



2 MARSHAM STREET
LONDON SW1P 3EB

01-212 3434

My ref:

Your ref:

10713/83

12 April 1983

Dear Michael

/ Further to my letter of 23 February, I now attach a short paper on privatisation in connection with Liverpool Sewage Treatment Works, the substance of which has been agreed with Treasury officials, and which has been approved by my Secretary of State.

I am sending a copy to John Gieve.

Yours sincerely,

Roger Bright

R BRIGHT
Private Secretary

~~CONFIDENTIAL~~

PRIVATISATION: LIVERPOOL SEWAGE TREATMENT WORKS

Background

1. In the course of discussion of the CPRS Paper on State Monopolies at E(NI), the Prime Minister enquired about the progress of the Department's ideas about involving private sector capital in a sewerage project in the North West.

Private sector finance and the water industry

2. Other things being equal private finance for capital investment is generally more expensive than public sector finance; but if the conditions are right the involvement of the private sector can lead to efficiency gains that more than offset the extra financing costs and give the customer a better service with lower charges. The Department has therefore been considering how the private sector could be involved in a major functional area of the water authorities' business on an experimental basis to establish what efficiency gains can be secured. Despite their relatively lower operating costs, sewage treatment seems the most promising of the main functional areas for private sector involvement since ST works are generally self contained.

3. Private sector companies could become involved either by taking over and operating existing assets or designing, constructing financing and operating new assets. What can be envisaged is a long term contract between a water authority and a private consortium which would have responsibility for the management of the activity in a defined area for a period and fee to be negotiated. The consortium would be responsible possibly for financing the necessary capital works but certainly for investment to maintain and improve the system, would carry the operating costs of the works and would be responsible for providing the service to an agreed standard with the contract providing financial penalties for non compliance. The fee would be paid by the water authority which would retain ultimate legal responsibility for the

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service and would continue to bill customers in the normal way. The contract period would need to be of sufficient duration for the private consortium to have the prospect of a justifiable return on its investment.

4. Whether or not the private financing of a water authority project fell outside the existing controls on public sector investment would depend upon the private consortium shouldering a genuine risk with no Government or water authority guarantee either implicit or explicit. It is recognised that it will not be easy to develop a genuine risk proposal without guarantees in a monopoly industry. But even if the risk requirement could not be satisfied it would still be worthwhile proceeding, with the investment counting as public sector investment, provided there was a demonstrable benefit to the customer in reduced charges.

Merseyside

5. The problem of the Inner Cities and the need for the re-juvenation of old urban areas is at its most acute on Merseyside. The Department's consultation paper on 'Cleaning up the Mersey' launched last November sees the restoration of the River Mersey to an acceptable standard of cleanliness as both a pre-requisite for, and a catalyst to, the general renovation of the area. The consultation paper recognises the scale of the problem. The North West WA's limited plans for removing objectionable solids and smell would involve capital investment on the estuary of some £170m by 1995. First estimates suggest that the Authority's more ambitious long term objective of raising the waters of the Mersey catchment to an acceptable standard might cost some £2,000m.

6. The consultation paper recognises that the private sector will be massively involved in the work on the estuary and the river system because construction work (perhaps 90% of total expenditure) will be undertaken almost wholly by private contractors. But in addition the consultation paper also mentions the possibility that the private sector might be

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involved in other aspects of the work. The initial focus for this possible further involvement is the Liverpool sewerage treatment works.

Liverpool STW

7. The Liverpool sewerage treatment works, provisionally costed /^{at} about £40m, is the next critical phase in the North West WA's programme to clean up the Mersey, and design work is planned to start in the financial year 1983/84. The works will provide not only a conventional sewerage treatment operation but will also serve as the terminus of a sludge pipe line and a loading point for the Authority's sludge fleet.

8. Construction of the new works will in any event be undertaken by the private sector, but the Department is keen to establish whether in addition there is a realistic possibility of private interests undertaking the design, operation and financing of the project on terms which would represent a better deal overall for the water authority's customers. With the agreement of the Chief Secretary and on the understanding that there should be no positive publicity since this might raise false hopes, the Authority has been asked to hold exploratory discussions with private sector firms to establish whether they would be interested in doing so, and if so, how they would expect costs to compare and whether there would be any special terms and conditions. The Authority are pursuing these points both with financial interests (Henry Schoder Wagg, Prudential Assurance Company) and major engineering interests (RTZ, Degremont Laing), and are due to report shortly.

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25 JAN 1984

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Prime Minister (2)

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref: K/PSO/10713/83

Your ref:

I have been
pursuing this sewage/private
sector involvement matter on
your behalf.

Ms 23/2

23 FEB 83

Dear Michael

Thank you for your letter of 4 February. This is by way of an interim reply.

The question of private sector involvement in Liverpool sewage treatment works is being pursued by the North West Water Authority at the Secretary of State's request and with Treasury agreement. The Authority have been asked to hold exploratory discussions with private sector firms to establish whether they would be interested in designing, operating and financing, as well as building, the proposed sewage treatment plant; if so, how they would expect costs to compare; and whether there would be special terms and conditions. The Authority have been asked to report by the end of March. However, in view of your request, my Secretary of State has asked for a paper to be prepared immediately with the aim of reaching you within 2 weeks.

I am copying this letter to John Gieve (Chief Secretary's office).

John Gieve

Rose Bright

mf

R BRIGHT
Private Secretary

Michael Scholar Esq
Private Secretary

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UNITED STATES
POSTAL SERVICE

22 FEB 1983

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c. c. Mr. Vereker

Sir R. Armstrong



10 DOWNING STREET

From the Private Secretary

4 February, 1983.

In the course of the discussion at ENI earlier this week of the CPRS's paper on State Monopolies, the Prime Minister enquired about the progress of your Department's ideas about involving private sector capital in a sewerage project in the North West.

I would be grateful if you would let me have a short paper, agreed between yourselves and the Treasury, on the present position.

I am sending a copy of this letter to John Gieve (Chief Secretary's Office, HM Treasury).

M. G. SCHOLAR

David Edmonds, Esq.,
Department of the Environment.

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Handwritten initials or signature in the bottom right corner.



Prime Minister (4)

MCS 18/5 *cc JV*

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Michael Heseltine MP
Secretary of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

17 May 1982

mf

R Michael,

PRIVATE FINANCE FOR THE WATER INDUSTRY : SEWAGE TREATMENT IN MERSEYSIDE

Thank you for your letter of 30 April. As I said in my earlier letter, I am sorry that the work done on this project has proved fruitless, but I am sure it was worth trying. I think the best way forward, now, is for you to consider with North West Water Authority what would be involved in accelerating their existing plans. When you have firmer proposals, and a better idea of the amounts of money involved and the timing, I will be happy to consider them. We are of course about to embark on this year's round of Survey discussion, and I would hope we could deal with the matter in that context, naturally without any commitment whatsoever on my part.

I am copying this to the Prime Minister and to Patrick Jenkin.

Leon

LEON BRITTAN



Prime Minister (2)

ms 5/5

CC JV
2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref: H/PSO/13035/82

Your ref:

30 April 1982

Dear hon

Thank you for your letter of 16 April. I am glad you would like to be able to support my proposal for a privately financed sewage treatment company on Merseyside. For my part, I regard the cleaning up of the Mersey as being exactly the kind of general environmental boost the area needs, and I am only sorry that you think the objections you raise are sufficient to justify abandoning the idea of proceeding as I had envisaged.

It seems to me that we have a choice. Either we could go ahead and approach the prospective members of a consortium, to see what their reactions are, so that we have something definite before us other than merely the exploratory work of our own officials, and decide later whether to go ahead that way. Alternatively, we could go ahead by asking NWWA to speed up their own programme, and give them an additional, and earmarked capital allocation for the purpose. I understand that NWWA reckoned they could accelerate their present £90m programme to be completed by 1991 instead of 1996, but I would like to see faster progress still and on a more ambitious scale on which the interceptor sewers would be built on both banks and improvements made to sewage treatment works at Wirral, Widnes, Warrington and Devyhulme, as well as the building of the Liverpool works. This would provide for the whole of the contents of the sewers now discharging into the estuary up to the tidal limit at Warrington. If we took the second course we would not know what extra allocation NWWA would need until they had told us what their faster timetable would be, but at this stage I would like your agreement to proceeding in one way or the other. There is a prize to be grasped here, and if orthodoxy has to be bent, it should be.

I am copying this to the Prime Minister and Patrick Jenkin.

Yes ear

MICHAEL HESELTINE



Regional Pol
cc JD
Prime Minister (2)

MES 16/4

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Michael Heseltine MP
Secretary of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

16 April 1982

D. M. ...

PRIVATE FINANCE FOR THE WATER INDUSTRY: SEWAGE TREATMENT IN MERSEYSIDE

I wrote to you on 24 November about your proposal for a privately financed sewage treatment company in Merseyside. We agreed that officials should consider "whether it is possible to devise an acceptable basis" for the scheme.

A great deal of constructive work has now been done. It is good to see such an imaginative idea being thoroughly explored. I am also grateful for the way your officials have included mine in their discussions with the North West Water Authority. This has helped me to keep in touch with the work, and to make an informed assessment.

I really do wish I could now write you an enthusiastic letter. But I am afraid that, the more I see of the exploratory work, the more difficult I find it to see how the introduction of private finance could offer efficiency savings sufficient to offset its extra cost. I thought it only right to tell you my doubts sooner rather than later.

Of the options being considered, the most promising seems to be the proposal that a new sewage treatment plant might be privately built on reclaimed land at Sandon Docks. This could be privately owned and operated; and with a new interceptor sewer - which might have to be publicly financed - could cure the most unsightly pollution of the Mersey.

As I understand it, the North West Water Authority is already hoping to build a treatment plant at Sandon as part of its regular programme, though the earliest possible starting date is some years away. The principal question for us is whether private finance could do better than the water authority, by letting market forces go to work. The doubts I have are not ones of principle, but of practice.

So far as I can see, there is little scope for private finance to bring savings in constructing the plant. It would be built by private contractors, after competitive tender, whether owned by the public or the private sector; and it would have to meet the same minimum standards in either case.

Similarly, there would be little scope for the private sector to remove the practical obstacles to progress faster than the water authority. The immediate problem is to negotiate for the land with the Mersey Docks and Harbour Company and to negotiate for planning permission with the local authority. If anything, it is the water authority which has the advantage here: if it came to the crunch, the water authority could use its compulsory purchase powers to acquire the land.

If the treatment plant were built, there would be little scope for savings from competition. No one is likely to build a rival: so the Sandon plant would have a captive market. It is bound to be a monopoly whoever owns it.

There would also be little scope for labour savings in running it. The proposed treatment plant would be no more than a group of covered concrete settling tanks, requiring very few staff to look after them.

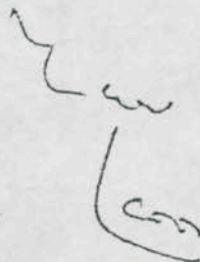
Finally, there would be little scope for getting the public sector out of the project, whoever were to own the treatment plant. The Regional Water Authority would be obliged to set minimum standards for design and maintenance to ensure satisfactory performance. It would have no option but to use the treatment works once they were built - effectively providing the plant with a guaranteed income. It would have effectively to underwrite the project: if the company failed to comply with discharge standards, went bankrupt or went into voluntary liquidation, the water authority would have to take over the plant. In short, there is no way the public sector can pass the buck.

For all these reasons, I am afraid I cannot see how private finance can really help us - and this is on the most promising of the options. On the more ambitious alternatives, the difficulties multiply.

There are other problems too. One would be to establish whether the water authority would have to incur conventional public expenditure costs in support of the project. Another would be to determine whether the apparently private element could in fact be properly regarded as private, in view of the likely contractual relations between the water authority and the sewage treatment company. But these problems will only arise if we succeed in identifying genuine efficiency gains to make the more expensive private finance worthwhile. For the practical reasons I have given, I cannot see how we could do so.

If I could see my way through this, I should be all for taking the work further. But with the best will in the world, it is hard to believe that any amount of research could do the trick. No one regrets this more than I do. But I think, reluctantly, that it would be better to stop now than to disappoint ourselves later.

I am sending copies of this letter to the Prime Minister and to Patrick Jenkin, who saw the previous correspondence.

A handwritten signature in dark ink, consisting of a stylized 'L' followed by 'e', 'o', 'n', and 'B', 'r', 'i', 't', 't', 'a', 'n'.

LEON BRITTAN



Secretary of State for Industry

Reg Pol WH 17/12
DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

14 December 1981

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

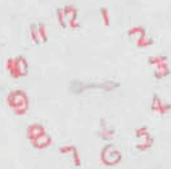
Dear Michael,

I was interested to see your letter of 19 November to Geoffrey Howe about the involvement of the private sector in the provision of facilities for cleaning up the Mersey. This is clearly a desirable aim in social and environmental terms. There are, however, considerable implications for industry, not only that located on the Mersey itself, but also industry elsewhere in the catchment area. I think, therefore, that officials from my Department should be involved in the discussion with the North West Water Authority and others and would want this Department's input to be focussed through the Regional Office in Manchester, involving, as necessary, those of its officials seconded to your Merseyside Task Force.

2 I am copying this letter to the Prime Minister and to Geoffrey Howe.

Your ever
Peter

5 DEC 1981





Regional Policy
Prime Minister
Mes 24/11
2

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Michael Heseltine MP
Secretary of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

ms

24 November 1981

PRIVATE SECTOR FINANCE FOR THE WATER INDUSTRY

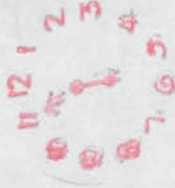
You asked us to consider the proposal in your letter to Geoffrey Howe of 19 November about private sector finance for a sewage treatment works to clean up the Mersey.

I have considerable sympathy with the intention behind your proposal and would certainly not rule it out in principle. I do have some reservations about the substance of the proposal, however. If the scheme is not to appear as a crude mechanism for evading our own expenditure controls, then the financing arrangements must be such that the whole risk of the project is borne by the consortium. Given the physical characteristics of the scheme, with the Water Authority obliged to use this treatment plant, I cannot immediately see how that can be arranged. But I am very willing to let my officials pursue this further with yours and with the North West Water Authority, to see whether it is possible to devise an acceptable basis. But I must ask that any public references to the scheme should be cleared with me, as we would need to make it quite clear the project would not go ahead without the full support of the Water Authority or if finance could not be attracted on an acceptable basis.

I am copying this letter to the Prime Minister and to Patrick Jenkin.

LEON BRITTAN

24 NOV 1981





Prime Minister

MUS 20/11

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

19 November 1981

Reg Pd

MH

See copy

I have been considering the problems of the River Mersey which I referred to in my report to colleagues in August following my stay in Merseyside during the summer. You will be very familiar, from your own political experiences, with the consequences that flow from pumping 80 million gallons a day of untreated sewage into this river. The North West Water Authority (NWWA) has outline plans to improve the quality of the river and has recently resolved to embark on their first phase. But capital expenditure on cleaning up the Mersey will have to compete with the other pressures on the NWWA's programme which NWWA have put at £120 million for the next 20 years at 1980 prices, notably the need to replace worn out Victoria sewers. So the first phase of the Mersey estuary programme is expected to extend over 15 years. At this rate it will make no significant impact until the end of the century.

I am therefore interested to accelerate this improvement by finding an alternative solution which would involve using private sector resources and which would be consistent with the ideas you put in your recent letter to Patrick Jenkin about privatisation and the gas industry.

The sort of scheme I would like to explore would take the form of the NWWA letting a contract to a private consortium which would build and operate a major new sewage treatment plant and associated capital works. The first liability of the NWWA would arise on the completion of the works and would be calculated at a rate per unit of sewage treated to a defined standard. There would have to be a formula for calculating this unit rate which allowed a profit for the consortium. The NWWA would raise the money to pay through its normal rating and charging processes.

My officials from the Department's Water Directorate will be pursuing this with the NWWA and will be reporting to me on how this could be taken forward. You may like your officials to join them.

I look forward to hearing your views on this proposition; and in view of general issues which this matter raises I am copying this letter to the Prime Minister and to Patrick Jenkin.

yes
MH

MICHAEL HESELTINE

Rt Hon Sir Geoffrey Howe QC MP

ECKEY

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