to quite low levels, not as low as the levels we subsequently experienced but there was a trough in early spring 2000 and that brought it at or a little under British Energy’s cost of generation at the time. The price subsequently recovered. I think it was assumed by analysts and others that this was pre NETA worries. The price was stable for a while before it subsequently collapsed. I think it was difficult to read the market at that stage, although there would have been a variety of analysts’ reports on the street.

Q110 Jon Cruddas: A variety of analysts’ reports. The point is it was out there, the worse case scenario, at the time, a year and a quarter before NETA came in, when it had just been introduced in the House of Commons, just after the issuing of the dividend of £432 million. Given the assumption in the Department and in the company about the 10% to 20% move it was being predicted almost precisely in terms of the end, the shake down and in terms of the price of electricity.

Mr Montague: They had seen the risk of a decline in prices beneath the generating costs. I do not think anyone at that stage had predicted a collapse of 40%.

Q111 Jon Cruddas: No because the Department only increased its monitoring of the situation a year later despite the fact that given these analysts’ predictions a couple of months later you registered to the Department that due to a 20% fall in prices difficulties in funding further cost reductions and given an “increasingly tough line by safety regulators”. Then we move into the whole climate change period and the like. Those analysts were predicting this before all of those debates about the climate change exercise. As far as I can see the price started collapsing in August/September 2000, it moved from £40, it plummeted, then it more gradually trend declined and then actually after the formal introduction of the energy changes it then moved down to the final period that precipitated the reconstruction of the company. Yes. Through all of this, and to repeat the comments of my colleagues, there was no increase in monitoring or surveillance in terms of requesting access to the company despite the prediction that what could happen and what did happen existed from January 2000, ie when the Bill was introduced in the House of Commons. It was only in early 2002 that any single individual post-holder or group in the Department was given defined responsibility as co-ordinator of risk monitoring in respect of British Energy’s residual liability. That was more to you, Sir Robin. I know there is a danger of repeating this but it is worth fleshing out more and more detail of what did and did not happen.

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Sir Robin Young: It is. It is key to understanding this. I think the Report sets it out reasonably and says that in the first period when the company was cash generative we monitored lightly. After May 2000 in response to lots of mixed messages, different analyses, different reports in the market place we greatly upped, greatly upped our monitoring and our discussions with the company, hence the discussions about the company's particular suggestions around tax. In the meantime the company was considering different strategies for responding to this, the company was not just waiting for inevitably it was looking at other strategies, which are set out in the Report after paragraph 2.17, we are talking there about vertical integration and international diversification. It was not clear to us or to anybody else whether those strategies were going to work and alter the complete picture, if that makes sense?

Q112 Jon Cruddas: Sure. The picture we were painting at the beginning of this period was that when the new regime was introduced in March 2001 that precipitated the dominos effect, the collapse, *et cetera, et cetera*. As we can see from here before it was introduced, "British Energy reminded the Department if the Company becomes insolvent in the worst case scenario 14 billion of undiscounted liabilities could fall to the Government. Agreement that future trends in prices will be a critical factor". Above that, "But the future level of prices remained uncertain and so whether the Company could survive the next 3 years". Eight months before that analysts were predicting a 40% reduction below British Energy's generating costs, so the picture which was painted at the beginning is slightly at odds with a more systematic look at the chronology of events, where there is more predictability of the final outcome than simply seeing what the implications were when the Bill received Royal Assent. That is all I wanted to say.

Q113 Mr Jenkins: We have now established that the advisers did not look inside British Energy until the company issued an express invitation in early 2002. Did the Department request at any time the ability to go in before that?

Sir Robin Young: No because we were meeting the company regularly and having discussions with them.

Q114 Mr Jenkins: Secondly, we now have the reconstruction of the company so now what is your position, do you have better powers now to intervene in taxpayers' interests?

Sir Robin Young: We have set up a hugely different monitoring system now which is the sort of thing which had recommendation five or six been in place we would have probably done if we were thinking of privatising. We are now meeting weekly to discuss live issues, we have a monthly meeting with the chief executive, we have daily liaison at official level, meetings at ministerial level, weekly project oversight group meetings, monthly risk review sessions. Yes is the answer. As a condition of our

acceptance of the company's suggested restructuring we have enforced very, very, very rigorous monitoring.

Q115 Mr Jenkins: On page 15, 1.12, the first recommendation by this Committee three years ago was, "the Department should monitor carefully the company's ongoing ability to meet its liabilities without recourse to the taxpayer". You now say that previously you have not managed to achieve that but in the future you shall.

Sir Robin Young: No. I am saying we did monitor carefully the company's ongoing ability. As a condition of restructuring we have enforced, obviously as we have now intervened ourselves and taken liabilities back which we had hitherto thought were privatised, we have set up a completely different regime. I am saying that paragraph 15 sets it out, the Department did indeed monitor, as we promised in response to this Committee's recommendation.

Q116 Mr Jenkins: I think the term "monitor carefully" springs to mind when you read the evidence of this Committee. I think the Department was remiss in that regard on this issue.

Sir Robin Young: I do not accept that.

Q117 Mr Jenkins: Maybe you did not have the power then but you have the power now, maybe you could do better in future.

Sir Robin Young: I do not accept that our monitoring was not appropriate, the Report does not actually say that either. Paragraph 15 sets out how we did deliver the commitment we gave to the Committee.

Q118 Mr Steinberg: I just want to follow up on some of the questions I asked and I did not get answers to. We have a bit of an argument here and Sir Andrew Turnbull does not like it.

Sir Robin Young: If he does not like it I do not like it because he is the boss.

Q119 Mr Steinberg: I do not care. Your Department actually identified that British Energy would be losers under the new electricity arrangements in 2001, I think Mr Cruddas mentioned that, why did the Department not actually ensure that British Energy would actually work under worse terms than their main competitors? Now I would like to ask the Treasury to explain why you refused to give them £150 million rebate on the Climate Change Levy—I am not very much of an environmentalist, I do it—because as I understand it nuclear fuel does not have problems with carbon, so why were they forced to pay £150 million climate tax?

Mr Molan: The first point, Mr Steinberg, is that the CCL, the Climate Change Levy, is what we call a downstream tax, a tax on use by business users, not on the generators. It was designed to encourage users to make more efficient use of energy. On that basis an exemption for an energy generator was contrary to the logic of the tax. I would also say that

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to exempt one nuclear generator and not others would undermine the credibility of the tax system. If we had gone further and exempted all of them—

Q120 Mr Steinberg: You say one nuclear generator.

Mr Molan: In essence, if you design a tax you say that a particular class of bodies pay that tax. To single out an exemption for one of those companies makes the integrity of the tax system look rather doubtful, so in essence you are driven towards considering whether the whole class, ie all nuclear generators, should be exempt and that in itself could undermine the whole viability of the levy.

Q121 Mr Steinberg: It is like saying my mother when she was alive who could not drive should pay a car tax.

Mr Molan: I do not understand your analogy.

Q122 Mr Steinberg: They do not produce carbon gas, you are saying that is irrelevant but you still have to pay the tax, I am saying my mother did not drive a car but your argument is it does not matter, it is a tax, she should pay the tax.

Mr Molan: The point I am making is that the tax was designed to encourage users of energy to change their methods of use, which is the logic of the tax.

Q123 Mr Steinberg: You did not think that by refusing this at the end of the day the taxpayer may well have to subsidise it to the tune of three times the amount you were refusing to let them off with.

Mr Molan: I think there are two points there. One is that in the case of the levy there was no analysis carried out on the impact of the levy on individual companies. Secondly, in the event of an exemption being agreed it would not have been sufficient to deal with all the financial difficulties British Energy faced—⁶

Q124 Mr Steinberg: It would have helped. I do not know whether you can answer this because you are not answerable to Prescott's Department, my understanding is that the other generating companies did not pay business rates but they were forced to pay business rates, why? You were saying they had to pay the carbon tax because it was a generating sort of tax, on the other hand other generating companies did not have to pay council tax but they did, it is just double Dutch.

Mr Molan: I cannot comment on the business rates, I am not qualified to comment on that.

Q125 Mr Steinberg: What was the reasons they refused to give them relief on rates?

Sir Robin Young: When the company made the proposition to us we took it to what is now ODPM and it turned out that their rateable value was actually reduced. I am looking at 3.13 where it says it is £14,000 per megawatt, the previous figure was £16,400, so actually they had a rate reduction in 2000, but not as big a rate reduction as some other generating companies, as Table 11 on page 26 shows.

We carried on discussing with the DETR, they did not accept unfairness, they just denied it, as can happen when you make special propositions to a department. They did also point out, if you look at the bottom of page 25 on the right there, this would have gained £2 million over the five years for the company because of phasing, and all of that. You are right that the Climate Change Levy was a very much more significant sum of money but against the hole in their accounts of 280 million, two million over five years was not very significant.⁷

Q126 Mr Steinberg: I accept that. Finally, the interpretation of paragraph 1.12 is clearly different to the interpretation that the Chairman made of it and I made of it. You did say during the hearing, I have not quoted you exactly, I did think you said that you would wait to see what the PAC future recommendations will be before making decisions on how to proceed?

Sir Robin Young: I think I must have said EC, the European Commission.

Q127 Mr Steinberg: Did you not say you were waiting for the recommendations the NAO would be making?

Sir Robin Young: The recommendations the NAO made are on page—

Q128 Mr Steinberg: No, in the future. You are going to wait for the results of this Committee's findings to see what we were going to say as to how you were going to proceed in the future.

Sir Robin Young: I do not think I said that. Obviously we are keenly waiting this Committee's conclusions.

Q129 Mr Steinberg: You ignored us the last time presumably you will ignore us this time.

Sir Robin Young: I do not accept that we ignored you the last time and I certainly would not propose to ignore you a second time.

Q130 Mr Allan: We focused in this session on trying to find failings in both the Department and British Energy post privatisation, you have already hinted, Sir Robin, your view is that problems were inherent in the nature of privatisation itself. Is that fair?

Sir Robin Young: I will put it more positively, I think it has moved on across government as a whole as to how to do this, how to look at sharing risks and the PPP methodology, which is importantly different from the privatisation model, which is the more up-to-date approach.

Q131 Mr Allan: With hindsight will it be wildly inaccurate for us to call this a botched privatisation?

⁷ *Note by witness:* In arguing for a level playing field with its competitors, British Energy had pressed simultaneously for the phasing arrangements to be waived. If this had been accepted, the benefits would not have been limited to the £2 million over the five years. Moreover, as the NAO Report noted, a decision to reduce our liability may have been a significant signal to financial markets that Government was supporting fuel diversity (para 3.14).

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Sir Robin Young: Last time you called it a robust and well-planned one, the last time this Committee looked at it you gave it a clean sheet. None of us would argue that that privatisation has turned out as we wanted.

Q132 Mr Allan: The answer is looking forward, picking up the recommendations, and not to do it like this again.

Sir Robin Young: Yes.

Q133 Mr Allan: Even though it was robust and well-planned.

Sir Robin Young: In my opinion, yes. I agree with the Report's recommendations.

Q134 Mr Simon: I suspect that if I ask you another question about the Nuclear Generation Decommissioning Fund you will say "nothing to do with me, governor", I want to ask it in order to have that on the record again, the way BE discounts it seems to me is wrong. BE provides for its future nuclear liabilities by discounting at a flat rate of 3%. That runs counter to the Green Book guidance for very long-term projects, which recommends that discounting after 30 years should be on a declining rate to take account of future uncertainties and minimise risk, ie future long-term risk is not being adequately provided and discharged by the way BE discount at the moment. I know what your response will be "that is nothing to do with me" but I would just like that official if you would not mind, or is this for some reason more within your ambit even though everything else I said about discounting and funding is just down to the trustees and nothing to do with the Department?⁸

Sir Robin Young: The position is that so the Department did not itself have to intervene in things like this, we set up a fund and its trustees. I think that is the position. I am conscious about how that will go down with you. It is not the case that the Department is checking a private company's—

Q135 Mr Simon: You keep saying it is a private company, we all know it is not an ordinary private company for two simple reasons, firstly it is a nuclear company and there is all that big nuclear, bang, explosion, everybody is dead stuff that makes it different from your run-of-the-mill private company and; secondly, this is a private company where the only question it seems to me is how many hundreds or whether it will get up into thousands of millions of pounds of taxpayers money you are going to give them in order that they can immediately pass it on to their shareholders in pure profit. This is not an ordinary private company, they give £432 million to their shareholders having changed their provisioning date a few months before, they know they are going to get hit, and a couple of years later we give them hundreds of millions pounds worth of taxpayers money. When this Committee says "does

this not seem a bit funny?" You say, "it is a private company, there is nothing I can do". If it is a private company what are you doing here?

Sir Robin Young: I am not sure this is going to help much, I am agreeing with recommendation six in the Report which says, where departments are looking at privatisation where there are significant contingent taxpayer liabilities they should consider all sorts of things, which were not considered in this case. We did a straightforward privatisation, rightly or wrongly, and that made it at law a private limited company. I am not saying it should have been one, I am saying it is one, that is the case, I cannot do anything about that, which means that the Department did not take powers to intervene on any aspect of its finances but in particular the aspect you are pursuing.

Q136 Mr Simon: Perhaps not to intervene but if it were pointed out to you that this company seems to be doing wrong things although you cannot statutorily intervene perhaps you can have a word in Adrian's shell-like and say, "Oi Adrian, this seems a bit risky doing it like this" and he might say, "Thank you, Sir Robin, for that advice I will speak to my fellow directors and trustees along the lines that you have set me so helpfully".

Sir Robin Young: Under arrangements if we were to enforce recommendation six that is the sort of arrangement we would have, there would be a joint consideration of liabilities and the ways they were approached. That is what I was saying to Mr Allan.

Mr Jenkins: One final question, could the Treasury Officer give us a note to clarify the answer to Mr Steinberg about the carbon levy, it was not a tax on the use of energy, it was linked because of the way energy was generated in this country by coal-fired stations or by carbon burning stations.⁹

Q137 Chairman: Before you finish I have had a note passed to me by Richard Bacon who was not able to come back, he reminds me that in reply to my question about your failure to include any analysis of British Energy in your 1998 paper you said "British Energy had the opportunity to make their case and no doubt they did". Clearly that is not the point, is it? Why was it not included when three private fossil fuel companies were included? You took account of the change in the system on them why did you not take account here?

Sir Robin Young: First let me refer you to 3.15 which gives the answer about what happened when British Energy was asked about the new arrangements. The answer to your second question is because it was those companies whose actions had most effect on the price, so we were modelling, we were trying to model the effect on the price of the price-makers, and it was those companies who made the price.

Q138 Mr Williams: You were not considering the price on the generator, would that not be another side of the picture?

⁸ Ev 18

⁹ Ev 19

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Sir Robin Young: The modelling we were doing was using those three companies to model different prices.

Q139 Mr Williams: You could not model the fossil fuel to a nuclear plant. In the case of fossil fuel plants you were not going to pick up £14 billion as the undiscounted amount. The Company brought to your attention £14 billion of liability and yet you did not bother to take them into account, this is negligence that is unbelievable.

Sir Robin Young: This is not true, we did take them into account, we asked British Energy, who were the company who did the modelling.

Q140 Mr Williams: It was your review, you were undertaking the review. You only looked at one segment of supply in the industry, you did not look at the nuclear sector, you did not look at the people who would have the most effect on your own finances.

Sir Robin Young: That is not true.

Q141 Mr Williams: That is true.

Sir Robin Young: We did not do separate modelling on nuclear but we did look at the effect on British Energy of the various price assumptions which came from our model, that is what we did do. We concluded it was not inevitable this would lead to them going bust and that was the consensus at the time, it was also the consensus of this Committee at the time, it was not seen that everything we were doing was inevitably driving British Energy into its current position. It certainly is not the case there was a lack of consultation with British Energy on our part.

Q142 Mr Williams: Will British Energy ever resume responsibility for the £1.7 billion worth of nuclear liability which has now appeared in your accounts out of theirs?

Sir Robin Young: The details of the restructuring are still to be finalised and they depend first on the agreement of the European Commission and secondly the Secretary of State made a proviso that not only do we need to get state aid approval from the European Commission but there must be no material adverse change in BE's financial position and she must be satisfied that British Energy will be viable in all reasonably foreseeable circumstances.

Q143 Mr Williams: Assuming you get everything you want from the Commission will you now be passing back the £1.7 billion to the company as a liability or will you be assuming more of their liability under the package you are putting to the EU? You must know about that, you wrote it.

Mr Montague: Could I make a point just to clarify? This may possibly help. When the Nuclear Generation Decommissioning fund, the present arrangement, was first set up British Energy made payments to it of round £18 million, now about £20 million a year, because it covered a relatively limited scope of decommissioning. Under the new arrangements the payments that British Energy will make to the Nuclear Liabilities Fund are much increased, they will include £20 million a year, an

additional payment of £150k/tonne for fuel that we use in one particular type of reactor, £275 million in bonds and 65% of our cash flow, so the amount that British Energy contributes for decommissioning and for fuel management has much increased. As part of that arrangement the ultimate liability will be transferred to government, but the contribution that British Energy is making is going to increase as part of this.

Q144 Mr Williams: I see. Following on the questioning from Mr Steinberg, he asked you about your role and your payment package, I am not interested in amounts, is there performance pay for yourself and directors?

Mr Montague: Yes.

Q145 Mr Williams: So if the taxpayer takes on responsibility for the nuclear liabilities so making your company more viable you will all get performance pay?

Mr Montague: For the—

Q146 Mr Williams: Will you or will you not?

Mr Montague: For the executive directors.

Q147 Mr Williams: For the executive directors.

Mr Montague: They have bonuses that reflect a variety of performance indicators. The challenge we have with British Energy is to re-establish the company as a viable generator in the current market.

Q148 Mr Williams: By the taxpayer taking on your liability you get performance benefit for us taking it on. Do you not see this will smell rather to the British public?

Mr Montague: I think the British public needs to have the best management team it can possibly see installed in British Energy and I believe if we are trying to recruit the best people to manage a turnaround of British Energy we must pay them a decent market related salary.

Q149 Mr Williams: I find it grotesque that a company which was privatised in order to take on the risk will not only stand to make profits itself but will receive massive hand-outs for its directors for handing those risks back to the taxpayer. It is grotesque, it is unacceptable, it is dishonourable.

Mr Montague: I am afraid I disagree, with most respect.¹⁰

Q150 Mr Williams: Of course you do, you and your colleagues are getting the money and our constituents are paying it. I have one final question to you, Sir Robin, because I despair of getting direct answers, British Energy is not the only private sector company whose failures have serious consequences for the national economy, in view of the inadequacy, to put it mildly, of your monitoring of this particular industry can we be assured these other industries are monitored more effectively?

¹⁰ Ev 18

 Department of Trade and Industry and British Energy

Sir Robin Young: One is always tempted to say yes. Obviously I hope that the relationship we have with all energy companies now is such that they will come to us earlier with true pictures of what is happening. That is the lesson we have learned.

Q151 Mr Williams: It was not that they did not come to you early, you just did not believe them.

Sir Robin Young: The story they gave us was not there was imminent collapse and it was not imminent

collapse. They came with three requests, which we looked into, that was phase two of our monitoring. I am hoping that the relationship we have with all major companies in this country in the energy sector is they will come and have frank discussions with us if there was anything like this risk.

Chairman: I thank you for attending. I must say this is one of the most appalling hearings in terms of the content of the evidence we have heard and I will expect the report when it appears to reflect that.

 Supplementary memorandum submitted by British Energy

Further to my appearance before the Committee last Wednesday, I promised to write to Sion Simon MP on the issues of provisioning and discount rates. I attach a copy of that letter for the attention of other members of the Committee.¹

In view of the attention given at the hearing to the dividend paid by the Company in 1999, and comments made about Directors' pay, I thought it might also be helpful to expand a little further on the evidence I gave to the Committee.

Question 86 (Mr Simon): (i) Impact of repository delay

You suggested that the decision to move back the NIREX repository date had meant that BE's decommissioning provisioning could be relaxed accordingly, facilitating the payment of the £432 million "return of value" special dividend in 1999.

In reality, the return of cash was from reserves, not from any fund linked to liabilities. The failure of Nirex's case to build the Rock Characterisation Facility did mean that the likely date for repository availability was put back in our liabilities assumptions, but this was from 2015 to c.2040—not 2115 as you suggested.

Out of prudence we took a pessimistic assumption that the future Nirex Intermediate Level Waste disposal costs would be greater, and that this would absorb any discounting benefit from the delay. As a result, the provisioning was left unchanged.

Question 88 (Mr Simon): 1999 Dividends—"Return of Value".

As I said at the Committee, the 1999 dividend honoured what the then Chairman regarded as a commitment made to shareholders the previous year to return value to them if the cash was not required for immediate expansion of the Company. The Directors believed that the Group would remain in a strong financial position following the return of value. Independent commentators supported that view: the Independent of 13 May 1999 commented that "even after the handout BE will be virtually ungeared and generating free cash at the rate of £300 million a year".

With 20/20 hindsight we now know how far the wholesale price was to fall. However, at the time of the return of capital, the price remained healthy—and although it was anticipated that NETA would depress the wholesale price, it was thought this would be tolerable, ie in the range of 10–15%. Against this background, it was believed that the Company would still be able to pursue its strategy of major acquisitions to become a more broadly based energy business.

The Chairman suggested, on p. 6 of the transcript, that the return of capital was made in order to sustain the share price and to mislead shareholders regarding the company's future prospects. On the contrary, as the attached chart² shows, the share price fell after the return of capital as it naturally would following a reduction in the company's capital resources, and as the growing impact of the price reductions became plainer for all to see. There was no suggestion at the time that our shareholders were in any way misled.

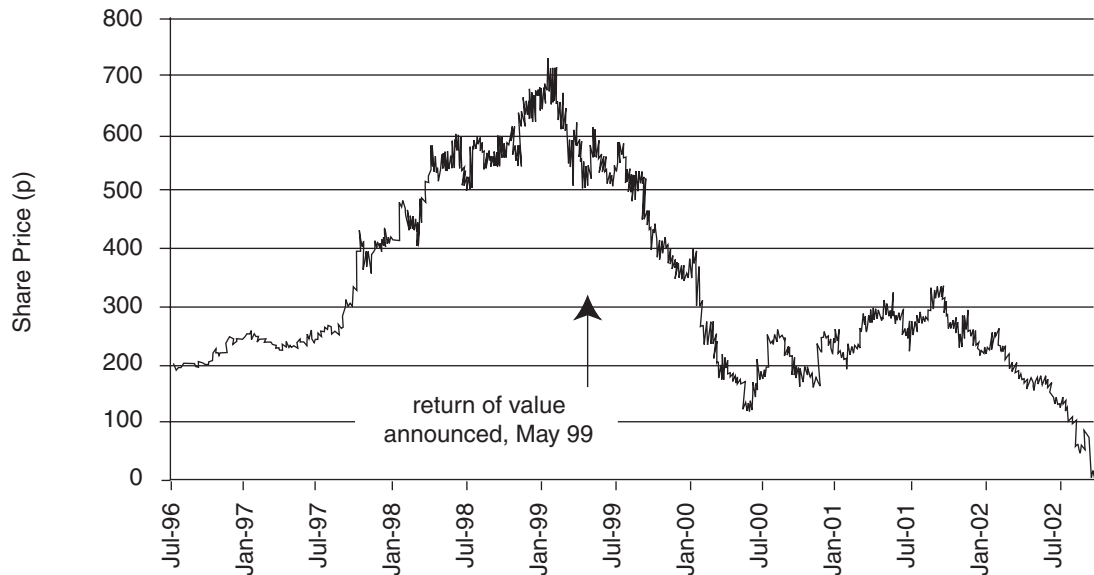
¹ Ev 17

² Ev 18

Question 134 (Mr Simon): (ii) British Energy discount rates

You also questioned the appropriateness of the discount rate employed for BE's liabilities. BE's long-term discount rate of 3%, which has been used since before privatisation, is driven by accounting standard FRS 12 which dictates that a long-term, nominal risk free pre tax rate should be used. The associated guidance points towards use of similar termed gilt rates as quoted in the FT. Given the long term nature of the liabilities, and with the agreement of our auditors, we have not changed the discount rate year on year.

British Energy's share price history, July 96-Sept 02

*Question 149 (Mr Williams): Directors' Remuneration*

I should also like to comment further on the discussion of directors' remuneration at the hearing, which is of course not a matter addressed in the National Audit Office's report.

It is important to note that under the terms of the Restructuring Plan, the more successful BE is in the market, the more it will contribute towards the liabilities transferred to the public sector via the ongoing 65% "sweep" of its available cash flow. It is therefore very much in the taxpayers' interest for BE to appoint a management team capable of delivering a successful business.

The Committee will appreciate that from the position of an incoming Director, joining the Company is a big challenge with significant risks. It is clear that any company—let alone one in British Energy's distressed condition—would not be able to attract a proven management team without paying the market rate. It does not benefit British Energy or the taxpayer to handicap our efforts to recruit the right team by denying the company the ability to pay a market rate on the grounds of the record of its previous management.

I hope this is helpful.

Adrian Montague CBE
Chairman

18 February 2004

Supplementary memorandum submitted by HM Treasury

Questions 119-123 (Mr Steinberg), Question 136 (Mr Jenkins): Note on the Climate Change Levy and the Carbon Levy

PURPOSE OF THE CCL

1. The CCL is a non-domestic tax on energy consumption designed to improve the energy efficiency of business energy users and is an important part of the UK's Climate Change programme. It applies to the use of gas, coal, liquefied petroleum gas (LPG) and electricity (including nuclear and some older hydro power) by business and the public sector.

2. The revenue raised by the levy (between £0.8—0.9 billion) is recycled back to business, primarily through the reduction in employers' National Insurance Contributions introduced at the same time as the levy. The levy package is therefore broadly revenue neutral between industry and the service sector, and creates no net gain to the public finances.

3. As the objective of the levy is to tackle the energy efficiency of business it is not carbon based. Furthermore, the arrangements in the UK electricity market would make implementing a carbon based levy administratively very difficult as it would require the electricity generated to be traced through numerous bilateral contracts, the power exchanges and the balancing mechanism, to its source. This is a particular problem for imported/internationally traded electricity. This complication would also make it difficult to exempt domestic consumers. The Government is concerned not to add to the problem of fuel poverty in low income households

BACKGROUND TO THE CCL

4. The CCL was developed following Lord Marshall's report *Economic instruments and the business use of energy*, published in 1998. There was extensive consultation with business during its development.

5. There are a number of exemptions from the CCL, including energy from "new" renewable sources (eg solar and wind power) and electricity from good quality Combined Heat and Power and from Coal Mine Methane. Energy used for non-fuel purposes or in "dual-use" purposes (where the primary purpose is as a chemical reactant) is also exempt from the levy.

COST TO THE UTILITIES OF THE CCL

6. Suppliers of taxable commodities, such as British Energy, are required to register and to pay to Customs and Excise the levy that is due on their supplies. Tax is due when supplies are made to non-domestic customers (i.e. businesses and the public sector). Energy suppliers pass on the cost of the levy to these customers when they bill them for the supplies.

4 March 2004
