House of Commons

Committee of Public Accounts

The Restructuring of British Energy

Forty–third Report of Session 2006–07

Report, together with formal minutes, oral and written evidence

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The Committee of Public Accounts

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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/pac. 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 Mark Etherton (Clerk), Philip Jones (Committee Assistant), Emma Sawyer (Committee Assistant), Pam Morris (Secretary), Anna Browning (Secretary), and Alex Paterson (Media Officer).

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Summary

British Energy (the Company) is the largest electricity generator in the United Kingdom, with an annual turnover of £2.6 billion in 2005–06. Its eight nuclear power 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 took responsibility for all its nuclear liabilities, including the disposal of spent nuclear fuels and the decommissioning of power stations.

In September 2002, the Company approached the former Department of Trade and Industry (the Department)[1] for assistance as it could not meet its liabilities. The Department does not normally intervene when private companies get into financial difficulty but in this case it decided to do so to preserve electricity supplies and ensure nuclear safety. As a result the taxpayer has taken on responsibility for underwriting the Company's nuclear liabilities valued in February 2006 on a discounted basis at £5.3 billion, a figure that is likely to increase. The Committee reported on the events leading up to the Company's request for support in its report *Risk Management: the nuclear liabilities of British Energy PLC*.[2] This report deals with the financial aid provided to British Energy and the terms of the restructuring arrangement.

The Department supported a financial restructuring of the Company with the latter undertaking to make an annual contribution to its liabilities of a fixed sum of £20 million a year plus a payment expected to be about £4 million a year for each tonne of fuel loaded into Sizewell B. In addition the Company will also pay 65% of its free cash each year. Free cash is defined as the Company's available cash after tax and payment of its financing costs but before any dividend payments. This payment is known as the cash sweep.

The Department sought to share the cost of the restructuring with the Company's shareholders and creditors. The shareholders, who would have received nothing in administration, agreed to exchange 100% of the existing equity for 2.5% of the equity in the restructured company. The Company's major creditors took 97.5% of the equity in the restructured Company. By February 2006 this holding was worth £3.9 billion, far more than the creditors would have received under administration and without any responsibility for meeting the nuclear liabilities.

In considering the proposed restructuring plan the Department looked in detail at the prospects for the Company if electricity prices remained low but not if they increased. In the event prices have risen from £24 per megawatt hour to just under £40 per megawatt hour since restructuring.

1 Three new departments were set up by the Prime Minister on 28 June 2007 replacing, amongst others, the Department for Trade and Industry. The new Department for Business, Enterprise and Regulatory Reform brings together functions from the former Department of Trade and Industry, including responsibilities for productivity, business relations, energy, competition and consumers, with the Better Regulation Executive (BRE), previously part of the Cabinet Office.

2 Committee of Public Accounts, Thirty-Seventh Report of Session 2003–04, *Risk Management: the nuclear liabilities of British Energy plc*, HC 354

British Energy now poses a significant risk to the taxpayer but the Department plays no formal role in approving the Company's commercial strategy. The Department now has the legal authority to obtain information from the Company and has placed some limits on British Energy's actions through conditions agreed as part of the restructuring.

A potential benefit for the taxpayer is that the Department can convert the stake it has in British Energy through the cash sweep into shares in the Company that it can then sell. On 30 May 2007 the Government announced that it intended to dispose of part of its interest in British Energy. The Government has stated that the net receipts will be paid into the Nuclear Liabilities Fund set up to help meet the Company's nuclear liabilities.

The Department's monitoring of the Company's performance will be key to preserving the taxpayer's interests. Monitoring responsibilities are currently split between different teams within the Department.

On the basis of a report produced by the Comptroller & Auditor General[3] the Committee took evidence from the Department and British Energy on the Department's role in the restructuring of the Company and how it is monitoring and influencing the Company's performance and managing the nuclear liabilities taken on by the taxpayer.

3 C&AG's Report, *The Restructuring of British Energy*, HC (2005-06) 943

Conclusions and Recommendations

1. **As a result of the restructuring of British Energy, the taxpayer has been left to underwrite a large and uncertain liability, recently valued at £5.3 billion.** The Company assumed full responsibility for its nuclear power stations, including the associated nuclear liabilities, on privatisation in 1996. In reality, the Government's international obligations always meant that responsibility would fall on the taxpayer if the company was unable to meet them.

2. **The most recent estimate of the liabilities underwritten by the taxpayer resulted in a 29% increase on the previous figure, a figure that may well rise further.** The previous revaluation of the liabilities was as long ago as 1996, which is unsatisfactory. Estimates of nuclear liabilities need to keep abreast of the developing knowledge of the decommissioning process and its likely costs. Under the restructuring agreement, the Company is required to produce estimates at not more than 5-year intervals. The Department should require the Company to do so and ensure its compliance.

3. **Uncertainty about the size of the liabilities is partly due to different discount rates which the Department and the Treasury use to convert the liability figures to present day values depending on the purpose of the calculation.** There is too much confusion and difficulty for the user in trying to interpret the figures in a meaningful way. The Treasury should produce a single statement setting out which discount rate is to be used for which purposes in estimating future costs and benefits, and Departments should be able to reconcile results produced by different rates.

4. **The Company's creditors would have got very little on liquidation, but on restructuring they received bonds worth £425 million plus 97.5% of the issued shares in the restructured Company, assets which were worth £3.9 billion by February 2006.** They have however assumed no responsibility for the nuclear liabilities. For electricity consumers and taxpayers, the balance of risk and reward is less favourable, although the Nuclear Liabilities Fund should benefit if the Company does well.

5. **In approaching the restructuring the Department concentrated on the viability of the Company if electricity prices were low but gave insufficient attention to the effect if prices were high.** In the event, electricity prices rose by over 80% in the year following restructuring. The Department's financial modelling should always test outcomes under a sufficiently wide range of scenarios.

6. **The Nuclear Installations Inspectorate had concerns about its ability to regulate the Company if it fell into administration.** The Department has known about this problem for four years but has yet to resolve it. The Department is now considering establishing a special administration regime for such companies and should take prompt action to resolve this issue.

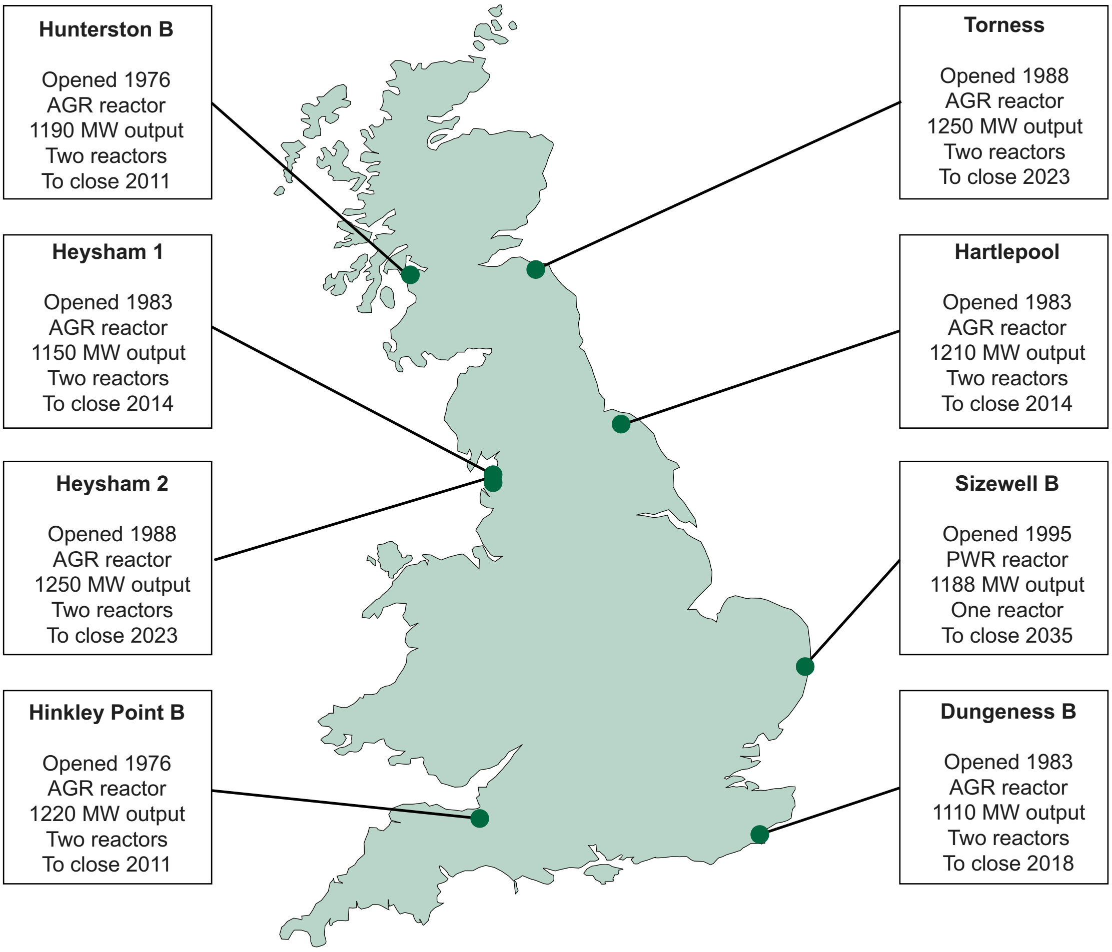
7. **The Department spent £29 million on advisers but of the four main firms it employed only one was appointed by competition**. The Department should have arrangements in place to appoint external advisers competitively, if necessary by appointing adviser panels who can then be drawn upon at short notice and should also benchmark the costs of its advisers against those of other large users. The Department should always review the quality of the advice and the value for money it receives from consultants, who in the case of British Energy did not test the restructuring plans against a sufficiently wide range of electricity prices.

8. **Without direct responsibility for meeting its liabilities, the Company may now lack the incentive to reduce the liabilities falling to the Nuclear Liabilities Fund.** The Department, working with the Nuclear Decommissioning Authority, should put in place adequate arrangements to confirm that the Company carries out its operations efficiently, reducing the eventual liabilities to be met by the Nuclear Liabilities Fund wherever possible.

1 Estimating British Energy's nuclear liabilities

1. British Energy has eight nuclear power stations located around Britain which generate about 20% of the electricity used in England and Wales and 50% of that used in Scotland. **Figure 1** shows the location and type of each of these power plants and the date that each one is due to be shut down.

Figure 1: Location of British Energy's power plants



Source: Electricity Association

2. British Energy got into financial difficulties in September 2002 and turned to the Government for support. When it was privatised in 1996, the Company assumed responsibility for meeting the cost of its nuclear liabilities. But in practice, international obligations undertaken by the United Kingdom Government mean that the State must meet the costs of these obligations if no other party is able to fulfil them.[4]

3. The Government has taken on three forms of nuclear liabilities (**Figure 2**). The spent fuel liabilities where the Company already had a contract with British Nuclear Fuels Ltd

4 1957 Euratom Treaty,1996 Convention on Nuclear Safety and other agreements

amount to some £2.6 billion and will largely arise over the next 10 years. Underwriting the costs of two other components relates to uncontracted liabilities for spent fuel and nuclear waste (£0.35 billion); and the liabilities for decommissioning of British Energy's eight nuclear power plants (£2.4 billion) which are expected to be incurred over the next 100 years.

Figure 2: Summary of British Energy's nuclear liabilities

The Department assumed direct responsibility for:

- ***Contracted spent fuel liabilities:*** estimated at 28 February 2006 at £2,573 million, mostly falling within the next ten years. The Department assumed responsibility for meeting payments for spent fuel liabilities under British Energy's "historic" contracts with British Nuclear Fuels plc (now British Nuclear Group Sellafield Ltd), covering the reprocessing and storage of spent fuel loaded into reactors at the Company's Advanced Gas-cooled Reactors before 14 January 2005, and other services including flask maintenance and rail transport. The Department made the first payment in March 2005.

The Department agreed to underwrite the Nuclear Liabilities Fund for any shortfall in meeting:

- ***Spent fuel and operational waste liabilities:*** estimated at 28 February 2006 at £350 million and falling due over the next 100 years. British Energy had liabilities for spent fuel and nuclear waste that were not covered by contracts with British Nuclear Fuels plc, referred to as "uncontracted" liabilities. The future management or disposal of derivatives from reprocessing and long-term storage and disposal of spent fuel are not fully covered under contracts, as the ultimate disposal site is not yet available and the process could not be fully defined.
- ***Decommissioning liabilities:*** estimated at 28 February 2006 at £2,364 million, mostly falling due within the next 50 years, and between 80 and 100 years from now. Decommissioning costs will comprise the costs of defuelling reactors, dismantling redundant ancillary buildings and making the reactor complex secure, and after a long period of care and maintenance dismantling the reactor to allow the site to be used.

Source: National Audit Office

4. In November 2002, the Department decided it would support a financial restructuring of British Energy but during the restructuring, which was not completed until January 2005, the Department did not have an up-to-date estimate of the likely liabilities it was taking on. The only estimates available had been prepared prior to the Company's privatisation in 1996. As part of the restructuring, the Department agreed with the Company that the liabilities would be re-valued at least every five years.

5. In February 2006, the liabilities underwritten by the taxpayer were estimated at £5.3 billion on a discounted basis, an increase of £1.2 billion (unaudited) on the previous forecast. The new estimate included revised figures published by the Company for its uncontracted and decommissioning liabilities. The Department cannot rule out further increases in the nuclear liabilities but considers that, based on experience in other countries, costs tend to increase as estimating methods are refined but could decrease thereafter as costs are optimised. Nevertheless, there remains considerable uncertainty over the scale of the future liabilities, reflecting the many technical uncertainties still associated, for example, with decommissioning, particularly affecting those liabilities that will mature in the longer term.[5]

5 Qq 4, 5, 19, 22

6. This uncertainty is increased by different discount rates used by Government departments when quoting liability estimates in different situations. Discount rates are used to estimate at current prices the cash flows which may occur in the future. The Treasury's Resource Accounting Manual, for example, set a flat discount rate of 3.5% for provisions in the Resource Accounts for the year ended 31 March 2005. This rate was used to prepare the £5.3 billion estimate of the nuclear liabilities.[6] The Treasury's Green Book on Investment Appraisal on the other hand states that for projects with long term impacts a declining schedule of discount rates should be used, starting at 3.5% and declining to 2.5% after 76 years. In addition, figures quoted by British Energy and other companies in the sector may differ again reflecting their individual circumstances. British Energy used a discount rate of 3% on its recent revaluation of the liabilities. Although the selection of specific rates is intended to provide a more accurate assessment of the present value of future costs, these varying approaches create confusion and difficulty for the user in trying to reconcile the different estimates.

6 An updated flat discount rate of 2.2% was set by the Treasury for Resource Accounts for the year ended 31 March 2006

2 The Department's approach to restructuring

7. The Department does not normally intervene when private companies get into financial difficulties. But in this case it had ultimate responsibility for the Company's nuclear liabilities should the Company fail, so it had to consider whether to provide support to keep the Company going. Assessments made by the Department in autumn 2002 suggested that unplanned closures of British Energy's nuclear stations would have put electricity supplies at risk, with the possibility of power cuts to domestic suppliers over the winter months. In addition because of capacity constraints for the receipt, storage and reprocessing of spent fuel, some stations would have had to remain fuelled for some years. The Department therefore decided it should provide support.[7]

8. The Department decided that it was unlikely to find a buyer for the Company in view of a depressed market for electricity prices and the scale of the Company's liabilities. The Department considered that the costs to the taxpayer of pursuing a solvent restructuring or allowing the Company to fall into a planned administration would be broadly similar. The Department was, however, concerned that a prolonged period in administration would pose a significant risk to the taxpayer. It therefore decided to opt for a solvent restructuring on the grounds that this carried less risk.[8]

9. The Nuclear Installations Inspectorate, which licences and inspects all nuclear sites in the United Kingdom, had expressed concern about its ability to regulate British Energy if the Company went into administration, particularly an unplanned administration. The Inspectorate feared that the Company might not have enough funds to make changes the Inspectorate might require as a result of its regulatory activities. It was also concerned that going into an unplanned administration might undermine staff morale with a possible loss of skills. There is still a risk that if the Company got into difficulty again, administration might be judged untenable thereby requiring the Department to step in again. The Department is considering whether a special administration regime should be available for Companies such as British Energy but has no timetable for taking a decision.[9]

10. In return for the Department taking on or underwriting the Company's liabilities, under the restructuring agreement British Energy agreed to issue new bonds worth £275 million which it gave to the Nuclear Liabilities Fund and to make annual contributions towards the cost of meeting the Company's liabilities. British Energy are making a fixed annual payment of £20 million towards decommissioning, a small payment linked to the quantity of fuel loaded into the Sizewell B reactor, and a contribution equal to 65% of the Company's free cash flow each year, known as the cash sweep. All payments will be made into a Nuclear Liabilities Fund. The first cash sweep payment of £105 million (relating to the 2005–06 financial year) was paid in September 2006.[10]

7 C&AG's Report, paras 2.2, 2.3, 24

8 Qq 44, 45; C&AG's Report, paras 2.8 to 210 and Figures 11, 12

9 Qq 46–48, 95; C&AG's Report, para 2.3 and Figure 12

10 Q 27; C&AG's Report, para 1.15

11. There is virtually no link between the size of the nuclear liabilities underwritten by the taxpayer and the contributions to be made by the Company. The bulk of the contributions are expected to arise from the cash sweep, which is directly linked to the Company's performance. In other countries it is common for nuclear liabilities to be transferred to the State but few instances, if any, where so much of the contribution is based on the market and operational performance of the waste producer. The Department considered that to have linked contributions to the level of liabilities would not have created a viable company, one of its principal aims. The result, however, is a greater transfer of risk to the taxpayer than in most other countries.[11]

12. The Department sought to share the cost of the restructuring with the Company's shareholders and creditors. The shareholders agreed to exchange 100% of their holdings in the old company for a 2.5% stake in the new company. The Company's main commercial creditors agreed to extinguish their debt claims against British Energy in return for £425 million of new bonds and 97.5% of the issued shares in the new Company. When they agreed to the restructuring plan in October 2003, the major creditors could have expected to lose £289 million compared to their position as at September 2002 before the Company approached the Department for help. The Department therefore believed that the risk of restructuring had been reasonably well shared. By the end of February 2006, however, the Company's share price had risen significantly, making the creditors' stake worth £3.9 billion (**Figure 3**)[12] without carrying any of the nuclear liability risks taken on by the taxpayer. If the Company had gone into administration in 2002 the amount received by creditors, in the absence of a credible buyer, would have been highly uncertain but much less than they received as a result of the restructuring plan.[13]

13. The Department, and its advisers, had tested the restructuring plan and the Company's viability against electricity prices in the range of £15 to £21 per megawatt hour scenarios. But they did not consider the high electricity prices experienced following restructuring. High prices would affect the distribution of risks and benefits between the parties to the restructuring plan, including the taxpayer. Following restructuring electricity prices rose significantly, in part reflecting increases in world oil prices (**Figure 4**). A rise in prices had been forecast at the time but the Department did not expect the extent of the price increase, though oil prices had attained similar levels in the past.[14]

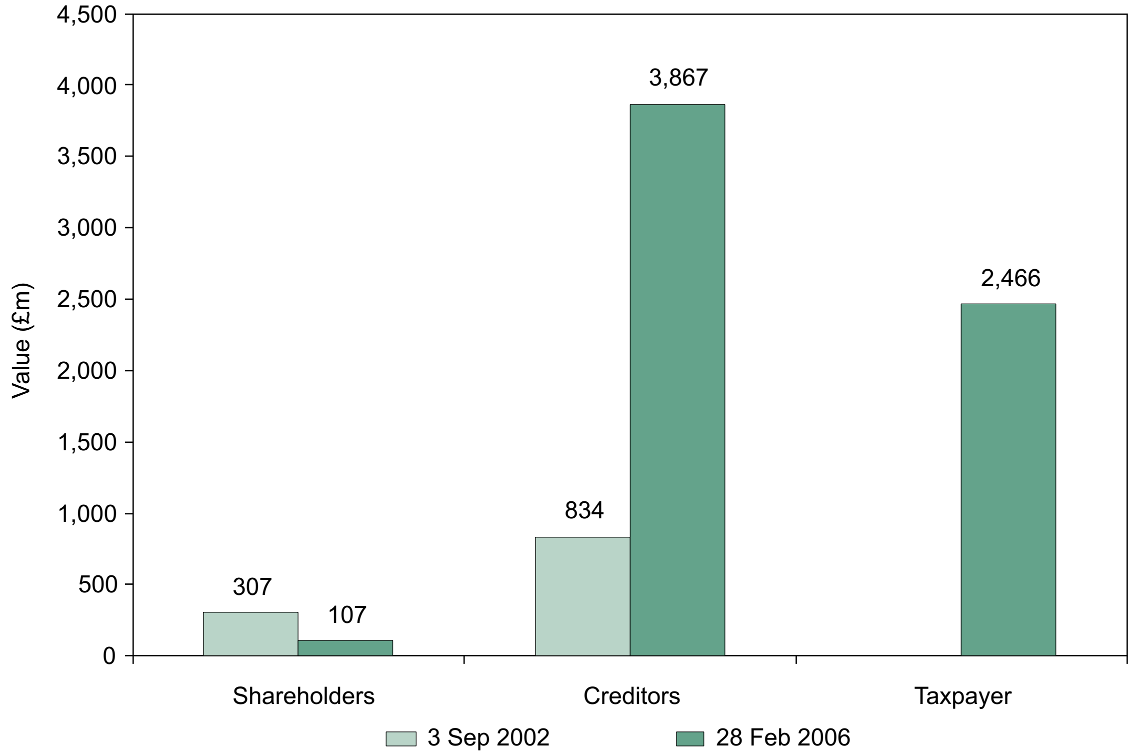
11 Qq 7, 29, 30; C&AG's Report, Appendix 6

12 Note: The value of the taxpayers' holding represents the net value after taking account of the forecast liabilities

13 Qq 33, 34, 35, 41, 42, 43; C&AG's Report, para 2.16

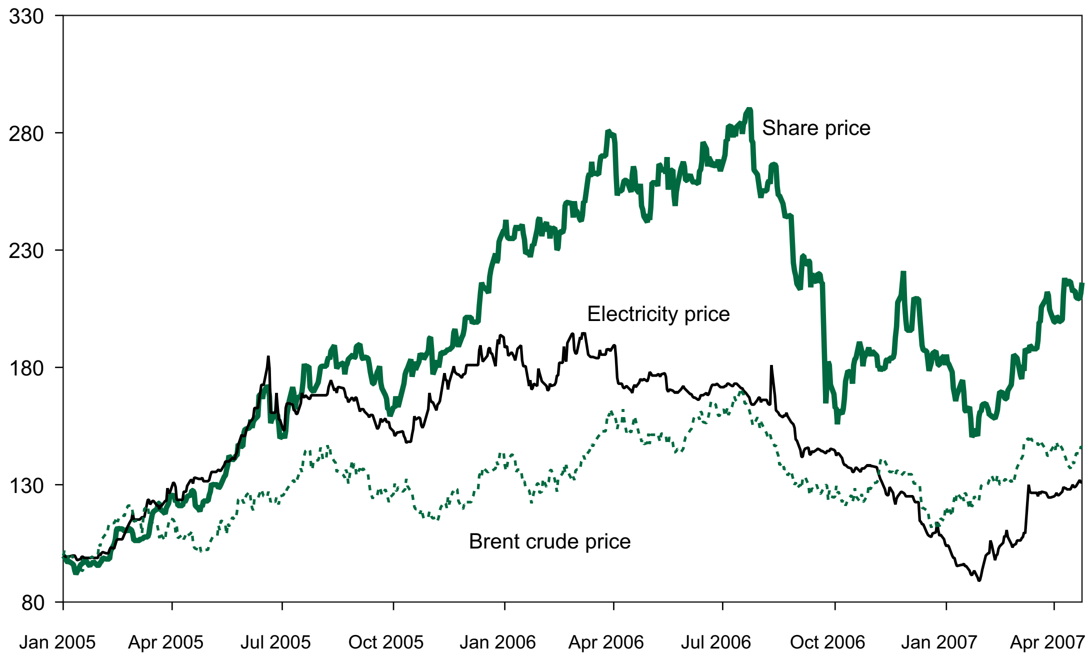
14 Q 140

Figure 3: The value of holdings in British Energy of shareholders, creditors and the taxpayer



Source: British Energy, former Department of Trade and Industry, National Audit Office

Figure 4: Movements in British Energy's share price, electricity and oil prices since relisting



Note: Measured from an index of 100 at 17 January 2005. One-year forward baseload electricity price.

Source: Citigroup Investment Research, Platts, Datastream

14. The Department spent over £29 million on advisers fees during restructuring, plus £2.5 million on its own administrative costs. £16.5 million was subsequently recovered from British Energy. Of the four main firms of advisers it used, only one was appointed through competition. For the other three companies the Department extended contracts for providing advice on other energy matters to include the advice provided on British Energy. The Department accepted that it should have appointed all of its advisers using competition. It intends to appoint panels of advisers, following competition, for this type of work in future, so that it does not need to re-tender every time advice is needed; but has not yet done so. The Department also accepted the need to benchmark the costs of its advisers.[15]

15 Qq 84–97; C&AG's Report, paras 2.25 to 2.30

3 Managing future risks

15. Restructuring has left the taxpayer facing a significant risk from British Energy's nuclear liabilities. The contribution by British Energy towards the liabilities will depend on how well the Company performs. This in turn, will be influenced by the success of the Company's commercial strategy, the reliability of its power stations and the market price of electricity. The Company accepts that it has been a poor performer in the past due to lack of investment and operating inefficiencies and has introduced a Performance Improvement Programme, with current expenditure of over £200 million a year, to improve its output performance. There have been unplanned shutdowns of some of its power stations, for example in October 2006 when the Company announced that two of its reactors, Hinkley Point B and Hunterston B, would have to shut down for inspection and repair. The Company's share price dropped following the announcement.[16]

16. The Department plays no formal role in approving the Company's commercial strategy. It does not, for example, have a direct shareholding in the Company although it does have an option to convert some or all of the cash sweep into shares. The Department has, however, set a number of conditions for the Company through the restructuring agreement: it must adhere to prudent trading principles; it cannot make capital distributions until it has built up sufficient cash reserves; it cannot undertake corporate restructuring without the Department's consent; and its freedom to borrow and scope of business activity is limited. The Department has developed contingency plans to deal with a range of scenarios should they occur.[17]

17. At present, the Nuclear Liabilities Fund is highly exposed to British Energy's future financial performance. The Department has, however, the option to convert all or part of the cash sweep into shares in the Company at any time, equivalent to up to 65% of the Company's issued shares. The increase in the Company's share price following restructuring had resulted in a significant increase in the potential value of the cash sweep (£6.5 billion at the end of February 2006) although the share price later fell back (**Figure 4**). On 30 May 2007 the Government announced that it intended to dispose of part of its interest in British Energy. The Government confirmed that the net proceeds from any such sale would be paid into the Nuclear Liabilities Fund.[18]

18. Our predecessors' report on the events leading up to the Company's request for support in September 2002, concluded that the Department had failed to establish a credible overview of British Energy's deteriorating financial position and that this inaction had been compounded by split responsibilities for energy matters within the Department. The Department has since strengthened its right of access to Company information and, for example, now receives a regular rolling 18-month cash flow forecast, supplemented with meetings with Company officials. But responsibility for monitoring the Company's performance and evaluating the information received remains split across a number of teams within the Department, including the Shareholder Executive and the Nuclear

16 Q 141; REG-British Energy Corporate Update, 16 October 2006, www.British-Energy.com

17 Qq 110–113, 116

18 Ev 16

Decommissioning Authority. There is regular contact between the various teams and regular risk reports to the Department's Management Board. But there remains a risk that information obtained by the different teams is not shared quickly and evaluated as a whole. The Department has commissioned its internal audit team to look at the current arrangements to ensure they are effective.[19]

19 Qq 15, 144–145

Formal minutes

Monday 9 July 2007

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mr David Curry
Mr Ian Davidson
Mr Philip Dunne
Ian Lucas
Mr Austin Mitchell
Mr Don Touhig

Draft Report

Draft Report (The Restructuring of British Energy), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 18 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Forty-third Report of the Committee to the House.

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

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned until Wednesday 10 October 3.30 pm.

Witnesses

Monday 27 March 2007

Sir Brian Bender KCB, Permanent Secretary, **Mr Hugo Robson,** Director, Shareholder Executive, Department of Trade and Industry and **Sir Adrian Montague CBE,** Chairman, British Energy	Ev 1

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Oral evidence

Taken before the Committee of Public Accounts

on Monday 27 March 2006

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Greg Clark
Mr Ian Davidson
Helen Goodman
Mr Sadiq Khan
Mr Austin Mitchell
Mr Alan Williams

Sir John Bourn KCB, Comptroller and Auditor General, National Audit Office, was in attendance and gave oral evidence.

Ms Paula Diggle, Treasury Officer of Accounts, HM Treasury, was in attendance and gave evidence.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

THE RESTRUCTURING OF BRITISH ENERGY (HC 943)

Witnesses: **Sir Brian Bender KCB,** Permanent Secretary, **Mr Hugo Robson,** Director, Shareholder Executive, Department of Trade and Industry and **Sir Adrian Montague CBE,** Chairman, British Energy, gave evidence.

Q1 Chairman: Good afternoon and welcome to the Committee of Public Accounts where today we are looking at the Comptroller and Auditor General's Report on *The restructuring of British Energy.* We welcome Sir Brian Bender, Permanent Secretary for the Department of Trade and Industry. Have we seen you recently Sir Brian?
Sir Brian Bender: It has faded from my memory.

Q2 Chairman: Do you want to introduce your colleagues then?
Sir Brian Bender: On my left is Mr Hugo Robson, who works in the Shareholder Executive and on my right is Sir Adrian Montague, who is the Chairman of British Energy.

Q3 Chairman: May I ask you first about the decommissioning liabilities? The latest figure for the decommissioning liabilities is now over £5.3 billion; it was announced in February that it was £5.3 billion. Is that right?
Sir Brian Bender: That is correct, yes.

Q4 Chairman: You understand that figure, do you? That is a rise of £1 billion, which is a very large sum of money. Are we going to see any further rises do you think?
Sir Brian Bender: The short answer is that we cannot rule that out. As I understand the matter, globally, and particularly taking anecdotal evidence from the United States, costs tend to increase over the first few years as the estimating methods are refined and then decrease as cost optimisation kicks in. The NDA has set itself the task of providing a robust baseline of decommissioning costs of its sites by March 2008, and they will be producing some decommissioning estimates as part of their strategy in a few days time which will apply across their suite of operations.

Q5 Chairman: So the answer is that we do not know.
Sir Brian Bender: We do not know and it may well go up. It is part of a process, as technology and regulation change, and learning and experience.

Q6 Chairman: It is very possibly going to go up, but we do not know.
Sir Brian Bender: It is very possibly going to go up, at least initially, and then likely to come down over time as cost optimisation kicks in.

Q7 Chairman: Can we now talk about the contributions, because when the restructuring took place they were supposed to give you some contributions. There is a mention of this in paragraph 3.15, if colleagues are interested, on page 36. So if these liabilities increase, why do the contributions not increase? It seems a logical thing to do. Why did the Department not require the company to do this at the time?
Sir Brian Bender: This was a process of a restructuring and a negotiated settlement with the aim of creating a viable company if we had had a variable contribution like that, it was unlikely that we would have got a viable outcome that would satisfy the market at the time. So this was considered to be the right way of setting up a framework looking forward and the contributions are, of course, linked, as the Report points out, to the company's ability to pay.

Q8 Chairman: This is all part of contributions, but tell us a bit about this scheme by which you can take an option out to take shares and sell some of them as an alternative? Tell us about that would you?
Sir Brian Bender: This is called the cash sweep and I might ask Mr Robson to explain a little more. Essentially, as the Chancellor said in his Budget statement last week, as part of the process of diversifying risk we may sell part of that stake in British Energy after the Energy Review.

Q9 Chairman: Am I right in saying that the share price was £2.63 at the time of restructuring and yesterday it was £6.40? Is that right?
Sir Brian Bender: Something like that; close to that.

Q10 Chairman: So you can sell up to 65% of the company then, is that right? How does it work?
Mr Robson: The position on the cash sweep is that it is like a convertible. It gives you the entitlement to 65% of the free cash flow of the business. It is owned by the NLF, but Government have the right to direct the NLF to convert it into ordinary shares which it can then place into the market.

Q11 Chairman: Will the share price not be affected by whether more nuclear power stations are going to be built?
Mr Robson: The position in terms of the value of the company is that primarily it is valued on the basis of the current plants that it operates, that is it is valued on a discounted cash flow of the value going forward. It is important to point out that in terms of the Energy Review no decision has been taken in relation to whether there will be new build or not. In the event there were to be new build, then clearly it would be quite some time away before that new build would actually be in place and therefore the value of the company is limited in terms of the new build opportunity.

Q12 Chairman: Of course the Chancellor can never be guilty of insider trading; I would never suggest that. However, he is not going to be entirely unaware of the nature of this review and what is happening when he sells these shares.
Mr Robson: That was indeed one of the reasons why the Chancellor took the view, and we obviously discussed with Treasury colleagues that it was appropriate not to do any sort of sale ahead of the Energy Review and that was indeed the reason why we thought it was important, from a perception point of view, to do everything once it was clear what the outcome of the Energy Review was.

Q13 Chairman: That is very fair. Thank you very much. Let us look at the creditors now and figure three on page five. This is the value of the holdings in British Energy of creditors. They have done rather well, have they not? Do you think that the Department should have pressed for a better deal with the creditors?
Sir Brian Bender: They took significant pain as part of the restructuring and the Government's view was that the pain was reasonably well shared through the restructuring deal. The taxpayer has, of course, benefited from the enhanced value of the NLF.

Q14 Chairman: All right; we shall leave it at that. What happens if there is a decline in performance? Would you like to look please at paragraph 1.7, page 13? Obviously the company's performance has a direct bearing on the contributions, does it not? So how are you going to manage the risk of a decline in performance? It has been performing quite well recently, but what happens if it does less well?
Sir Brian Bender: When the restructuring was being decided on, the arrangements the Government set out were intended to ensure that a suite of scenarios could be covered and addressed. Consequently, there was a worst case scenario, a base case and a best case and we believe that the risks are covered adequately in any of those scenario outcomes in any real world situation which is likely to emerge.

Q15 Chairman: What about the risks and protecting the taxpayer's interests? Would you like to look please at paragraph 20 on page 7? It mentions there "Overall responsibility for managing the taxpayer's interest . . . lies with a senior official within the Department". Do you think this is an adequate way of managing the risks to the taxpayer?
Sir Brian Bender: We have set up much tougher monitoring arrangements under the restructuring; tougher monitoring arrangements by the Department, some conditions on British Energy. Then two parts of the Department have an interest in this. The Shareholder Executive monitors the arrangements in relation to British Energy and the Energy Group monitors the arrangements as far as the energy market is concerned, and that is brought together with meetings on a regular basis between the two, regular discussions with the company and regular risk reports to the board. I have also asked, as the Report says, my internal audit department to look at our internal governance arrangements to make sure that we have this as effective as it needs to be.

Q16 Helen Goodman: I wonder whether I could draw your attention to footnote five on page four which says: "Liabilities and other monetary amounts shown in this Report . . . are discounted to present values using a real discount rate of 3.5% unless stated". I am working on the assumption that in figure three the figure of £5,287 million, which is the figure for estimated nuclear liabilities, has been calculated using that 3.5% figure and that is the net present value of those liabilities. Would that be correct?
Mr Robson: Yes, that is correct.

Q17 Helen Goodman: Turning to page 36, figure 18, you have set out the profile of nuclear liabilities and I am assuming that that profile of liabilities is the profile which you then discounted to reach the £5,287 million figure. Is that correct?

Mr Robson: Yes, I believe that is correct.[1]

Q18 Helen Goodman: Are you aware of the guidance in the 2003 Treasury Green Book about the long-term discount rate?
Mr Robson: Yes, I am. I cannot precisely remember which figure it is.

Q19 Helen Goodman: I am interested in drawing your attention to annex six in the Green Book on long-term discount rates. In paragraph 12 it says that it is recommended that, for costs and benefits accruing more than 30 years into the future, appraisers use the schedule of discount rates provided in table 6.1. That shows that a discount rate of 3.5% should be used only for the first 30 years; for years 31 to 75 the figure should be 3% and for years 76 to 125 the figure should be 2.5%. Could I ask you why you have not used those discount rates to calculate the net present value?
Sir Brian Bender: If we are not able to answer that question now, we shall give the Committee a note on it.[2]
Ms Diggle: May I make one small guess or suggestion, which is that these are very, very uncertain figures. The way in which the actual work will be done is not known with any confidence at this stage.

Q20 Helen Goodman: I am sorry, but that is not the point. We are not talking about the physical costs of the decommissioning. We are talking about the discounted value of the costs on the basis of the best estimate which British Energy and the DTI have provided. So if I might draw your attention again to figure 18, what that means is that from 2035 to 2080 you should be using a figure of 3% and from 2080 onwards you should be using a figure of 2.5%. If you do that, the net present value will turn out to be quite a lot higher than £5,287 million. I wonder whether you could possibly provide the Committee with a note on the basis which is recommended in the Treasury Green Book.
Sir Brian Bender: We shall do that.

Q21 Chairman: I should like to press you further. Are you sure you cannot say anything now to the Committee rather than just offer a note which will get buried? Helen Goodman asked a very sensible and serious question and I think she should have an answer now.
Mr Robson: What you say is clearly correct, that if you use different discount rates from 3.5% to 2.5%, that is clearly going to make a difference to the value of the liabilities. At the end of the day, what we have taken is the Treasury guidance as to what it should be at the 3.5% level.

Q22 Helen Goodman: You clearly have not used the Treasury guidance.
Mr Robson: We shall certainly provide a note, but what we should remember is that we are talking about liabilities that are over 80 years away, at which time it will be a very different situation in terms of the management of those liabilities as well.

Q23 Helen Goodman: In footnote 33 on page 36 it says: "The Trustees undertook a first Quinquennial Review in 2001, concluding that the assessed value of the Fund at that date was not less than its total discounted liabilities". If you recalculate using the recommended discount rate, can you still be sure that that is the case?
Mr Robson: One thing that is worth pointing out about the NLF and the way the NLF work on this is that we are dealing with two situations: we are dealing with the liabilities on one side and the value of cash sweep on the other. In terms of the responsibility of the NLF, its purpose, and it was clearly stated in the Report, it is not specifically there and designed to cover the overall costs of decommissioning and historic fuel liabilities. What it is there and designed to do is indeed to maximise the value of the contribution from British Energy towards meeting those liabilities. What we have here is a situation where, based on the situation of the 3.5% discount rate, what we are saying is that there is a £2.9 billion benefit based on today's share price to the taxpayer. Quite clearly if you take a different discount rate, that £2.9 billion will be reduced.
Sir Brian Bender: I am sorry that we are not able to provide the answer; we shall provide a note. There is one additional fact which I can add to the discussion which is, as I understand it, that £2.3 billion of the £5 billion relates to the historic spent fuel liability which will mostly come over the next 10 years. We shall provide a note on this.

Q24 Helen Goodman: That is not what the chart in figure 18 shows. You can see that the peak of the costs falls after 2075 and you have a very substantial difference. There is a systematic bias in the way the numbers have been presented.
Mr Robson: This is the uncontracted liabilities, the decommissioning liabilities and excludes the historic fuel liabilities which are paid by the DTI. The uncontracted liabilities and the decommissioning liabilities are the ones that the NLF are specifically required to cover and that is more in the region of about £2.5 billion. The historic fuel liabilities are primarily over the next 10 years and therefore unaffected by the discount rate.

Q25 Helen Goodman: It does not look like that from the information provided in the NAO Report. Would you still say, reflecting on this point about the systematic bias because of the way you have used the discount rate, would you still hold to the position in paragraph 3.15 that the Department has adopted a prudent position?
Mr Robson: Yes, in terms of our position in relation to the way we set this up, we have indeed taken a prudent position in terms of looking at how the cash

[1] *Note by witness:* Mr Robson's answer to question 24 clarifies this position: Figure 18 represents only the NLF's liabilities (the decommissioning and uncontracted liabilities) not the £2.3 billion of historic spent fuel liabilities.
[2] See supplementary memorandum on Use of Discount Rates (Ev 16): this memorandum verifies that the Department used the appropriate discount rate, as set out in HM Treasury's Resource Accounting Manual.

sweep can lead towards meeting the liabilities going forward and on the discussion about whether it is at 3.5% and 2.5%, we have conceded that that would affect and will reduce the £2.9 billion positive effect for the taxpayer, but it will not increase it by a very significant amount. We shall get back to you in terms of what that is.

Q26 Helen Goodman: Could you explain why there does not appear to have been any cash sweep for the period September 2002 to January 2005?
Sir Brian Bender: We were prevented from doing it for the initial period.

Q27 Helen Goodman: In what sense were you prevented from doing it in the initial period?
Mr Robson: The cash sweep in 2002 was not actually in place. The cash sweep came into existence upon restructuring in January 2005 when the company was restructured and that was the point at which the cash sweep effectively became effective. You are right that there was no cash repayment in the period from January 2005 to March 2005.

Q28 Helen Goodman: Would I be right in saying that this is because you were more concerned with the viability of the company than in covering the cost of the liabilities to the taxpayer of the nuclear decommissioning?
Sir Brian Bender: I would not make that assertion, no. It was important to make sure that the company that was set up was viable and would then, as part of its commercial success, contribute to the handling of those liabilities.

Q29 Helen Goodman: Could you explain why the contribution to the Nuclear Liabilities Fund made by the company is dependent on the cash generated in the company, not the nuclear liabilities generated, which is the practice in Belgium, Finland, Germany and Japan?
Mr Robson: The position there is very much in terms of restructuring. The purpose of restructuring was to create a viable company. It was required under state aid rules anyway to give the minimum amount of aid to British Energy. We established what was a viable company, which was to remove the liabilities which were a fixed cost, and then, as a result of that, put in a cash sweep which was variable depending on the success of the company so that we were able to benefit from the success going forward of the company. If we had put in a position whereby the liabilities were to increase, then the contributions would have had to go up. We would not, as of January 2005, have been able to say that this was a viable company because the purpose was to remove these fixed and uncertain costs.

Q30 Helen Goodman: I can see that you might have had problems with the European Union on state aid, but presumably all we are doing is shuffling the burden around between taxpayers today and taxpayers in the future because of the way you have restructured this?
Sir Brian Bender: In most countries the taxpayer is heavily involved in one way or another in nuclear costs and risks. In the circumstances in 2002, the analysis showed that we needed to remove those fixed liabilities in order to be able to create a viable company so that the taxpayer could get a return. That was why we did it in this way.

Q31 Helen Goodman: It may be the case that in most countries the taxpayer is involved, but it is in this country that shareholders are receiving dividends and creditors have debts converted into equity. Your point does not explain whether or not that is, and I am contending that it is not, an appropriate distribution of the risk between the taxpayer and the shareholders.
Sir Brian Bender: We have imposed limits about the company's ability to give dividends in the future, if there are problems in relation to the liabilities. These are set out later in the Report in chapter three.

Q32 Greg Clark: May I pick up on Helen Goodman's excellent questions? I am astonished that you cannot come up with an answer as to why you used a different discount rate. I should have thought the fact that you used a variation on the Treasury's rate would mean that you would know exactly why, and what the justification was. I just find it astonishing that it is something you have to take away and come back to the Committee with a note. If the default is the Treasury rate, how can you not use that? Are you able to choose whichever rate you want?
Sir Brian Bender: I apologise for the fact that we are not able to answer this question now; I simply do not have the information with me to provide that answer and I regret that.

Q33 Greg Clark: I am very surprised. Just on the restructuring. You obviously face a choice between restructuring and administration and, as we understand it from the NAO Report, there is a fairly finely balanced financial case at least between the two. The best case had restructuring costing the taxpayer more, the worst case had administration costing more and so the solution is for the public purse to absorb more or less all of the liabilities, which are £5 billion. The Report is pretty clear, looking at page 21 paragraph 2.5, that when it actually came to the choice between restructuring and administration that there was no potential purchaser in prospect for administration. The Report says: "The Department concluded that given the prevailing low wholesale electricity prices and the scale of British Energy's nuclear liabilities, no credible and qualified purchaser existed" with an exception. So given that, given that the creditors of this company had nowhere else to go, why were they given 97.5% of the share capital?
Mr Robson: They were given 97.5% of the company with 2.5% going to the shareholders. At the end of the day the restructuring plan was a company plan. What the Government received was, in effect, 65% interest on a converted basis. So to say that the creditors got 97.5% of the company is not quite

correct, because in effect, in terms of financial interest, it is down to around 30% of the company as opposed to—

Q34 Greg Clark: Nevertheless, they had a major financial interest in a company when actually this must have been a windfall for them. I am sure they did the same assessment and, like the Department no doubt, concluded that they should write off the sums of money they had exposed to this company. They had no basis for expecting any sort of financial return and yet they were given 97.5% of the share capital. Now you say that this is a shared risk and the taxpayer is exposed to it too, but the fact is that this stake is now worth £4 billion. They have been given £4 billion worth of value for no risk.
Mr Robson: What the Report demonstrates is that at the time, and of course we were looking at a very different period of time with electricity prices down to the £15 level, at that point analysis was done and showed that creditors were indeed taking a very significant pain. They were losing effectively around £300 million out of the £1 billion that they were owed.

Q35 Greg Clark: Yes, but they had lost that money. The fact was that because of the low electricity prices and because of the liabilities, they had waved goodbye to that and the white knight of the public purse came riding to the rescue and gave them £4 billion for nothing.
Mr Robson: It did not give £4 billion.

Q36 Greg Clark: That is what it is worth.
Mr Robson: It is worth that today, but it was not worth that at the time.

Q37 Greg Clark: What was the downside for them?
Mr Robson: The downside in what respect?

Q38 Greg Clark: They were given this. They could not anticipate any further reward.
Mr Robson: Yes, but the creditors were owed £1.1 billion.

Q39 Greg Clark: But if it went into administration, they would not have got a penny of it.
Mr Robson: Correct. The amount that they would have got in return would have been extremely uncertain.

Q40 Greg Clark: We need to be clear here. The amount that they got may have been uncertain, but it would also have been infinitesimally small, if it went into administration at that point. That is correct, is it not?
Mr Robson: I do not have the precise details.

Q41 Greg Clark: It is not a question of detail Mr Robson. Are you saying that the creditors, if British Energy had gone into administration at the time of this restructuring, would not have had an extremely small reward from it, if any? The fact is that it would have been virtually zero. You are not trying to tell the Committee that it would have been in any way significant, are you?
Mr Robson: I am not trying to say that it would have been significant.

Q42 Greg Clark: Would you agree that would have been insignificant?
Mr Robson: It would have been less than the £700 million that they took in terms of value at that point.

Q43 Greg Clark: I do not think this is terribly satisfactory. It is pretty clear from the finances of this organisation that this was, effectively, almost a bankrupt organisation. It is clear from that, that the creditors were not expecting any significant sum of money. If it was so valuable, why is it not the case that some other purchaser has stepped in? The assessment is very clear that this was unsaleable.
Mr Robson: The assessment is absolutely clear that it was unlikely that any buyer for the entire business would come forward. What precisely would have happened, if it had gone into administration, is clearly uncertain and that was indeed why it was important to come to a position whereby there was, if we could achieve it, a solvent restructuring, because under the solvent restructuring route, then we did not have indeed that uncertainty that you mentioned.

Q44 Greg Clark: The Report makes clear that actually the possibility of a planned administration was possible; one can see the disadvantages of an abrupt administration but page 22 of the Report is very clear that a planned administration was a perfectly feasible thing. I am slightly mystified as to why it is the case that British Energy, with £5 billion of nuclear liabilities, should have been left in the private sector and restructured with creditors, who contributed very little, who had low expectations of what they should get back, benefiting significantly, whereas, not far from that time, it was felt that Railtrack, which did not have such significant liabilities from a public safety point of view, had to be taken back into the state sector. I do not quibble with that here, but it seems bizarre that a nuclear company should have been found fit to stay in the private sector and the creditors rewarded but not the shareholders of Railtrack. What would you say to that?
Sir Brian Bender: The conclusion reached as part of the discussion on restructuring, as stated in the Report, was that the costs of the two were roughly equal, but the risks of going into administration were greater, and therefore a solvent restructuring was likely to provide the better return to the taxpayer as well as protection of the interests of security of supply and safety.

Q45 Greg Clark: On reading the Report it is clear that those risks attached to an unplanned, abrupt administration, not to a planned administration. It is slightly misleading to posit a distinction between administration and restructuring as being as stark as that.

Sir Adrian Montague: The difficulty of a planned administration is that there is no such thing as a sure plan when you enter administration, because the administrators tend to have minds of their own, they have duties to the creditors as a whole, not to Government, not to health and safety. This was not directly my concern, it was a government matter rather than my matter; I was looking after the company at this stage. I think that there would probably have been worries as to whether it would be as easy to get out of administration as it would have been to get into it.

Q46 Greg Clark: The Report makes clear that the Department could have funded an administrator and thereby kept the company running and satisfied safety standards. If administration is so unpalatable, and there are one or two remarks which mention the loss of staff morale, for example, if these are significant, then surely these things apply just as much to British Energy today running nuclear power stations as they did before the restructuring. Okay, we have taken out the nuclear liabilities, but these risks remain, so is it any more conceivable today that British Energy could be allowed to go into administration if it were to fail financially?

Sir Brian Bender: There is a NAO recommendation in the Report that we are looking at which is that, if the company were to go into administration in the future, a special administration regime should apply. That is something we are looking at and we are discussing it currently with the NII, the Nuclear Industry Inspectorate.

Q47 Greg Clark: It is the case, is it not, that this is a private company and the evidence from this Report is that the Government were not allowed to go bust, which puts it in a very unique position?

Sir Brian Bender: There were issues then, as there may well be now, to do with security of energy supply, electricity supply and safety, which caused the Government to decide, since the costs were about equal and those risks skewed it one way, that solvent restructuring was the better option. That was the reason the decision was taken, as it was, in 2002 onwards.

Q48 Greg Clark: Are you concerned as to the consequences of administration and that the duties would be to creditors rather than the Health and Safety Executive and all the rest of it? It strikes me that, sitting where we are today, those risks continue to be there for administration, if you are to be consistent, and therefore this company, where another tranche of shares is about to be sold, comes with a government guarantee behind it.

Sir Brian Bender: The point I was trying to make a couple of minutes ago, and there is a recommendation in the Report on this point, is that we are currently reviewing whether legislation is required to establish provisions which could assist if it were to go into administration. In other words, there is an issue being looked at now as to whether it would be useful to have a special administration regime to address this type of problem in legislative form.

Q49 Greg Clark: When will that be decided?

Sir Brian Bender: I cannot answer that; it is currently being considered.

Q50 Greg Clark: Before the sale of shares?

Sir Brian Bender: I cannot answer that.

Q51 Chairman: May I just ask one thing on the line of questioning of Helen Goodman and the early part of Greg Clark's before we move on? I want to ask the Treasury, if I may? It is quite clear from the questions that Mrs Goodman put to you that the DTI did not follow the Green Book rules on the discount rate. Did the Treasury specifically accept this departure from their own rules?

Ms Diggle: We are going to have to look into that for you Chairman.

Q52 Chairman: We do want to know.

Ms Diggle: I certainly want to have a look at this note before it is sent.

Q53 Chairman: We want to know what you think of this answer that it is all rather vague in 2085. That does not sound a very good answer to me. A rule is a rule is it not?

Ms Diggle: Certainly.

Q54 Mr Mitchell: I wonder whether we really have a situation here where the sky is black with chickens coming home to roost. The accounts of the whole nuclear industry have been fiddled for so long to try to show it as profitable, when it is not, and to try to show it as competitive, when it is not, that you have just got lost in a miasma of figures. I have been corresponding for several years with the DTI about the accounts of British Nuclear Fuels. I have brought the papers along for Sir Brian, because they might just have gone into that black hole marked DTI. We had reports done in an association of business and accountancy which proved that British Nuclear Fuels had been capitalising on the repairs and the maintenance expenditure for years, that they had been fiddling the depreciation levels, they had been fiddling the provision relative to long-term nuclear liabilities, they had been fiddling accounting standard FRS12, they had given a pension holiday to add to profits and, long term, they had shown income above the line. Now here is British Nuclear Fuels, they are a creditor, they are a beneficiary of what you did for British Energy. If the accounts of British Nuclear Fuels, and I imagine the accounts of the rest of the industry, have been fiddled as vigorously as that for so long, it was no wonder you had no figures you could rely on in 2002. You did not know where the hell you were.

Sir Brian Bender: It seems to me largely a rhetorical question, but—

Q55 Mr Mitchell: No, no, no; my question was pointed. I shall give you the papers afterwards. The accounts were in a mess.
Sir Brian Bender: I am not aware of the issues to do with British Nuclear Fuels and you will give me those papers afterwards. The NAO Report states that the analysis the Department did, at the time of the risks that the taxpayer and the economy were facing, were properly examined. That is the conclusion NAO have reached in relation to this restructuring.

Q56 Mr Mitchell: But it also says there was some confusion as to the figures and what the accurate figures were. That is true, is it not?
Sir Brian Bender: We did not have the liabilities figures, as is evident from the Report.

Q57 Mr Mitchell: When it comes to the decision whether to put it into administration or to carry it on, it was a very different decision to the one for MG Rover we were talking about last week. Of course, as the Report says, normally when private companies get into difficulties, the Department's policy is not to intervene, on the argument that the United Kingdom productivity goes up if a relatively inefficient firm is allowed to close. Here was an inefficient loss-making electricity producer and you decided to keep it going. That is really a political decision, is it not? You can disguise it with figures, but essentially they had got you by the balls.
Sir Brian Bender: I was explaining in reply to previous questions that the costs of administration versus solvent restructuring were roughly equal, not much to choose between them, but there were issues around nuclear safety and security of energy supply that led to the policy decision that the lower risk option would be to go down the road of restructuring. Those considerations did not apply in relation to the Rover Group; it was a very different context.

Q58 Mr Mitchell: Those safety issues could possibly have been dealt with, but the basic argument was that you did not want and you could not afford nuclear to fail in that kind of fashion.
Sir Brian Bender: The decision was taken at the time that there were very significant risks to do with nuclear safety and electricity supply if it went into administration, for the very reasons I was trying to explain to Mr Clark.

Q59 Mr Mitchell: Did the fact that you could not find anybody else who was willing to come forward and run it, even at a knock-down price—that is what administration is all about, finding some sucker to take it on—not tell you something about the viability of this organisation?
Sir Brian Bender: It was an issue around the greater risks, as I described earlier, of going into administration rather than restructuring.

Q60 Mr Mitchell: Why did you get rid of bits in the United States which I assume were more profitable? I do not know, perhaps you will tell us whether they were profitable or not. Why were they got rid of?
Sir Brian Bender: In order to realise some assets to help with the potential—

Q61 Mr Mitchell: To save the British company, the non-profitable company.
Sir Brian Bender: To help the potential cost to the taxpayer.

Q62 Mr Mitchell: Yes, but were the American assets more profitable and more saleable than the British assets?
Sir Brian Bender: Yes.
Mr Robson: They were clearly more saleable because they were indeed sold. The position, very firmly, was that in relation to any company that goes into severe difficulty, as indeed British Energy did, you look around and you try to sell those parts of the business that you are able to sell. That was very firmly the case with both Bruce in Canada and Amergen in the US. In relation to Bruce in particular, one of the problems would have been that, had the company gone into administration, there were terms in the lease of the stations in Canada which would have effectively been an equivalent of a change-of-control clause, which would have meant that there would have been great difficulty in getting any value from that business. That indeed was a factor that was put into the reason why it was considered better from a financial point of view to go down the solvent restructuring route.

Q63 Mr Mitchell: But the North American assets were sold at a loss in a kind of fire sale, were they not?
Sir Brian Bender: No, they were sold for the best price that we got.

Q64 Mr Mitchell: Which was a loss.
Sir Adrian Montague: They were sold for a positive value in each case. It is true to say that this was a fire sale and that therefore we did not have a good negotiating platform, but we got good value in the circumstances.

Q65 Mr Mitchell: You do not accept my contention, because of long years of fiddling the figures, the inference, as I read it from the Report, that the Department was largely working in the dark with its wide variations between the best and worst case estimates of the likely costs of restructuring versus administration. You do not accept that contention.
Sir Brian Bender: No. The only aspect where it would be fair to say we were in the dark was the exact sum of the liabilities that we then removed from the company. The Report makes clear that we did not know that figure at the time, but, for the rest, we were looking at a range of assumptions, this of course against a background that when you last had a hearing on this issue, one of the criticisms of the Department was that we had not looked at a very wide range of assumptions on electricity prices post

1996. This time we looked at a wide range of assumptions, including prices, including other aspects, and it was right to do that.

Q66 Mr Mitchell: Was the fact that the restructuring so substantially benefited the shareholders and the creditors and the costs fell on the state, which is the usual pattern with nuclear, a deliberate decision to keep shareholders and creditors sweet or was it just an accidental consequence of the way it was done?
Sir Brian Bender: It was not an accidental consequence, but the rationale for what was done was to remove the liabilities and then have arrangements in the restructured company which would enable the company, if it was robust and successful, to contribute towards the reduction of those liabilities, and that was indeed what the Chancellor was announcing as a possibility in the Budget last week.

Q67 Mr Mitchell: Why? It is unlike the situation in other countries. Why is there virtually no link between the size of the contributions back to the state to be made by the company and the size of its liabilities? Why is all the risk placed in the public sector?
Sir Brian Bender: The basis of the restructuring was that the company would contribute according to what it could afford and when it performed well it would make a larger contribution. That was the rationale and indeed, I hope that in the months ahead, we may see some of the benefit of that.

Q68 Mr Mitchell: Why do they apparently do it better in other countries? Is it that they have smarter accountants better at fiddling the figures or a smarter government better at setting up the financial size and investment patterns of the nuclear industry?
Sir Brian Bender: There are issues about how the liabilities were assessed in the first place, for which we have to go back to the decisions taken in the 1970s and 1980s, but ultimately, one way or another, in most countries, as the NAO Report says, in the last resort it does come back to the state to deal with the liabilities, particularly around nuclear waste.

Q69 Mr Mitchell: Is it on this scale in other countries?
Sir Brian Bender: As the Report says, there are many different models but the general characteristic is that the costs and the risks do come back eventually to the taxpayer.
Mr Mitchell: I frankly feel a bit resentful, as a taxpayer, at having paid for all those years of propaganda and lies about the nuclear industry.

Q70 Mr Bacon: Mr Robson, I should like to ask you about this discount rate question which Helen Goodman asked you about earlier. I heard you say to Helen Goodman, in answer to one question, that the Department and you had followed the Green Book, except you were stopped by Helen Goodman who waved the Green Book in your face and said you did not. Can you just confirm now, even if you are not able to give the full explanation, as Sir Brian said you are not, that you did not follow the Green Book guidance? That is correct, is it not?
Mr Robson: All I would say is that we took guidance from the Treasury and from the NAO.
Mr Bacon: That is not what I want you to say. My question was: did you follow the Green Book, yes or no?

Q71 Chairman: Did you say you took advice from the NAO? Is that right?
Mr Robson: According to NAO rules.

Q72 Chairman: The Comptroller and Auditor General indicated no.
Mr Robson: Apologies; according to NAO rules.

Q73 Mr Bacon: Did you follow the Green Book? In calculating what discount you would use over the life of this, did you follow the Green Book?
Mr Robson: Clearly not.

Q74 Mr Bacon: So the answer is no?
Mr Robson: The answer is no.[3]

Q75 Mr Bacon: Thank you; I just wanted to be clear about that.
Sir John Bourn: I should just say that it is not the task of the NAO to lay down what discount rates executive government uses in its calculations. There were no rules that we had laid down here.

Q76 Mr Bacon: I understand Mr Robson that you did not follow the Green Book. So you effectively made up the rules as you went along, did you, in terms of what discount rate you would use?
Mr Robson: I cannot answer further. We said we shall provide an additional note on this. I understood it to be the Treasury rules that 3.5%—

Q77 Mr Bacon: You understood it to be the Treasury rules?
Sir Brian Bender: I apologise, but we are clearly not able to answer.

Q78 Mr Bacon: No hang on; Mr Robson just said an interesting thing. You thought you were following Treasury guidance? Is that what you are saying?
Mr Robson: We took guidance from Treasury; yes.

Q79 Mr Bacon: So the Treasury advised the DTI and British Energy not to follow Treasury guidance?
Ms Diggle: I can only offer to go back and look at precisely what did happen at the time.

Q80 Mr Bacon: It would be quite interesting to see.
Ms Diggle: You are absolutely right that we need to know.

[3] *Note by witness:* See supplementary memorandum (Ev 16) on Use of Discount Rates: it was not appropriate to follow Green Book rules, but rather to follow HM Treasury's Resource Accounting Manual which set a 3.5% flat discount rate.

Q81 Mr Bacon: Okay, that is fine; I shall move on. Sir Brian, Sir Adrian made a very interesting point when he said that once it is in administration, administrators have duties to all the creditors not to Government, not to health and safety. This may be a better question for Sir Adrian to answer, who I understand is a lawyer. Is it the case in company law that health and safety law is suspended in administration and that the administrators do not have duties to health and safety, because that is what you said?
Sir Adrian Montague: I do not believe so. I am a renegade lawyer of no current standing, so you must not take my word as gospel on this, but I believe it is correct.

Q82 Mr Bacon: That there are circumstances in which health and safety law is, at it were, suspended?
Sir Adrian Montague: No, the way that this works is that health and safety law must continue. To be honest, in operating the power stations safety is the paramount concern but in the financial implications of an administration, the administrator's duty is to the creditors as a whole. I was not party to these discussions, but I could imagine that NII could possibly have had some concerns about the reliance on administrators to operate these stations.
Sir Brian Bender: That is my understanding. It was essentially an expression of NII concern about the uncertainties, if it went into administration, for nuclear safety. It was not a certainty; it was a concern on their part that that was one of the risks that the Government took into account in going down the road, all other things being equal, of restructuring versus administration.

Q83 Mr Bacon: What slightly surprises me is that when the analysis and the risk assessment were done in the first place, when the company was first sold, no-one asked the obvious due diligence question in this circumstance "What happens if it goes bust?" or did they?
Sir Brian Bender: I cannot answer that beyond the hearing this Committee had a couple of years ago that looked at the circumstances up to that. I have read the transcript of that hearing, I have read the Committee's Report and the Treasury Minute, but I have not looked at that particular question.

Q84 Mr Bacon: I should like to ask about the professional fees. On page 29 there is a chart which explains the amount paid to different professional advisers. This is figure 15. Could you say why the Department is not able to appoint all its advisers using competition?
Sir Brian Bender: If I may say so, I think that the NAO recommendation here is quite right. The Department should have had a competition and the recommendation here is something we shall need to implement as soon as we can. I am advised there may be a question in relation to what is described as the magic circle of legal advisers, who have some doubts about whether they want to be on such a list because it might rule them out of other business. My general point is that we should not have been in this position and I accept the NAO recommendation on this point.

Q85 Mr Bacon: You only reviewed the fees once between September 2002 and January 2005. Why did you not review the fees more regularly and what savings did you make as a result of the reviews you did make?
Sir Brian Bender: We did have a new risk-sharing arrangement with Slaughter and May in early 2004 when that review happened. We did, of course, get a recovery from British Energy of a large part—

Q86 Mr Bacon: I was going to come onto that in a minute. Could you talk about the savings from the advisers? The British Energy compensation is a separate matter.
Sir Brian Bender: I understand that. I do not have data with me on what savings we did obtain, but we had contracts by monthly fees and success criteria that we built in, or hourly rates for Deloitte and Slaughter and May, and we did carry out the review as described. For example, Slaughter and May were reviewed in early 2004, but I do not have with me the data of what saving that brought about. Again, I can provide material for the Committee, if that is helpful.[4]

Q87 Mr Bacon: Is it the case that you now have professional panels in place, rather like framework agreements for consultants in other departments?
Sir Brian Bender: We have in most cases. On this particular area, this is still work in progress and it needs to be completed quickly.

Q88 Mr Bacon: Why did you not reclaim all of the professional fees for external advisers used by British Energy?
Mr Robson: It was a matter for negotiation with British Energy at the start of the process and an amount of £15 million was negotiated with British Energy as what would be covered. All of the costs of managing the credit facility, the £6.5 million, were recovered in full.

Q89 Mr Bacon: In paragraph 2.28 it says: "The original contract with Credit Suisse First Boston was capped at £5 million". It says in the next sentence that the actual value of the work undertaken was £11.1 million. It is possible to read from that that therefore Credit Suisse First Boston did £6.1 million of work for free. Am I right in supposing that Credit Suisse First Boston does nothing for free and indeed you paid them the £11 million?
Sir Brian Bender: You are correct in the last part.

Q90 Mr Bacon: How did you go from having a cap of £5 million to paying them £11 million?
Sir Brian Bender: Looking at the Report again, there is something that comes across as slightly misleading. The cap related to a contract they

[4] Ev 17–20

already had for working for the Department on British Nuclear Fuel's matters and we used those contractual arrangements—

Q91 Mr Bacon: It says: ". . . extended an existing contract".
Sir Brian Bender: Exactly. So we had the arrangements that were in place for BNFL that we then brought across to apply to this restructuring, and early on it became clear that this would be a long project and we needed to negotiate new contractual terms. We then negotiated a new contract with Credit Suisse to cover the British Energy work and it had fixed monthly fees and success fees as part of it. The £11 million was entirely subject to the new contract and unrelated to the capped fees.

Q92 Mr Bacon: What lessons have you learned from this and how will these be applied in the future?
Sir Brian Bender: There are two main lessons. One is the one we touched on earlier, that we do need to have panels and have companies on those lists that we can draw from. Secondly, we do need to have methods of benchmarking which we do have in the Department; we need to make sure we use benchmarking.

Q93 Mr Bacon: You have them, but you just have to make sure you use them.
Sir Brian Bender: Correct.

Q94 Mr Bacon: It is the case is it not, that many big consulting firms and law firms and banks have done very well out of Government in recent years through all kinds of projects, including PFI/PPP. I am thinking particularly of London Underground where the fees were over £450 million from recollection. In fact this £29 million total here, from memory, was exactly the same as Freshfields got in total, so compared with London Underground you are doing very well on this, but it is still a lot of money. I have met people who say that when they are negotiating with Government, compared with when they are negotiating to provide professional services to the private sector, it is usually a lot easier; they do not encounter the same reluctance to pay their high professional fees as they do from private sector clients and there is less of a negotiation than has to be had with the public sector client to get the public sector to pay what they want.
Sir Brian Bender: Well I am sorry to hear that. I have some data with me which say that when Telewest, the cable company, was restructured, there was a total of £110 million in adviser fees for a £3.8 billion rescue and for Marconi the legal costs alone were £56 million. This was one of the most complicated restructuring packages in British commercial history. It is therefore not surprising that the fees were high and the NAO Report does talk about the importance of us having the right sort of professional advice. Nonetheless, there are plainly lessons about how we can make sure that we do not pay over the odds for that advice.

Q95 Mr Bacon: Finally, if I might return to my second question about being in administration and the legal framework, you say this is something that is currently being considered. Obviously a policy matter is not really an issue for this Committee, but at the same time, getting this right or wrong could have considerable implications for the taxpayer and I was surprised you were unable to answer Mr Clark's question about whether any legal changes would be put in place before the sale of shares.
Sir Brian Bender: I cannot answer that. If there is any more we can say when I have gone back and provided a note subsequently, I shall cover it in that, but that is the present position.

Q96 Mr Bacon: In what sort of timescale, roughly, without signing your name in blood, do you think you are looking at before shares are sold?
Sir Brian Bender: I really do not want to be drawn and it would be unwise of me to speculate on the timing. It is market- sensitive and I simply do not know. The only commitment the Chancellor gave last week was that it would not be before the Energy Review report was published and the public timetable for that is the summer.

Q97 Mr Khan: Sir Adrian, are you pleased with the way the restructuring has gone?
Sir Adrian Montague: There are two parts to our restructuring process: firstly, arriving at a stable financial framework, which is what the restructuring itself delivered; then secondly, there is, as the Report says, work to do on the operational side.

Q98 Mr Khan: So happy with the first and reasonably happy with the second.
Sir Adrian Montague: We are making good progress on the second and the first has delivered a stable framework.

Q99 Mr Khan: Sir Brian, could I ask you whether you think that the Department has achieved an equitable sharing of the costs, the benefits and the risks of restructuring?
Sir Brian Bender: In what was an extraordinarily difficult position that we were discussing in response to earlier questions, and given the importance of nuclear safety and security of supply, and given that we shall not actually know for certain the answer to that for many tens of years, the answer is that it is a reasonable outcome. We now need to make sure that we monitor the situation closely and secure the best return for the taxpayer as well as the policy objective in the period ahead.

Q100 Mr Khan: Do you really mean that? Do you think it is a reasonable outcome at this stage?
Sir Brian Bender: We are in a middle stage at the moment. The restructuring has happened and it has only been completed for about 12 months. I read the NAO Report as saying that in all the circumstances it was a reasonable position, although the Comptroller and Auditor General can answer for himself. Looking forward, the question is then the

performance of the company and the effectiveness and efficiency of managing the liabilities and the decommissioning costs.

Q101 Mr Khan: You have not touched upon the cost and the risk to the taxpayer, yet you are reasonably pleased with that.
Sir Brian Bender: For as long as the company is viable and being successful, the cost to the taxpayer is actually an asset not a cost, as the table at the back that has a figure in it describes.

Q102 Mr Khan: Quite clearly this is a complex restructuring, huge financial figures at stake and you are reliant upon the advice you receive. Mr Bacon touched upon concerns about the lack of competition and you have acknowledged that. Are you happy with the advice you received from those people who were given the job without competition?
Sir Brian Bender: I believe, from having read the files, that we received good advice. Again, the Comptroller and Auditor General can speak for himself, but I understood the Report to be saying we examined the right sort of issues and received the right sort of advice. There are other people, of course, who will be giving advice on these matters. I believe the NDA will themselves be publishing a strategy later this week and they will be setting some of the framework for the future decommissioning costs and therefore the liabilities over the next decades. So there is another source of advice there.

Q103 Mr Khan: Are you pleased with the outcomes to your negotiations?
Sir Brian Bender: I think that, in the light of the really difficult circumstances that were faced in 2002, we are now in an adequate position. We have a solvent company which is still producing electricity, doing so safely and potentially there is an asset here for the taxpayer. The question is how we manage those liabilities to make sure that actually it is an asset for the taxpayer and not a liability.

Q104 Mr Khan: Do you wish you had had either the advisers or the negotiators that the creditors had?
Sir Brian Bender: I believe, having talked to people who were involved at the time, having read the files, that we had good advice.

Q105 Mr Khan: Do you believe that you pushed hard enough to get a better deal on the cash sweep?
Sir Brian Bender: We shall see, later this year, or whenever it may be, how the cash sweep works when it is first deployed and what return that brings. Again, this was a balance in terms of trying to ensure the viability of the company with the Government and taxpayer sharing, if it was successful, and the risk that if we had struck too hard a deal there, it would not have been a successful restructuring. That was the balance to be struck.

Q106 Mr Khan: Sir Adrian, do you think that your creditors and shareholders have a fantastic deal vis-à-vis the risks to them with regard to nuclear liabilities or lack thereof?
Sir Adrian Montague: The decisions which were taken very early in the restructuring process were taken with a view to securing a solvent restructuring. As I understand it, the cash sweep which we were discussing earlier on was intended to create a way of the contributions that the Government received from British Energy fluctuating over time according to the fortunes of the company. Actually, as things have turned out, we are now creating value in excess of the liabilities that have been transferred to Government.

Q107 Mr Khan: So they have done pretty well and have not shared any of the risks.
Sir Adrian Montague: Clearly there is risk around the long-term evolution of these costs, but, as matters stand today, in my judgment it is a successful restructuring.

Q108 Mr Khan: If you are a creditor or a shareholder.
Sir Adrian Montague: No, no. I would suggest, although it is not for me to say, also as regards the Government.

Q109 Mr Khan: Sir Brian, you have heard what Sir Adrian has said. Why did you not take a direct shareholding in the company?
Sir Brian Bender: We took the view that the monitoring arrangements we had, and the cash sweep arrangements we had, and the controls we set on the company, would provide the right sort of framework to give us the returns without us being involved in actually running it and therefore potentially diluting the—

Q110 Mr Khan: Just pausing there. Paragraph 2.24 talks about the huge cash payments all the executive directors received when they left. It says at the bottom of that paragraph: "Since the completion of restructuring the Department has no right of consultation on executive remuneration". That is one example where you have no control at all.
Sir Brian Bender: We have no control over that. The money which was paid out at the time was subject to contract and the Department received its operating loan back from the company. The controls we do have relate to the financial trading and other trading arrangements of the company, so it must adhere—

Q111 Mr Khan: Okay, let me read paragraph 3.15: "The Department plays no formal role in approving the company's commercial strategy". Another example of your lack of leverage.
Sir Brian Bender: We have set a number of conditions for the company: it must adhere to prudent trading principles; it cannot make capital distributions until it has built up sufficient cash reserves; it cannot undertake corporate restructuring without the Department's consent; and its borrowing ability and scope of business activity is limited.

Q112 Mr Khan: Sure; I have read that as well. What control do you have over the performance of British Energy's operational side?
Sir Brian Bender: None.

Q113 Mr Khan: Am I able, for example, to ask you for your comments and your influence over figure 17, paragraph 3.2, where you see that the company is lagging well behind not just upon the maximum annual load factor, but also *vis-à-vis* international comparators? Do you have any say over that?
Mr Robson: What we have and what we put in place are monitoring arrangements which did not exist previously. Our main focus is to lead British Energy, as a company operating in the private sector, to being a FTSE 100 company now and having the private disciplines with shareholders. We are looking to have significant monitoring arrangements, so we can actually determine how the company is performing as well as having, through various controls, ability to ensure that, for example, dividend payments are not able to be made until a certain amount of cash is within the business. We think we have the right balance between the controls that we feel we need, but also allowing the company to put forward its own strategy and take the business forward.
Sir Brian Bender: And we do discuss operational performance with them as part of the regular monitoring meetings.

Q114 Mr Khan: But they can ignore you, can they not? You have fantastic teamwork today, but they can ignore you if they want to. You would have much more stake if you were a shareholder, would you not?
Mr Robson: May I just deal with the point about why we did not take a direct shareholding? One of the issues that we considered was whether there was any additional benefit in having equity which would obviously have entitlement to dividends. One of the benefits of the cash sweep is that we have a contractual entitlement to 65% of the cash created by the company. So if the company were to decide that it did not want to pay a dividend, which is at the discretion of the directors, we nevertheless would have a contractual right to 65%, with the ability to convert if we wished to do so.

Q115 Mr Khan: I have one final question I wish to put. I have heard all that. How can you assure us that you have adequate contingency plans to minimise the risks for the taxpayer should things take a dip?
Sir Brian Bender: We have close monitoring, as I have described already.

Q116 Mr Khan: You cannot impact the way the company behaves. You can monitor, yes.
Sir Brian Bender: We can monitor closely, we have controls in the way described. As part of the restructuring process, we did have detailed contingency plans for different scenarios. The company itself now has a stronger hedging strategy so that it will not be as vulnerable to movements in electricity prices as it was in the past; and we have reviewed, and keep under review, the contingency plans.

Q117 Mr Davidson: May I clarify this point about liabilities? Do I take it that essentially there is an unlimited liability to the taxpayer in the event of catastrophic failure of any sort and ultimately responsibility for anything like that would fall back on us?
Sir Brian Bender: The liability essentially is to do with the waste and the other material that is described there. That, as the Report makes clear, was not calculated at the time of the restructuring and that was removed from the company.

Q118 Mr Davidson: But it still falls back on the taxpayer. So any catastrophic event, any outage, the ultimate liability falls back on the taxpayer, does it? I am seeking to clarify where it does fall, if it does not fall on us.
Sir Adrian Montague: The answer is that under the network of international treaties, which regulate not just the nuclear business here but the nuclear business worldwide, each state, as it says in paragraph 1.8 of the Report, ". . . must bear the responsibility and by implication meet the costs in those cases where no other party is able to discharge those obligations". That does not mean that the primary recourse is not to the operator. Clearly that is right. Our responsibility as nuclear energy producers is to run these businesses competently.

Q119 Mr Davidson: Once you have finished, it falls back on us.
Sir Adrian Montague: I believe that is correct.
Sir Brian Bender: That was the case before the restructuring.

Q120 Mr Davidson: I just wanted to be clear about that. Page 21, figure 10 on the cost of closing power plants. May I clarify whether, knowing now what you know now and looking back, those figures are accurate or are there factors which have been discovered since which would have changed those?
Sir Brian Bender: Subject only to Helen Goodman's questions about the discount rates, I believe those figures to be accurate.

Q121 Mr Davidson: May I turn to page 23, figure11, where we have the restructuring costs: best and worst, then best, central and worst? Can you just clarify for me what the actual figure was at the end of the day and how it relates to these?
Mr Robson: These were looking at different scenarios at different times. Obviously, it was in a way looking at a theoretical position looking forward and therefore it is not possible to say—

Q122 Mr Davidson: So these are useless, are they?
Mr Robson: No, they were relevant at the time, but obviously—

Q123 Mr Davidson: How accurate? I just want to clarify how accurate they can be said to have been?

Sir Brian Bender: There was a range of scenarios for planning. At any point in time they are still predictions. We were talking about liabilities many decades out.

Q124 Mr Davidson: Yes, but obviously we have moved on a bit since the date that these were drawn up and I am just wondering to what extent there is anything that has changed so badly. I am trying to work out whether or not any of this was actually accurate at the time.
Mr Robson: The position with restructuring is obviously here. What it is talking about is the cost and, as we discussed earlier, there is a benefit of £2.9 billion and therefore, by definition, the forecasts at that time were incorrect. In terms of administration, we obviously have not been updating those numbers, given that administration was not the chosen option.

Q125 Mr Davidson: What I am not clear about then is just what value for money you got for the advisers and others who drew up these sorts of figures, if, several years down the road now, you cannot tell me whether or not there was any accuracy in this at all. I could just as easily go out and ask a couple of people in a pub for a couple of figures and then come back and give you those figures, because there is no way of assessing.
Mr Robson: The test though is what the NAO Report did and what the advisers to the NAO, Grant Thornton and Lumis did, which was to go back and look at the situation at the time, review the numbers and review on that basis whether the forecasts were appropriate and relevant to come to a sensible view.

Q126 Mr Davidson: I am seeking to clarify whether or not then they were all wrong. Can you not help me at all with that?
Sir Brian Bender: The calculation now is influenced by the share price. So the share price is £6.40 and that impacts on the value of the assets or the contingent asset to the Government. When the share price was different, then that gave different calculations.

Q127 Mr Davidson: The possible movements in the share price should have been reflected in the best case presumably then? Was it? Is it?
Mr Robson: No. On the basis that you could regard the share price as a proxy for the forecast cash flows coming in, and that is effectively what the share price is trying to get at, or at least analysts are trying to get at, at the time we looked at the forecast cash flows coming in from the business based on various assumptions in terms of electricity price between £15 and £21. That was the basis on which we looked at it at that point, as Sir Adrian has mentioned. At the moment prices are very different to that level and, as a result, result in a very different value.

Q128 Mr Davidson: Sorry. Prices are very different to what they were at that level means that effectively all these best and worst paradigms are pointless or useless. I ask this not just for fun but in the sense that on other occasions we will be asked to make judgments having been given various figures. What I am just seeking to clarify for our benefit is that these things can be made up just as easily by a couple of guys in a pub and they would not be much the wiser.
Sir Adrian Montague: Fundamentally these negotiations were carried out in a world where power prices were £15, £16, £17 per megawatt hour. They are now £55 per megawatt hour; during this month they have reached that figure and nobody anticipated that huge growth in prices. The Report says that the £15 to £20 band was regarded as a—

Q129 Mr Davidson: What is the point of scenario planning which did not actually include the scenarios which came to pass?
Mr Robson: One point that we were clearly looking at in terms of the restructuring was the downside scenarios, because the downside was what we were particularly concerned about.

Q130 Mr Davidson: It strikes me, in terms of dealing with professional advisers, that they gave you figures and so on based on scenarios which did not actually include what happened.
Sir Brian Bender: The criticism of the Department when the Committee had its last hearing was that between the Department and the company, there had been inadequate planning for the worst case, which was where electricity prices then got to around the turn of the millennium. In this instance we were planning for a range of scenarios including a worst case one.

Q131 Mr Davidson: The best case has turned out even better than you expected. So we can get you for that one then.
Sir Brian Bender: But if the best case is better, then the taxpayer is going to benefit because of the value of the cash sweep.

Q132 Mr Davidson: I understand where the benefit falls. I understand that completely. It is a question of the accuracy of the scenarios which quite often get put in front of us and I think you are confirming my view that they are not much better than asking a couple of people in a pub and it would be a great deal cheaper to do it that way. I can take you to pubs which would give you much cheaper estimates. May I just clarify a point with Mr Robson? Is that note going to help you with this?
Mr Robson: No, it is confirming the point about Grant Thornton.

Q133 Mr Davidson: May I just clarify the role of the Shareholder Executive in all of this? You did seem to be rather all part of the one team. I am not sure whether or not Sir Adrian is holding someone very close to you as a hostage, but you do seem very much to be just simply defending the position of the company. At what point do you actually stand back from them, or what differences are there? What is the point of having the Shareholder Executive involved?
Sir Brian Bender: The role of the Shareholder Executive, which was set up nearly three years ago, was to try to bring in more expert analysis and skills

for where the Government is a shareholder in a company. So the Shareholder Executive is on the side of the taxpayer and Government in getting value out of its shareholding, whether in the energy sector or indeed in other publicly owned companies.

Q134 Mr Davidson: Do you understand why we can be forgiven for assuming that you have been captured by the company, since you seem to be so closely implicated and drawn in and so defensive of the decisions that I cannot see the join?
Mr Robson: The position is that we are called the Shareholder Executive but we do not have any shares in British Energy; it is the other companies where we tend to have our shares.

Q135 Mr Davidson: And you do not have executive powers either.
Mr Robson: At the end of the day what we are trying to achieve is a good relationship with the companies within the portfolio so that we can work with the companies in order to be able to maximise the value of those shareholdings. It is very important that we do recognise that there is a mutual interest here in terms of British Energy being very successful.

Q136 Mr Davidson: I understand that. Give me an example where you have clashed.
Mr Robson: Since the restructuring?

Q137 Mr Davidson: Since the restructuring.
Mr Robson: There is a point coming up where we shall have what I would describe as an interesting debate, as opposed to a clash, which is potentially in relation to the cash sweep payment. If any cash sweep payment were to be due, there would be a debate that we would potentially need to have there. In relation to any point on which we have clashed, I cannot think of one.
Sir Adrian Montague: It is worth saying that you are slightly conjuring up the picture of a cosy relationship. It is not my view that it works that way. It is handled professionally and you can handle professional relationships cordially without compromising people's independence. I cannot think of any major issue or principle that has separated us from the Executive since re-listing, but we are conscious of an active monitoring from the Executive. Nothing is taken for granted.

Q138 Mr Davidson: I understand that, but if we had specialist advisers inside the Department who were doing the same thing, presumably the relationship would be the same. I do not quite understand how having a Shareholder Executive adds value to the whole process.
Sir Brian Bender: It adds value as far as the department is concerned by making sure that we have the investment analysts and specialist expertise that we need to have the right sort of relationship with companies with whom the state has a particular relationship, whether it is Royal Mail which the Shareholder Executives is heavily involved in or British Energy in this type of case. It is not a skill that the Civil Service has naturally and we therefore need to have a mixed team of secondees from outside and civil servants to make sure that we have those skills.

Q139 Helen Goodman: Mr Robson, when you were answering questions about the restructuring earlier on in the session, you made it clear that the way things have turned out was not as you had expected because the electricity price had gone up and the share price had gone up and that, of course, affects the distribution of benefits and risks between the three parties. Obviously the electricity price is highly dependent on the oil price. Could you say what the forecast for the long-term oil price was at the time of the restructuring in the Department?
Mr Robson: I should have to check to see precisely on that point.

Q140 Helen Goodman: Would you say that it was perfectly realistic to expect the oil price to rise again since it is only in the past year that it has reached the real terms level that it was already at in 1983? In real terms the oil price is now back where it was about 20 years ago. So why is it a surprise that it should go up and push up the electricity price and push up the share price?
Mr Robson: People were indeed forecasting a rise at the time, but not to the extent that has been the case.

Q141 Helen Goodman: Sir Adrian, in answer to questions from Sadiq Khan you talked about the annual load factor. What assurances can you give the Committee that British Energy will get nearer to the maximum annual load factor or indeed achieve the annual maximum load factor in the future?
Sir Adrian Montague: The best way of answering that question is to spend a moment just on the performance improvement programme that we have at British Energy. The causes of British Energy's bad performance in the past were both a lack of investment in the plants and some operating inefficiencies in the way that the business was managed. The performance improvement programme tries to hit both of those categories. We are spending large amounts on restoring the material condition of the plant. This year we shall have spent somewhere in excess of £200 million; next year we expect to spend between £250 and £300 million. There is a lag factor before the mechanical condition starts to improve, but the encouraging sign for us is that when it comes to human performance, we are seeing huge improvements in things like the accident statistics, the defect backlog, indicators of improvement short of output. Output is clearly the most important consideration and we are driving towards restoring the output at least to where it was in the best year of British Energy's performance in the past and I hope to improve that.

Q142 Helen Goodman: You are saying that, even though the performance has in fact declined between 2002 and 2005.

Sir Adrian Montague: Yes.

Q143 Helen Goodman: What is your forecast for where we shall be in 2010?
Sir Adrian Montague: I am not able to give you that forecast, partly because it might get me into difficulty with the Stock Exchange. I can give you some indication of how things are going. At the moment we are at 79% across the fleet. Sizewell, which is admittedly the most modern plant, has now been operating continuously without any form of interruption for more than 300 days and this is a sign of a business which is consolidating an improvement.

Q144 Greg Clark: Sir Brian, you assured Sadiq Khan that the Department was actively and robustly monitoring British Energy at the moment, but the last time this Committee looked into the matter and commented on the situation in 2004, the Department's inaction on British Energy was compounded by split responsibilities for monitoring British Energy. Yet today, two years on, the NAO conclude that responsibility for managing these risks remains distributed across a number of teams within the Department and there is a real possibility that information learned by the different teams is not shared quickly and evaluated as a whole. How can you be confident in giving Mr Khan the answer you gave him?
Sir Brian Bender: I did say in response to somebody earlier that I had asked my internal audit team to look at the way we are managing these relationships and give me whatever assurance or recommendations for changes which are necessary. The risk is pulled together at one individual at board level, the Director General for Energy; so the two different teams pull in at that one level. The monitoring, for the reasons described and set out in the Report, is a lot tougher and tighter than it was previously. The answer as to whether or not I can give that assurance is a combination of the tighter and tougher arrangements, but also the work underway by my internal audit to look at the point, and it is referred to in the Report, that the NAO raised and to see whether—

Q145 Greg Clark: A recommendation was made two years ago and the NAO now find it has not been followed up.
Sir Brian Bender: The risk does come together with the Director General for Energy in the Department, but there are different teams under him: one Reports direct and one is the Shareholder Executive. The question is therefore whether it is pulled together adequately or whether there are other improvements that my internal audit will recommend we make.

Q146 Mr Bacon: On page 21 there is a chart, figure 10, which says in the note at the bottom of it: "The costs estimated in November 2002" this is the net cost of early closure for these various different stations, Sizewell B at the bottom there being £839 million, have been worked out and discounted at a nominal rate of 8%. I just wanted to know how the nominal rate of 8% got chosen.
Mr Robson: It would probably be best to respond to you in a fuller note on that point.

Q147 Mr Bacon: In so doing, could you indicate whether it was following Treasury guidance or following some other kind of guidance, or Treasury guidance to avoid their guidance? That would be very helpful.
Mr Robson: Absolutely.
Sir Brian Bender: We shall cover that.

Q148 Chairman: I wanted to ask you about this note as well, because Helen Goodman drew my attention to it. Let us read it for a moment, figure 10, page 21: "The costs estimated in November 2002, based on the Net Present Value of foregone future income and decommissioning costs brought forward, less future costs avoided (discounted at a nominal rate of 8%)". That sounds to me like an explanation of Sir Humphrey to Mr Hacker. It is utterly meaningless to me. Would you like to explain this to me now?
Sir Brian Bender: I cannot do it justice Chairman beyond what it says there.

Q149 Chairman: Can anybody in the National Audit Office help me with this?
Sir Brian Bender: Mr Robson can make a better effort of it than I can, that is for sure.

Q150 Chairman: In a way that I shall understand.
Mr Robson: It was looking at the forecast cash flows of the stations, discounted by the 8%, versus the forecast cash flows of the business if you had to close early and, as a result, the decommissioning payments, as opposed to being further out, would be further forward. That is probably still Sir Humphrey; apologies.

Q151 Helen Goodman: I understand that that is what you have done, but I do not understand why you would use one discount rate for one stream and another discount rate for another stream.
Mr Robson: We shall need to check. My supposition is that in November 2002 something needed to be done reasonably quickly, so we were probably taking the company's discount rate at that point. However, that is a guess and therefore we should come back with a proper note.

Q152 Chairman: My last question is on paragraph 17, page 6: "The existing equity investments of the Nuclear Liabilities Fund will be converted to gilts". Why limited to gilts?
Sir Brian Bender: If I may, this is a question I shall ask the Treasury to reply to because these are Treasury rules.
Ms Diggle: It is a matter of prudence. If we did not do that, it would mean essentially borrowing at the margin from the gilts market and then putting it into something else, equities, which is far more risky.
Chairman: Thank you very much gentlemen.

Letter from the Permanent Secretary, Department of Trade and Industry, to the Committee

In advance of Monday's PAC hearing into the British Energy restructuring I would like to bring to your attention the statement in Wednesday's Budget Report regarding British Energy, namely that the Government will: "consider selling part of its stake in British Energy after completion of the Energy Review". If there were a sale, any proceeds would go into the Nuclear Liabilities Fund to meet British Energy's liabilities.

24 March 2006

Supplementary memorandum submitted by the Department of Trade and Industry

Questions 17 (Helen Goodman) & 74 (Mr Richard Bacon): Use of discount rates

Use of Discount Rate generally

1. As footnote 5 of the NAO Report into the British Energy restructuring set out, monetary values in the Report were discounted to present values using a real discount rate of 3.5% (unless otherwise stated).

2. This was the rate the Department used to report its provisions and contingent liabilities in its 2004–05 Resource Accounts (the last available accounts).

3. HM Treasury's Resource Accounting Manual (RAM) provided the framework for production of Department's 2004–05 Resource Accounts and set a flat rate discount rate for provisions of 3.5% real, the rate the DTI used. The RAM is based on Generally Accepted Accounting Practice (GAAP) and is subject to review in this respect by the independent Financial Reporting Advisory Board.

4. As Helen Goodman pointed out at the hearing on 20 March, the 2005 Green Book sets as standard a declining discount rate for long-term liabilities. The declining rate is appropriate for evaluations into the distant future where the forecast sums for periods far ahead are increasingly less certain. The Treasury advises the cautious approach for evaluations because it seems a prudent way to allocate public resources and make decisions on projects.

5. It does not follow, however, that this approach should also be used in annual accounts. Many industrial and commercial companies use a every tough internal rate of return in evaluating their own individual projects which may differ significantly from that used for general financial reporting purposes in their annual accounts.

Figure 10

6. The 8% rate referred to in figure 10 was a Weighted Average Cost of Capital (WACC). The WACC represents the cost to a business of obtaining capital via debt and equity and reflects the risks inherent in the business. The WACC of 8% would have been selected by British Energy to reflect the risk inherent in the cash flows and is consistent with best practice in the private sector.

7. This analysis was done by British Energy as part of the process of establishing whether it could find its own solution to its financial difficulties. The prevailing Green Book rate of 6% (there was no declining discount rate for long term liabilities at that time) was therefore not applied to the initial analysis of the economics of early station closure because the analysis was carried out by British Energy.

8. It was clear from British Energy's modelling that early station closure would uneconomic in the context of the individual stations, regardless of a change in discount rate.

9. The Department did however consider the impact on the viability of British Energy of early closure of one or more stations, by looking at the effect on annual cash flows (undiscounted). Here it was shown to be the case that early closure would have had a negative impact on the viability of the Company.[1] Moreover, the Department considered the wider implications of early closures, for example competition issues, security of supply, safety and environmental issues. This backed up the economic analysis that station closures were not justified.

10. The Department considers therefore that its actions were appropriate.

Question 86 (Mr Richard Bacon): Review of advisor's fees

1. Through the course of restructuring, the Department reviewed the fees of each of the principal advisors: Slaughter and May, Deloitte and Credit Suisse First Boston (CSFB).

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[1] Had the Department reworked the figures provided by British Energy based on the Green Book rate of 6%, Green Book Guidance states that it would have been necessary to adjust underlying cash flows to reflect the risk premium which had previously been taking into account through use of the 8% of WACC.

2. The Slaughter and May contract was reviewed in December 2003. The review resulted in, inter alia, the introduction of a risk-sharing cap, such that hourly rates would have reduced had a certain threshold been reached. This reduced the Department's exposure to an overrun in its legal budget.

3. The Deloitte contract was reviewed in January 2004 and July 2004. These reviews resulted in the introduction of, inter alia, six monthly budget caps and hourly rates being frozen at 2002 rates.

4. The CSFB contract was negotiated on the basis of monthly payments paid according to a fixed schedule (based on expected intensity of work) and success fess. In March 2005, as a result of more intensive work than anticipated, CSFB made a request to increase the monthly payments. This request was rejected by the Department.

5. More generally, it is worth noting that the Department is increasingly using the OGC Buying Solutions Frameworks in order to procure advisers and in doing so, from April 2005 to December 2005, the Department (and its arm length bodies) saved £5.4 million against spend of £46.9 million.

3 April 2006

Further supplementary memorandum submitted by the Department of Trade and Industry

Questions 17 (Helen Goodman) & 74 (Mr Richard Bacon): Applying the Green Book rates to British Energy's liabilities

1. As set out in the DTI's Supplementary Memorandum Note on use of Discount Rates: British Energy liabilities to the Committee for Public Accounts, in reporting its liabilities the Department follows the flat discount rate set out in HM Treasury's Resource Accounting Manual (RAM) (RAM provided the framework for production of departments' 2004–05 resource accounts). The last available accounts (2004–05) therefore used a flat rate of 3.5%. This is the rate used in the NAO Report.

2. At the time that the decision to restructure was taken and the level of Government support agreed (2002), the prevailing Green Book did not set out a declining discount rate for long term liabilities. Once it was clear the Government needed to take financial responsibility for the spent fuel liabilities (which fall within the next 30 years) and to underwrite the Nuclear Liabilities Fund, the focus was on agreeing the financial structure of BE. In undertaking this analysis, because the restructuring required BE to be viable in the longer term (under State Aid rules), the focus was on the annual cash flows (undiscounted).

3. We have, however, been asked to apply the declining discount rates set out in the latest Green Book (Appraisal and evaluation in central government). This calculation would increase the liabilities reported in the NAO Report by £0.3 bullion:

	NAO Report *£'billion*	*Green Book Declining Discount Rate* *£'billion*
Uncontracted and decommissioning liabilities	2.7	3.0
Historic spent fuel liabilities	2.6	2.6
Total	5.3	5.6

4. The uncontracted and decommissioning liabilities span approximately 175 years and therefore attract a range of discount rates from 3.5%–2.0%. Applying the declining discount rates to the NAO's forecast liability data increases the liability figure presented by the NAO by £0.3 billion.

5. The historic spent fuel liabilities span less then 30 years and therefore attract a discount rate of 3.5%. Therefore applying the declining discount rate to the NAO's forecast liability data does not alter the figure presented by the NAO.

7 June 2006

Further supplementary memorandum submitted by the Department of Trade and Industry

At the hearing on 19 March 2007[2] the Committee requested information on nuclear liabilities, including an explanation for the use of particular discount rates, and figures on a discounted basis for the liabilities of British Energy, UKAEA and the NDA.

[2] http://www.publications.parliament.uk/pa/cm200607/cmselect/cmpubacc/uc409-i/uc40902.htm

DISCOUNTED LIABILITY FIGURES FOR BE, UKAEA, BNFL & THE NDA

1. Members have asked for information on the discounted liabilities figures for British Energy, UKAEA, BNFL and the NDA as calculated using HM Treasury's Green Book declining discount rates for long term liabilities.

2. The table below summarises the British Energy and NDA (which, following implementation of the Energy Act 2004, incorporates the liabilities of UKAEA and BNFL) liabilities position. For completeness, this note also sets out the British Energy and NDA liabilities figures as at 31 March 2006 calculated according to the 2.2% discount rate. This information can also be found in the Department's and NDA's latest Resource Accounts (2005–06) respectively. It also includes the British Energy liabilities figures as reported in the company's Annual Report and Accounts. Detailed background information can be found following the table:

British Energy liabilities (£bn)

Description of liability Undiscounted figures in brackets	*2005–06[3] BE Accounts (3%)*	*2005–06 DTI Accounts (2.2%)*	*2005–06 Liabilities as calculated using the Green Book discount rates*
Historic Spent Fuel Liabilities: Reprocessing and storage of historical AGR fuel (ie fuel loaded prior to 14 January 2005) until 2086 (ILW up to 2040)	2.2 (2.9)	2.4 (2.9)	2.2 (2.9)
Uncontracted liabilities: Storage of reprocessed historical AGR fuel and derivatives beyond 2086 (2040 for ILW). Management of PWR Fuel (past and future), ILW and HLW derived from historical AGR Fuel, and other ILW	0.5 (2.5)	0.7 (2.5)	0.5 (2.5)
Decommissioning costs.	2.7 (8.6)	3.3 (8.6)	2.7 (8.6)
Total	**5.4 (14.0)**	**6.4 (14.0)**	**5.4 (14.0)**

NDA liabilities (including BNFL and UKAEA) (£bn)

Description of liability Undiscounted figures in brackets	–	*2005–06 NDA Accounts (2.2%)*	*2005–06 Liabilities as calculated using the Green Book discount rates*
NDA's historic nuclear civil liability	N/A	30.6 (53.3)	25.0 (53.3)

3. For ease of reference, the Green Book declining discount rates are set out below:

Period of Years	0–30	31–75	76–125	126–200	201–300	301+
Discount Rate	3.5%	3.0%	2.5%	2.0%	1.5%	1.0%

Background

4. It should be noted that HM Treasury's Financial Resource Manual (FReM) provides the required framework for production of departments' Resource Accounts including the reporting of long term liabilities. It requires long term liabilities to be discounted using a single discount rate. For the year ended 31 March 2006 this rate was set at 2.2% (3.5% in 2004–05) and, as is required, was the rate adopted by the Department and NDA in their 2005–06 Accounts. FReM is based on generally accepted accounting practice

[3] 2005–06 refers to the liabilities as at the year end date 31 March 2006.

(GAAP) and is subject to review in this respect by the independent Financial Reporting Advisory Board. HM Treasury do not advise using the Green Book for calculating long term liabilities for the purposes of the accounts.

5. The Green Book declining rate is appropriate only for evaluations of proposed investment projects into the distant future where the forecast sums for periods far ahead are increasingly less certain. The Treasury advises this cautious approach for evaluations because it seems a prudent way to allocate public resources and make decisions on projects.

6. It does not follow, however, that this approach should also be used in the calculation of or reporting of long term liabilities in annual accounts. It is common business practice for industrial and commercial companies to use a tough internal rate of return in evaluating their own individual projects which may differ significantly from that used for general financial reporting purposes in their annual accounts.

7. The figures calculated using the Green Book rates should therefore be treated with caution in light of the caveat in paragraph 4 above on Treasury's requirement to use FReM disciplines.

8. On 1 April 2005 specified BNFL liabilities transferred to the NDA under the Energy Act 2004, which provided for the NDA assuming responsibility for the decommissioning and clean up of BNFL's UK nuclear sites and these liabilities are now reflected in the NDA's financial statements.

9. Although the Energy Act 2004 did not prescribe any legal transfer of liabilities or assets from UKAEA, the NDA's directors believe that the purpose of the NDA also creates a constructive obligation in respect of the liabilities to decommission and clean up UKAEA's nuclear sites. Consequently, the NDA's financial statements also reflect these liabilities.

A. *NDA liabilities*

10. The Life Time Plans (LTP) for each of the NDA's sites is used to derive the estimate of the nuclear provision (ie the historic civil nuclear liability) as set out in the NDA's Annual Report and Accounts (http://www.nda.gov.uk/documents/nda_annual_report_&_accounts_2005-06.pdf). However, as explained in the Accounts a number of adjustments are necessary to the cost estimates, principally to net out the costs of commercial activities that are expected to be funded by future income and to express the provision at a discounted value.

11. The nuclear provision in the NDA's 2005–06 Annual Accounts, the latest figures, are recorded as £30.6 billion on a 2.2% discounted basis (£53.3 billion on an undiscounted basis[4]).

12. If the Green Book declining discount rates are applied this figures falls to £25.0 billion.

B. *Government's British Energy related liabilities*

Historic Spent Fuel Liabilities

13. As a result of the financial restructuring of British Energy, the Department has taken direct financial responsibility for spent fuel liabilities relating to fuel loaded into British Energy's AGRs prior to 14 January 2005 (the "historic spent fuel liabilities"). British Energy has contracts in place with British Nuclear Group for the management of spent fuel arising from fuel loaded into those reactors on or after 14 January 2005.

14. As set out in the Department's 2005–06 Consolidated Resource Accounts (http://www.dti.gov.uk/files/file33910.pdf), the Department recognises a provision in note 23 relating to these historic spent fuel liabilities at a discounted value of £2.4 million.

15. This will be updated in due course for the purposes of the 2006–07 Departmental Consolidated Resource Accounts.

16. When applying the Green Book rates to the historic spent fuel liabilities, the liability falls to £2.2 billion.

Decommissioning and Uncontracted Liabilities

17. The Department also underwrites the Nuclear Liabilities Fund (NLF), British Energy's segregated decommissioning fund (which also covers certain uncontracted liabilities). Each year in its Accounts, the Department sets out the value of the NLF's assets and liabilities to determine the contingent asset or liability associated with this underwriting. The liabilities set out in the 2005–06 Accounts, which are the latest figures available, were valued at £4.0 billion (which was more than offset by the most recent valuation of the NLF assets). The next NDA review of these liabilities is expected in 2008.

[4] When taking account of the estimated costs of delivering the NDA's total mission (ie including estimated costs directly related to clean up and decommissioning as well as all operating costs), on the basis of lifecycle baseline estimates at 1 April 2005, the undiscounted figure was £62.7 billion. If we then take into account 2005–06 costs already discharged and additional life time plan costs since 1 April 2005 the figure increased to £64.8 billion at 31 March 2006. This figure is then adjusted to provide a base for the calculation of the provision in accordance with Financial Reporting Standard (FRS 12), and this adjustment is described in detail in the management commentary to the NDA Annual Report and Accounts (page 70).

18. This will be updated in due course for the purposes of the 2006–07 Departmental Consolidated Resource Accounts.

19. When applying the Green Book rates to the decommissioning and uncontracted liabilities, the figure falls to £3.2 billion.

20. It should be noted that the discounted liabilities figures recorded in British Energy's 2005–06 Annual Report and Accounts differ from those reported in the Department's 2005–06 Consolidated Resource Accounts due to the different discounting assumptions used by British Energy to derive the net present value of the decommissioning and uncontracted liabilities[5]. However, the underlying undiscounted data is consistent with that used by the Department in calculating its discounted liabilities.

30 March 2007

Further supplementary memorandum submitted by the Department of Trade and Industry

British Energy—Liabilities figures

1. Members asked for information on the discounted liabilities figures for British Energy, as calculated using HM Treasury's Green Book declining discount rates for long term liabilities.

2. This note supplements the earlier note submitted by the Permanent Secretary's office to the PAC on 3 April 2007[6] following an amendment of the discount factor calculation. This amendment was discussed in the letter from Peter Gray of the NAO to Helen Goodman MP on 25 May 2007. The impact of the amendment is to decrease the British Energy liabilities as calculated using the Green Book rates from £5.4 billion to £5.1 billion.

3. The table below summarises the British Energy liabilities position. The detailed background information on British Energy remains as per the earlier note.

Description of liability	*Undiscounted £'bn*	*2005–06[7] BE Accounts (3%) £'bn*	*2005–06 DTI Accounts (2.2%) £'bn*	*2005–06 Liabilities as calculated using the Green Book discount rates £'bn*
Historic Spent Fuel Liabilities	2.9	2.2	2.4	2.2
Uncontracted liabilities	2.5	0.5	0.7	0.4
Decommissioning costs	8.6	2.7	3.3	2.5
Total	14.0	5.4	6.4	5.1

Letter from the National Audit Office to Helen Goodman MP

At our recent meeting in your office you asked us to review the Shareholder Executive's recent note to the Committee of Public Accounts regarding the discount factors applied to estimates of the cost of decommissioning.

You remarked that the note shows exactly the same numbers in two columns—British Energy's liabilities discounted at the 3% rate used by the Company in its Accounts, and the Shareholder Executive's calculation of the same liabilities discounted using the Green Book rates.

We have now examined the discounts applied to the original liability figures in some detail. The position is perhaps clearer to see if the figures are expressed in terms of millions, rather than rounded to the nearest billion as set out in the previous note. The figures are therefore reproduced at Annex A.

Our review indicated that the Shareholder Executive did use the declining or tapered discount rate recommended in the Green Book for liabilities likely to be incurred by British Energy beyond 30 years. It, however, used an incorrect formula when applying these tapered discount rates to liabilities occurring after

[5] See British Energy website for its annual report for the year ended 31 March 2006 http://www.british-energy.com/documents/7005_BE_AR06_FINAL.pdf

[6] Ev 16

[7] 2005–06 refers to the liabilities as at the year end date 31 March 2006.

30 years—explained at Annex B. Column E at Annex A shows our revised calculation of the estimated liabilities using the rates recommended in the Green Book and the appropriate discounting formula, and column F shows the difference from the Shareholder Executive's note.

The Nuclear Decommissioning Authority provided the Shareholder Executive with estimates of its liabilities for inclusion in the note to the Committee. We have checked the discounting process employed by the Nuclear Decommissioning Authority and found that it used both the discount rates recommended in the Green Book and the correct formula for calculating discount factors.

We have brought the issue regarding the discount rate applied to British Energy's liabilities to the attention of the Shareholder Executive. They have agreed to submit a revised note to the Committee correcting these figures.

Peter Gray
Director, Trade and Industry Area (Value for Money Audit)

25 May 2007

Annex A

SUMMARY OF BRITISH ENERGY'S NUCLEAR LIABILITIES AT DIFFERENT DISCOUNT RATES

Nuclear liabilities at 31 March 2006	*Undiscounted*	*Discounted*				
	British Energy calculation	*British Energy accounts 3.0%*	*DTI Accounts 2005–06 2.2%*	*DTI calculation at Green Book rates*	*NAO calculation at Green Book rates*	*Difference (overstatement)*
	(A)	*(B)*	*(C)*	*(D)*	*(E)*	*(F)*
	£m	*£m*	*£m*	*£m*	*£m*	*£m*
Historic contracted	2,874	2,245	2,391	2,162	2,162[1]	–
Uncontracted	2,535	444	665	473	395	**78**
Spent fuel total	5,409	2,689	3,056	2,635	2,557	**78**
Decommissioning	8,623	2,697	3,344	2,687	2,500	**187**
All nuclear liabilities	14,032	5,386	6,400	5,322	5,057	**265**

[1] These liabilities will fall due within the next 30 years and therefore were discounted at the flat rate of 3.5% and were unaffected by the taper.

Source: Shareholder Executive analysis of British Energy data; Nuclear Decommissioning Authority.

Annex B

NOTE ON USE OF FORMULAE FOR CALCULATING DISCOUNT FACTORS

Discounting is used to reflect the fact that the value of money changes over time: people prefer to receive £1 today rather than in a year's time. Future monetary amounts are discounted to a present value using a discount factor, which is dependent on how far into the future the cost or benefit arises and the rate used to discount future costs and benefits.

The Shareholder Executive employed the following widely known formula (listed in the Green Book, page 26) to calculate the discount factor for every year in which liabilities are expected to arise:

$$(1)\ d_t = \frac{1}{(1 + r)^t}$$

, where d is the discount factor, r is the discount rate and t is the period to be discounted from. Using this formula, the discount factor for 3.5% in one year's time is 0.966, so £100 now is worth £96.60 in a year's time.

However formula (1) is only appropriate for situations where the discount rate does not change over time (for example as with the 2.2% used in discounting for DTI's Accounts). The appropriate formula for calculating the discount factor in each period when discount rates change over time is specified in a paper by Oxera[8] which is referred to in the Green Book bibliography:

$$(2)\ d_t = \frac{d_t{}^{-1}}{(1 + r)^t}$$

This formula differs from (1) because it recognises that the discount r changes over time when using the tapered rate recommended in the Green Book. The discount factor at any time t in the future is dependent on the discount factor in the preceding year, and by extension in all preceding years.

Both formulae produce the same discount factor of 0.356 for years one to 30, because r is the same (3.5%) for all of the periods. From year 31 the formulae produce different discount factors, because:

[8] A Social Time Preference Rate for Use in Long-Term Discounting, Oxera, 17 December 2002.

- Formula (2) reflects the fact that years one to 30 have been discounted at 3.5% and then discounts year 31 at 3%, giving a discount factor of 0.346.
- In formula (1), the discount factor formula used by the Shareholder Executive, the discount factors are calculated independently of each other and therefore only the discount rate of 3% in year 31 is taken into account. This results in a discount factor in year 31 of 0.399, which is higher than the discount factor of 0.356 for year 30 and therefore runs counter to the principle of discounting.

The different approaches also result in different discount factors for all years after the discount rate first changes, so the approach used by the Shareholder Executive results in an incorrect discount factor for every year from year 31 onwards.

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