


PO - CH / NL / 0267  
PART A

Part. A -

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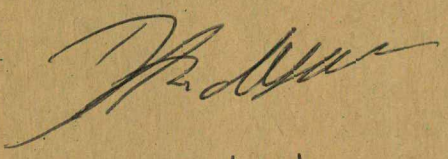
Begins: 8/6/88  
Ends: 16/6/88

  
PO -CH /NL/0267  
  
PART A

Chancellor's (Lawson) Papers:

EUROPEAN COMMUNITY LARGE  
COMBUSTION PLANTS  
DIRECTIVE

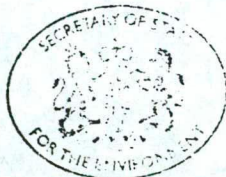
Disposal Directions: 25 years



11/10/95

PO -CH /NL/0267  
PART A

CHIEF SECRETARY	
REC.	- 9 JUN 1988
ACTION	Mr M I Williams
COPIES TO	Cx Sir P Middleton
	Mr Anson, Mr Mackie
	Mr Bingham, Mr Moore
	Mr Turnbull, Mr S Wood



CONFIDENTIAL

8 June 1988

PRIME MINISTER

Mr Call

**ACID RAIN: DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE**

The intense pressure on the German Presidency to finalise the long-running Large Combustion Plants directive offers us an unexpected but limited opportunity to secure an acceptable agreement. This comes at a time when pressure is mounting, both on the political and scientific fronts, to take a step forward with our policy. This letter seeks colleagues' agreement to the negotiating line for the Environment Council on 16 July.

The EC Context

The hard line Malcolm Caithness took at the March Council has paid off. Bilateral contacts have since elicited concessions on a number of important issues for the UK. It looks as though agreement on the pollution abatement standards for new plant (one part of the directive) could be within the Council's grasp on 16 June, although there are still issues on which negotiations could founder. But the UK is isolated on the more sensitive issue of reductions in overall emissions from existing plant (the other part of the Directive). We are the only state unable to agree the 1993 and 1998 targets proposed for sulphur dioxide (SO<sub>2</sub>) emissions.

European expectations of progress on the whole directive therefore depend on our willingness to make a further commitment to reduce SO<sub>2</sub> emissions. The Presidency are however willing to negotiate here. They are offering less rigorous UK targets for 1993 and 1998 in return for a strong commitment - a 70% reduction - by 2003. The details are in our paper at Annex 'A'.

Unfortunately we have very little time to reach a decision. If we cannot close an agreement whilst the Germans are under pressure, we shall be left with (and blamed for) a major unresolved draft Directive. The Germans will revert to their hard-line national position and the Commission have an alternative line of attack available through the air pollution framework directive.

Current policy on SO<sub>2</sub>, and pressure to take it forward

In 1984, we set a target of a 30% reduction in total UK SO<sub>2</sub> emissions (on 1980 levels) by the end of the 1990s. As a contribution to this aim, we endorsed CEGB plans in 1986 to retro-fit flue-gas desulphurisation (FGD) to 3 power stations to come on stream between 1993 and 1997. We also required all new power stations to be fitted with low-acid technology, so ensuring a low acid emissions future in the long term. This policy has served us well, but now needs to be reassessed for three reasons:

RIDLEY  
→  
PM  
8/6

- a) upward pressure on electricity demand, fuelled by our economic performance, has stopped and threatens to reverse the downward trend in emissions in the short term and delay the long term reductions by prolonging the lives of existing high polluting power stations -figure 1;
- b) the different tests applied to capital investment in the electricity supply industry, following privatisation, will increase the pressure to extend the lives of stations;
- c) the scientific case for securing and, if possible, improving on our planned 30% policy aim has hardened (Annex B).

The Select Committee on the Environment expects to report on 15 June following its inquiry into air pollution policy. The Committee's report is expected to point to the lack of a clear programme to respond to the trends outlined above; and to compare the scale of our current programme unfavourably (when our size and contribution to acid depositions is taken into account) with that of some other states notably the Netherlands, Denmark and Germany. Unless it can be pre-empted by significant progress in the EC negotiations, the Committee's report could therefore touch off a new round of controversy. There is no shortage of influential voices prepared to make this a high profile issue.

#### The Scientific Position

The effects of acid deposition on lakes and soils in Norway was a prominent consideration in the Government's 1986 decision. The results of subsequent research (summarised in Annex B) have (i) established that deleterious effects in certain parts of the UK are more significant than had been thought, notably the Scottish uplands, Wales, Cumbria and the South Pennines; and (ii) confirmed and strengthened the case for ensuring a continued downward trend in emissions. The evidence currently emerging suggests that the recovery of most UK acid waters will depend on a halving of total present sulphur deposition, of which the great bulk comes from our own sources, mostly large combustion plant. This suggests that the Presidency proposal of a 70% reduction in large plant emissions, on a 1980 base, which would produce an approximate halving of current UK emissions, is a desirable long term environmental objective for the UK. The key question is by what date we should aim to meet it, and what price we are prepared to pay.

#### Likely Shape of an Agreement and its Cost

Depending on growth in demand and trends in fuel use, the cost of meeting the Germans' 70% proposal by 2003 could be of the order of £670 - £775 million in lost profits (and £250 - £285 million in tax receipts foregone). If passed on to the consumer, which I would prefer (in accordance with the polluter pays principle) the increase in electricity prices would be no more than  $\frac{1}{2}\%$ , taking effect only in the late 1990s. In my view this is not an excessive cost. As our paper explains, the industry will expect to have to incur a substantial proportion of this anyway - with or without the Directive. There is in any case a good possibility

of negotiating the final EC target down, by offering the Germans a better deal than they expect for 1998 (probably securing other useful concessions in the process).

The strategy for which I seek endorsement would require us to plan for 2 additional FGD retrofits by 1998 and a possible further 2 or 3 by about 2005 (cost £560 - £670 million in profits foregone (£210 - £250 million in tax foregone), or 0.4% on prices. However, we should be ready to accept the German proposal for 2003 if it proves absolutely necessary and our other major concerns are met. In all cases we should aim to have a "force majeure" provision because the Directive's requirements (expressed as percentages, not retrofits) would be binding.

I can add that the CEEB take a more optimistic view of the programme needed to meet the above requirements, and hence their costs. They would expect to be able to deliver my preferred strategy with 3 retrofits, and the bottom line position with 4. It would seem advisable, however, to plan on the basis of the more cautious estimates I gave above.

#### Impact on Electricity Privatisation

This is a key consideration. It is explored in paragraphs 17 to 19 of Annex A. I am convinced that a presentable deal in the EC will be a help here, not a hindrance. Without such a deal, privatisation will be more complicated. Walter Marshall has made clear to me that we can no longer rely on the "cosy" relationship to secure our policy objectives. If Government is unable to give a clear lead, the markets will form their own view of the inevitable pressures for tighter environmental standards, and the flotation price will be hit anyway.

#### Conclusion and Recommendations

Meeting the Germans on the basis outlined would be a substantial undertaking. But it would be a much better deal than we might have anticipated and it is unlikely that any Presidency other than a German one could deliver on such terms. The benefits to the UK environment are also now better established. Whilst it remains open to us to reject the German advances, this would involve digging in for what would undoubtedly be a difficult campaign with no end in sight, and I do not recommend it. A deal would take most of the steam out of a sensitive issue which, as well as souring relationships with our neighbours, has domestic implications too. It would end the uncertainty which has hung over the heads of industry for several years and which now threatens to complicate electricity privatisation. We would have European endorsement for our position on acid rain.

I therefore recommend that in the Council on 16 June Malcolm Caithness, whilst seeking to minimise the overall burden placed on the UK, should be allowed to negotiate on the basis of paragraph 21 of Annex 'A'. If this does not enable the Presidency to deliver a directive, it should at least give a clear final position amongst the key Member States (and our agreement must be subject to this proviso).

I should be grateful for colleagues' endorsement of the strategy I propose. I am copying this letter to the members of E(A) Committee, to Sir Geoffrey Howe and to Sir Robin Butler and Sir David Hannay.

A handwritten signature consisting of the letters 'N' and 'R' in a cursive, stylized font.

N R

CONFIDENTIAL

## DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE

1. Despite an inauspicious start to the Germany Presidency (in particular, their mishandling of the March Environment Council), negotiations on the Directive are now back on the rails. Bilateral contacts between the German Minister, Dr Topfer, and Lord Caithness, and with the Commission, have elicited carefully calculated concessions on a number of important issues for the UK. It looks as though agreement on the pollution abatement standards for new plant (one part of the directive) could be within the Council's grasp on 15 June, although some hard bargaining is still needed and one particular loose end - Spain's request for a derogation - needs to be tied up. But a qualified agreement on new plant will not allow the more sensitive issue of reductions in overall emissions from existing plant (the other part of the Directive) to disappear. Here the UK is isolated as the only state unable to agree the targets proposed for sulphur dioxide (SO<sub>2</sub>) emissions. European expectations of progress on the whole directive therefore effectively depend on the UK's willingness to make a further commitment to reduce SO<sub>2</sub> emissions. The Presidency have however given a clear indication that they are willing to negotiate.
  
2. The deal which the Presidency is offering us would involve Germany accepting less rigorous 1993 and 1998 UK targets (somewhere between the relaxed figures originally proposed by the Danish Presidency and the German figures) in return for a strong commitment - a 70% reduction - in the third stage (2003). For 1993 and 1998 the reductions likely to be required are substantially less than those for other major Northern European states. (Our relatively low 1993 and 1998 targets, even under the original German proposal, include an allowance for the emission reduction which occurred before the 1980 base year).

3. It may just be possible to push the date for stage 3 back to 2005 but it is extremely unlikely that the Presidency will budge further or lower their figure of 70%. We need to be prepared for both 70% and 2003 to be sticking points within the Community.
4. The science analysis in Annex 'B' suggests that the Presidency's figure of 70% for large plants is in fact a desirable long term environmental objective for UK policy. The key question is whether the target date, and the intermediate steps towards that target, can be viewed as realistic.
5. The key stage to consider is the third stage (2003 or possibly 2005). If we can agree on a figure for this stage, the requirements in stage 2 (1998) fall into place quite readily - as a matter of phasing. Stage 1 (1993) is difficult for technical reasons (there is insufficient lead time to squeeze more out of the present FGD programme by 1993) but our position is reasonably well understood and we should expect to have our target adjusted provided we make a better effort later on - see para 15).

#### Emission forecasts

6. Our best estimate of the trend in SO<sub>2</sub> emissions, on present policy, to the year 2010 is at fig 1. A low and high forecast, agreed between officials, are included - the first based on the industry's own projections and the second a Department of Energy scenario presenting a more pessimistic case.
7. The forecasts indicate that up to the early 1990s SO<sub>2</sub> emissions will increase. They then begin to fall with the impact of the retrofit programme and increased imports of low sulphur coal from abroad. We should be able to achieve our target of a 30% reduction in total SO<sub>2</sub> by 1999. However, the later reductions anticipated as a result of plant retirements will have slipped well beyond 2000. We need to decide what targets and timetable we are prepared to impose



on the industry to achieve our commitment to a low-acid future.

8. The figures which we believe are negotiable, and the extra effort we should expect to have to undertake to meet this are set out in Table 'A'. For simplicity, this "effort" is referred to (and has been costed) as FGD retrofits, although it would be up to the industry to decide whether it would be preferable to retire the plant in question earlier than would otherwise be the case. In such cases, capital requirements would initially be larger, but the longer term cost less.
  
9. To achieve the Presidency's demand for a 70% reduction by 2003 could require the retrofitting (or retirement) of 5 or 6 large power stations (10-12,000 Mw of capacity) in addition to the 3 (6000 Mw) already programmed. The number would reduce to 4 or 5 extra (8,000 or 10,000 Mw) if the target date could be pushed back to 2005, or if a 60% target were negotiable for 2003 (which is much less likely, although this would be a good starting point in negotiation). The CEEB take a more optimistic view of the programme needed to meet these requirements. The contribution they would expect to have to make in order to meet a national requirement for a 70% reduction by 2003 is 4 retrofits; in the case of a 2005 target date or a 60% reduction by 2003 this could be as little as 3 retrofits.

#### Costs

10. The cost of meeting these requirements is set out in Table 'B', on two alternative bases, depending on whether the regulatory requirements for the privatised industry allow the costs of retrofitting to be passed on to the consumer. If the formula does not allow such passing on, then profits and corporation tax receipts are reduced (but see para 11 below). The net present value of these losses in the 5 to 6 retrofit case is of the order of £670 - 775 million in profits foregone and therefore privatisation proceeds foregone (and £250 - 285 million in tax losses); in the 4 to

5 retrofit case, the losses are of the order of £560 -670 million in profits foregone (and £210 -250 million in tax losses). However in neither case would the impact on electricity prices be greater than a ½% increase if the costs are passed on to the consumer which, in accordance with the polluter pays principle, would be desirable. This latter method would also largely satisfy investors that profits would not be affected. On the CEEB scenarios referred to, the costs would be £560 million in lost profits (£210 million in lost tax) or 0.4% on prices for the 4 retrofits case; and £440 million in lost profits (£165 million in lost tax) or 0.3% on prices, for the 3 retrofit case.

11. These costs are by no means small. It should be borne in mind, however that:

a) the necessary retrofits should not all score as a cost of meeting the EC directive: it is anticipated that 1 to 3 of these stations will in any case need to have been brought up to HMIP's new plant standards as part of a major refurbishment. The higher number would apply in the high growth scenario because the latter contains such a wide gap between demand and feasible new build.

b) besides retrofitting, other means are available to generators to reduce SO2 emissions, for example by burning more low sulphur coal (which, by 2003, will be imported in large quantities to meet the expected high demand for electricity) in existing stations; or by extra imports direct from France (another Channel link would give the equivalent of one full retrofit).

Even on the high scenario, with 6 extra retrofits/retirements, in 2003 a third of the large stations remaining from today will still be unretrofitted.

Proposed negotiating strategy

12. Our assessment of the mood of the Presidency and other members of the Council points to two possible strategies if we are to obtain an agreement. The first (strategy A) is to negotiate with a view to accepting the Presidency's 2003 date for the 70% target, which would buy us a less onerous commitment in stage 2 (possibly a figure we could achieve with the present FGD programme); however, the end price (up to 5 or 6 retrofits/retirements) would be greater than in the second option.
13. Under the latter (strategy B) we could concede a better figure for stage 2 (1998) - possibly the Presidency's own preferred figure (46%, requiring 2 extra retrofits) in return for a later target date for stage 3, ie 2005, or a lower target, e.g. 60% or 65%. This should enable us to limit the total "cost" to 4 or 5 extra retrofits/retirements and would be the most sensible option in planning terms because the environmental benefits would be achieved sooner and the capital expenditure spread fairly well. It would also help resolve the difficulty with stage 1. This strategy is our preferred option.
14. If we are to secure a firm agreement it may, in the end, be necessary to accept the Presidency's 70% by 2003. We should be ready to do so if this is the case, but only on condition that our other major concerns are met in the Directive.
15. This leaves the problem with stage 1 (1993) referred to in paragraph 5. Because of the lead time involved, there is no practical prospect of achieving more with our present retro-fitting programme by 1993 - by which date the FGD at Drax will only be partially on stream. (The consent application for Drax is still under consideration). This real technical constraint is recognised by the Presidency and the Commission, but we should not assume that the Community will allow our 1993 target to be raised to suit our schedule without exacting some tangible extra effort in

the early stages. It may be necessary to accept a tougher target by, say, 1995 which would involve bringing forward the existing programme. Whether this is feasible is not entirely clear. Lord Marshall informed Ministers in March that it would be perfectly feasible to complete the current retro-fitting programme by 1995 instead of 1997. (Indeed, he claimed to be able to do one more retro-fit by 1995 too). We should be prepared, if necessary, to accept an obligation to accelerate the existing timescale subject to technical feasibility. We should avoid conceding this, however, if we can secure our objective through the targets we settle for in stages 2 and 3.

#### Catering for uncertainty

16. The directive will require commitments to fixed emission targets, presented as percentage reductions, and not a set number of retrofits/retirements. (The latter is not a negotiable option, nor is it necessarily desirable as it would reduce flexibility in the future). It is necessary to ensure that we are covered for unavoidable problems such as a delay in bringing new power stations or retrofitted plant on stream, or an unexpected surge in electricity demand, which could cause a temporary breach of what are otherwise binding requirements. Our negotiators have made it clear that a "force majeure" or safeguard provision is an essential part of any package the UK could subscribe to, and we expect to be able to achieve this in return for agreeing to substantial reduction targets. This, together with the Directive's rather complex reporting provisions, allow a significant degree of flexibility.

#### Impact on Electricity Privatisation

17. Clearly any obligation to meet anti-pollution requirements will have an impact on the capital requirements and profitability of the electricity supply industry. What is equally clear, however, is that in the absence of a clear lead from Government the markets will form their own view of

the inevitable pressures for tighter environmental standards and - unless the regulatory arrangements clearly allow the costs to be passed on to the consumer - will discount accordingly the price they are prepared to pay for the industry on floatation. When we met Walter Marshall in March he made it clear that he now saw it for the regulatory authorities to set the requirements within which the industry is to work. We can no longer rely on the "cosy" relationship to secure our policy objectives.

18. We cannot of course be certain that an agreement will put a complete stop to calls for a further acceleration of our programme in the years to come. However, a substantial long-term programme, endorsed in an EC Directive, would be a major stabilising factor for the next decade, giving a much needed confidence on which to base the development of the restructured industry. It is hard to predict the precise course of events if the Directive remains unagreed because of the UK. The Germans, no longer as Presidency, would revert to their hardline position. One option open to the Commission would be to start proceedings under Article 13 if the Framework Directive on combatting air pollution from industrial plants, which imposes a general obligation to make plans to bring existing plant up to new plant standards. It would take a long time for this to get to the European Court of Justice, but the proceedings could loom large at the stage prospectuses are being written. Agreement on the Large Combustion Plants Directive would effectively seal off Article 13 for these plants.
19. The mechanics of spreading the burden of emission reductions fairly throughout the restructured industry will need to be addressed before the prospectuses are written before 1991/2. Existing and planned pollution control legislation should be sufficient to ensure that action needed to meet the Directive will be taken, so there would be no need for provisions in the privatisation legislation. These are not new issues which affect our position in the EC negotiation:

the same principles apply in the context of fulfilling our current FGD programme, and are under discussion between Departments.

#### Conclusions and Recommendations

20. Meeting the Germans on the basis outlined would be a substantial undertaking. But it would be a much better deal than we might have anticipated and it is unlikely that any Presidency other than a German one could deliver on such terms. The benefits to the UK environment are also now better established. Whilst it remains open to us to reject the German advances, this would involve digging in for what would undoubtedly be a difficult campaign with no end in sight. A deal would take most of the steam out of a sensitive issue which, as well as souring relationships with our neighbours, has domestic implications too. It would end the uncertainty which has hung over the heads of industry for several years and which now threatens to complicate electricity privatisation. We would have European endorsement for our position on acid rain.
21. It is therefore recommended that in the Council on 16 June, Lord Caithness should seek to minimise the overall burden placed on the UK, and in particular

a) if essential in order to secure an acceptable target for stage 1 (1993), be prepared to undertake to accelerate the present FGD programme, subject to technical feasibility, aiming for completion in 1995 rather than 1997;

b) for stage 2 (1998), be prepared to accept a reduction target of up to 46% (2 retrofits) with appropriate "force majeure" provisions;

c) for stage 3, press for a later date (eg 2005) or a lower target reduction, but if necessary, and only in the context of an overall satisfactory deal, accept the Presidency's figure of a 70% reduction by 2003.

He should, of course, seek to secure maximum advantage, by means of these concessions, in the related negotiations on new plant standards and on overall NOx reductions; and in particular, should not offer concessions going beyond the line agreed between officials on these issues.

DEPARTMENT OF THE ENVIRONMENT

8 June 1988

## ANNEX B

### ACID RAIN: THE SCIENTIFIC POSITION

#### EFFECTS ON SCANDINAVIA

The effects of acidic deposition on lakes and soils in Norway was a prominent consideration in the Government's 1988 decision. At that time UK depositions in Norway were about comparable with those originating from Norway itself, and somewhat higher than from Poland and East Germany. By 1990 abatement programmes in Scandinavia and West Germany will have raised the percentage deposition in Norway attributable to the UK from about 12-13% to 20%. On a strong UK energy growth scenario UK emissions would remain at this level for much of the decade. In comparison Norway's contribution to depositions on its own soil will have dropped to about 10%.

As a result of the national abatement programmes we would expect some signs of recovery in Norwegian lakes. This is likely to take the form of improvements in lake acidity, and could be quite rapid in catchments with thin soils or bare bedrock. The rate at which these lakes are able to sustain greater biological diversity and to support fish stocks will depend on how soon the acidity of the lakes can be improved to above PH 5.5 or so, and the rate at which concentrations of aluminium dissolved from soils by earlier acidification is reduced. It will therefore depend on emissions not only from the UK but also comparable contributions from Poland and East Germany. In contrast the prediction of the effect of emission reduction is more straightforward for the UK where 80% of the deposited sulphur is of UK origin.

#### EFFECTS ON UK ENVIRONMENT

It is well established that most catchments of the South East of



England, Midlands and North East England are at little risk from acidification even if UK emissions were to continue at their present levels almost indefinitely. Most of the soils in these areas are managed for agricultural purposes and some contain base rich bedrocks well able to neutralise acidified waters. In contrast about a third of Great Britain has soils that are unable to neutralise acid deposition. The most sensitive areas are North Wales, Cumbria, parts of the Pennines and the uplands of Scotland. Here particularly because of high rainfall, total deposition rates of sulphur are much closer to that found in Norway. The soils are sometimes thin, often acid, on poor bedrock with land management often devoted to coniferous forestry. These are all factors which make the catchments in these areas particularly sensitive to acid depositions.

As with Norway the major casualty in the UK sensitive areas has been the loss of fish stocks, with some associated impoverishment of other fauna such as birds. Acidity of surface waters increases as calcium is depleted from the soil and eventually the acidity is sufficient to mobilise aluminium which is toxic to fish in the catchment. Consequently fish stocks decline as the concentration of calcium falls and as the concentration of aluminium rises.

If levels of sulphur emissions were held constant at today's levels the condition of many of the headwaters and lakes in Wales, NW England and the Western Highlands will continue to deteriorate. There is a major international research effort (including the important SWAP joint work between the Royal Society and the Scandinavian Academies of Science) devoted to determining the level of deposition that soils can tolerate before they present a risk to surface waters. Indications are that current deposition levels on the type of soil found in Norway and in UK's sensitive areas are about twice the rate that can be tolerated in the long term. The final 'low acid' target of present policy is therefore likely to show considerable improvements in the lake systems.

The timescale of this recovery will depend on local geology (in particular the weathering rates of local minerals) and local land use practices. However there are encouraging signs from UK sites where declines in deposition rates over the last few years have been amplified by natural changes in rainfall pattern, that the first beneficial responses are rapid and maintained.

In summary the developments in our scientific understanding of the acidification of surface waters have served to underpin the decisions taken earlier by the Government. Firstly there is benefit to be gained by ensuring a continuing downward trend in national emissions of sulphur. Secondly the relatively low levels of sulphur deposition that can be withstood by the more sensitive soils justifies the Government's intention that the long term aim should be a low acid electrical power supply industry.

In terms of an environmental objective, a halving of present deposition would enable the recovery of most UK acid waters. This would suggest that the Presidency proposal of a 70% reduction on 1980 levels would be a desirable long term target for UK policy.

#### WASTE DISPOSAL IMPLICATIONS

The domestic environmental implications of an enhanced FGD retrofitting programme (for example limestone supply and by-product (gypsum) disposal) would be significant. However, as the effect of such a retrofitting programme would be to bring forward the advent of FGD already anticipated through the power station new build programme, the problem would need to be addressed anyway at a later date; the issue is essentially one of timing.

Department of the Environment

6 June 1988

Fig. 1 Trend in SO2 Emissions

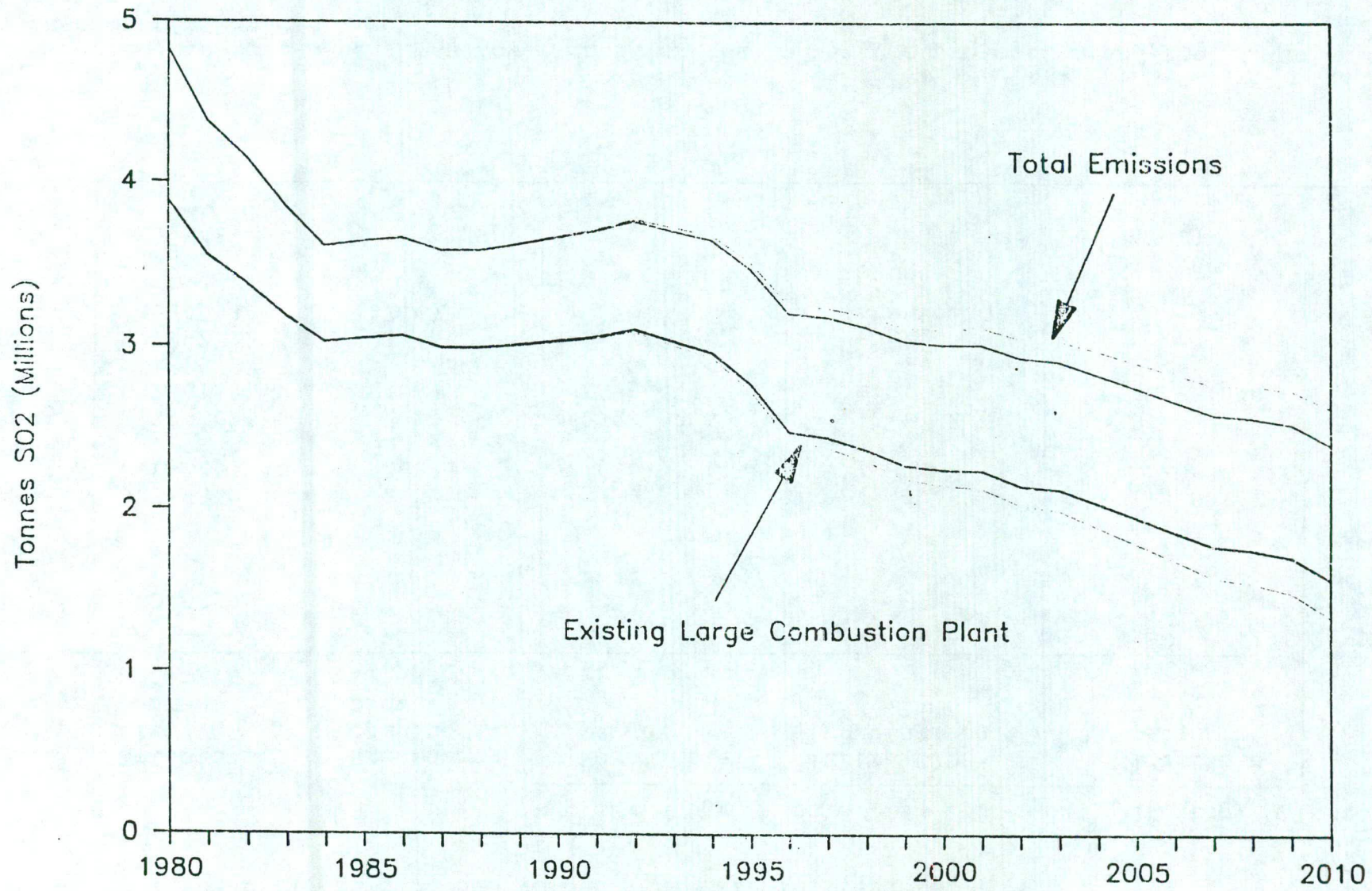


TABLE A

## LARGE COMBUSTION PLANTS.

Extra retrofitting/retirement needed to meet "negotiable" targets

m tonnes SO<sub>2</sub>  
(% reduction, 1980 base)

	Emissions with current policy(*)	Presidency opening bid	Strategy A (para. 12)		Strategy B (para. 13)	
			Negotiable target	Extra FGD (cumulative) (+)	Negotiable target	Extra FGD (cumulative) (+)
1980	3.88					
1987	2.99					
1993	3.01-3.04 (21-22%)	2.87 (26%)	3.1 (20%)	-	3.0 (20%)	-
1998	2.30-2.36 (39-41%)	2.10 (46%)	2.1 - 2.6 (33-46%)	0 to 2 stations	2.1 - 2.3 (40 - 46%)	1 to 2 stations
2003	1.99-2.12 (45-49%)	1.16 (70%)	1.16 (70%)	5 to 6 stations	-	-
2005	1.79-1.95 (50-54%)	-	-	-	1.16 (70%)	4 to 5 stations

(\*) Two scenarios are used : the lower based on the industry's projection and the higher a more pessimistic DEN case.

(+) "Extra FGD" simplifies the extra effort required which may be obtained for example by retirements (see para. 8)

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Cost of expanding FGD Retrofit Programme

Option 1: Regulation Formula does not allow passing on of FGD costs

No. of Extra Retrofits	Discounted effect on profits £m		Loss of Corp Tax Receipts £m. (Discounted @ 5%)	Total £m	
	Discount Rate			Discount Rate	
	8%	12%		8%	12%
+3	440	350	165	605	515
+4	550	440	210	770	650
+5	670	520	250	920	770
+6	775	595	285	1060	880
+7	870	655	320	1190	975

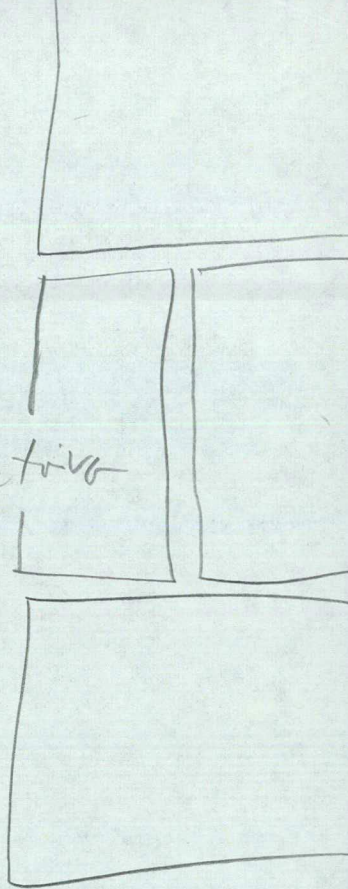
Option 2: Regulation allows FGD costs to be passed on

No. of Extra Retrofits	Effect on Prices
	% Increase
+3	0.3
+4	0.4
+5	0.4
+6	0.5
+7	0.5

Note: Price increases would take effect from late 1990's.

"Put it to God"

Legal challenge  
under framework Directive



CONFIDENTIAL

*On*  
*CST (& officials) keen to know letter you are content (my personal sympathies are with Mr Morrison, rather than this rather wet advice)*

FROM: N I HOLGATE  
DATE: 10 June 1988

- 1. MR D MOORE
- 2. CHIEF SECRETARY

cc  
Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Turnbull  
Mr M Williams - o/r  
Mr 3 Wood  
Mr Call

*Given that major additional expenditure seems inevitable to deal with this problem, there is a strong case for clinching a deal now. The privatisation prospectus can then be clear on the issue; otherwise analysts will point to large uncertain costs.*

*It would be better for Treasury & Energy to beat one another and so you may like to delay until Mr Parkinson is back - the news are*

ACID RAIN: DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE

*AA*  
*Keen*  
*10/6*  
*10/6*

Mr Ridley's minute of 8 June seeks urgent agreement to a major concession in the targets for emissions of sulphur dioxide (SO<sub>2</sub>). Higher targets would require more coal station retrofits in the 1990s. This would reduce proceeds from electricity privatisation or lead to a marginal increase in electricity prices.

2. If no agreement is reached on this EC directive in time for the prospectus, there is a significant risk that investors will assume the worst and that privatisation proceeds could suffer anyway. Therefore, subject to certain conditions, and in the light of our negotiating position, this submission concludes that you should agree with Mr Ridley. However you may wish to wait for Mr Parkinson to make his views clear first.

Background

3. This directive has been discussed for four years. It is intended to cover a range of emissions from existing and new combustion plant. Difficulties remain in several areas, such as the stringency with which emissions are measured. But the major issue is the target for SO<sub>2</sub> emissions from existing plant.

4. This now takes the form of target percentage reductions by 1993, 1998 and either 2003 or 2005. At the end of the Danish

HOLGATE  
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10/6

Presidency in December, Ministers agreed that these targets were too high. The Germans began their Presidency by proposing still higher targets, but have since moved back towards the Danish position.

5. Table A in Mr Ridley's paper summarises the implications of the current proposed targets of 26%, 46% and 70% reductions in 1993, 1998 and 2003. The UK's formal position is that of a 30% reduction by the end of the 1990s and it is the only country unable to agree to the Presidency's proposal. The Danes had a lower target for 1998 and a higher, 80% target for 2003-05.

6. There is no practical prospect of the UK meeting the 1993 target but other states apparently understand and are willing to accept this. The second stage can be met by retrofitting up to two power stations with flue-gas desulphurisation (FGD) equipment; the third stage could require a further three or four retrofits. Each retrofit has capital costs of around £220 million and £11 million annual running costs. All these retrofits would be in addition to the three already agreed by the CEGB in 1986.

### Cost

7. Expenditure would be incurred from 1992-93 onwards after the industry is privatised and build up to a post-tax peak of £214 million in 1998-99. However, if potential investors believed that these costs could not be passed through to customers, privatisation proceeds would be hit. In his letter, Mr Ridley gives a range in net present value terms of £670-£775 million. Table B of the paper gives further details on the order of magnitude of profits foregone as a net present value discounted at 8% and at 12% (which makes some allowance for higher discount rates in the private sector). Even on the latter basis, the retrofits would cost about £520 million in profits foregone and one might expect the valuation of the generation companies to be lower than they otherwise might be by a comparable amount.

8. If investors could be convinced that this cost would be passed



on to customers, the effect on proceeds would be much reduced. As Table B shows, the price increase required for the extra retrofits is very small, of the order of a once-and-for-all increase of ½% in the mid-1990s. Provisionally, we believe that this could be achieved by including certain pollution costs in the pricing formula, so that they can be passed through and the polluters pay. Further work is needed on the best mechanism. (Even then, there would still be tax foregone and there may still be doubts as to the competitiveness of the retrofitted plant, which could have a smaller impact on proceeds).

### Benefits

9. The major advantage of a settlement now is that of reduced uncertainty as to the obligations that may be placed on the esi. If the directive is agreed in June, these issues are unlikely to be reopened for many years. We will be able to include in the prospectus a clear and guaranteed programme. Depending on the mechanism for passing on the costs, this could also be made explicit, for instance, as part of the pricing formula.

10. Mr Ridley points to a number of other advantages:

(a) This proposal will reduce lake acidity in Norway, Wales, Northwest England and the Western Highlands. Scientific evidence suggests that a faster reduction in emissions is needed for recovery.

(b) It will enable him to head off a report by the Select Committee on the Environment on air pollution, which is expected to stir up controversy. He will be able to show that the UK is acting to restore a downward trend in emissions which has been reversed because of fast economic growth.

(c) If the directive falls on the point of SO<sub>2</sub> emissions, the UK will get the blame. Other states will make mischief and it is likely that succeeding presidencies will make little headway on the directive, with the Germans reverting to a more hard-line stance. The generating companies' liabilities will remain unclear.

*the  
customers  
of the  
polluter*

## Assessment

11. A major uncertainty on the esi's obligation to reduce emissions could have a serious effect on privatisation. The meeting on 16 June is a good, and possibly the last, real opportunity to settle this. There is very little prospect of further concessions whether it is settled or not.

12. Provided certain conditions can be met, the deal may well be acceptable

(a) Because the UK cannot meet the 1993 target, Mr Ridley wishes to offer an acceleration of the current programme of three retrofits. The condition that this is subject to technical feasibility must be clear; other states have been impressed by the scale of work necessary in the UK and should be persuaded to accept this.

(b) A wide-ranging safeguard clause (or what Mr Ridley calls a 'force majeure' clause) is required in the directive so that the CEGB's successors are not forced to undertake still more retrofits because of a shortfall in nuclear output or an unexpected increase in demand. A draft clause is attached. Again, this is an important comfort for the prospectus.

(c) Other outstanding issues must be resolved to the UK's advantage, in return for this major concession on SO<sub>2</sub> emissions. Mr Ridley accepts this.

(d) There should be the minimum of penalty on the CEGB's successors for undertaking this programme, i.e. the customer must bear the full cost. Mr Parkinson is likely to be sympathetic to this. It is consistent with the 'polluter pays' principle and with the view that has been taken on endurance.

13. Mr Ridley outlines two strategies in paragraphs 12 and 13 of his paper. He recommends B, whereby the UK concedes the Presidency's 46% figure for 1988 (the second stage) in return

for a lower or later third stage target. This reduces the total likely number of retrofits and maximises the lives of retrofitted plant. This is clearly preferable to A (accepting the third stage in return for a softer second stage). But he proposes that in the end, the UK should agree even the 70% third stage target of all other concerns have been met and B is unacceptable to other states.

14. Given the vagaries of forecasting the extra cost, the practicalities of negotiation and the other conditions above, even this may seem reasonable. But DEn officials do not yet know whether Mr Parkinson will agree (as he is abroad). It is likely that he will go as far as strategy B, for the sake of concluding discussions and on the grounds that the CEGB regard this as technically feasible and a reasonable investment. But strategy A is that much more onerous, and the remaining lives of the retrofitted stations may be as short as five years. He may conclude that it would be better to play it long.

15. DTI and the Foreign Office have indicated that their ministers are likely to support the proposal subject to gaining concessions in return on other outstanding issues.

### Conclusion

16. The agreement by the UK to tougher SO<sub>2</sub> emission targets is the major obstacle remaining to concluding this EC directive. There is little prospect of further concessions on this issue, but as other states appreciate the difficulties it poses for the UK it should give the scope for securing favourable terms on the other, less important issues which will save smaller sums. And with suitable handling of the costs, it much reduces the risk of paying for increasing concern for the environment through privatisation proceeds.

17. I believe that even strategy A would be worth agreeing on these grounds. But I do not think that you should write in support of A if Mr Parkinson decides that Strategy B is the most that can be offered.

18. I attach a draft reply suitable for agreement to strategy A. If you decide that this concedes too much, or if you agree that we should support Mr Parkinson, I will redraft as appropriate.

*N. I. Holgate*

N I HOLGATE

LARGE COMBUSTION PLANTS

SAFEGUARD CLAUSE

Addition to Article 3

4. If, as a result of a substantial and unexpected change in energy demand, in economic activity, or in the availability of certain fuels and plant types, it becomes technically difficult for a Member State to implement a plan drawn up under para 1 in such a way that the overall reduction targets are reached by the due date, that Member State may draw up and implement a further plan to achieve such overall reduction targets as soon as possible at a later date.

The details of the plan, together with a full account of the nature of the difficulties, shall be submitted to the Commission. The Commission shall examine the submission and, in the case of disagreement with the Member State concerned about the nature of the difficulties and the details of the plan, shall submit appropriate proposals to the Council.

26A/1/jno/300/049

DRAFT LETTER TO:

The Rt Hon Nicholas Ridley MP  
Secretary of State for the Environment  
2 Marsham Street  
LONDON

June 1988

**ACID RAIN: DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE**

Thank you for copying to me your letter of 8 June to the Prime Minister.

2. I can see some advantage in agreeing this directive now. It is a pity that the Germans delayed progress by mishandling the start to their Presidency and that we have been unable to wring further concessions out of them on the central issue of sulphur dioxide emissions. We must ensure that if we now agree to a very onerous and expensive programme of retrofitting, beyond the three retrofits already planned by the CEGB, our objections on the other outstanding issues are secured. I am grateful for your agreement that we will not offer any further concessions there; and that any adjustment on stage one of the target will be subject to technical feasibility.

3. It is also essential to have a safeguard clause for the later SO<sub>2</sub> emission targets so that we have some reassurance upon the maximum number of retrofits; and to recognise that there is no question of reopening the debate on this area for the next ten years at least.

4. By agreeing to these targets, we gain the benefit of greater certainty for the privatisation of the electricity supply industry. We will be able to give a clear statement on the need for retrofits in the prospectus; and as you say, there is a strong case for ensuring that the costs of the retrofits will be passed on to electricity consumers, so that

the polluter pays. We will have to take account of this in planning the regulation of the privatised industry.

5. I am therefore content with the negotiating strategy that you have outlined. I am copying this letter to members of E(A), to Sir Geoffrey Howe, Sir Robin Butler and Sir David Hannay.

JOHN MAJOR

*MMB @ ...*

*Ch see note below 13/6/88. AA*

CH/EXCHEQUER	
REC.	13 JUN 1988
ACTION	CST
COPIES TO	

*13/6*

Prime Minister

**ACID RAIN: DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE**

Nicholas Ridley's minute of 8 June recommends that we be prepared to make major and costly concessions to the Germans at the Environmental Council on 16 June. The costs would arise from the possible need to retrofit up to 6 more CEGB stations with FGD equipment by 2003.

MORRISON  
→  
PM  
13/6

Cecil Parkinson will not be returning from the Far East until Wednesday. I shall need to consult him about the proposals, but I think I should let you know that I have serious doubts whether the additional cost would be justified.

The Annex to Nicholas Ridley's paper acknowledges that, without taking further action, we should achieve the Government's target of a 30% reduction in SO<sub>2</sub> emissions by 1999. Table A shows that we should go on to achieve a reduction of 50-54% by 2005. This will be a very substantial improvement on the level of emissions in 1980. I have serious doubts whether total additional costs of about £1 billion are worth incurring so as to go beyond that and achieve 70% by 2003.

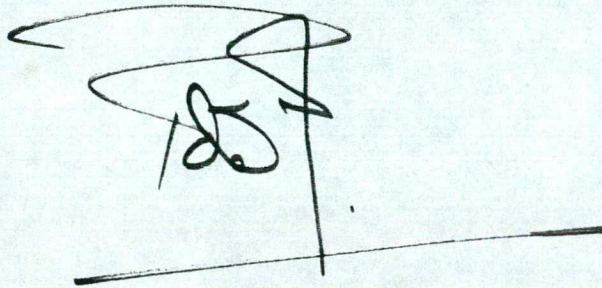
I recognise that, without a commitment to further FGD retrofits, the chances of reaching agreement in the near future on a Large Combustion Plant Directive are poor. I do not think this should cause us undue concern. We already have a substantial programme of three retrofits of large coal stations, at a capital cost of about £700 million at 1988 prices; and all new coal stations will have FGD fitted. That seems to me sufficient proof that we are prepared to play our part in reducing SO<sub>2</sub> emissions.

Nicholas Ridley suggests that, without a deal, privatisation will be more complicated. I agree that it is very desirable that when we come to draw up the prospectuses for the sale of the generating and distribution companies the uncertainty over future



investment in FGD retrofits should be minimal. However, I suggest that this could be achieved equally as well by stating that the Government did not expect more than the existing programme to be undertaken, or by stating that HMIP would require a specific number of further retrofits to be undertaken. (Paragraph 11 of the Annex to Nicholas Ridley's paper mentions 1 to 3).

I am copying this minute to Nicholas Ridley, other members of E(A) Committee, Sir Geoffrey Howe, Sir Robin Butler and Sir David Hannay.



Minister of State for Energy

13<sup>th</sup> June 1988

*This proposal is a complete nonsense. We have already done more than P is asking for. This will not prejudice electrical plants (K1) any more. I am for the Council. Mr. Butler has a proposal. Mr. Ridley. M...*



FROM: J M G TAYLOR

DATE: 14 June 1988

PS/CHIEF SECRETARY

cc PS/Financial Secretary  
Sir Peter Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr D J L Moore  
Mr Turnbull  
Mr M Williams o/r  
Mr S Wood  
Mr N I Holgate  
Mr Call

JMGT  
→  
PS/CS  
14/6

**ACID RAIN: DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE**

The Chancellor has seen the Minister of State for Energy's minute of 13 June to the Prime Minister.

2. He has commented that the proposal set out in Mr Ridley's minute of 8 June is a complete nonsense. We have already done more than enough in this field. If Mr Parkinson is satisfied that this will not prejudice electricity privatisation - and the Chancellor is far from convinced that it will - then we should most certainly back him in opposing Mr Ridley.

A handwritten signature in black ink, appearing to be 'JMG'.

J M G TAYLOR

Ch.

Distributed.

You may like to add to your  
E(A) folder

2. We expect <sup>written</sup> advice from Kleinwants  
tomorrow.

~~X~~

Imad  
PSE circulate  
to CST +  
Stewart  
AGAL

With the Compliments of

**The Lord Marshall of Goring Kt, CBE, FRS**

CENTRAL ELECTRICITY GENERATING BOARD

*Sudbury House, 15 Newgate Street, London EC1A 7AU. Telephone 01-634 5111*

cc PS/CST  
PS/FST  
PS/Sr P Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Turnbull  
Mr S Wood  
Mr NL Williams  
Mr Holgate  
14 June 1988 Mr Call

CENTRAL ELECTRICITY GENERATING BOARD

Sudbury House, 15 Newgate Street, London EC1A 7AU. Telephone 01-634 5111

From the Chairman  
The Lord Marshall of Goring Kt, CBE, FRS

CONFIDENTIAL

The Rt. Hon. Nicholas Ridley MP,  
Secretary of State for the Environment,  
2 Marsham Street,  
London,  
SW1P 3EB

Dear Secretary of State,

LARGE PLANT COMBUSTION DIRECTIVE

I understand that the German Presidency is making a determined effort to secure agreement for this directive at the meeting scheduled for 16 June. If they succeed there will be adverse implications for electricity privatisation. In Cecil Parkinson's absence abroad, I thought I should write to you directly with my views.

You will know that in support of the Government policy, as set out in Cmnd 9397, the CEGB is actively pursuing a strategy leading to a downward trend in sulphur dioxide emissions from the 1990s. We have announced plans to retrofit 6000 MW of existing generating capacity equivalent to three 2000 MW stations. We estimate this voluntary programme will cost some £660 million. This scale of commitment properly reflects our developing understanding of the science but no more can be justified. Alongside should be seen our plans for ensuring that all significant new capacity will be essentially free from sulphur emissions e.g. nuclear or clean coal with full FGD, or renewables.

The effect of the proposed directive will be to superimpose a major compulsory retrofit programme above and beyond the voluntary programme. On our best estimates the German

proposals in undiluted form would involve an additional commitment by the CEGB's successor companies equivalent to five major retrofits costing £1100 million. It would involve retrofitting plant with a residual lifespan after FGD commissioning of less than 10 years - an economically absurd proposition. Even a so-called "compromise" formula, to achieve a 60% rather than 70% reduction, would require three further retrofits costing some £700 million. On top of the cost of the initial programme, and perhaps also allowing some £300 million to secure NOx requirements, it could bring our successors' commitment to approaching £1700 million, on readily foreseeable costs alone.

Even more important than the total capital requirement for new expenditure is the incidence of that expenditure and its impact upon the ability of Big G and Little G to raise capital for the new investment that will be needed.

It is clear that, even on the most optimistic assumptions about the size of the future power station building programme and entry of new generating companies, both Big G and Little G will face a major investment programme to the end of the century. To a substantial extent this will cause each to rely on external borrowings, with a particular risk that investment in new generating plant - including nuclear, where funding demands are inevitably heaviest - will be curtailed by cash-flow problems and capital rationing enforced in practice by the exigencies of having to conform to City expectations when raising capital. At a time of such difficulties, to compel significant additional expenditure commitments on non-productive emission control investment of dubious real value would be a serious set-back - even if the costs are passed through to consumers. Without pass-through, the problems, for Big G at any rate, would seem insurmountable.

These matters will have to be spelt out in the prospectus. The result is bound to depress flotation proceeds. Moreover, it will be difficult to convince investors that such a retrofit programme is stable and will endure. They may well perceive a risk of further demands being added over time to a baseline target which for the UK starts off unjustifiably high in business terms. I therefore strongly urge you and your colleagues to proceed with caution in considering any proposals for additional requirements on top of the present voluntary programme. Even for that, full cost pass-through with a proper return on capital will be essential.

Nevertheless, if, despite these implications, you and your colleagues instruct that, for political reasons, it is necessary for the UK to support the proposed directive, we and our successors in Big G and Little G will of course comply to the extent (with cost pass-through) it is within our financial ability to do so.

I am copying this letter to the Chancellor of the Exchequer, and the Secretary of State for Energy.

Yours sincerely,

*Walter Marshall*

Marshall of Goring

CONFIDENTIAL

HOLGATE  
→  
CST  
14/6

FROM: N I HOLGATE

DATE: 14 June 1988

- 1. MR M WILLIAMS
- 2. CHIEF SECRETARY

*WJ*  
14.6

- cc
- Chancellor
  - Financial Secretary
  - Sir P Middleton
  - Mr Anson
  - Mr Monck
  - Mr Moore
  - Mr Burgner
  - Mr Turnbull
  - Mr S Wood
  - Mr Call

*Chy*  
*If original is given to*  
*write it should probably be given.*  
*But I think it should*  
*do so.*

**E(A) 15 JUNE ACID RAIN: DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE**

Following the Chancellor's view that there is no need to make concessions on SO<sub>2</sub> emissions, I attach a speaking note for tomorrow's meeting.

2. As Mr Morrison has written to dispute Mr Ridley's case, there is probably no need to write before tomorrow's meeting. But if you do wish to send a letter to colleagues, we can quickly provide a draft.

*N I Holgate*

N I HOLGATE

CONFIDENTIAL

DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE

Current commitment

Existing programme of three retrofits will cost nearly £700 million (1988-89 prices); also fitting 12 stations with low nitrogen oxide burners; and new stations will be fitted both with flue-gas desulphurisation (FGD) equipment and low-NO<sub>x</sub> burners. Therefore a substantial programme.

2. Doubt that EC partners fully appreciate the extent of this commitment - a pity that German Presidency mishandled the March Council and failed to build on Danes' proposals.

Cost of Mr Ridley's proposal

3. This could amount to a further £670 million to £775 million (net present value) or an increase in electricity prices of over 1% in the peak years of such a programme. This is surely too expensive a response to a critical report from a Select Committee.

4. Understand that the CEGB doubt the feasibility, let alone the economics, of Strategy A: this could require the retrofitting of stations with only five years' life remaining.

Effect on privatisation

5. Important for privatisation that there are provisions in the price formula for pass-through of costs of existing programme. Also officials working on schemes to ensure that retrofitted plant does not suffer competitive disadvantage.

6. Provided the price formula allows pass-through, and this is made clear in the prospectus, impact of uncertainty on privatisation proceeds should be small. Gather that City advisers have been consulted and they do not regard this as a major difficulty.



If sense of meeting goes against you:

7. Mr Ridley's Strategy B (conceding second stage target but arguing for lower third stage) much more acceptable than Strategy A. Strategy B costs less and achieves more (as retrofits come on-line earlier). CEGB has indicated that can meet Stage II if pushed.

K/warts  
H/b

'88-06-15 14:27  
17:36

K.B CORPORATE FINANCE LONDON.

01 623 5535

15.06.88 14:30

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A MEMBER OF TSA  
AND OF THE AIBD

J R S Guinness Esq CB  
Deputy Secretary  
Department of Energy  
Thames House South  
Millbank  
SW1

14th June 1988

*Jean John*

Large Plants Directive

You have asked us to write to you on the proposed EEC large plants directive which is due to be negotiated on 16th June.

We understand from a memorandum prepared by the Department of the Environment that, depending on the levels of electricity demand in the UK, the directive might involve the fitting of a further two power stations with FGD equipment by the year 2000 at an outturn cost of \$440 million. These retrofits would be in addition to the three already volunteered by the CEGB for the Drax and Fiddlers Ferry stations, of which we understand that the outturn capital cost will be around \$660 million.

\* revised  
in subsequent  
letter.

We also understand that the Department of Environment and HMIP have the legal right to enforce the retrofitting of FGD equipment to all existing coal-fired power stations independently of the requirements of any EEC directive.

From a purely financial point of view, we can see little advantage in having an agreed EEC directive unless:-

- (a) it reduces the risk of an even more demanding EEC directive being imposed on the domestic electricity industry in further years. We understand that this is unlikely without a change in Government policy, since the adoption of this type of directive is currently subject to the veto of any member nation.
- (b) it would reduce the risk of the Department of Environment/HMIP imposing a more rigorous programme for fitting such equipment to power stations. I understand that you believe that HMIP might find it difficult to impose a long-term retrofit programme on the industry which was harsher than that either agreed to or contemplated in the proposed EEC directive.

On this basis, we do not believe that agreement to the EEC directive is likely to be either a pre-requisite of flotation of Big G or a serious impediment.

Although the sums of money are substantial, we understand that they will be spread over a number of years and thus likely to be far less material than the potential outlays associated with nuclear. That said, we believe the position at flotation should be made as clear as possible to investors. We would therefore seek to have, in the prospectus, a statement of the attitude of both the EEC and the Department of Environment /HMIP towards environmental issues. To the extent that any FGD equipment installation programme has been statutorily specified (whether or not it extends beyond the CEGB's current proposals) it should be possible to allow for the potential cash outlay either by a modest adjustment to Big G's capital structure (if necessary) or by partial or total pass through of FGD costs.

Yours sincerely

*T. G. Barker*

T G Barker

**Kleinwort Benson**  
**Limited**

A MEMBER OF TSA  
AND OF THE AIBD

P.O. Box 560  
20 Fenchurch Street  
London EC3P 3DB

Telephone: 01-623 8000  
Telec: General 888531  
Foreign Exchange 886771

J R S Guinness Esq CB  
Deputy Secretary  
Department of Energy  
Thames House South  
Millbank  
SW1

*Ch.*  
This is a revised version of the K/worts  
15/6 letter. The change (highlighted)  
is v. small.

15th June 1988

*Jean John*

Large Plants Directive

Following my letter of yesterday and our subsequent discussions, I am writing to you to confirm our views on the effect of the proposed EEC large plants directive which is due to be negotiated on 16th June.

We have read the letter from Lord Marshall to the Secretary of State for the Environment dated 14th June 1988. We have also talked to Mr Fremantle, as you requested. We now understand that the additional cost of the German proposals could be of the order of £1 billion by 2003. Alternatively, if the "compromise" solution referred to in Lord Marshall's letter was adopted, we understand that the additional cost would be £660 million by 2003. These costs are in addition to the £660 million due to be incurred on the three retrofits already volunteered by the CEGB and the £300 million due to be spent on NOx equipment, both of which had already been taken into account by us.

There is clearly a direct impact on proceeds resulting from the expenditure by the CEGB (or its successor companies) of large sums of money which do not, of themselves, generate any income. It is hard to specify the precise effect on value, but the sum is likely to be of the same order as the present value of the additional cost. In the absence of any adjustment to the CEGB's capital structure on flotation, this sum would represent a diminution in the equity value of the CEGB's successor companies. If, alternatively, the additional costs require such an adjustment, the sum would again represent a diminution in proceeds to the Treasury. Although these substantial extra costs will have a significant adverse impact on proceeds, they would not of themselves make it impossible to float the two generating companies. By agreeing to such extra costs on the one hand, the Government would in effect be reducing the financial benefits of privatisation on the other.

You also asked us for further advice on the statement of attitude on the part of the Department of Environment/HMIP which we would expect to be contained in the prospectus. In the event that the generating companies were subject to any EEC directive at the time of flotation, it would be necessary both to describe the requirement entailed by the directive and to have a statement of the attitude of the Department of Environment/HMIP towards any additional requirements. Clearly from a financial point of view it would be beneficial if such a statement of attitude made it clear that the Department of Environment/HMIP would not require any additional equipment to be fitted over and above the EEC requirement for a stated period. In the event that no EEC directive was in force, it would still be necessary to express clearly in the prospectus any existing requirements of the Department of Environment/HMIP together with their attitude towards any foreseen changes to this requirement. Again, from a purely financial point of view, the more comfort such a statement was able to give to investors that capital expenditure on environmental grounds was not to be required in the immediate future, the better this would be for the flotation.

Yours sincerely

*T G Barker*

T G Barker

Rifkind  
15/6



SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Nicholas Ridley MP  
Secretary of State for the Environment  
2 Marsham Street  
LONDON  
SW1P 3EB

CH/EXCHEQUER	
REC.	15 JUN 1988 ✓ 5/6
ACTION	CST
COPIES TO	

15 June 1988

*Dear Nicholas,*

**ACID RAIN - DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE**

The proposals in your letter to the Prime Minister of 8 June are realistic, and I am happy to endorse your recommended negotiating line for the 16 June Council.

The German Presidency position offers us a rare opportunity to reach agreement on terms which are reasonably advantageous to the UK. Agreement would buy considerable international goodwill; failure to agree would only intensify our isolation. As a net importer of acidification, and one of the areas of the UK most vulnerable to continuing acid inputs, Scotland stands to benefit in the long term from an agreement. It is my understanding moreover that the Scottish power stations have relatively low emission levels and would not require retrofits. I welcome therefore the change of stance which you are recommending and hope that Malcolm Caithness will be able to bring the subject to a satisfactory conclusion on 16 June.

*Well, that's all right then!*

Copies of this letter go to the recipients of your minute.

*Yours ever,  
Malcolm*

**MALCOLM RIFKIND**

K/Worb  
15/6

'88-06-15 13:47

15.06.88 13:50

J R S Guinness Esq CB  
Deputy Secretary  
Department of Energy  
Thames House South  
Millbank  
SW1

15th June 1988

Large Plants Directive

Following my letter of yesterday and our subsequent discussions, I am writing to you to confirm our views on the effect of the proposed EEC large plants directive which is due to be negotiated on 16th June.

We have read the letter from Lord Marshall to the Secretary of State for the Environment dated 14th June 1988. We have also talked to Mr Fremantle, as you requested. We now understand that the additional cost of the German proposals could be of the order of £1 billion by 2003. Alternatively, if the "compromise" solution referred to in Lord Marshall's letter was adopted, we understand that the additional cost would be £660 million by 2003. These costs are in addition to the £660 million due to be incurred on the three retrofits already volunteered by the CEGB and the £300 million due to be spent on NOx equipment, both of which had already been taken into account by us..

Although these additional costs are considerably higher than those envisaged in my letter to you, we do not believe that agreement on either of the two bases outlined above is likely to prove a serious impediment to flotation. That said, there is clearly a direct impact on proceeds resulting from the expenditure by the CEGB (or its successor companies) of large sums of money which do not, of themselves, generate any income. It is hard to specify the precise effect on value, but the sum is likely to be of the same order as the present value of the additional cost. In the absence of any adjustment to the CEGB's capital structure on flotation, this sum would represent a diminution in the equity value of the CEGB's successor companies. If, however, the additional costs require such an adjustment, the sum would represent a diminution in the value of the proceeds to Treasurer.

Assumes  
no  
pass-through

You also asked us for further advice on the statement of attitude on the part of the Department of Environment/EMIP which we would expect to be contained in the prospectus. In the event that the generating companies were subject to any

EEC directive at the time of flotation, it would be necessary both to describe the requirement entailed by the directive and to have a statement of the attitude of the Department of Environment/HMIP towards any additional requirements. Clearly from a financial point of view it would be beneficial if such a statement of attitude made it clear that the Department of Environment/HMIP would not require any additional equipment to be fitted over and above the EEC requirement for a stated period. In the event that no EEC directive was in force, it would still be necessary to express clearly in the prospectus any existing requirements of the Department of Environment/HMIP together with their attitude towards any foreseen changes to this requirement. Again, from a purely financial point of view, the more comfort such a statement was able to give to investors that capital expenditure on environmental grounds was not to be required in the immediate future, the better this would be for the flotation.

Yours sincerely

*would still be necessary to  
express clearly in the  
prospectus.*

T G Barker



CONFIDENTIAL

FROM: N I HOLGATE

DATE: 15 June 1988

1. ~~MR M L WILLIAMS~~

2. CHANCELLOR

cc Chief Secretary  
Financial Secretary  
Mr Monck  
Mr Moore  
Mr Call**E(A)15 JUNE: DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE**

Since my speaking note was prepared yesterday:

(a) the Environment Select Committee has recommended that the existing three retrofits be completed by 1993 and that three additional retrofits be added to the programme. Lord Marshall has said that the existing programme can be completed by 1995; it is presently scheduled for completion in 1997.

(b) Lord Marshall has written to urge caution in agreeing additional commitments. Significantly, he concentrates on the cash flow implications for the privatised companies and the need to pass through the costs to consumers if the UK makes concessions; he does not cast doubt on the technical feasibility of further retrofits.

(c) Kleinwort Benson have given their views (draft letters attached): they are fairly clear on the central issue, which is whether uncertainty over a future commitment would have a major impact on privatisation. They say not.

*(d) An (unhelpful) letter from Mr Ripkind - behind.*

2. You may also wish to be aware of two difficulties in the way of relying too heavily upon KB's equivocal advice:

(a) their attitude has apparently altered since they were first approached on this issue, when they took a more serious view of the effects of uncertainty. It is

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very difficult to say whether their latest view reflects more mature consideration or an attempt to second-guess DEn. DEn and KB are still trying to reach an agreed view.

(b) They do not cover the question raised by Mr Ridley at paragraph 18 of his paper: that without an agreement, the EC Commission may start proceedings under an article in the framework directive which obliges states to plan to bring existing plant up to the standards of new plant. Similar proceedings have begun on the directive concerning the quality of drinking water; and Schroders' unequivocal advice is to get it sorted out before privatisation.

Wif White

pp. N I HOLGATE



*amp*

FROM: J M G TAYLOR

DATE: 16 June 1988

MR HOLGATE

cc Chief Secretary  
Financial Secretary  
Mr Monck  
Mr Moore  
Mr M L Williams  
Mr Call

**E(A)15 JUNE: DRAFT EC LARGE COMBUSTION PLANTS DIRECTIVE**

The Chancellor was grateful for the briefing you provided for this meeting.

*JMG*

J M G TAYLOR