PART TEN. MT

SECRET

CONFIDENTIAL FILING

Gas and Electricity Pricing Policy

Gas and Electricity Industries EFL's

Industrial Energy Policy

FUTURE OF THE GAS INDUSTRY.

THE ELECTRICITY COUNCIL ANNUAL REPORT 83/84

BRITISH GAS ANNUAL REPORT 83/84 Attached in folder

NATIONALISED INDUSTRIES

Pt 1: September 1979

Pt 10: September 1984.

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~24.9.84~~		~~25.3.85~~					
~~27.9.84~~		~~26.3.85~~					
~~4.10.84~~		~~28/3/85~~					
~~16.10.84~~		~~12.4.85~~					
~~29.10.84~~		~~15.4.85~~					
~~12.11.84~~		~~17.4.85~~					
~~13.11.84~~		~~18.4.85~~					
~~28/11/84~~		~~23.4.85~~					
~~12.12.84~~		~~24/4/85~~					
~~17.12.84~~		~~25.4.85~~					
~~20.12.84~~		~~1.5.85~~					
~~4.1.85~~		~~2.5.85~~					
~~5.2.85~~		~~9.5.85~~					
~~8.2.85~~		~~14.5.85~~					
~~11.2.85~~		~~15.5.85~~					
~~19.2.85~~		~~17.5.85~~					
~~27.2.85~~		~~21.5.85~~					
~~12.3.85~~		24.5.85					
~~15.3.85~~		ENDS					
~~18.3.85~~							
~~20.3.85~~							

PREM 19/1582

Dd 8398366 2M 11/83 JET

PART 10 ends:-

E(A)(85)30 16 24.5.85

PART 11 begins:-

53/Energy to Ch.Exch 3.6.85.

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(A)(85) 30	24/05/1985
CC(85) 15th Meeting, item 5	02/05/1985
C(85) 10	30/04/1985
E(A)(85) 9th Meeting, item 2 Limited Circulation Annex	25/04/1985
E(A)(85) 24	22/04/1985

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed J. Gray Date 6/3/2014

PREM Records Team

RESTRICTED

020

Prime Minister (2)

Another moderate settlement in public sector. The wider claim for white collar workers should be resisted. AT 22/5

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

MS

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

21 May 1985

Dear Nigel

BGC PAY

I am pleased to report that a settlement was reached yesterday with BGC's manual workers. The terms differ only slightly from the offer described in my letter of 20 March. The increase on basic rates ranges from 5.0%-5.7%; the only other change from the Corporation's earlier offer is that the increase in stagger payments is £2 rather than £1.50. I understand that the effect on average earnings is 5%, and the effect on the pay bill a little under 5.3%.

The Corporation recently received a pay claim from its white collar workers, whose settlement date is 1 June. The terms are:

- a pay increase of the RPI prevailing, plus 3%;
- a minimum of 6 weeks' holiday;
- retirement at 60, instead of 63, with no loss of pension entitlement.

BGC will meet the unions on 30 May to discuss the claim and I will let you know as soon as possible the terms of any offer which is made.

I am copying this letter to the Prime Minister, to other members of E(PSP) and to Sir Robert Armstrong.

Peter

PETER WALKER

RESTRICTED

CONFIDENTIAL

NDPM
AT
20/5

CC NO

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01-211-6402

Miss Margaret O'Mara
Private Secretary to
The Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

17 May 1985

Dear Margaret

GAS MANUALS' PAY

In his letter of 20 March my Secretary of State agreed to keep his colleagues informed of developments.

Although they have not been told formally by the trade unions, British Gas understand that the ballot to seek support for industrial action on the pay claim was lost, with only 45% in favour of action. This is also the substance of a recent press report.

The next meeting between management and unions is on Monday 20 May. The Corporation team will meet that morning to determine the broad lines of their negotiating brief. As on previous occasions, the terms for achieving a settlement might only emerge during the negotiations: British Gas are consequently unable to define final parameters beforehand.

The union side's main objective may well be to refer the issue to arbitration in the hope of securing a more favourable award. The union also knows of the higher figure under consideration by the electricity manuals, so could put considerable pressure on the Corporation to improve their offer. Nevertheless the Corporation will continue to work for the right settlement for the industry.

I am copying this letter to the Private Secretaries to the Prime Minister and to other members of E(PSP), and to Richard Hatfield (Cabinet Office).

Yours sincerely,

Philip Evans

P R EVANS
Private Secretary

CONFIDENTIAL

NAT IND Pt 10

GAS+ELECTRIC

CONFIDENTIAL

C&NO

NDPM
AT
16/5

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

15 May 1985

Dear Nigel

ELECTRICITY SUPPLY INDUSTRY PAY - ENGINEERS

Further to my letter of 9 May, I have now received a report from the Electricity Council on the confidential discussions on the power engineers' pay claim that took place at the meeting of the National Joint Board on 14 May. As I mentioned earlier, the union (the EPEA) had agreed that no publicity would be given to these discussions in order not to prejudice the ESI manuals' pay ballot.

The Electricity Council offered an across-the-board increase of 5.9% with effect from the settlement date, 1 February 1985, plus an additional increment at the top of the principal engineer's and senior engineer's scales respectively with effect from 31 January 1986 ie operative immediately before the next settlement. The increase in average earnings would be 5.9%.

The union recognised this as an opening offer but said that it was not enough to compensate them for all their efforts during the past year. They therefore tabled counter-proposals which comprised a 5.9% increase on all sacle points, a major restructuring of the scales involving extension at the top and an immediate increment on the relevant scale for all individuals.

The Electricity Council have calculated that the union's counter proposals would increase average earnings by about 8.9%. They have, of course, no intention of conceding this; but the unions will be expecting an improved offer from them at the next meeting. They are now considering what shape this might take. A further informal confidential meeting has been arranged for 4 June, by which time the result of the manuals' ballot should be known. I will keep you informed of developments.

I am copying this letter to the Prime Minister, other members of E(PSP), George Younger, Nicholas Edwards, Douglas Hurd and Sir Robert Armstrong.

Peter

PETER WALKER

CONFIDENTIAL

NAT IND PT10

GAS + ELECTRIC

16 MAY 1985

M4.67

CONFIDENTIAL

CC NO

NBPM

AT 15/5

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

14 May 1985

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1

Dear Peter

ELECTRICITY SUPPLY INDUSTRY PAY

Thank you for your letter of 9 May commenting on the ballot about to be conducted on the pay offer to the Electricity Supply Industry manuals and outlining the employers' position in the pay negotiations for power station engineers on Tuesday 14 May.

As I pointed out in my letter of 15 April, special considerations apply this year to the pay negotiations for the Electricity Supply manuals. Nevertheless, I welcomed the fact that you thought it should be possible for the Electricity Council to secure for other groups of workers in the electricity industry increases below the level given to the manuals.

Your latest letter points out the formal links between the pay of power engineers, and the pay of certain foremen in the manuals' group. I accept that these links make it difficult to avoid some read-across from the manuals' pay offer to the power engineers and I am therefore glad to note that the meeting on 14 May with the power engineers is to be conducted in secrecy. This is important not only because of the potential effect on the Electricity Supply manuals' ballot, but also because of possible implications for the gas manuals, who, as you know, are still some way from settling.

While I accept that it is difficult to ignore the formal link resulting from the 1979 Arbitration Agreement, the proposed increases for power engineers seem high. I recall that the Monopolies and Mergers Commission has from time to time criticised the Electricity Supply industry for employing an excessive number of qualified engineers. Given the pressure on the industry's External Financing Limit for 1985/86, I therefore hope that scope could be found for further reductions in numbers here.

I am copying this letter to the Prime Minister, the other members of E(PSP), George Younger, Nicholas Edwards, Douglas Hurd and Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

Nationalised Industries Pt 10

Gas + Electricity Pricing

CONFIDENTIAL

CC NB

NBPM
AT
8/5

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

9 May 1985

Dear Nigel

ELECTRICITY SUPPLY INDUSTRY PAY

Further to my letter of 18 April, I have now received from the Electricity Council details of the arrangements for the ballot on the manual workers' pay offer and a warning that pay negotiations with the engineers are likely to start next week.

The unions have been unable to arrange the meeting with their local officers to ensure that they campaign actively for a positive result before Friday, 10 May. This means that the ballot papers will now not be circulated until Monday, 13 May. They are due to be returned to the Electoral Reform Society by the morning of Friday, 31 May. The papers will be counted as they are received and so it is hoped that the result of the ballot will be known in the course of 31 May.

The next meeting of the National Joint Board (NJB) covering the power station engineers is due to be held on Tuesday, 14 May. The union have asked for this to be a negotiating meeting on the understanding that the discussion at the meeting will not be made public in order to avoid prejudicing the ballot of NJIC staff. The Electricity Council will therefore need to make an opening offer at this meeting.

There is a formal link, resulting from a 1979 arbitration agreement, which lays down that the percentage increase awarded to point 9 of the NJB scale should be the same as the average increase covering the first and second points of the Foreman II scale in the NJIC settlement. On the basis of the present offer to the manuals this would amount to 5.9%. This link in practice sets an effective bottom limit and the Electricity Council negotiators would aim to open with an offer of 5.9% across the board, coupled with an increment on the top of the principal engineer's scale. This would only affect a small number of people, but is judged necessary because of the compression of the scales over time.

The unions are likely to reject this and counter with a request for at least 6.7% across the board (the highest figure in the NJIC settlement) and may even seek to go significantly higher than this. In this event, the Electricity Council's aim would be to try to hold the 6.7% figure at the top of the scales, tapering the settlement downwards at the lower end. They will obviously seek to minimise the overall increase, but it is likely that the increase in average earnings will significantly exceed 6% in any settlement acceptable to the union. I will keep you informed of progress.

I am copying this letter to the Prime Minister, other members of E(PSP), George Younger, Nicholas Edwards, Douglas Hurd and Sir Robert Armstrong.

PETER WALKER

NAT IND: Gas & elec: Pt 10

, 020

NBPM

cc N.O.

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

JU409
Secretary of State for Trade and Industry

8 May 1985

CONFIDENTIAL

M F Reidy Esq
Private Secretary to
The Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

Dear Michael,

GAS PRIVATISATION

As you know, it is intended that our Department should look closely at the regulatory framework appropriate to the privatised British Gas Corporation, and officials from our two Departments are already in touch on this. Until your proposals are formulated and agreed by E(A), we need to keep our options open in any public comment on the regulatory aspects. We have therefore proposed the following amendments to the draft statement which have already been passed to your officials and by telephone to your office. Their purpose is:

a to avoid the presumption that it will only be necessary for the regulatory arrangements to deal with the gas supply business, leaving other aspects such as the sale of gas appliances unaffected. Your Secretary of State's proposals referred to the need for at least transparency of accounts. The BT licence prohibits tie-in sales, and requires separate charging for apparatus supply. We shall want to look at this area with you in the planned further work on the regulatory regime;

b to remove the presumption that there will necessarily be a new regulatory body. This needs to be considered against other options, including OFT and Oftel.

Our proposed amendments are:

Paragraph 3, lines 5 and 6:

... and for appropriate regulation of monopoly aspects of its businesses

Paragraph 5, lines 1 and 2

The legislation will protect the consumer by establishing regulatory arrangements to oversee gas prices...

Paragraph 7

Outside the areas of gas supply, the new company will be able to develop other areas of its business in a competitive environment, subject like any other company to the general framework of competition legislation.

I am sending copies of this letter to Andrew Turnbull (No 10), Rachel Lomax (Treasury), Martin Hill (Lord Privy Seal's Office) and Richard Hatfield.

Yours sincerely
Maureen Dodsworth

PP ANDREW LANSLEY
Private Secretary

COVERING ~~SECRET~~ UNTIL 7 MAY

Copy 1 of 6

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 7214

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON SW1

Prime Minister:
After your Economic Summit statement

3 May 1985

Dear Andrew,

GAS PRIVATISATION

I attach the text of the Parliamentary statement which my Secretary of State proposes to make next Tuesday.

I am sending copies to Rachel Lomax (Treasury) Martin Hill (Lord Privy Seal's office), John Mogg (DTI) and Richard Hatfield.

Yours sincerely

Michael Reidy

M F REIDY
Private Secretary

COVERING SECRET UNTIL 7 MAY

With permission, Mr Speaker, I would like to make a statement about the future of the British gas industry.

Major progress has been made with the Government's privatisation programme. Management and enterprise have been freed from bureaucratic intervention in industries as diverse as aerospace, the ports and cross-Channel services, the oil industry and British telecom.

The Government has
~~I have~~ decided that the time has come for a further major step in the transfer of state industry to the private sector. I propose to introduce legislation at the earliest opportunity to provide for the transfer to a new private sector company of all the assets of the British Gas Corporation, and for ~~the~~ appropriate regulation of monopoly aspects of the gas supply business. Following that legislation the Government intend that the shares in the new company should be sold to those employed in the industry and to the public.

This change, like the earlier ones, will remove state intervention and substitute realistic tests of performance for bureaucratic or political ones. It will create a real ownership by the public and employees in place of the nominal public ownership of the nationalisation statute. It will place new emphasis on efficiency for the benefit of consumers and give employees a new stake in the business.

The legislation will protect the consumer by establishing ~~a~~ regulatory arrangements to ~~body which will~~ oversee gas prices to the consumer and terms and conditions of supply. The new company will have an appropriate obligation to supply consumers, as has been the case with the British Gas Corporation. The legislation will protect consumers against discrimination and will contain necessary safety provisions, including the obligation on the new company to maintain the emergency services.

The opportunities for greater competition opened up by the Oil and Gas (Enterprise) Act will be maintained and kept under review. In particular it is the Government's intention that competitors should be able to supply not only large industrial consumers but also smaller domestic and commercial consumers in areas not already supplied by BGC, with suitable safeguards for safety.

Outside the ~~regulated~~ areas of gas supply, the new company will be ~~free~~ able to develop other areas of its business in a competitive environment, subject like any other company to the general framework of ~~jurisdiction of the Monopolies and Mergers Commission and the Office of Fair Trading.~~ competition legislation.

I intend to provide special opportunities to gas consumers and other small investors to purchase shares, in line with our policy on wider share ownership. All gas consumers will benefit from the emphasis on efficiency which will be built into the regulatory system and from a straightforward system of gas pricing related directly to achieved commercial performance.

In line with practice with previous privatisations, I propose to make generous provision to enable all who work in the industry to acquire shares and thus to take a new stake in the company's performance and success. There will be new opportunities, as well as new challenges, for management and employees in the new company.

The British gas industry is now nearly two centuries old. It has spent nearly 40 years as a nationalised industry but was developed for a century and a half in the private sector. It has undergone great change in the last two decades with the transition to natural gas, which has linked it to the great expansion of British industry into the North sea. I believe that today's announcement will mark a new and long period of successful development into which the management and all who work in the industry can bring their present talents ~~and advantages~~, and link them with new freedoms in the interests of the nation.

RESTRICTED

CC NO

NBPM AT 2/5

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon George Younger TD MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
London
SW1A 2AU

2 May 1985

Dear Secretary of State

SCOTTISH ELECTRICITY BOARDS' BORROWING LIMIT

Thank you for your letter of ~~2~~3 April about an Order to increase the borrowing limit for Scottish Electricity. It was helpful to have warning early.

I should like to settle revised external financing limits for these Boards with you before the Order is introduced. I cannot judge fully the public expenditure implications of your proposal until then, and I shall need to discuss with you what savings the Boards might make this year. It is also important to get the usual financial framework back in place as soon as possible after the coal strike.

Nonetheless I accept that the Order is likely to be needed this session and I have no difficulty about your planning with John Biffen and John Wakeham on that basis.

I am glad that you envisage a reduction in borrowings after Torness. It does seem wise not to raise expectations of further major power stations in Scotland for the foreseeable future.

I am copying this letter to the Prime Minister, Peter Walker, John Biffen, John Wakeham, Norman Lamont; and to Sir Robert Armstrong.

Yours sincerely

J Broadbent

for PETER REES

[Approved by the Chief Secretary]

RESTRICTED

NAT IND: Gas & elec: Pt 10

Ref. A085/1243

PRIME MINISTER

Gas Industry Privatisation
(C(85) 10)

BACKGROUND

FLAG A At its meeting on 25 April (E(A)(85) 9th Meeting, Item 2), E(A) agreed:

a. that a decision to privatise the gas industry was for Cabinet;

b. that QL should consider the implications for the legislative programme of proceedings;

c. that, subject to the views of Cabinet, the Secretary of State for Energy should bring specific proposals on the major issues, including regulation, the continuing obligations and responsibilites of the privatised industry, and gas imports and exports, to E(A) within a month.

2. The Lord President of the Council's report (C(85) 11) of the QL discussion on 30 April is to be discussed as the next item. It suggests that, if gas privatisation goes ahead, the Nationalised Industries (NI) Bill and the Northern Ireland (Emergency Provisions) Bill should be dropped from the 1985/86 session.

MAIN ISSUES

3. C(85) 10 is virtually identical to E(A)(85) 24. (The only substantive change is the addition of the final sentence,

offering a report to E(A) on regulation, but not the other issues listed in paragraph 1c. above.) The brief of 24 April for E(A) is therefore still relevant. Paragraphs 6-12 list some of the many major issues which need to be addressed if the gas industry is to be successfully privatised.

4. If the Cabinet, like E(A),are sympathetic in principle to gas privatisation but are concerned about the need to resolve any important questions of detail, the main issue is likely to be whether:

a. the Secretary of State for Energy should go ahead with an early announcement of the Government's intentions in general terms, or

b. any announcement should wait until after detailed proposals have been considered by E(A) in mid to late May.

HANDLING

5. You will wish to ask the Secretary of State for Energy to introduce his paper. Bearing in mind the pressure on the Cabinet agenda you will not wish to duplicate the E(A) discussion; it may therefore be best simply to invite comments from those who did not take part in that discussion.

CONCLUSIONS

6. You will wish Cabinet to reach conclusions on:

i. whether to privatise BGC in the present Parliament;

ii. if so, whether this should be either:

a. broadly along the lines and on the timetable proposed in C(85) 10; or

b. on some other basis;

iii. the timing, and broad content, of any announcements.

Robert Armstrong
(agreed by
ROBERT ARMSTRONG
and signed in his absence)

1 May 1985

BRIABG

10 DOWNING STREET

Prime Minister

I feel uneasy about the number and importance of the issues which have yet to be resolved.

The choice is between an early announcement which prevents leaks or a later announcement which runs the risk of leaks but puts the Government in a position to answer some of these major issues.

AT 24/4.

11

SECRET

P.01535

PRIME MINISTER

Flag A

Privatisation of the Gas Industry
(E(A)(85) 24)

BACKGROUND

The 1983 Manifesto promised "to seek ... means of increasing competition in, and attracting private capital into" the gas industry.

Proposals

2. The Secretary of State for Energy proposes, in E(A)(85) 24:

a. Flotation of the British Gas Corporation (BGC) as a Companies Act company largely in its present form, in Autumn 1986;

b. The creation of a new regulatory body to control gas prices and investigate complaints of discrimination against consumers. (Terms and conditions of supply and obligation to supply would be dealt with in the necessary legislation);

c. Price regulation on the basis of a formula (annual price rise = RPI (rate of inflation) - X (target reduction in onshore costs) + Y (increase in gas costs);

d. No regulation of BGC's other activites (appliance retailing, installation and servicing, offshore assets);

e. Employee participation in the share issue;

f. An announcement this month, followed by legislation in 1985/86 session (Second Reading December, Royal Assent July/August 1986.)

MAIN ISSUES

3. If BGC is to be privatised, there are many important questions which will need to be resolved. Some of these are mentioned in paragraph 11 below, in order to aid assessment of the practicalities. The main issues which need to be addressed at this meeting are as follows:

i. The scope for privatising BGC.

ii. The form and timing of privatisation. ✓

iii. The need for and form of regulation. ✓✓

iv. Employee participation. ✓✓

v. How to accommodate the necessary legislation in the 1985/86 session.

Scope for privatisation

4. The British Telecom (BT) flotation has demonstrated that it is possible to float very large monopoly utilities successfully. There are however a number of differences between the BT and BGC situations. BT is operating in a growth market, with the added attraction of important high technology developments. BGC has limited growth prospects and will face increasing competition from

other energy sources as the cost of gas rises (recently at about double the rate of inflation.) It seems very unlikely that BGC can look forward to substantial increases in profitability through the application of new technology to the gas distribution business.

The Government should not [illegible] present this privatisation as a repeat of BT. Exaggerated claims about competition will discredit the exercise

5. In the case of BT, there is a prospect of some competition. The economics of the gas industry mean that there is little or no prospect of competing suppliers emerging other than for very large industrial consumers (already allowed under the Oil and Gas Enterprise Act 1982; but so far not forthcoming.) Mr Walker suggests that BGC might be licensed to carry out gas supply, which would hold out the prospect of a later change of licensee. However the need to attract potential investors, and the nature of gas supply contracts with producers, which are usually for the life of the field (typically 15 years for significant fields) mean that any licence would have to run for a substantial term. Other suppliers might also be licensed, but would be unlikely to have anything other than a marginal presence in the market. Generally the advantages of gas privatisation would arise from wider share ownership and early Government capital receipts rather than from the effective application of market disciplines or the exploitation of new technological or market opportunities.

6. There are a number of areas where the position of BGC as a nationalised industry allows the Government to intervene in the national interest. This is of course a double-edged sword, in that the Government is held responsible for BGC's actions. Privatisation would mean setting a clearer public limit to the Government's role; the precise nature of that limit will have an impact on the potential proceeds. Merchant banking advice will be needed, but examples of areas where the Government would probably have to step back are:

(a) Gas Imports. The Government decided that the purchase of Sleipner gas from Norway was not in the overall national interest, although BGC considered it to be clearly in their commercial interest. A future import deal could discourage development of the UKCS and lead to the loss, or at least lengthy postponement, of significant tax revenues.

(b) Pipeline routes. If the Sleipner deal had gone ahead, the Government would have wished to influence the pipeline route, in order to maximise tax revenues and to collect gas from other fields. Although the powers in the Petroleum to Submarine Pipelines Act would be available to promote the Government's objectives in such circumstances, there could be difficulty in using them where this could be shown to be clearly disadvantageous to BGC.

(c) Exports. A definite decision will be needed on whether or not to allow exports, and if so on what basis. Unless the form of the regulation is such as to make BGC completely indifferent to the price it pays for gas supplies (which could result in higher outflows of profits from the exploitation of the UKCS), there is likely to be strong pressure from UKCS licensees for the lifting of the landing requirement from new UKCS gas supplies, in order to limit the privatised BGC's ability to exercise monopoly power.

(d) Gas Levy. BGC earns significant windfall profits on old PRT-exempt contracts. The Gas Levy recoups some of the benefit (currently about £525 million a year) for the Exchequer, and will continue to do so until the fields in question become exhausted in the early 1990s. At present, the rate of Levy can be varied by Order. It will probably be necessary to fix the rate of the Levy prior to privatisation. Freezing the rate would accelerate the real reduction in Exchequer take as the fields tail off, and would leave the new company with access to significant economic rent. Prescribing an increasing rate of Levy would feed through to reduced profits (and reduced sale proceeds) or increased prices (which would increase the political difficulty of selling privatisation to consumers.)

(e) In recent years, the Government has put pressure on BGC to moderate price increases to industrial consumers (and has compensated it by reducing the Levy.) Mr Walker now proposes to prohibit the privatised BGC from discriminating against particular classes of consumer. This need not mean all consumers paying exactly the same, but it seems likely to preclude any new Government policy to favour commercial and industrial consumers. Meanwhile the restriction on BGC's commercial freedom resulting from the requirement of non-discrimination could tend to reduce the privatisation proceeds.

(f) The cost averaging element in the form of price regulation would have the effect of precluding a policy of marginal cost pricing (which would generally be expected to be the efficient approach in circumstances of rising gas supply prices). This effect could be partly overcome if there were a large increase in gas prices before privatisation (which would also have the effect of increasing the total proceeds).

(g) BGC's former oil interests have largely been disposed of, and BGC confined to gas exploration. A privatised BGC would probably need to be given freedom to retain and develop any future oil discoveries.

7. A completely arms-length relationship is probably impossible, given the safety implications. Mr Walker says that it is for consideration whether the Government would need to retain powers to step in if the company collapsed. If so, this need not mean assuming obligations to the shareholders, although the position on this will need to be made very clear, in order to avoid creating an implied guarantee.

Form and Timing of Privatisation

8. BGC's non-gas supply activities - appliance retailing (9,000 staff; turnover £219 million); installation, servicing and contracting (30,000 staff; turnover £278 million); and offshore assets - are not natural monopolies. They could in principle

be hived off and sold or floated separately. This would be likely to lead to greater competition than Mr Walker's proposal for separate accounting to prevent cross-subsidisation from the gas production and supply business (which accounts for 99% of BGC's profits.) However the physical (as opposed to paper/ accounting) separation of these aspects of what is currently run as a highly integrated business would take a considerable amount of time and effort. More radical options, such as turning BGC into a pipeline authority and licensing a number of regional gas distribution companies, would be likely to be even more complex and time consuming. Mr Walker therefore argues that privatisation of BGC in its present form is the only possible option for action in this Parliament. It will also have the advantage of making the core business more attractive, by providing a base (after some pruning and re-organisation) for diversification, and the opportunity for unregulated profits (particularly offshore).

Regulation

9. Finding the right regulatory framework is the key to securing both a successful flotation and consumer acceptance. The arrangements have to provide reasonable assurance of the probability of profit to attract potential investors, whilst providing BGC's sixteen and a quarter million customers with sufficient confidence that they will not face sharp price rises as a result of privatisation. Mr Walker's suggested formula, which would be policed by a body similar to (or associated with) OFTEL, would allow prices to rise by the rate of inflation minus a target for reduction of controllable onshore costs (which account for only about a third of total costs), but plus rises in gas costs (which are linked to oil prices and currency movements, and are largely outside BGC's control.) The apparent simplicity of such a system is attractive, but much would depend on the effectiveness of the arrangements for ring-fencing gas supply and on the toughness of the onshore cost control target.

Employee Participation

10. Mr Walker believes that employee participation would aid the flotation by reducing employee resistance, and would improve post-privatisation performance. No details are given; concessionary purchase might reduce the potential sale proceeds. (In previous informal discussions Mr Walker has suggested that the path to a successful privatisation could be made easier by conceding to BGC's employees a stake in the company several times larger than that provided in other major privatisations.)

Other Issues

11. A number of important issues will need to be resolved before the legislation can be finalised. Among those likely to need collective consideration are:

(a) The import/export regime (see paragraph 6 above).

(b) The future of the Gas Levy (see paragraph 6 above).

(c) Pipeline Regulation (see paragraph 6 above).

(d) The licensing regime (Who issues? Other licensees? What happens if BGC fails?).

(e) New safety arrangements. (Mr Walker suggests that the Health and Safety Executive (HSE) take over BGC's present role.)

(f) The future of the Consumer Councils (to be absorbed within the new regulatory body?)

(g) A separate regulatory body, or combined with OFTEL?

(h) Whether to prevent foreign takeover.

E(A)(85)24 makes no proposals for handling these issues (except (e) above).

12. Prior to flotation, Ministers will need to decide:

a. The details of price regulation.

b. Details of the licence.

c. Whether to float 100% of the new company. (It is not clear in E(A)(85)24 whether Mr Walker proposes this. Can the market absorb £5-7 billion in 1986-87?)

d. The balance sheet structure (as between debt and equity).

e. Details of employee participation.

Legislative Timetable

13. The necessary legislation will be complex and controversial. It cannot be accommodated within the present legislative programme without dropping at least one other major bill. The most obvious candidate is the Nationalised Industry Bill, which would also be controversial, on which major policy issues have yet to be settled, and which some Ministers oppose. The NI Bill is to be discussed at the E(NI) meeting immediately following the E(A) discussion.

14. Mr Walker proposes to make an announcement before the end of the month, presumably to pre-empt any leaks. Ministers may wish to consider whether such an announcement should be postponed until more of the detailed issues have been resolved.

HANDLING

15. As discussed above, a large number of difficult issues will need to be settled if BGC is to be privatised in this Parliament. Although not all of these questions have to be resolved immediately, the more of them the Government are able to answer, the greater the conviction the privatisation proposals will carry. It will probably be convenient to address first the general principle of whether BGC should be privatised in its present form, and the practicability of doing so, before moving on to discuss some of the main detailed questions and to consider whether the way ahead is clear enough for the Government to undertake a public commitment to privatisation.

16. You will wish the Secretary of State for Energy to introduce his paper. Thereafter the Chancellor of the Exchequer might be asked to respond. All Ministers present are likely to wish to comment. In particular the Secretary of State for Trade and Industry will wish to probe the implications for domestic and industrial gas prices and the gas appliance manufacturing industry; the Secretary of State for Employment the implications of the new safety regime for the HSE; the Foreign Secretary the effect on relations with gas suppliers, principally Norway, but potentially also the Netherlands, the USSR and Middle Eastern countries. The Lord Privy Seal and the Lord President can advise on the Parliamentary prospects, particularly timing. The Attorney General can advise on any legal aspects, eg. in relation to a potential export regime.

CONCLUSIONS

17. You will wish the Sub-Committee to reach conclusions on the following:

(i) whether to privatise BGC in the present Parliament;

(ii) if so, whether this should be either:

(a) broadly along the lines and in the timescale proposed in E(A)(85)24; or

(b) on some other basis.

(iii) what, if any, guidance to give on:

(a) the form of regulation;

(b) BGC's non-gas supply activities;

(c) employee participation;

(d) further collective consideration of the various matters needing to be resolved;

(iv) how to accommodate the necessary legislation in the 1985/86 Session;

(v) the timing of any announcements.

PLG

P L GREGSON
Cabinet Office.
24 April 1985

PRIME MINISTER 24 April 1985

BGC PRIVATISATION

The E(A) meeting must ensure that a tight timetable is set which will work. Some other planned legislation for 1985/6 will have to be sacrificed: we have briefed on this separately. (In E(NI) folder.

There are 3 principal objectives for BGC privatisation:

1. Exposing a fat public-sector monopoly to the rigours of competitive pressure and commercial discipline, and thereby offering a better deal to customers.

Should emphasis be on competition which will come only from other fuels or on meeting a tough regulatory formula.

2. Another BT-scale step towards a share-owning democracy, with a high level of employee participation.

3. The money from flotation.

There are some choices to be made in emphasis between these objectives. Backing gas consumers by exposing BGC to a tough pricing formula will reduce the proceeds from the sale. BGC is a mature business with limited growth prospects in its current areas of activity. It lacks the technological glamour of BT - a difficult act to follow. The more rigorous the commercial disciplines on BGC, the lower the price will have to be pitched to capture the enthusiasm of the man in the street.

Conclusions

We favour holding firm to our original aims, backing gas consumers, and inducing efficiency and business acumen by exposing BGC to a tough commercial environment. Given a privatised BGC, we would support the Treasury's proposal to lift Government controls on gas exports from the UKCS. In practice, little, if any, gas is likely to be sold into the over-supplied continental gas markets, but BGC will be persuaded to pay realistic prices to producers which will stimulate UK exploration and production further.

The regulatory regime should not give BGC a free hand to pass all increases of gas supply costs directly through to consumers. Supplying a markedly seasonal pattern of demand is becoming increasingly expensive as gas supply costs rise. Normal market disciplines would require BGC to reorientate its marketing/pricing policy, look for cost-effective storage and, above all, be uncompromising in searching for the cheapest sources of supply.

JW

JOHN WYBREW

CRO

NBPM AT 24/4

NEW ST. ANDREWS HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

The Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

23 April 1985

Dear Peter,

SCOTTISH ELECTRICITY BOARDS' BORROWING POWERS

It seems likely that the present aggregate borrowing limit of £2,300m for the Scottish Electricity Boards will be exceeded by October or November of this year. I am therefore seeking your approval to introduce an Order to amend Section 29 of the Electricity (Scotland) Act 1979 in order to increase the figure to £2,700m which is the upper limit provided by the Act. The Order will be subject to affirmative resolution of the House and it would need to be in place before the end of the Parliamentary session.

When the borrowing limits were last revised, following introduction of the Electricity (Financial Provisions) (Scotland) Act 1982, we had expected that the interim level of £2,300m would not be reached until mid-1986. The effect of the miners' strike on the Boards' finances has, however, upset this forecast. This will need to be made clear during the debate and could heighten Parliamentary interest in what would normally be a fairly straightforward order.

Since the Boards' borrowings are likely to begin to decline as work on Torness comes to an end there should be no need for the revised limit of £2,700m to be increased in the foreseeable future.

I am copying this letter to the Prime Minister, Peter Walker, John Biffen, John Wakeham and Sir Robert Armstrong.

Yours ever,

George

MO9

CONFIDENTIAL

ND PM AT 25/4

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

23 April 1985

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1

Dear Peter

ENERGY SECTOR: PAY NEGOTIATIONS

You wrote to me on 17 and 18 April about the state of play in the negotiations with the gas and electricity manuals respectively. I should be grateful if you would continue to keep me in close touch with developments.

I am sending copies of this letter to the Prime Minister, to the other members of E(PSP) and to Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

Nat Ind: 'Gas + Elec.' Pt 10

CONFIDENTIAL

NIO

N/O

Prime Minister ②

AT 19/4

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

NL

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

18 April 1985

Dear Nigel.

ELECTRICITY SUPPLY INDUSTRY PAY

I am now in a position to report the outcome of the Electricity Council's meeting with the trade unions on Wednesday 17 April to discuss the pay settlement for manual workers. After a lengthy and difficult meeting agreement was reached on an improved offer which will now be put to the workforce in a secret postal ballot with a "strong recommendation for acceptance" by the unions. The unions have also undertaken to call meetings with their local officials to ensure that they argue for and support the offer at local level around the country. The Electricity Council attaches importance to this as it means that the ballot will not just contain a token recommendation, but one that will be fully supported by the unions putting their own credibility on the line.

The improvements offered relate to the pay element of the offer, the other details remaining as set out in my earlier letters. The increases now range from £5.31 a week (4.8%) at the bottom of the labourer's scale to £10.85 a week (6.7%) at the top of the craftsmen's scale. The increase at the top of the labourer's scale amounts to £7 a week (5.7%). For the foremen, the increase ranges from £8.69 a week (5.7%) at the bottom of the scale to £13.19 a week (6.7%) at the top. The offer is structured so that in all cases the increase is less at the bottom of the scale in percentage terms than at the top. The overall effect of the revised offer will be an increase in average earnings of some 5.8%. The Electricity Council negotiators are satisfied that this was the absolute minimum necessary in order to achieve a positive union recommendation for acceptance in the ballot.

The ballot, which will cover all NJIC staff and not only union members, is likely to take between five and six weeks to complete and so the outcome is not likely to be known until late May. The offer will be presented publicly by the Electricity Council in terms of the cash increase in basic rates and no percentage figures will be mentioned.

CONFIDENTIAL

I am satisfied that this result is as good as we could have expected in the circumstances and, indeed, the final offer is exactly what you had hoped for in your letter of 15 April.

I am copying this letter to the Prime Minister, other members of E(PSP), George Younger, Nicholas Edwards, Douglas Hurd and Sir Robert Armstrong.

PETER WALKER

CONFIDENTIAL

CCNO.

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

Prime Minister (2)

To note.

AT 17/4

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

NL

17. April 1985

Dear Nigel.

Following my letter of 20 March the main gas manuals union, GMBATU, have written to the Corporation rejecting the offer and, without waiting for a reply, have begun a ballot of the membership on strike action. The ballot is scheduled to be completed by 3 May; it is possible that the result may be known a few days earlier.

The union rules require a two thirds majority and BGC say their latest soundings suggest it will be close run. However, a yes vote does not necessarily mean action will be taken. It strengthens the hand of the negotiators and may be designed as an instrument in the negotiations in both the electricity and gas industries (the national union officer in the gas negotiations is secretary of the electricity union side).

Meanwhile, there remains on the timetable a further meeting on 25 April. Because the ballot is unlikely to be complete by then it may not be a significant occasion. Whilst BGC do not think it is likely to be the occasion on which a further offer should be made it is worth noting that the direction of these negotiations is anything but certain.

At this stage there is no call for any action on the part of Government. There are several steps ahead before a strike becomes a reality and should it do so the immediate impact is likely to be limited to inconvenience to consumers with non-essential services.

I am copying this letter to the Prime Minister, to other Colleagues on E(PSP) and to Sir Robert Armstrong.

Peter

PETER WALKER

CONFIDENTIAL

NAT. IND: Gas & elec. Pt 10

17 APR 1985

R3.38

CONFIDENTIAL

CC NO

NBPM AT 17/4

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

15 April 1985

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1

Dear Peter

ELECTRICITY SUPPLY INDUSTRY PAY

Thank you for your letter of 11 April outlining the offer which the Electricity Council are minded to make to the manuals' unions on 17 April.

The proposed offer is high, and were it not for the particular circumstances affecting the electricity supply industry this year, I should want to argue against it. As it is, I accept that there is a strong case for making an offer of roughly the order proposed.

There would, however, be considerable presentational advantages in holding the offer below 6 per cent on average earnings. I would hope there is scope for constructing the package outlined in (b) of your letter in such a way as to produce an overall increase of earnings of, say, 5.8 per cent. It would help further if, in presenting the offer, the two sides could focus on the basic increase in rates, rather than on the overall effect of the package. This would bring the figure down even further. I am sure that you will do all you can to ensure that any settlement for the electricity supply manuals does not repercuss on the pay negotiations for the gas supply manuals, where the same considerations do not apply.

I welcome the fact that you feel it should be possible for the Electricity Council to secure increases below the level given to the manuals for the other groups of workers in the electricity industry, including the clericals. This will be essential in order to achieve the cost savings needed in 1985-86.

I am copying this letter to the Prime Minister, to other members of E(PSP), George Younger, Nicholas Edwards, Douglas Hurd and Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

NAT^D IND PT 10

GAS + ELECTRIC

Subject

File BEMACQ JD

COPY NO 6 of 7 COPIES

9

CC Master

10 DOWNING STREET

From the Principal Private Secretary

15 April 1985

Dear Michael,

GAS INDUSTRY PRIVATISATION

The Prime Minister held a meeting this morning to discuss your Secretary of State's minute of 10 April and the enclosed paper. The Lord President, Chancellor of the Exchequer and the Financial Secretary were present, as well as your Secretary of State.

It was generally agreed that your Secretary of State should proceed on the general lines suggested in his paper and in line with the timetable attached at Annex 5. The Chancellor of the Exchequer said that he would want to discuss further with your Secretary of State the proposals for employee participation. The Prime Minister said that she also had doubts about this part of the proposals, and particularly about the proposed Trust Company. But it was not necessary to decide the details before the Secretary of State made his statement: it was sufficient for the Secretary of State to say in his original announcement that there would be provision for an attractive share offer to employees on similar lines to that which applied in the case of British Telecom.

The Lord President said that the next session's legislative programme was already very full, and would become even more difficult if it was necessary to add a Bill to cover EC enlargement. But he recognised that this Privatisation Bill should have priority, and that something else would have to be dropped. He was inclined to think that this should be the Nationalised Industries Bill, but this question could also be considered later. The Chancellor of the Exchequer said that he accepted that gas privatisation should have priority over the Nationalised Industries Bill, but he did not want to agree at this stage to dropping the Nationalised Industries Bill until he had had an opportunity to consider all the possibilities.

On the choice of merchant bank to advise on the sale, it was agreed that Kleinwort Benson should be allowed to compete, and that the decision should be taken by the Treasury in the normal way. Other things being equal, there were arguments for appointing a different merchant bank to advise on this sale.

Summing up the discussion, the Prime Minister said that your Secretary of State was authorised to tell Sir Denis Rooke privately at the end of this week that the Government was proposing to privatise the Gas Industry on the lines proposed in your Secretary of State's paper. Your Secretary of State should then circulate a paper to E(A) at the beginning of next week, with a CMO distribution, for consideration at the meeting of E(A) arranged for Thursday, 25 April. The Lord President should inform the Lord Privy Seal privately of what was intended, and should arrange for consideration of the implications for the legislative programme for next Session as quickly as possible after E(A) had reached a conclusion.

I am sending copies of this letter to Janet Lewis-Jones (Lord President's Office), Rachel Lomax (H M Treasury), Helen Goodman (Financial Secretary's Office, H M Treasury) and Richard Hatfield (Cabinet Office). As before, no copies of this letter should be made, and it should be retained at Ministerial Offices until the E(A) meeting has taken place.

Yours ever,

Robin Butler

Michael Reidy Esq
Department of Energy

CONFIDENTIAL

file DA

(53)

CC HMT DTI SO
HO DIM WO
DES DOT NIO
DOE CDL CO
DHSS CST

10 DOWNING STREET

From the Private Secretary

15 April 1985

Dear Michael,

The Prime Minister has seen your Secretary of State's letter to the Chancellor of 11 April about electricity supply industry pay. She has commented that she agrees with the desire of the Electricity Council to avoid a ballot on the basis of a recommendation for rejection. In the context of an industry in which labour costs form a relatively small proportion of total costs the factors pointing towards an offer of the kind set out in your Secretary of State's letter are very strong.

I am sending copies of this letter to Private Secretaries to members of E(PSP), John Graham (Scottish Office), Colin Jones (Welsh Office), Jim Daniell (Northern Ireland Office) and Richard Hatfield (Cabinet Office).

Yours ever

Tim Flesher

(Timothy Flesher)

Michael Reidy, Esq.,
Department of Energy.

CONFIDENTIAL

PRIME MINISTER 12 April 1985

BGC PRIVATISATION

After your meeting with Peter Walker on 25 March, Energy and Treasury officials were asked to consider the feasibility of achieving a successful flotation of BGC as an integrated whole around the end of 1986. They conclude that this can be done, provided high priority is given both to the legislation and the flotation. It will mean that other legislation in 1985/86 will have to be sacrificed to make room for it, and that there will not be time to devise a more radical, competitive alternative to an Oftel-type regulatory régime for the monopolistic core of BGC's business. An enticing employee participation scheme is envisaged as a carrot to BGC's management and employees.

The game is still worth the candle. Peter Walker's paper rightly points out that natural gas is a mature business with only limited further growth potential. The immediate prospects are good, but the cost of the raw material is rising steadily as new, higher-priced supplies replace the original cheap gas. In the longer term, a high-cost gas industry will probably have to defend a declining market against competition from other fuels. The business logic is to move now in exposing a privatised BGC to tougher commercial discipline, thereby equipping it to cope in a hard-headed way with the demanding problems of the 1990s and beyond.

Arguably, it is the Nationalised Industries Bill which should be dropped to accommodate the legislation for BGC privatisation in the 1985-86 Session. The main target of this Bill would be the profitable, cash-generating industries like Gas and Electricity. The privatisation of BGC would pave the way for the privatisation of Electricity. That being so, the Nationalised Industries Bill begins to look less relevant.

An Oftel-type regulatory régime for BGC may be no worse than splitting BGC into competing elements. So far, the signs are that Oftel is a sound model to build on. Success in developing a good standard model of price regulation for natural monopolies established in the private sector would be a valuable prize; as well as Gas, there are Electricity and Water. However, our supporters will be disappointed that a monopoly remains. The two defences we need are, first a tough pricing formula, and second, employee participation.

We should not become committed to a specific form of pricing formula without careful consideration. Peter Walker proposes RPI-X+Y, according to which BGC would be expected to make economies capable of beating inflation in their onshore gas distribution and marketing, but they would be allowed to pass through to consumers the increasing real cost of gas supplies. The latter is far too soft an option. BGC should be exposed to the normal market discipline on a business faced with a seasonal pattern of demand, and the opportunity to pay significantly less for a steady offtake of supply. It needs to reorientate its marketing/pricing policy, look for cost-effective seasonal storage, and search for the cheapest sources of supply.

In his paper, Peter Walker talks of "encouraging a management/employee buyout to the extent of around 10-15% of the equity". This is likely to be a bit rich for the Treasury's blood. Rightly, they will question the proposition that it "will have a very considerable (positive) impact on the price we can obtain for the business". They will see this feature as representing a net cost to Government revenue from the flotation.

That is no reason to downgrade the idea, which is good from a business point of view and is consistent with your political objectives. But again it would seem wise not to become committed to specific details when there is time to consider and develop imaginative alternatives. For example, how about making the ultimate extent and value of the employee participation option a function of BGC's performance over the 3-4 years following flotation?

Peter Walker wants to exclude Kleinwort Benson because they have already had much of the privatisation work so far, and because he was not satisfied with their performance on Enterprise Oil. We need the best talent and experience we can get. In Kleinwort's case, that experience includes the successful BT flotation. Why not ask the Treasury to provide an analysis of where the privatisation business has gone, and to carry out an initial screening of potential candidates for the BGC privatisation beauty contest? If Kleinwort's are shortlisted on merit, it would be a pity to deny ourselves access to their expertise and experience.

Conclusions

1. Political and business logic gives you the green light for BGC flotation around the end of 1986.

2. However, adherence to a tight timetable is critical. Without the resolution to do so, it would be better to abort now. Part of the resolution may have to be the dropping of the Nationalised Industries Bill.

3. Let Peter Walker prepare an early statement outlining the Government's plans for BGC privatisation. This will include references to the regulatory régime and employee participation; but, at this stage, should not tie the Government to specific details. Tight timetabling is one thing. Closing options prematurely is another.

4. Keep an open mind on Kleinwort Benson until the Treasury have made an appraisal. The needs of the job come first.

JW

JOHN WYBREW

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

Prime Minister

To note

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

11 April 1985 12/4

Labour costs are such a small proportion of the price of electricity that these increases can be afforded. It is more important to establish the Hammond position and to keep these people with us than to be overshadowed by the knock-on effects.

Dear Nigel

ELECTRICITY SUPPLY INDUSTRY PAY

The Electricity Council met their trade unions on Thursday 4 April to discuss the pay settlement for manual workers.

At that meeting, the Council's negotiators did not formally table the offer described in my letter of 25 March, but outlined it as a possibility. The unions said that if such an offer were made, they could not accept it, and would feel obliged to put it to a ballot of their members with a recommendation for rejection. They explained that they regarded the credibility of the new union leadership, in the first negotiations after the departure of Mr Chapple, as needing to be established; and it was out of the question that they could recommend their members, in the aftermath of the coal strike, to accept a settlement below what was current in the private sector. They went on to say that they regarded it as inescapable that they should ballot their members before concluding any settlement; and that they would not wish to do so on the basis of a neutral recommendation.

As you know, the Electricity Council have been anxious to avoid a ballot on the basis of a recommendation for rejection. In the light of the further informal discussions they had with the unions on 4 April, their negotiators judge that the minimum which might secure a recommendation for acceptance would involve improving the offer which they previously had in mind as follows:-

a) An increase on all scale points of at least 5.4% in line with the increase in the cost of living. The Council's negotiators regard this as unavoidable.

b) Higher increases on some scale points: the Council have not come to firm conclusions on this; but they seem likely to take the view that they would need to offer of the order of 7% at the top of the craftsmen and foremen scales.

The effect on earnings would naturally depend on the details of what was done under (b), but might be of the order of 6%.

The next meeting with the unions is on Wednesday 17 April. The unions will be pressing for an offer to be made on which they will be able to go to a ballot with a clear recommendation for or against acceptance. The Industrial Relations Committee of the Electricity Council is meeting during the afternoon of Monday 15 April to decide on tactics. Clearly the negotiations are not going as well as we had hoped; but the Council will, of course, continue to try to secure the lowest deal that is possible.

In your letter of 2 April you mention the prospects for negotiations with other ESI groups. There is no doubt that the power engineers will seek to build on whatever increase may be conceded for craftsmen and foremen: and the increase will have to be reflected to some extent in the engineer's settlement. But the Electricity Council will not wish to carry it right through the range. They think that there is a fair prospect of resisting any demands to this effect: in particular, if the industrial unions are satisfied with their settlement, they will not be well disposed towards attempts by the engineers to exploit it unreasonably for their own advantage. As for the clerical grades, the settlement with the industrials is bound to have some effect; but the electricity Council will naturally try to negotiate the lowest deal they can.

I am sending copies of this letter to the Prime Minister, other members of E(PSP), George Younger, Nicholas Edwards, Douglas Hurd and Sir Robert Armstrong.

PETER WALKER

File

Copy no. 1 of 6

PRIME MINISTER

GAS INDUSTRY PRIVATISATION

Following our discussion on 26 March, I have prepared the attached paper for our meeting on 15 April. This is in the form of a draft paper to E Committee, since you envisaged that a reference to that Committee might be necessary.

The paper has been agreed by John Moore. The Treasury's position is, of course, reserved on the employee participation point. But I believe it is vital that we make generous provision here, in order to establish a real employee stake in the business and win their support. Success in winning that support will have a favourable impact on the share price that can be obtained.

A further question we shall need to resolve quickly is whether Kleinwort Benson should be allowed to compete for appointment as merchant bank advisers on the sale. They have had the lion's share of privatisation work so far and there are, I think, good arguments in terms of our general approach to Government procurement for avoiding over-concentration. I was not fully satisfied with the performance of Kleinworts' on Enterprise Oil. If we decide that they should not be advisers for the BGC sale, I would propose to tell Kleinworts, immediately following announcement, that I did not expect them to enter the contest; and be ready to defend our decision on grounds of avoiding over-concentration.

In order to meet the timetable, I shall need to make a statement before the end of this month. If reference to E Committee is necessary I would hope it can be arranged as early as possible after the 15th: with special arrangements for security of papers. I would propose to make a statement as soon as possible after the E Committee meeting, and in any case not later than 29 or 30 April.

I am copying this minute and enclosure to the Lord President, the Chancellor of the Exchequer and the Financial Secretary. I would be grateful if particular efforts could be made to restrict circulation to an absolute minimum.

Secretary of State for Energy
11 April 1985

GAS INDUSTRY PRIVATISATION

This paper sets out my proposals for privatising the gas industry.

2 With British Telecom and the coal strike out of the way, we now have the opportunity, if we act quickly, to put through this further, key denationalisation in the present Parliament. It will mark a decisive step in the creation of real ownership by the public and employees and in harnessing capital and other market disciplines for the benefit of consumers, processes which we have begun with the British Telecom and other flotations.

3 I shall need to make an announcement as rapidly as possible, and at latest by the end of April. This is essential in order that work can go ahead with all possible speed on drafting a bill for introduction in December. The aim would be to float the new company as soon as possible following passage of the legislation, in the autumn of 1986. Any delay in this programme would put at risk the completion of the exercise before the Election.

The Gas Business

4 Natural gas is a mature business with only limited further growth potential. The immediate prospects are good, but the cost of the raw material is rising steadily (See Annex 4) as new, higher priced supplies replace the original cheap gas. In the longer term the gas industry, in Britain as in other countries, will have to look further afield for its supplies and may well have to invest heavily in plant for manufacturing substitute natural gas (SNG) from coal - at more than twice the cost of the most expensive natural gas - to supply a declining market against competition from other fuels.

5 This is a different picture from British Telecom, which was a growth industry with improving prospects. Successful sale of gas will depend on convincing investors that there are still attractive returns to be made and that the business has adequate scope for reinvestment of profits, and for diversification within Monopolies Commission rules.

SECRET/2

Gas Supply and Regulation

6 The main business of gas supply to the majority of small consumers is an inherent monopoly and will require regulation on price and on terms and conditions of supply (including an appropriate continuation of an obligation to supply). The principal regulatory features, for which we would provide in the legislation, are described in Annex 1. In summary these are:

(a) establishment of a regulatory body with a small permanent staff working within guidelines laid down, which would be capable of amendment by defined procedures. The regulatory body would have its own distinct functions but could, in practice, work closely alongside or be combined with OFTEL.

(b) a system of price regulation similar to that applied to BT. In the gas case the formula (RPI-X+Y) would provide that prices could rise no faster than inflation less a performance target (X) for reducing onshore costs within the company's direct control plus an additional term (Y) covering costs of offshore gas purchase. The formula would be averaged across the prices charged by the company and would be backed up by a duty not to discriminate between customers.

(c) various detailed requirements governing connection of customers into the system, maintenance of supply and withdrawal of supply (an issue with potentially important regional implications).

7 The company would be a Companies Act company with rights and duties in gas supply defined in the statute and probably conferred by a licence. The licence would need to run for a substantial term but the possibility of licensing others in appropriate circumstances - with corresponding obligations eg. on safety - would not be excluded. The provisions of the Oil and Gas (Enterprise) Act for common carriage of gas by the company and for direct sale of gas by competitors would be continued, possibly with some adjustments and improvements. The strictly "gas utility" part of

the company's business would be operated within a ring fence, separately accounted to the regulator and policed by him. It will be for consideration whether Government should be able to step in, in the last resort, eg. if the company collapsed, to maintain gas supply and secure the safety of the system. Government would assume no obligation to the shareholders in this event.

Other activities

8 The British Gas Corporation's other activities are neither natural nor statutory monopolies. They would be passed to the new company which, freed from the Gas Act restrictions, could be expected over time to take a more thoroughly commercial approach to their operation and development. Among the more important points:

Showrooms: The new company would be unlikely to want to maintain the retail outlets in their present form, once restriction to gas retailing with its relatively poor economics ceased. The way forward would most likely lie in more flexible joint venture arrangements with other more experienced retailers and, in some cases, probably a more diverse range of retailing by the company itself.

Installation and Servicing: The company could also be expected to take a more searching look at its servicing operation and the underlying economics. Some gradual shake-out would be on the cards and probably some growth in activity by independents. It would be necessary to provide that BGC's non-chargeable emergency service to deal with gas leaks on the consumer's side of the meter continues: this would be funded by a charge on the regulated gas supply business. The registration of independent installers would be surrendered by BGC to the Health and Safety Executive and my Department will be assessing urgently with HSE the detailed arrangements needed to meet the new circumstances.

Offshore Assets: A similar new emphasis on cost-effectiveness and profitability should emerge offshore. The residual BGC assets have a disproportionate importance as one of the few areas of interest and potential to which we can point investors in writing the prospectus for the new company.

9 Activities in these areas will be subject in the normal way to the controls of the MMC and the Office of Fair Trading.

Gas Imports and Exports

10 Privatisation raises important issues in this area. I am considering urgently the implications for imports and exports of a decision to privatise BGC.

Employee Participation

11 We need to win the support of employees and existing management for the change and demonstrate, by contrast with nationalisation, that a stake in the enterprise through the market brings a sense of participation, direct benefits and a degree of protection against unwelcome takeover. It would, I think, be right to aim for this purpose at actively encouraging a management/employee buyout to the extent of around 10-15% of the equity. Success in meeting these objectives will have a very considerable impact on the price we can obtain for the business.

12 A possible approach is set out at Annex 2. There was misunderstanding in the BT case which we cannot afford to repeat. To forestall employee opposition we need to establish by the time of the announcement what can be offered to employees. This would greatly assist achieving maximum proceeds from the flotation.

Proceeds

13 BGC's turnover is £6½ billion. Its pre-tax profits are running at £1 billion and its net assets employed are some £4½bn (both historic

cost basis: see Annex 3).

14 The Corporation is at present practically debt free. The issue would be divided between debt and equity. On varying assumptions the total value of the business is in the region of £5-7 bn. Actual proceeds would, of course, be much affected by the state of the markets, the extent of management and employee resistance, the degree of controversy about the likely success of the new company, the Election shadow and the risk of re-nationalisation. This sort of share is eminently suited to wider share ownership and, as with BT, the offer would probably include vouchers and/or bonus shares.

Timetable

15 The timetable (Annex 5) is already tight in the extreme. It can only be achieved given prompt decisions based on the simplest practicable solutions, early announcement and rapid preparation of what will be a complex and controversial Bill for introduction in December. The aim would be to obtain Royal Assent by the summer of 1986 and to float the company in the second half of next year on a partly paid basis, with further calls during 1987.

Conclusion

16 I invite my colleagues to agree:

(a) that the gas industry should be privatised on the basis set out in this paper;

(b) that I should make an announcement to this effect by the end of April; and

(c) that work should proceed on preparing the necessary legislation for introduction in the 1985/86 Session and, in parallel, on preparing the subsequent flotation.

ANNEXES

SECRET

ANNEX 1

REGULATION OF THE GAS SUPPLY UTILITY

1 Much of the regulatory framework for a private gas utility can make use of existing provisions for BGC. A new system will be needed to control the industry's prices.

Non Financial Provisions

2 The operational requirements for a private gas company will remain largely unchanged and customers and the public will continue to expect similar standards of service, eg. in emergencies and on safety. The rights and duties for a private gas utility will therefore be similar to those laid down by the Gas Act 1972 as amended. The main points are:-

(i) a general obligation to maintain a gas supply system within certain rules on what is regarded as economic, as at present.

(ii) a duty to supply individual customers. At present BGC must supply all customers within 25 yards of a main who do not consume more than 25,000 therms/year (in practice all domestic and small commercial customers). To avoid duplication of supply pipe systems BGC has a monopoly right for such customers. Both right and duty will be carried over, subject to the provisos that if the company failed to meet its obligation others could enter the market and, possibly also, that small consumers off the company's existing grid could be supplied by competitors.

(iii) Gas Supply Code. The provisions concerning the present industry's everyday operations (eg. laying of pipes, metering, billing) are set out in a schedule to the Gas Act 1972. These would be carried over to the new company.

(iv) non discrimination. Provision will be needed to require that the company does not discriminate between customers.

Annex 1 - Contd.2.

(v) Safety and emergencies. There is extensive legislation on gas safety (responsibility for which now rests with HSE). Some adjustment and reinforcement of the present provisions are likely to be needed but can be achieved within existing powers.

(vi) carriage of third party gas and direct supply by competitors. The present provisions of the Oil and Gas (Enterprise) Act would remain in place. These include unrestricted freedom to supply customers consuming more than 2m therms/year and freedom, subject to HSE consent on safety grounds, to supply those taking between 25,000 and 2m therms/year.

(vii) Code of Practice on disconnections. The company would need to give undertakings similar to the voluntary code agreed with the energy industries on disconnections.

3 The Government may also need reserve powers to intervene and secure the safety of the system in the event of the commercial collapse of the company. No financial obligations would be assumed towards the company or its shareholders. Provisions will also be required on planning permissions for plant and buildings and wayleaves for new pipelines and other issues such as the rating of the industry's buildings and installations.

Financial Aspects

4 A new framework will be necessary for the control of the industry's prices.

5 A price control system would operate on prices to consumers (including the company's onshore gas supply costs and the element of gas purchase cost). The system would not extend, however, to the operation of the ancillary businesses upstream and in retailing, where general legislation (eg. on fair trading) already provides the framework for all participants.

Annex 1 - Contd.3.

6 The system of control operated by the regulator would extend to all gas sales by the company including contract sales to industry.

7 The control system for the industry's prices will have to take account of the fact that gas accounts for a large part (49% in 1983/4) of the cost structure and that the price which is paid for this will in the short term be determined by factors (eg. oil prices, exchange rates) entirely outside the company's control. By contrast, the remaining costs, ie. those for delivery of gas onshore, are directly within the company's control and recent BGC experience suggests that there remains considerable scope for real reductions through greater efficiency. This points to a system which allows gas prices to consumers to take account of the company's acquisition costs, but puts firm downward pressure on the onshore cost components which should reduce over time in real terms. The system would be analagous to the RPI - X system for control of BT's prices, but with the addition of a further element of cost (which could be made explicit on bills) representing the cost of gas. It would act as a direct spur to efficiency in control of onshore costs and should give incentives to keen purchasing through the public exposure of the gas purchase price element.

8 The details of the system and other controls such as on quality of service will need to be further elaborated. Details of the role of the regulator in implementing the system (eg. frequency of examination of industry, arrangements for determining the correctness of charges for gas costs) will need to be settled.

9 Extra provisions will also be needed to back up the non-discrimination duty (para 2 (iv)) in order to assure individual customers that they were not paying too much for their gas and hence subsidising others. The precise regime will need to be related to the details of the non-discrimination duty but might involve:-

(i) a reporting system which would show costs and profits by main markets on a predetermined accounting basis.

Annex 1 - Contd.4.

(ii) some broad rules (eg. that all broad categories of sales should at least cover costs) to which the regulator could hold the company.

(iii) provision for the regulator to examine with the company complaints and report on them.

10 In order to carry out these and any other duties the regulator would need a range of powers:-

(i) to examine the industry's finances (ie. rights to examine the books similar to an auditor).

(ii) to rule on prices to be charged and then breakdown by market etc. for both gas and non-gas costs.

(iii) to examine accounting principles and practices used by the company.

(iv) to investigate complaints on discrimination

SECRET

ANNEX 2

EMPLOYEE PARTICIPATION

I believe that we should illustrate that privatisation results in employees having a direct interest in the success of their firms, never known under nationalisation. It is for that reason that I would suggest that around 10% of the equity should be given to the management and the staff. I believe that half of this should be in the form of providing free shares, or matching offers, and the other half should be placed into a Trust Company in which the management and staff would be the sole shareholders and would appoint their own Board of Directors. This Trust Company should own 10% of the equity, 5% provided from the Government and the other 5% financed by appropriate gearing. Staff leaving the gas industry would be able to sell their shares on an agreed formula of the valuation, and staff joining the gas industry could use existing Government saving schemes to become shareholders in the Trust Fund

If the total value of the business were £6bn and the capital structure set up on a 50 : 50 debt/equity ratio, the value of the equity would be about £3bn. With about 100,000 employees this would mean free and matching shares of about £1,500 per employee, a further £1,500 per employee allocated to the trust company which would itself borrow a similar sum to buy shares. This should bring the total employee stake via both personal and trust company holdings in the main company to a maximum of £4,500 per employee or 15% of the total equity.

This benefit would work out at something similar to about six months' salary and would be of a magnitude that would make the employees enthusiastic about the prospects of privatisation. I believe that such enthusiasm would have a considerable impact upon the price realised from privatisation and would therefore, to some extent, be self-financing.

ANNEX 3

BRITISH GAS CORPORATION STATISTICS (1983/4 ACCOUNTS)

CURRENT COST FIGURES

	1983/4 £m
Profit	
Current cost profit before tax and interest	667.9
Taxation	(350.4)
Net interest receivable	99.4
Current cost profit after tax and interest	416.9
Assets	
Current cost fixed assets before depreciation	26136.6
Depreciation	(14260.5)
Net current assets	1333.9
Total current cost assets	13210.0

Activity Analysis	Turnover	Current Cost Profit	Net Fixed Assets
Gas supply*	5964.0	660.5	11843.7
Appliance marketing	229.1	4.7	27.9
Installation and contracting	229.3	2.7	4.5
Total	6422.4	667.9	11876.1

HISTORIC COST FIGURES

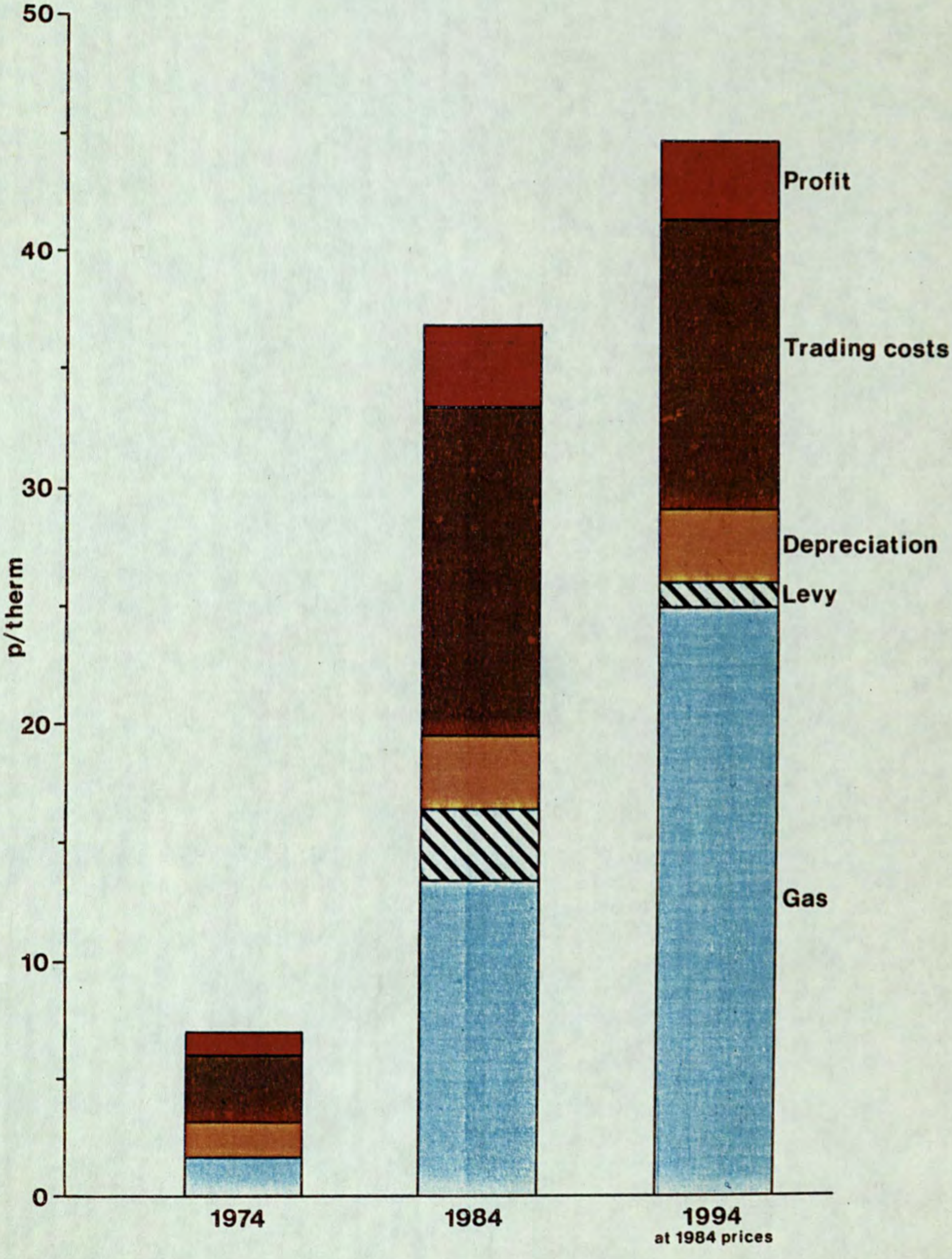
	£m
Net operating revenues	1244.8
Historic cost depreciation	228.1
Historic cost operating profit	1016.7
Average net assets employed at historic cost	4505.0

Other Statistics

Volume of gas sold (m therms)	17,281
Number of customers (m)	16,214
Average number of direct employees	99,200
Miles of mains in use	144,200
Number of appliances sold	1,323,000
Customer jobs completed	14,426,000

*Including miscellaneous other income

Figure 1 : Estimated cost breakdown for gas supply industry



ANNEX 5

TIMETABLE

1985

April	Announce Intention
May	Begin drafting Instructions to Counsel
December	Introduce in Parliament
	Second Reading debate

1986

January	Committee Stage begins
July/August	Royal Assent
Autumn	Earliest date for first tranche sale

Gas pt 20

8.80 CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

2 April 1985

The Rt. Hon. Peter Walker MBE MP
Secretary of State for Energy

NB PM.

Dear Peter

ELECTRICITY SUPPLY INDUSTRY PAY

I was grateful for your letter of 25 March, alerting me to the Electricity Council's plans for the negotiating meeting on ESI manuals' pay on Thursday.

I am content with the proposals. Looking further ahead, I think there is a strong case on merits for differential pay increases for the various ESI groups this year. In particular, the ESI clericals do not have a case on merits for the same increase as the manuals are likely to receive, and they are, in addition, generously paid: you will recall the discussions you had about this with Peter Rees last autumn. Some variation in the settlements in the industry this year would also help to achieve the cost savings that we shall need in 1985-86.

Copies of this letter go to the Prime Minister, to the other members of E(PSP), to George Younger, Nick Edwards and Douglas Hurd and to Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

Nat Ind Pt 10

GAS + ELECTRIC

~~Rotin~~. Fixed for 10.30 on Monday 15/4 MEA 27/3

RRB

10 DOWNING STREET

Mark

Re the attached.

I have agreed with Rachel Lomax and Michael Reidy that the meeting will be on Mon. 15 ~~11.30~~ or Tues 16 April. Pl. will you fix a meeting then with:

Lord President
Chancellor
S/S Energy
Financial Secretary

Walker will circulate a paper ~~for the~~ on 12 April for the PM's return RRB

SECRET

Copy No 1 of 5

CE JR

7

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211-7214

Robin Butler Esq
Principal Private Secretary to the
Prime Minister
10 Downing Street
LONDON SW1

27 March 1985

Dear Robin

GAS PRIVATISATION

Thank you for your letter of 26 March recording Ministers' decision that the best course in present circumstances was to go for an overall sale of the whole BGC business. Ministers envisaged legislation in the 1985/6 Session of Parliament and a flotation date in the autumn of 1986.

My Secretary of State believes this timetable can be achieved provided decisions are now taken with the utmost speed and that any temptations to introduce complexities into the decision-taking or the preparatory work are firmly resisted. If there is to be any question of flotation before the end of 1986, the Bill must be law before the 1986 Summer Recess and that in turn must mean, for a Bill as substantial and controversial as this, planning on Second Reading in December 1985. The later the introduction, the greater the incentive to the Opposition to try to hold up the Bill so as to make flotation in this Parliament impossible.

Against this background my Secretary of State is quite clear that the timetable for Ministerial consideration set out in your letter is far too relaxed. He urges most strongly that provision be made for the further small meeting of Ministers before Easter on Wednesday, 3 April. He will circulate a paper on Monday for such a meeting (based on his paper of spring, 1984) and hopes to take account in it of a discussion which he is arranging with the Financial Secretary.

Thereafter he trusts that it will be possible to timetable any further collective discussion so as to permit a Parliamentary statement on the Government's intentions at latest by the end of April. In his view, any further delay runs a very high risk of pre-emption by leak. It would also hamper dangerously the extremely urgent preparatory work on legislation and flotation.

I am copying this letter to Rachel Lomax (Treasury), Helen Goodman (Financial Secretary's office, Treasury) and Sir Robert Armstrong.

Yours sincerely
Michael Reidy

M F REIDY
Private Secretary

Nat Ind: Gas + Elec Pt 10.

27 MAR 1985

file DSG

Copy No: 6
of 6 copies

6

cc MASTER

10 DOWNING STREET

From the Principal Private Secretary

26 March 1985

Dear Michael,

GAS PRIVATISATION

The Prime Minister discussed your Secretary of State's minute of 25 March with your Secretary of State, the Chancellor of the Exchequer and the Financial Secretary this morning. Mr. Redwood was also present.

In discussion, it was argued that there was considerable scope for privatising both the upstream and the retail and servicing activities of the British Gas Corporation. At all events, it was desirable to make further progress in reducing the monopoly position of the BGC. However, there was now little time to achieve this sort of privatisation in the remainder of this Parliament and there was, therefore, a strong case for proceeding with a sale of the business as a whole, accompanied by the necessary regulatory arrangements which would have to cover the potential extensions of the business, as well as exports and the capital structure. A proposal of this sort would require very early decisions with a view to achieving agreement with the Corporation in time to work out details and present legislation in the next Session.

Summing up the discussion, the Prime Minister said that, while some Ministers thought that there was more scope for privatisation of separate upstream and downstream activities of the British Gas Corporation than was suggested in your Secretary of State's minute, there was general agreement that the best course in the present circumstances was to go for an overall sale of the whole business provided that decisions could be made quickly in time for legislation in the coming Session. Treasury and Department of Energy officials should prepare urgent proposals with the aim of presenting them to a further small meeting of Ministers on the present lines towards the end of April, a paper to 'E' Committee in the first week of May and decisions by the end of May. Urgent consultation could then be undertaken with the Chairman of the British Gas Corporation with a view to introducing legislation in the next Session of Parliament and a flotation date in the autumn of 1986.

JB

Copy No. 6
of 6 copies

I am copying this letter to Rachel Lomax (HM Treasury), Helen Goodman (Financial Secretary's Office, HM Treasury) and Sir Robert Armstrong. In view of the sensitivity of this subject, I should be grateful if no copies of this letter could be made, and if it could be retained in Ministerial offices.

Yours ever

Robin Butler

Michael Reidy, Esq.,
Department of Energy.

CONFIDENTIAL

PRIME MINISTER

Meeting with the Secretary of State for Energy
Tuesday, 26 March, 10.30 a.m.

You said that you would like to ask the Secretary of State to stay on at the end of the meeting on gas privatisation so that you could report to him your conversation with Mr. MacGregor.

I have already told Mr. Walker's office about:-

(i) your proposed drinks with Woodrow Wyatt and others on Sunday evening;

(ii) Mr. MacGregor's concern about the drafting of the Health and Safety Regulations;

(iii) the effect of the transfer of the responsibility for mineral planning from the Department of Energy to DoE;

(iv) our provisional thoughts about inviting Messrs. Lynk, Prendergast and, separately, Mr. Mackay to General Receptions and the three working wives + their husbands to Beating the Retreat.

I have also written to the Department of Energy about Bechtel (UK).

I have left it for you to tell Mr. Walker:

(i) Mr. MacGregor's views about the short-term future of the industry;

(ii) Mr. MacGregor's thoughts about dual-firing.

F.E.R.B.

25 March, 1985

Copy No 1 of 3
CCJR

5

PRIME MINISTER

GAS PRIVATISATION

I undertook at our meeting in December to put in hand further work on the partial privatisation possibilities for gas appliance retailing, servicing and the offshore gas assets.

2 I have concluded that the options available in these areas are very limited:-

(a) BGC's servicing operation is not a realistic privatisation candidate. The activity holds few attractions for investors, there would be real union opposition and genuine public concern - heightened by this winter's explosions - about maintenance of adequate safety cover. Attempts to push this through would, as in 1981, most likely impede progress on other fronts.

(b) The retailing activity could be privatised, with a minority gas industry involvement and suitable provision for customer inquiry points. This would, however, be a time consuming exercise and would yield little in the way of proceeds for the Exchequer.

(c) BGC's offshore gas assets could be sold to the oil industry. But they would not fetch a good price. The main asset, the Morecambe gas field, suffered from severe problems of underbudgeting and cost escalation in 1982/83 and might realise about half what BGC have spent. Consumers would also face a price increase of about 5% to cover a return to the new owners. Our opponents would, inevitably, seize on both these features and attention would become focussed on the Government's handling of the Morecambe project in its earlier stages.

3 Our best prospect for gas industry privatisation remains a radical change of ownership for the business as a whole, along the lines I proposed in 1984. This would require proper regulatory arrangements. But it will roll back the frontier of the public sector, creating new spurs to efficiency through the capital market and a more entrepreneurial approach to the running of the business. With a suitably managed flotation it would bring into being a genuine ownership by the public and employees and is the only option available which holds out both proceeds of any magnitude for the Exchequer and real benefits for consumers.

I am copying this minute to the Chancellor of the Exchequer.

Peter Walker

SECRETARY OF STATE FOR ENERGY

25 March 1985

CC NO

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

NBPM

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

25 March 1985

Dear Nigel

ELECTRICITY SUPPLY INDUSTRY PAY

Further to my letter of 6 March, the Electricity Council has just informed me that, following further informal discussions, the unions have requested that a revised firm offer should be made at the next formal negotiating meeting to discuss manual workers' pay on Thursday, 4 April. The unions have told the Electricity Council that they would then intend to ballot their members on the basis of this offer.

In the light of this, the Electricity Council intends to increase its original offer in the following areas:-

(i) The increase in scheduled salaries will now range from 4.5% at the bottom of the labourers' scale to 5.9% at the top of the craftsmen's scale. The increase at the top of the lowest scales will be increased to 5.2% to bring them broadly into line with the RPI. The cash offer will range from a minimum of £5 a week for labourers to up to £8.99 a week for craftsmen.

(ii) The payment for changing shift may be increased to £16 (a useful flexibility payment which has an absolutely minimal effect on the pay bill).

The other elements in the package will remain as set out in my earlier letter.

The overall effect of the revised offer will be an increase in average earnings of some 5.4%. This increase is the minimum that the Electricity Council believes to be necessary in order to achieve a neutral recommendation from the unions in the ballot. They believe that anything less would lead to a positive recommendation from the unions to reject the offer and a likely massive rejection by the workforce with consequential risks of industrial action. As it is, the Electricity Council expect the ballot to lead to a rejection of the offer and the need for a revised offer in May.

I am copying this letter to the Prime Minister, other members of E(PSP), George Younger, Nicholas Edwards, Douglas Hurd and to Sir Robert Armstrong.

PETER WALKER

NAT IND: Gas & elec : Pt10

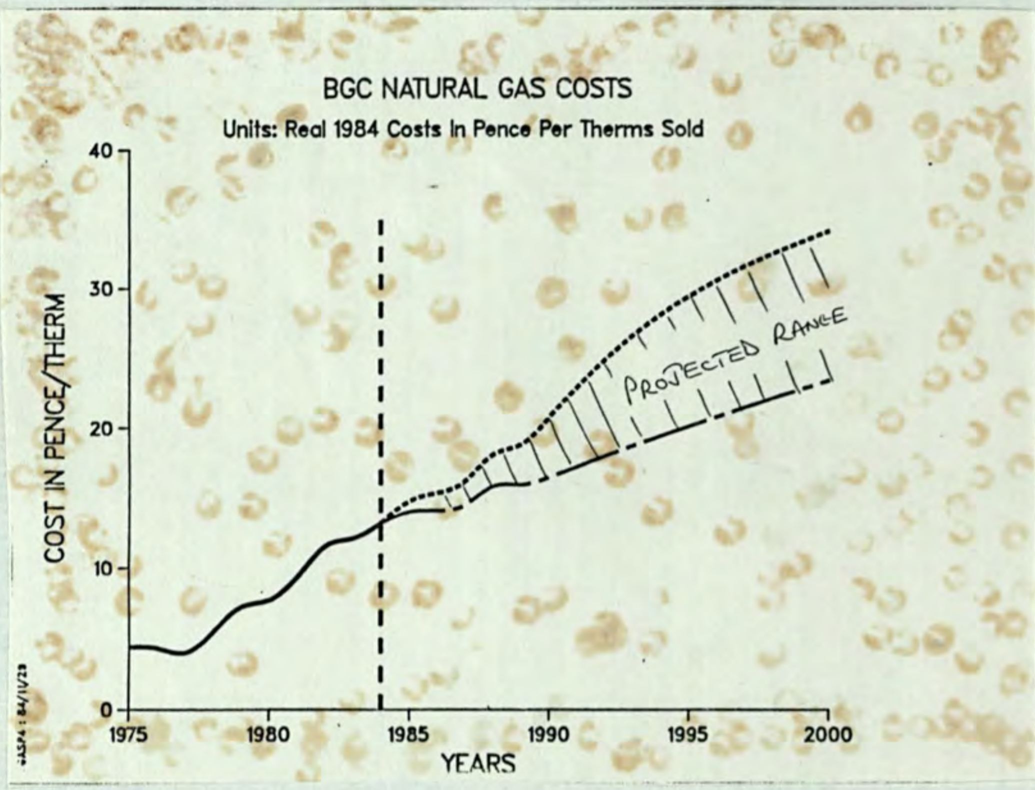
PRIME MINISTER 22 March 1985

BGC PRIVATISATION

If we are to accomplish the privatisation of BGC at all in the remainder of this Parliament, it will have to be with the active support of BGC and the Department of Energy. That means privatising BGC as a whole, within a framework of regulation and limited competition - from electricity, oil, and perhaps from gas producers directly supplying large customers, under the Oil and Gas Enterprise Act.

It is a pity that lack of zeal in the Department of Energy has now foreclosed more radical options to move closer to a free gas market in the UK. Nonetheless, we still have the big prize of another BT-scale step towards a property-owning democracy - and with it a further scaling down of the public sector. Moreover, the commercial disciplines on BGC, even in the form of a privatised monopoly, could be surprisingly tough; so much so, that BGC will certainly have to become more efficient and may be forced to shed peripheral activities.

This stems from the fact that the real cost of supplying gas from the North Sea is on a well-established upward trend.



BGC is currently paying an average of 13-14p per therm for gas supplies. Yet new contracts for UKCS gas are being concluded at around 25p per therm (1985 money) because the fields are smaller, less productive and require proportionately more investment than the large, low-cost fields initially developed in the southern North Sea. There is little sign of that trend being reversed. Ten years ago, gas supplies accounted for 20% of BGC's total costs. Now that figure is 40%, and rising steadily.

What does this imply for a privatised BT-style BGC? As with BT, the Government will need to have a tight grip on gas pricing to the consumer so as to prevent BGC abusing its monopoly position. But, unlike BT, which has new technology working in its favour, BGC's future margins will be squeezed between the increasing unit cost of gas supplies and tightly-regulated consumer pricing. That could really force BGC to make a hard-headed appraisal of their business objectives. They would have to concentrate their resources on core activities. They would have to face up to the disposal of peripheral assets and activities - retail outlets, land, contract services, wide-blue-yonder research, and even their upstream interests.

Conclusion

The bird in the hand may yet give us most of the benefits we have been seeking from the privatisation of BGC. We can, and should, press ahead to launch a privatised BGC early in 1987. That means:

- rapidly laying down a master timetable and adhering tightly to it;

- quickly resolving important policy questions such as how best to construct a framework of regulation to protect consumers, whether to curb BGC from expanding beyond its core activities, and whether in conjunction with privatisation to introduce a gas export regime.

JW

JOHN WYBREW

CONFIDENTIAL

ECMO

SECRETARY OF STATE FOR ENERGY

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

20 March 1985

Wbtm

Dear Nigel

BGC MANUALS' PAY

Following your letter of 18 March you will wish to know the outcome of BGC's negotiations.

BGC spent some time convincing the union that the Corporation was not willing to accept consolidation of bonus payments into the basic rate, and instead made a straightforward offer which increased basic rates within the range 4.7% for semi-skilled and trainee workers to 5.3% for technicians. This averages at 5.0%, an increase of 0.3% on the last offer. Although bonus payments have not been consolidated they have been increased by similar amounts. The package includes 1 day's extra annual leave, 2 days' per month of pre-retirement leave in the last year of service and an increase in stagger payments (adding £1.50 to the existing rate of £10.50).

The union side said it was disappointed at both the shape and pitch of the offer and that it could not either accept or recommend the offer to its members, although it would be in touch in due course. Meanwhile, the union side will collect the view of its members. This may involve calling a delegate conference, and it remains conceivable that the members will consider whether some form of industrial action is needed to press the claim further. Insofar as there is a call for industrial action, the judgement is that this will be in respect of action at the margins and not an all out strike.

I am not yet in a position to suggest to you what level of pay offer is likely to achieve a settlement, although BGC have put the current offer forward very firmly. The gas industry unions are, of course, well aware that the offer put to them is less attractive than the offer already put to the electricity unions. They are also aware that the gas industry is profitable and that, within the private sector, pay increases are reported by the CBI to be running in the range of 5%-7%.

CONFIDENTIAL

As far as advance notice is concerned I shall continue to let you know of developments as early as possible, consistent with allowing the industry to determine its position through established practices.

I am copying this letter to the Prime Minister, to other members of E(PSP) and to Sir Robert Armstrong.

PETER WALKER

NAT IND; Gas & elec: Pt 10.

20 MAR 1985

M78

CONFIDENTIAL

CLA/O

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London SW1

18 March 1985

Dear Secretary of State,

BGC MANUALS' PAY

You wrote to me on 15 March about the negotiations on BGC manuals' pay. I found your letter worrying on a number of counts.

First, I see disadvantages in increasing the basic rate offer from 4.7 to as much as 5.3 per cent when there is no strong indication that the unions will settle as a result. Increasing the offer in this way would simply raise the stakes for the next round of negotiations and could also repercuss unhelpfully on the negotiations with the electricity and water supply manuals. I therefore do not see any case for moving above 5 per cent.

You also mention that even if the offer is increased in the way they propose, the BGC management believe the unions may seek a mandate for some form of industrial action. I should be grateful for your urgent assessment of what form such action might take, when it might take place, how damaging it might be and what level of pay offer you think <u>would</u> achieve a settlement.

Finally, I am concerned about the lack of time I and other colleagues have had to consider and comment on the way these negotiations are developing. You will appreciate that it is particularly important when there are significant upward pressures on settlements, that colleagues should have good warning of developments in both the gas and electricity negotiations. In the absence of any settlement with the miners, they are bound to have a major influence on other groups.

I have copied this letter to the Prime Minister, to other colleagues on E(PSP) and to Sir Robert Armstrong.

Yours sincerely,

Margaret O'Mara

NIGEL LAWSON

(approved by the Chancellor and signed in his absence)

NAT IND: Gas & elec: ~~Att~~ Pt 10
Sept 84

DEPARTMENT OF ENERGY
Thames House South
Millbank
LONDON SW1P 4QJ

Tel: Direct Line 01 211 6402
Switchboard 01 211 3000

with the compliments of

the Private Secretary to

the Secretary of State

150

NDPM of 15/3
CC NO

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

CONFIDENTIAL

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

15 March 1985

Dear Nigel

BGC MANUALS' PAY

The next formal meeting between BGC and the unions is to take place on Monay 18 March. The situation remains both complex and fluid and BGC say they can only judge the next move as the meeting progresses.

There are problems about the extent to which bonus payments should be consolidated and this has a direct bearing on any further offer they make. Inso far as they are able to judge the signals, they believe they may need to restate their position in simple terms and make a modest improvement to the offer already on the table.

If a new offer is needed at this stage and if the unions press for it to be carried on the basic rates, they have in mind figures of up to 5.3%. which would add between 4.5% and 4.6% to the pay bill. They also have in mind to concede an extra day's leave which they calculate to be worth 0.2%.

They do not believe that even a new offer will be accepted at this stage, but may be used by the unions as a case for seeking a mandate for some form of industrial action.

I am copying this letter to the Prime Minister, other members of E(PSP), George Younger, Nicholas Edwards, Douglas Hurd, and to Sir Robert Armstrong.

PETER WALKER

2

1) Mr Turnbull NT 15/3
2) Mr Powell CDP 15/3
3) Prime Minister

He said this to you in Moscow, I think.

Foreign and Commonwealth Office

London SW1A 2AH

14 March, 1984

The Foreign Office advise no further reply necessary to Mr Willoch
NT 15/3

Dear Tim,

Thank you for your letter of 12 March enclosing a copy of Mr Willoch's letter of 7 March about Sleipner gas.

The Prime Minister's letter to Mr Willoch of 19 February set out in detail the arguments behind HMG's rejection of the draft Sleipner contract. Mr Willoch's reply, which is couched in courteous and measured terms, does no more than re-state the Norwegian view. We do not therefore consider that further correspondence from the Prime Minister is required.

MT

I am copying this letter to Michael Reidy (DOE).

Yours ever,

Peter Ricketts

(P F Ricketts)
Private Secretary

Tim Flesher Esq
10 Downing Street

NAT IND: Gas & elec : Pt 10

hlē

MJS

10 DOWNING STREET

From the Private Secretary

12 March 1985

You recall that the Prime Minister wrote to the Prime Minister of Norway about Sleipner gas on 19 February. We have now received the attached reply from Mr. Willoch. I should be grateful for your advice on whether a further reply is now needed.

BF ||

I am sending a copy of this to Michael Reidy (Department of Energy).

Tim Flesher

Peter Ricketts Esq
Foreign and Commonwealth Office

MJ

10 DOWNING STREET

From the Private Secretary

12 March 1985

I am writing on behalf of the Prime Minister to thank you for your letter of 12 March with which you enclosed a letter from the Prime Minister of Norway.

I shall place this before the Prime Minister on her return from Moscow.

Tim Flesher

His Excellency Mr Rolf T Busch.

$o

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T 43A/85 CL MASTER OPS

THE ROYAL NORWEGIAN GOVERNMENT

THE PRIME MINISTER

Oslo, 7 March 1985

Dear Prime Minister,

I have received your letter of 19 February 1985 and appreciate your informing me personally of the reasons for your Government's decision not to endorse the agreement between Statoil and the British Gas Corporation for the purchase of the gas from the Sleipner field.

You state in your letter that the main reason for your decision was the changed estimates of reserves on the UK Continental Shelf and that with the improved availability of gas from these increased reserves, the purchase of the Sleipner gas would have resulted in an over-supply in the 1990's. We, do of course, respect your decision on that basis. However, I would be failing in my duties if I did not convey to you the fact that your decision came as a great disappointment to me and my collegues in the Norwegian Government.

As you know, it is a declared Norwegian policy that the marketing of oil and gas from the Norwegian Continental Shelf should be based on commercial negotiations with a minimum of government interference. The agreement between Statoil and the British Gas Corporation had come about as a result of commercial negotiations over a period of nearly two years. It was therefore with some reluctance we decided, in July last, to meet with your request and ask

The Rt Hon Margaret Thatcher, FRS, MP
10 Downing Street
LONDON SW 1

Statoil and the British Gas Corporation to renegotiate the delivery rate. In order to accomodate you further, we also agreed to have discussions at official level on certain other questions of importance to you in connection with the agreement. Considerable progress was made during these discussions, which lasted for half-a-year and were conducted in a very open and friendly atmosphere. We were therefore genuinely disappointed when we learned of your decision.

I do, of course, share your views on the question of future cooperation between our two countries, not least in the field of offshore exploration and exploitation of oil and gas. In spite of the set-back caused by the Sleipner decision, it is my Government's firm belief that Norway still has an important role to play as a secure supplier of both oil and gas to Western Europe.

Yours sincerely

Kåre Willoch

(Kåre Willoch)

NAT IND Pt 10
GAS + ELECTRIC

ROYAL NORWEGIAN EMBASSY

THE AMBASSADOR

12 March 1985.

Dear Mr. Butler,

I have been asked to forward the enclosed letter from the Prime Minister of Norway, Mr. Kåre Willoch, to your Prime Minister, The Rt. Hon. Margaret Thatcher.

Yours sincerely,

Rolf T. Busch

(Rolf T. Busch)

F.E.R. Butler, Esq.,
Principal Private Secretary
to the Prime Minister,
10 Downing Street,
London, S.W.1.

NAT IND Pt 10

GAS + ELECTRIC

12 MAR 1985

CC/B1

~~1. NO~~
2. CF

PRIME MINISTER ②

Interesting

AT 8/3

8 March 1985

GEC AND THE SUBSIDY MACHINE

GEC has lost its way and has become an arm of the UK public sector. For years it has under-invested and become too dependent on public sector markets. It is sitting on a £1.6 billion cash mountain, but has few ideas about how to spend it. Its purchase of its own shares is an admission of failure.

Turnover

GEC's largest, and most profitable, markets are in the public sector. Through its Marconi subsidiary, GEC is MoD's largest supplier, involved in every major programme. Its defence sales will be around £1,200 million in 1984-85, compared to Plessey (£510 million), Racal (£340 million), Ferranti (£220 million) and United Scientific (£140 million). GEC's order book with MoD stands at £2 billion. Defence has been GEC's fastest growing business. GEC's sales pattern overall is set out below.

E.R.

CONFIDENTIAL

Table 1: GEC's Activities, 1984

Activity	Worldwide Turnover (£m)	Profits as % of Turnover (%)
Electronic Systems (Mostly Defence)	1580	12.7
Telecoms (Mostly BT)	735	12.8
Automation	450	11.7
Medical Equipment	435	5.6
Power Generation (CEGB)	620	8.4
Electrical Equipment (BR/CEGB)	755	6.6
Consumer Products	280	8.4
Distribution and Trading	200	7.2
	5050	10.1

Source: Company Accounts

CONFIDENTIAL

Before it acquired GEC and AEI in the 1960s, GEC was primarily a consumer product company. The table above shows the extent to which GEC has withdrawn from competitive, private sector markets (consumer products and distribution), which together account for less than 10% of turnover, and positioned itself in the predominantly public sector capital equipment markets. GEC's sales to the public sector (defence, BT, local authorities, CEGB, British Rail) probably accounted for three-quarters of UK turnover last year, and over one-third of GEC's total turnover worldwide. These sales yielded comfortable profit margins, of around 10%.

But what has been good for GEC has not always been good for Britain. Two of GEC's major MoD projects have been disasters - the AEW Nimrod and the Tiger Fish Torpedo. A recent Panorama programme revealed that Britain's airborne early-warning system is "already 3 years late; it will cost £1,000 million and still doesn't work properly". The Shackleton, which currently performs the task, has already achieved a unique distinction - the first operational RAF plane to be in a museum. Nimrod was commissioned in 1977 on a cost-plus basis, so the overruns merely add to GEC's profits. GEC's Tiger Fish Torpedo entered service in 1980 but has proved inadequate (this may explain why Conqueror used a pre-War vintage Torpedo to sink the Belgrano). The Tiger Fish programme cost £250 million; another £170 million may be needed to make the Torpedo work.

Under-investment?

Compared to its competitors, GEC is investing little in new equipment and products. Only 21% of its cashflow (or £225 million) was invested last year. Whereas 39% (or £420 million) was added to its bank balances.

The pattern was the same in 1983. As in previous years, GEC has difficulty in investing its cash surpluses. In relation to its profits, GEC has been investing at less than half the rate of Plessey and Racal.

This approach is not new; it is entirely consistent with the history of the group. GEC was a product of an IRC merger between GEC, English Electric and AEI. English Electric had the technology, AEI the manufacturing capability. GEC had underfunded R&D, and had the necessary cash, the stock market rating and the aggression to make the acquisition. GEC itself brought little to the group, other than financial discipline. The only apparent business strategy was to milk established markets, preferably in the public sector, rather than develop new ones.

GEC closed down one of Britain's earliest micro-curcuit design teams in 1971 and recently pulled out of robotics. Profitability has been achieved partly by under-funding investment. The results of this policy are beginning to show through. GEC is increasingly uncompetitive, losing out to Plessey in defence and telecoms contracts. The recent success of GEC Avionics with the MoD contract for a remotely-piloted vehicle was its first victory over Ferranti for some time.

The Subsidy Machine

GEC has shown great skill in manipulating Whitehall. It is a regular visitor to the DTI cash dispenser. Leaving aside regional grants, which are automatic, GEC has secured offers totalling around £80 million in the last 5 years from DTI's discretionary support schemes. Around £20 million is likely to be paid over to GEC in both 1985 and 1986 - sums equivalent to around 10% of GEC's investment. Since GEC is sitting on a £1.6 billion cash mountain, it seems odd that GEC can get away with the argument that, without DTI support, GEC would not support "sound" investment projects. GEC is in effect saying to DTI: I won't invest unless you pay me to do it. We need to call GEC's bluff.

GEC is also well supported by fixed rate export credit. At July 1983, loans of £1.5 billion of fixed rate credit support were outstanding on support for GEC exports under the fixed rate credit scheme. This support amounts to a subsidy of 10-15%. GEC's share of the UK total (11%) was the largest of any company. The recent Guangdong power station negotiations revealed, among other things, GEC's presumptuous attitude to this support. When asked to share some of the profits which may materialise from this project with the taxpayer who is subsidising one quarter of the cost of the bid, GEC protested that this was "an unwarranted interference with commercial decisions".

Conclusions

GEC's approach reflects many of the ills of the modern, Government-dominated economy. It is easier to make money by influencing Government, both as buyer, supplier of credit, and supply of subsidy, than by fighting for new markets. GEC has developed its own form of "churning" - lending to Government the profits from Government contracts.

What can be done?

1. Encourage MoD to abandon cost-plus contracts (it is moving away from them) and to renegotiate existing ones which have overrun, eg AEW Nimrod.

2. Encourage DTI to end discretionary grants to large companies with adequate financial resources. Norman Tebbit will be writing to you shortly about his review of support for industrial R&D. This is an opportunity to make a start on ending grants to large grant-takers.

3. Tighten up on soft export credit.

4. Use competition policy to prevent GEC from acquiring major competitors and customers eg BAe.

Nicholas Owen

NICHOLAS OWEN

CONFIDENTIAL

cc NO.

NOPM

AT 6/3

SECRETARY OF STATE FOR ENERGY

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

6 March 1985

Dear Nigel

ELECTRICITY SUPPLY INDUSTRY PAY

The Electricity Council has just informed me that, following informal meetings with the unions representing the esi manual workers, they intend to make an offer to the unions at the next formal negotiating meeting to be held on Thursday 7 March. The offer is expected to be along the following lines:-

(i) An increase in scheduled salaries ranging from 4.5% to 5.6%. This will be expressed to the unions as a cash, rather than a percentage, offer ranging from £4.50 to £5 a week for labourers to £8.50 a week for craftsmen.

(ii) The overtime calculator, frozen in last year's settlement, will be advanced by one year ie 1985/6 overtime will be paid on the basis of 1984/5 salaries.

(iii) Shift pay will be increased in line with basic pay.

(iv) The payment for changing shift will be increased from £8 to £12 to bring this useful flexibility payment in line with present needs.

The overall effect of the offer will be an increase in average earnings of some 5.1%. The Electricity Council will reject the unions' claim for a reduction in working hours.

The offer is expected to be rejected at the meeting and the Electricity Council believe that the unions are likely to seek further informal discussions before the next formal meeting in April rather than seek to consult their membership at this stage.

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I am copying this letter to the Prime Minister, other members of E(PSP), George Younger, Nicholas Edwards, Douglas Hurd and to Sir Robert Armstrong.

PETER WALKER

NBPM
AT
cc NO
1/3

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

Michael Reidy
Private Secretary to
Secretary of State for Energy

1 March 1985

Dear Michael,

PROPOSED BGC FARM IN

with AT?

Thank you for your letter of ~~25~~ February.

The Chancellor was surprised to learn that your Secretary of State has already issued the consent necessary for BGC to acquire Guthrie Energy's licence interest in block 22/5b. David Peretz's letter of 16 October asked you to let us know if there was "any possibility" of BGC being allowed to make the acquisition. Whatever the merits of the case, the Chancellor remains of the view that, in view of the implications for privatisation, and the fact that it is not the Government's policy to expand the state sector of industry, there should have been discussions with colleagues before the decision was taken.

I am copying to Andrew Turnbull (No 10).

Yours ever
Rachel

MRS R LOMAX

-1 N[illegible]

PRIME MINISTER

Policy Unit recommend giving the privatisation programme another push. This could be done by a meeting of E(A), immediately after the Budget, to consider a Paper by the Treasury. The Financial Secretary would welcome such a request from No. 10.

Agree?

Gas privatisation creates special problems as Mr. Walker is reluctant to see it discussed in open session. I understand he is finally getting round to discussing this issue with his officials and he will be ready to talk to you and the Chancellor in two to three weeks time.

Agree a separate meeting on gas privatisation?

27 February 1985

25 February 1985

PRIME MINISTER

PUBLIC EXPENDITURE SURVEY: GAS PRICES

The Treasury's answer to many public expenditure problems at the moment is to put prices up. Whether it's water or gas, prescription charges or dental charges, the message is the same. We cannot control the costs, so we will make the customer pay more.

This should be very much a second best solution. It is unpopular, and many see little difference between a tax increase and a monopoly charge increase.

In the case of the gas industry, we would be much better advised to push ahead with gas privatisation. There are substantial sums of money to raise from selling the gas reserves of BGC - perhaps as much as £2 billion - to say nothing of the improvement in customer service that could come from selling off the retail outlets. We could move towards a more competitive gas market, where prices were no longer the worry of government departments but were established by the market and would fluctuate like oil prices. Then there would be the right signals to produce more or to sell less, depending on the state of the market. If it is politically impossible to move ahead with gas privatisation and the establishment of competition, then reluctantly we would agree with the Treasury that you should try and push the prices up a bit. But it is very much a second best option, and we would urge you instead to fight the important battle on gas privatisation. This should be brought to E(A) immediately.

JOHN REDWOOD

012/105

CONFIDENTIAL

cc HO AT

Subject Filed On: Econ Pol: Public Expenditure Pt 31

Prime Minister (1)

Agree to support Chief Secretary in pressing for study of gas prices (though without committing yourself to outcome)?

AT 22/2

FROM: CHIEF SECRETARY
DATE: 22 February 1985

I do not think such a study would achieve very much MT.

PRIME MINISTER

PUBLIC EXPENDITURE SURVEY: GAS PRICES

At your January 15 discussion of the 1984 and 1985 Public Expenditure Surveys you suggested that the Treasury should seek substantial savings from among the programmes I listed in the papers for that meeting. We are pressing forward with the programme of reviews I then outlined - on industrial subsidies, housing, defence research and development, and of course on social security. But there is one area - gas pricing - in which, without your help, I do not believe it will be possible to get ahead with the necessary assembly of factual material and analysis.

2 It has been our consistent policy with the nationalised industries that they should fix their prices at economic levels. These are the prices that would be charged for the products concerned if they were produced by firms in a competitive market place rather than by state monopolies insulated from market disciplines.

This gives room for enormous debate -

3 Back in October 1983 your private secretary wrote to Peter Walker's private secretary about gas prices in the following terms:

> "On pricing principles themselves the Prime Minister has noted that there is as yet no agreement. She hopes that agreed criteria can be put back to her on what would be implied by the adoption of economic pricing. The implications of moving towards economic pricing during the course of this Parliament and the timescale to be adopted can then be considered."

CONFIDENTIAL

Peter has yet to respond to this. I understand a good deal of work has been done by his officials and mine using information provided by BGC last Spring in the discussions on Sleipner. On the basis of this information my officials considered gas prices are at present about 25 per cent below the level indicated by economic pricing.

4 There are obvious political problems in increasing gas prices quickly by this amount. In view of this I proposed in the last autumn's discussions on public expenditure that gas prices be raised in each of the years 1985-86 to 1987-88 by 4 percentage points more than BGC were proposing; BGC had then in mind increases in line with general inflation. My proposal would have brought in some £1,400 million over the three year period. It would have added only some 0.3 points to the RPI. On the basis of published information, such an increase would not have pushed prices to domestic or industrial customers above average European levels.

5 In the event MISC 106 felt unable to go along with my proposal. Time was short and, as Peter had not responded to your remit, the Group did not have all the information it would have needed to take an informed decision.

6 In view of the public expenditure problems we still face, and bearing in mind our policy of economic pricing, I do not think it would be right to leave matters as they now stand. Your remit to Peter of October 1983 pointed in exactly the right direction. We need from his department a full assessment of the facts and figures. In the light of this we would then be able to consider fully the issues and timescale involved in moving to proper pricing for gas. I am also conscious that, as the decisions on Sleipner have been announced, BGC and Peter's department, are no doubt re-examining the options facing the Corporation. Gas prices should be an important part of this. For all these reasons it therefore seems timely to press Peter for an early response to the remit of October 1983.

PR

PETER REES

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MASTER

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cFCO

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T34/85

10 DOWNING STREET

THE PRIME MINISTER

19 February 1985

Dear Prime Minister,

I know that our decision not to endorse the agreement between Statoil and the British Gas Corporation for the purchase of Sleipner gas was a disappointment to you. Alick Buchanan-Smith has explained to Mr. Kristiansen the reasons for it. I have been following the discussions closely, as I know you have, too, and would like to set them out to you personally.

The main reason for our decision is the changed estimates of reserves on the UK Continental Shelf. The draft contract was negotiated against the background of an expected shortfall in supplies of gas in the 1990s, but even when the British Gas Corporation first referred the draft contract to the Government it seemed very likely that the rate of delivery would be too great for the size of the gap we foresaw. This was one of the main reasons for our approach to your Government in June, and we were grateful for your agreement that we should ask the British Gas Corporation and Statoil to renegotiate the delivery rate. Since the summer, the prospects for gas supplies for the UK Shelf have markedly improved, and exploration and appraisal are at record levels. Estimates of proven and probable reserves have gone up from 40.6 trillion cubic feet (tcf) to 46.8 tcf. With the improved availability of gas from these increased reserves, the purchase of Sleipner gas would have resulted in an over-supply in the 1990s, if development of our own resources was not to be put back unreasonably.

Over the same period the dollar has risen against most other currencies and this further enhances the attraction of developing our own resources.

I know that you hoped for an earlier decision from us and am very grateful for the patience which you and your colleagues have shown. I am also very conscious of the domestic factors which have made the delay even more difficult for you. I hope you will accept that for us the decision was a difficult one, and that the time we took to reach it reflected not only the size of the proposed contract, which would have entailed a very large expenditure over a number of years, but the need to come to a considered assessment of our own resources at a time when the estimates were changing rapidly and significantly.

The British Gas Corporation may still need to import gas in the future. If they do, I am sure that Norway will be among the sources they consider. In any event, I am confident that, as in the past, there will be many other examples of co-operation between Norway and the United Kingdom, and that relations between us will continue to be as close as they have always been.

Yours sincerely

Margaret Thatcher

His Excellency Mr. Kare Willoch

CONFIDENTIAL

Foreign and Commonwealth Office

London SW1A 2AH

15 February, 1985

OJ

Dear Charles,

Sleipner Gas

You asked for a revised draft message from the Prime Minister to the Norwegian Prime Minister to replace that enclosed with my letter of 14 February. You asked that the new draft should bring out the reasons why HMG had turned down the Sleipner deal.

/ I enclose a draft which has been agreed with officials in the Department of Energy, who tell us that Mr Walker may have some comments to make on Monday morning.

I am copying this letter to Michael Reidy.

Yours ever,

Peter Ricketts

(P R Ricketts)
Private Secretary

C D Powell Esq
10 Downing Street

 DSR 11C

Pl. type for PM's signature ay.

DRAFT MESSAGE FROM THE PRIME MINISTER TO THE NORWEGIAN PRIME MINISTER

I know that our decision not to endorse the agreement between Statoil and BGC for the purchase of Sleipner gas was a disappointment to you. Alick Buchanan-Smith has explained to Mr Kristiansen the reasons for it. I have been following the discussions closely, as I know you have too, and would like to set them out to you personally.

The main reason for our decision is the changed estimates of reserves on the UK Continental Shelf. The draft contract was negotiated against the background of an expected shortfall in supplies of gas in the 1990s, but even when BGC first referred the draft contract to the Government it seemed very likely that the rate of delivery would be too great for the size of the gap we foresaw. This was one of the main reasons for our approach to your Government in June, and we were grateful for your agreement that we should ask BGC and Statoil to renegotiate the delivery rate. Since the summer, the prospects for gas supplies for the UK Shelf have markedly improved, and exploration and appraisal are at record levels. Estimates of proven and probable reserves have gone up from 40.6 trillion cubic feet (tcf) to 46.8 tcf. With the improved availability of gas from these increased reserves, the purchase of Sleipner gas would have resulted in an over-supply in the 1990's, if development of our

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own resources was not to be put back unreasonably.

Over the same period the dollar has risen against most other currencies and this further enhances the attraction of developing our own resources.

I know that you hoped for an earlier decision from us and am very grateful for the patience which you and your colleagues have shown. I am also very conscious of the domestic factors which have made the delay even more difficult for you. I hope you will accept that for us the decision was a difficult one, and that the time we took to reach it reflected not only the size of the proposed contract, which would have entailed a very large expenditure over a number of years, but the need to come to a considered assessment of our own resources at a time when the estimates were changing rapidly and signficantly.

BGC may still need to import gas in the future. If they do, I am sure that Norway will be among the sources they consider. In any event, I am confident that, as in the past, there will be many other examples of co-operation between Norway and the UK, and that relations between us will continue to be as close as they have always been.

ØP

CPC

Foreign and Commonwealth Office

London SW1A 2AH

14 February 1985

Dear Charles,

Anglo-Norwegian Relations: Sleipner Gas

Our Ambassador in Oslo has reported the reactions of the Government and Opposition parties and the press in Norway to our decision not to go ahead with the British Gas Corporation/Statoil deal for the purchase of Sleipner Gas. Sir William Bentley's verdict is: 'Better than might have been feared but not as good as might have been hoped. Nor can we assume that the worst is over'. In the light of this he has put forward views on action to limit the effect of the decision on Anglo-Norwegian relations.

He recommends a visit to Norway at a high political level, preferably before Easter, and an early message from Mrs Thatcher to the Norwegian Prime Minister, Mr Willoch.

There is, as you know, an outstanding invitation from Mr Willoch to the Prime Minister to visit Norway and we had recommended that this should be taken up early this year in order to avoid the approach to the Norwegian elections due in September. The Foreign Secretary still hopes that the Prime Minister will be able to go to Norway as soon as she may find it convenient, but does not think it would be right to arrange a visit immediately in the wake of the Sleipner decision. This would be seen as too obviously connected with Sleipner, and designed to placate the Norwegians for a decision that was taken on sound commercial grounds.

Sir Geoffrey therefore recommends that the Prime Minister should if possible take up Mr Willoch's invitation next year, if Mr Willoch wins the September elections.

Meanwhile, there is no lack of bilateral contacts. Mr Stray, the Norwegian Foreign Minister, will be spending a weekend at Chevening in March as the guest of Sir Geoffrey Howe, and Lady Young is considering a visit at the end of this year.

/The

The Foreign Secretary thinks it would be helpful if the Prime Minister were to send Mr Willoch a message. I enclose the draft which Sir W Bentley has put forward. I understand from Michael Reidy (to whom I am copying this letter) that the Secretary of State for Energy agrees and is content with the draft.

Yours ever,

Peter Ricketts

(P F Ricketts)
<u>Private Secretary</u>

C D Powell Esq
10 Downing Street

appears in the correspondence. Therefore, the right hon. Gentleman is condemned by his own correspondence with the local authority.

Is not this part of a political strategy? The Secretary of State knows that all the rate-capped authorities have agreed to act in unison. The right hon. Gentleman wanted Haringey to come to see him personally and he would then have conceded the £6·4 million, thereby making it beneficial for those authorities to come to see him, and as a result breaking the unity——

Mr. Speaker: Order. We cannot have speeches during questions on a statement. The hon. Gentleman must bring his question to a close, because he has now been on his feet for several minutes.

Mr. Atkinson: Is not a political strategy the purpose of these "behind the scenes" discussions with friends of the right hon. Gentleman's own family whom he has known for many years? Was it not from out-of-hours discussions that these revelations emerged?

Mr. Jenkin: The hon. Gentleman knows that the leader of Haringey council, Councillor Meehan, has consistently argued that he ought to be free to talk to the Department about the rate limit, but that because of this stupid boycott imposed by Labour's national executive committee he has been precluded from doing so. There is still time, and if Councillor Meehan wishes to argue for a higher rate limit, my door is open.

Mr. John Cartwright (Woolwich): Will the right hon. Gentleman confirm the statement apparently issued by his Department on Friday that the deputy treasurer of Haringey telephoned his Department and had certain calculations confirmed? Will he make a similar service available to the other rate-capped authorities? More important, will he make available to the House details of the assumptions which he has used so that we do not have a repetition of last week, when the House was asked to rubber stamp rate limits without adequate information?

Mr. Jenkin: I have made it clear that in relation to Haringey there were no assumptions. If any authority wishes to discuss the calculation of its rate limit, it is absolutely clear under the Act that it should use the right of appeal to come in and put forward an alternative rate limit. These matters may then be discussed. The deputy treasurer of Haringey did have a consultation, and, as I have said frequently, skilled treasurers are perfectly well able to work out how their authority's rate limit has been calculated. Haringey got the relevant calculations right within two days of the announcement last December.

Several Hon. Members *rose*——

Mr. Speaker: Order. Private notice questions are an extension of Question Time. We have a heavy day ahead of us, with Private Members' motions.

Mr. Clive Ponting (Trial)

3.45 pm

Lord Privy Seal and the Leader of the House of Commons (Mr. John Biffen): On a point of order, Mr. Speaker. It may be of assistance to the House if I say now that it is the Government's intention for an oral statement to be made tomorrow concerning the Ponting case.

Mr. John Morris (Aberavon): Further to that point of order, Mr. Speaker. Would it be in order for me to make an application under Standing Order No. 10 at this stage? If not, at what stage would it be appropriate?

Mr. Speaker: Not until after the statements.

Mr. John Morris: In that case, I give notice that I intend to do so.

Mr. Speaker: I say to the right hon. and learned Member for Aberavon (Mr. Morris) and other right hon. and hon. Members who have given notice of Standing Order No. 10 applications that this is a private Members' day, and we already have two statements and two other applications under Standing Order No. 10 that came in before 12 o'clock. I appreciate that the judgment in the Ponting case was not received until after noon, so it might be appropriate to delay further applications under Standing Order No. 10 until tomorrow, in the interests of private Members.

Mr. John Morris: Further to that point of order, Mr. Speaker. It is my intention, as I have given notice, to move my application today because the earliest that we could have a debate, as opposed to a statement, would be tomorrow.

Mr. Norman St. John-Stevas (Chelmsford): Further to that point of order, Mr. Speaker. As many hon. Members will not even have heard the verdict in the Ponting case as yet, and as my right hon. Friend the Leader of the House has given an undertaking that there is to be a statement tomorrow, would it not be reasonable for hon. Members to read and reflect on the verdict before we have a discussion in the House?

Mr. Speaker: I have not heard the details either, so I am as much in the dark as anybody else.

Dr. David Owen (Plymouth, Devonport): Further to that point of order, Mr. Speaker. As the Leader of the House has raised this point of order, would it be in order to ask him which Minister will make the statement? Will it be the Prime Minister, in view of her responsibilities as head of the Civil Service? Can it be made clear to the Government that many of us feel that, as the Prime Minister has misled the House, she should make the statement?

Mr. Biffen: Further to that point of order, Mr. Speaker. The purpose of my point of order was to inform the House that a statement would be made at the earliest possible opportunity. I shall take account of what right hon. and hon. Members have said.

Sleipner Gas

3.47 pm

The Secretary of State for Energy (Mr. Peter Walker): With permission, Mr. Speaker, I wish to make a statement on the proposed purchase of gas from the Norwegian Sleipner field.

As the House is aware, major negotiations have been in progress for some time between the British Gas Corporation and the licensees of this gas field, which has reserves of some 7 trillion cubic feet; for supply of gas to the British market. Any deal resulting from the negotiations required the endorsement of Her Majesty's Government, and I had made this clear to the parties concerned.

The British Gas Corporation approached me during 1984 with the terms of a provisional agreement under which delivery of gas would start in the early 1990s, reaching a plateau in the mid-1990s at a rate which would be sufficient to meet up to 30 per cent. of United Kingdom requirements and continuing at that level well into the 21st century. The Government immediately examined the details of the contract from the point of view of the broader national interest and thereafter entered into discussions with the Norwegian Government. We explained to the Norwegians that, at the rate of delivery proposed, there was a serious risk that prospective development of gasfields on the United Kingdom continental shelf would be held up. We accordingly sought agreement that the rate of delivery provided for in the draft contract should be reduced. Discussions with the Norwegians on this and other matters continued throughout the remainder of 1984 and good progress was made.

The Government have now reviewed the proposed purchase in the light of the situation which has developed during the period of these discussions. In particular, the Government have been impressed by the results of the recent record levels of exploration and appraisal activity. As a result the estimates of proven and probable gas reserves remaining in the United Kingdom continental shelf, as shown in the Brown Book published in April 1984, have increased by 6·2 trillion cubic feet. As a consequence the Government have concluded that it will no longer be necessary to import gas in the 1990s on the scale anticipated even last summer. Accordingly, the Government have decided not to endorse the draft contract negotiated by the British Gas Corporation for the purchase of gas from the Sleipner field. The Norwegian Government and the British Gas Corporation have been informed of this decision. We recognise that the Government's decision will cause disappointment to our Norwegian friends. I emphasise that we shall continue to value the relationship which has developed between our two countries through our common interest in oil and gas matters.

The Government welcome the fact that current and prospective developments on the United Kingdom continental shelf now seem likely to provide sufficient gas to meet the needs of the British market well into the 1990s. However, they recognise that the British Gas Corporation has clear obligations in regard to the security of gas supply. The Government, in consultation with the corporation, will therefore keep under review the likely availability of supplies to meet demand in the coming decades.

The improved prospects for the development of our own offshore gasfields over the next few years will have important and welcome implications for the generation of additional orders and employment in the offshore supplies industry as well as reducing expenditure on imports in the 1990s.

Mr. Stanley Orme (Salford, East): The statement begs as many questions as it answers. Above all, I find it astonishing that the Secretary of State has made no mention of price. He has based his decision on a major revision of North sea gas reserves. The question is not just about the size of the reserves, but whether they can be developed to meet gas demands in the 1990s.

In recent reviews it was assessed that 45 new fields could be developed between now and the year 2000, providing North sea related jobs, but that that would still leave a significant gap between supply and demand. Will the Secretary of State tell us which additional fields he has identified to fill that gap?

In view of the potential demand for gas in the 1990s, will the Secretary of State at least confirm that British Gas will be allowed to consider importing gas in the future if it finds that it has insufficient supplies?

The Secretary of State mentioned the discussions with the Norwegian Government. I hope that the decision will not damage our good relations with Norway. Will he make it absolutely clear that there will now be no question of exporting North sea gas from Britain?

With regard to the future of gas, will the Secretary of State say whether supplies from the North sea will be significantly cheaper than those offered under the Sleipner contract?

What role has the collapse of the pound played in the Government's decision?

The Secretary of State has taken a risk and a gamble on the nation's future gas supplies. The House deserves a much fuller assessment than he has included in his statement. Will he provide it as urgently as possible, so that the House can make a proper judgment as to the extent of the gamble?

Mr. Walker: I understand the views put by the right hon. Gentleman. I understand his fears about supplies, as he does not have the updated detailed information. We shall be making that detailed information available to the Select Committee in the very near future, so it will be available to the House, and the right hon. Gentleman and other hon. Members can then make their judgments on the validity of the improvement in the supply position. It is a genuine improvement and a pleasing one for both sides of the House. Some people think that we are still underestimating the supplies that will be available during the period concerned, but we have made our estimates in accordance with the usual prudent methods employed by the Department, under all Governments.

With regard to price, if we are talking about the price of deliveries in 10 years' time, obviously the exchange rates then prevailing will have an enormous influence. The variation in the currency exchange rate during the period since the contract was originally negotiated shows the degree to which, if the dollar is strong at a particular time, it produces a big variation in the price.

In looking at the availability of our own supplies, as opposed to the need to import them from Norway, my guess is that the availability of our own supplies will mean that prices will be lower than they would have been if we had taken the Sleipner contract—*[Interruption.]* There is no way in which one can make a valid pronouncement on that. However, that is my genuine guess about the position.

As I made clear in my statement, I accept that there is a statutory obligation on the British Gas Corporation to ensure security of supplies. It is the duty of any Government to ensure that that is so. As I also made clear in the statement, judging by the now known reserves, we believe that far fewer imports will be required in the 1990s than was originally envisaged. On current estimates, it is still likely that some imports will be required during that period. Of course, the BGC will negotiate in consultation with Government—as it always has done—about the possibility of those supplies coming from Norway or elsewhere. While that remains the position the question of exports does not arise, especially if the demand for gas in this country is not met by our own supplies. In the foreseeable future we shall need all the supplies from the North sea. As hon. Members know, at present we are a major importer from the Frigg field in Norway.

I assure the right hon. Gentleman that I have not taken a gamble. We have consulted carefully, and the BGC has increased its estimate of gas reserves since it began negotiations. That implies is no criticism of the corporation because when it began negotiations it was working, perfectly sensibly, on the then known facts.

Several Hon. Members *rose*——

Mr. Speaker: Order. I repeat that we have a private Members' day today, and it would be very unfair if a lot of time was taken up by the statements. I therefore propose to allow questions to run for a further 15 minutes on this statement, and that goes for the next statement as well.

Mr. Michael Morris (Northampton, South): Is not the key fact that we now have rate of increased finds in the North sea? Does that not have major implications for security of supplies and, just as importantly, for British jobs? Can my right hon. Friend estimate how many British jobs will flow from this decision?

Mr. Walker: It is impossible to give any accurate estimate, but, obviously, as we find more gas fields in the North sea there will be substantial investment. As the majority of that investment will come from firms operating in Britain, the availability of more supplies, and new and better discoveries, are obviously good news for jobs, particularly as many of those jobs will be provided in the north east and in Scotland, which are areas of high unemployment.

Mr. Dick Douglas (Dunfermline, West): In view of his statement, will the Secretary of State give an assurance that he will not under any circumstances permit the export of southern sector gas from the United Kingdom? Will he give some assurances about the finds of probable and possible reserves about which he spoke. The probable reserves are very futuristic. What is the right hon. Gentleman's guesstimate of how long we can be assured of security of supplies? What——

Mr. Speaker: Briefly.

Mr. Douglas: Yes, Mr. Speaker. What is the likelihood of publishing the BGC's background papers, together with the right hon. Gentleman's views, on the contract that he has renounced?

Mr. Walker: Obviously, it is for the BGC to decide what it should publish.

The hon. Gentleman asked about security of supplies. I can only say that the increase of about 15 per cent. in availability that has occurred since we published the Brown Book in July is something that I could not have predicted last June. The hon. Gentleman has considerable experience of, and interest in, these matters, and he will understand the difficulty. Ten years ago, when I previously had responsibility for oil and gas, I was shown predictions which have now been proved to be totally wrong. I hope that that trend will continue, because they are often proved wrong in the right direction for this country. The estimates that we are now making are below those of some oil companies and above those of others. To some extent, because of what is required from the licensing agreements that we have with various fields, is only the Department that has all the detailed information. Thus we believe that there is good security of supply. Judging by present requirements, all the gas in the North sea will be required by the BGC in the immediate future. Obviously, if the time comes when our gas supplies are such that we have surpluses, any Government would have to review the scene.

Mr. Albert McQuarrie (Banff and Buchan): I am grateful to my right hon. Friend for his statement, because had it not been for the excellent news about reserves additional to those published in the Brown Paper in April the position would have been unfortunate for my constituents. Will my right hon. Friend maintain close liason with the British Gas Corporation on the question of increased production? Does he agree that that would not only secure existing jobs at St. Fergus in my constituency, but possibly create further jobs?

Mr. Walker: My hon. Friend referred to the Brown Book published in April. He is right. I referred to it as the July Brown Book, but it was published in April. This decision will be helpful for jobs. A great deal of investment will take place in the new fields. In the period leading up to the 1990s there will be further requirements for pipelines, which will also provide more work.

Mr. James Molyneaux (Lagan Valley): In the light of the Secretary of State's encouraging words about improved prospects for the development of our own offshore gas fields over next few years and his hope that they will have welcome implications, will he look sympathetically at the desirability of extending supplies of gas from the continental shelf to areas such as Northern Ireland, where such gas is not currently avaialble?

Mr. Walker: I shall certainly discuss that with my right hon. Friend who has responsibility for Northern Ireland.

Mr. Tony Speller (Devon, North): Does my right hon. Friend agree that although deciding not to buy may or may not be a big decision at this time, it could have traumatic effects upon a supplier who has relied upon a contract, as in this case? May we have my right hon. Friend's assurance that the Norwegian Government—very good friends of ours—have been kept fully in the picture and that there is no financial liability upon us for non-completion of the contract?

Mr. Walker: Yes. I can assure my hon. Friend that we value the manner of our talks with the Norwegian

[Mr. Walker]

Government. I have been involved in meetings with Norwegian Ministers and my right hon. Friend the Minister of State has been in Norway over the last few days having full consultations with the Norwegian Government. They will be disappointed, but they understand the reasons. The Government's objective is to continue to have good relations with Norway.

Mr. James Tinn (Redcar): Is the Minister aware that, following the earlier Government decision not to go ahead with the gas-gathering pipeline, to encourage the development of a totally unnecessary and unwanted petrochemical complex at Mossmorran is yet another body blow to the people of Teesside, where unemployment is the highest in mainland Britain? What does the right hon. Gentleman propose to do? Why will the Government not allow the corporation to go ahead with an agreement which makes good commercial sense to it and sound common sense to our good friends the Norwegians?

Mr. Walker: I do not think that the news is bad for Teesside. There will be more developments in our own sector of the North sea and more suppliers, investment and equipment will be required, much of which can come from the north-east. Further pipelines are likely to be developed in this period and requirements in refining capacity are likely to be increased from our own resources of gas in the North sea. That should not be bad news for the north-east.

Mr. Peter Rost (Erewash): Does my right hon. Friend agree that one of the unsatisfactory aspects of the proposed deal was that the British Gas Corporation was prepared to offer a higher price for Norwegian gas than it was to our own suppliers? If our suppliers had been offered better prices earlier, we should not have had to negotiate for the gas.

Mr. Walker: The fact that there has been such success in our exploration over the period, and that there have been finds, shows that every encouragement and incentive have been given for people to develop and produce. If one is negotiating an import contract for the 1990s, one has genuinely to calculate the world price for that volume of contract at that time. I am sure that that is what the British Gas Corporation did. I am pleased that the taxation and other policies pursued by the Government have encouraged this development of our own resources.

Mr. Malcolm Bruce (Gordon): Is the Secretary of State not in danger of misleading the country by presenting this as an either/or decision, when the reality is that even the best forecasts suggest that we are likely to need Sleipner, and everything else that has been discovered and is not yet discovered? Is the Minister not gambling on supplies which have not yet been found? Will he acknowledge that by using the improving success rate as a justification for his decision he is giving the opposite reason to that which the Government gave for not going ahead with the gas-gathering system, which might have secured the gas supplies which we now need?

Mr. Walker: I think that further pipeline developments will take place. I totally disagree with the first part of the hon. Gentleman's question. If he looks at the facts and the figures he will see that a contract for sales from Sleipner is not needed for the 1990s.

Mr. T. H. H. Skeet (Bedfordshire, North): Is my right hon. Friend aware that, to get security of supply, it would be best to link the European grid system with the English grid system? Is my right hon. Friend aware that by his good decision announced today producers will be given the incentive to bring their gas production forward, because there are ample supplies in the North sea?

Mr. Walker: My projections show that there are better supplies in the North sea than we predicted for the 1990s. Forecasts of consumption suggest that there might well be a need for imports during that period. Any Government and the corporation have a duty to keep the position under careful watch and care. Linking pipelines here with those in Norway or elsewhere depends upon the nature of the supply and demand built up. At present we are in the happy position of being able to take ourselves all the gas from North sea.

Mr. Frank Cook (Stockton, North): In reply to my right hon. Friend the Member for Salford, East (Mr. Orme) the Secretary of State said he was unable to make any prediction about price. How then is he able to predict capacity and volume? Further to that, and following the question by my hon. Friend the Member for Redcar (Mr. Tinn) about employment—which is of dire importance to us in the north-east—is the right hon. Gentleman saying that the 650 jobs at the Philips handling, storage and processing facility which will be at risk before the end of the decade will be guaranteed beyond the end of the century by the home-based reserves which he says we shall tap for the next 15 to 20 years?

Mr. Walker: There was no guarantee under any Sleipner agreement. Under that agreement, no decision was made about where the liquids would go. There was no agreed position on that. As a generalisation, I think that for jobs in the north-east today's announcement is a plus. On estimates and capacity, one must take the best information available. The Department of Energy, under all Governments, can never be accused of having made over-optimsistic estimates of capacity. The Department has made the current estimates of capacity in the same way as it has done over the years, under all Governments. The estimates are highly conservative and they are not as accurate in their optimism as they could be. The Department has always been wise to be on the side of prudence rather than of extravagance. It has continued that with these estimates.

Mr. David Crouch (Canterbury): Does my right hon. Friend agree that we have given a great deal of thought to this complex problem for many years? Does he think on reflection that, looking at the possibility of a serious gap in the 1990s, we might have passed up a valuable opportunity by turning down this contract? Does he agree that we might have to resort to panic buying of Dutch and even Soviet gas in the 1990s?

Mr. Walker: Obviously, if I had thought that I should have given approval to the Sleipner deal without hesitation. As my hon. Friend knows, we examined the matter carefully, without any prejudice against the deal. The situation has genuinely changed to the advantage of our country. It is the duty of any Government and the British Gas Corporation to ensure that they have secure supplies for the decades to come. Those supplies may be available from many parts of the world, including Norway, in the future.

Mr. Ian Wrigglesworth (Stockton, South): Do not the anxieties mentioned by the hon. Member for Canterbury (Mr. Crouch) exist because the country and the House are so uncertain about the Government's hopes and intentions for energy supplies from all different sources in the coming years? Will the Secretary of State make much more clear to the House and to the country how the Government see the energy mix for the future, so that better judgments can be made on such deals? What is the British Gas Corporation's reaction to the decision that he has just announced?

Mr. Walker: The British Gas Corporation must be free to make its own pronouncements. It has been fully consulted throughout and knows of the adjustments we have made with regard to capacity and also the validity of the reasons on which we have based our judgments. Obviously, having negotiated the Sleipner deal, the corporation must be disappointed that it has not been completed. I am sure that the BGC will wish to continue good relations with Norway as a potential supplier of gas in future, as it is at the present time.

On the hon. Gentleman's question about projections on a whole range of energy supplies, I remind him — although not wishing to do so — of his political past. The party of which he used to be a member published a series of projections for energy supplies over five and 10-year periods, but the only thing that can be said about them is that they were all proved to be dramatically wrong.

Atomic Energy Authority

4.10 pm

The Parliamentary Under-Secretary of State for Energy (Mr. Alastair Goodlad): With your permission, Mr. Speaker, I should like to make a statement about the future of the Atomic Energy Authority. My right hon. Friend the Secretary of State for Energy told Parliament on 28 March that he had set in hand a wide-ranging review of the role and activities of the authority. On 3 October he placed in the Library of the House a press statement which summarised the recommendations of the review. Following consultations with the interested parties, I can now inform the House of the conclusions reached by the Government.

Since the authority was established in 1954 as a vote-funded body with a high degree of statutory independence, it has made a crucial contribution to the development of the civil uses of nuclear power in this country. Today, civil nuclear power is an essential and established part of our national life. Last year more than 18 per cent. of electricity supplied in the United Kingdom was nuclear. The proportion will reach 21 per cent. when the three nuclear stations most recently linked to the national grid reach full power, with a further increase when stations now under construction are completed. The civil nuclear industry in the widest sense now provides about 100,000 jobs. All this has been achieved with an excellent safety record. The authority's work is held in high regard and it will continue to have a major role to play in both the nuclear and non-nuclear field.

The review had two guiding principles: first, that the authority should move further towards a commercial basis of operation; secondly, that a defined customer-contractor relationship should be applied as far as possible to its work. The Government fully endorse those principles.

The review recommended, and the Government accept, that the activities of the authority should be placed on a trading fund basis. The authority will be required to account for its activities in a fully commercial manner, within financial objectives set by the Secretary of State. We intend to provide the authority with a capital structure and powers to borrow as required to enable it to operate as a trading fund from April 1986, and will introduce legislation as soon as possible for that purpose.

I have considered carefully, in consultation with the authority and with its customers in the nuclear industry, how the principles of the review should apply to the funding of particular programmes at present financed by my Department. A balance is required between the application of the customer-contractor principle, which is valuable for financial discipline and a more commercial approach, and the retention of an independent capability for safety and underlying research in the authority. The electricity industry, like the Government, attaches importance to that independent capability. Although the generating boards will increase the amount of work which they pay for on a customer-contractor basis, my Department will continue to fund a substantial authority programme of thermal reactor and general safety research. The Government broadly endorse a recommendation of the review group that there should be an element in the authority's charges to customers, including the

[Mr. Alastair Goodlad]

Department, in respect of underlying research. I am discussing the application of this recommendation with those principals concerned.

The effect of the proposals will be to carry further the development of recent years under which the funding of the authority's expenditure has become more broadly based and proportionately less dependent on Department of Energy Votes. In particular, there will be a further increase in funding by the CEGB. With other changes, I expect this to result in a reduction of £5 million in my departmental Vote in 1985-86 compared with previous plans.

I have already mentioned the authority's contribution to the development of civil nuclear power in this country. It continues to give valuable support to the nuclear industry in both the public and private sectors. It is diversifying its services in the non-nuclear field, and has made and important contribution to technology relevant to North sea development.

The evolutionary changes I have just announced will put the authority on an increasingly commercial footing and will give its staff a new incentive. I am confident that the changes will enable the authority further to develop its role and contribution to the economy on both a national and international basis. I am also confident that all those concerned will join in taking full advantage of this new opportunity.

Mr. Alexander Eadie (Midlothian): The Minister's announcement is unsatisfactory on three counts. First, as the Minister said, to put the authority on a commercial basis is an evolutionary change. We believe that it is a change towards privatisation. I draw the Minister's attention to the note appended to the statement of 3 October so that the House is under no misunderstanding about the way in which the Government have clothed today's statement. Paragraph 9, entitled

"The Authority as a Trading Fund"

states:

"The extension of the customer/contractor approach to the Authority's nuclear work for the Department would be facilitated by putting the Authority on a Trading Fund basis. This would require all work to be accounted for on a fully commercial basis, impose additional discipline through the requirement to meet financial objectives, create financial flexibility between years, highlight major issues which need to be dealt with in commercial terms, and facilitate possible eventual privatisation."

Secondly, does the Minister realise that the people of this country will be appalled that work connected with nuclear power, whether research or in any other area, will be on a commercial basis, in private hands? The Minister has argued that the justification for that is the saving of £5 million. That is not an argument; it is an unsafe betrayal in the interests of private profit.

Thirdly, is it not monstrous that the result of the announcement will be to take from Parliament the right to question and seek accountability for that aspect of nuclear power activity?

The Government appear not only to be preparing the way for privatisation, but to be weakening the authority of Parliament.

Mr. Goodlad: I may be able to put some of the hon. Gentleman's fears at rest. There are no plans to privatise the Atomic Energy Authority. Therefore, the fears that animated his first and second points do not apply.

On the hon. Gentleman's third point, there will be no reduction in accountability to this House because of the change to the trading fund.

Mr. John Hannam (Exeter): Does my hon. Friend agree that this decision really consolidates the existing trend on outside financing? Will he reiterate that research into the safety of nuclear reactors will still be a top priority of the Government?

Mr. Goodlad: My hon. Friend is quite right to say that the move to a trading fund will reinforce a trend that is already taking place. He is also correct to say that the resources available to the authority for thermal reactor and general safety research will not be reduced. The Department will continue to fund substantial authority programmes in that area. The Government attach paramount importance to safety, and will continue to do so.

Mr. Merlyn Rees (Morley and Leeds, South): Under the trading fund structure, will capital borrowings now cease to be counted by the Treasury in the public expenditure totals?

Mr. Goodlad: The capital structure of the trading fund has yet to be established by my right hon. Friend, and will be the subject of continuing consultations.

Mr. Rob Hayward (Kingswood): In welcoming the statement, may I ask whether the authority will continue to co-operate with its European partners in the projects that are currently operating?

Mr. Goodlad: Yes, Sir.

Mr. Robert Maclennan (Caithness and Sutherland): I accept that, after it has successfully spearheaded the development and research of the nuclear programme during about 30 years, it is sensible to move towards a recognition of the commercial possibilities of the authority. However, does the Minister realise that his statement is unsatisfactorily opaque in that, although it accepts in principle, the recommendation of a trading fund, it does not begin to define which matters will still be funded by the Department? There have been six months of consultation on this matter. Is there a risk that fundamental research will not be commissioned, and therefore, not carried out? How does the Minister propose to continue to fund the fast-breeder reactor programme?

Mr. Goodlad: I said in my statement that the underlying research of the authority will remain a priority. That will be the case. My Department will continue to provide funding to underlying research, and the industry will also contribute. The position of the fast-breeder reactor programme will remain as it is at present. The programme is proceeding through the collaborative arrangements set out in the intergovernmental memorandum of understanding which my right hon. Friend the Secretary of State signed in January last year. The resources available to the programme are not changed by this decision, but the work will be carried out on a more explicit customer-contractor relationship between the Department and the authority.

Viscount Cranborne (Dorset, South): My hon. Friend's statement will be studied with the keenest interest at the atomic energy establishment at Winfrith, which is the largest employer in my constituency. The workers there will appreciate his remarks about their work in safety

SLEIPNER GAS

With permission, Mr Speaker, I wish to make a statement on the proposed purchase of gas from the Norwegian Sleipner field.

As the House is aware, major negotiations have been in progress for some time between the British Gas Corporation and the licensees of this gas field, which has reserves of some 7 trillion cubic feet, for supply of gas to the British market. Any deal resulting from the negotiations required the endorsement of Her Majesty's Government and I had made this clear to the parties concerned.

The British Gas Corporation approached me during 1984 with the terms of a provisional agreement under which delivery of gas would start in the early 1990s, reaching a plateau in the mid-1990s at a rate which would be sufficient to meet up to 30 per cent of UK requirements and continuing at that level well into the 21st century. The Government immediately examined the details of the contract from the point of view of the broader national interest and thereafter entered into discussions with the Norwegian Government. We explained to the Norwegians that at the rate of delivery proposed, there was a serious risk that prospective development of gasfields on the United Kingdom Continental Shelf would be held up. We accordingly sought agreement that the rate of delivery provided for in the draft contract should be reduced. Discussions with the Norwegians on this and other matters continued throughout the remainder of 1984 and good progress was made.

The Government has now reviewed the proposed purchase in the light of the situation which has developed during the period of these discussions. In particular the Government has been impressed by the results of the recent record levels of exploration and appraisal activity. As a result the estimates of proven and probable gas reserves remaining in the United Kingdom Continental Shelf, as shown in the Brown Book published in April 1984, have increased by 6.2 trillion cubic feet. As a consequence the Government has concluded that it will no longer be necessary to import gas in the 1990s on the scale anticipated even last summer. Accordingly the Government has decided not to endorse the draft contract negotiated by the British Gas Corporation for the purchase of gas from the Sleipner field. The Norwegian Government and the British Gas Corporation have been informed of this decision. We recognise that the Government's decision will cause disappointment to our Norwegian friends. I emphasise that we shall continue to value the relationship which has developed between our two countries through our common interest in oil and gas matters.

The Government welcomes the fact that current and prospective developments on the United Kingdom Continental Shelf now seem likely to provide sufficient gas to meet the needs of the British market well into the 1990s. However, it recognises that the British Gas Corporation has clear obligations in regard to the security of gas supply. The Government, in consultation with the Corporation, will therefore keep under review the likely availability of supplies to meet demand in the coming decades.

The improved prospects for the development of our own offshore gasfields over the next few years will have important and welcome implications for the generation of additional orders and employment in the offshore supplies industry as well as reducing expenditure on imports in the 1990s.

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bc JR ✓

10 DOWNING STREET

From the Private Secretary 8 February 1985

Dear Michael.

SLEIPNER

The Prime Minister has seen your Secretary of State's minute of 7 February. She is content with the draft statement and content that it should be issued on Monday if arrangements can be made to inform the Norwegians beforehand of the decision.

The Prime Minister hopes that Departments can quickly come to agreed conclusions on the export regime.

I am sending copies of this letter to the Private Secretaries to the Lord President, the Secretary of State for Foreign and Commonwealth Affairs, the Chancellor of the Exchequer, the Lord Privy Seal, the Secretary of State for Trade and Industry, the Parliamentary Secretary (Treasury), the Captain of the Gentlemen-at-Arms and the Secretary to the Cabinet.

Yours sincerely
Andrew Turnbull

Andrew Turnbull

Michael Reidy, Esq.,
Department of Energy.

NB PM NJ 8/2 ECNO

PRIME MINISTER

I have seen Peter Walker's minute to you of 31 January, on which Nigel Lawson and Geoffrey Howe commented on 4 February. Your Private Secretary's letter of 5 February recorded your conclusions with which I agree.

2 Industry's interests are in ensuring adequate and secure supplies of gas for the foreseeable future, at realistic but not excessive prices, and vigorous development of our indigenous resources on the UK continental shelf. These requirements seem to point towards a limited level of gas imports, whether from Norway or elsewhere, combined (if this is sustainable) with a controlled gas export regime. The full Sleipner deal on offer is not now attractive, and it should be rejected. I am therefore content with the draft statement attached to Peter Walker's minute to you of 7 February.

3 I am sending copies of this minute to Geoffrey Howe, Nigel Lawson, and Peter Walker, and to Sir Robert Armstrong.

NT

N T

8 February 1985

Department of Trade and Industry

JH5ARM

Nat Ind: Gas + Elec Pt 10

CONFIDENTIAL

Prime Minister (1)

Yes (i) Content with draft statement?

Yes (ii) Agree Depts be urged to get on with examination of Mr Walters proposals on exports?

AT 7/2

PRIME MINISTER

SLEIPNER

I very much agree with your view that the decision on Sleipner should be announced as soon as possible. I am trying to arrange for Kristiansen, the Norwegian Minister, to come to London next Monday, so that I can tell him what we have decided. I propose to make a statement to the House at the first available opportunity thereafter, preferably on Monday afternoon.

I know that BGC do not intend to enter into any negotiations in the immediate future in respect of their requirements for a smaller quantity of imports. It would be my intention to see that if and when negotiations are required, they are handled in a way which avoids any inter-governmental embarrassment of the type that has occurred on this occasion.

I do not propose to include anything in the statement on the question of future imports, but must of course say that I recognise the statutory supply obligations which the British Gas Corporation has.

Both the Corporation and my Department believe that there will be a need for some future imports as the existing fields from which we import run out of gas. It would therefore be disastrous to mention publicly any active consideration of a controlled export regime, particularly as the Attorney General has drawn attention to the considerable legal problems involved. If the question is raised in supplementaries following my statement I will therefore give a holding reply along the lines you suggest.

I attach a draft of the statement which, in view of the urgency, I should be grateful for clearance by you and colleagues by lunchtime on Friday. I believe that this draft statement will be acceptable to the Norwegians, who are concerned that our decision should be based on our own national considerations and not on the positions adopted by them in the inter-governmental negotiations.

CONFIDENTIAL

I am sending copies of this minute to the Lord President of the Council, the Secretary of State for Foreign and Commonwealth Affairs, the Chancellor of the Exchequer, the Lord Privy Seal, the Secretary of State for Trade and Industry, the Parliamentary Secretary (Treasury), the Captain of the Gentlemen-at-Arms and the Secretary to the Cabinet.

SECRETARY OF STATE FOR ENERGY
7 February 1985

SLEIPNER: DRAFT ANNOUNCEMENT OF GOVERNMENT DECISION

With permission, Mr Speaker, I wish to make a statement on the proposed purchase of gas from the Norwegian Sleipner field. As the House is aware, major negotiations have been in progress for some time between the British Gas Corporation and the licensees of this gas field, which has reserves of some 7 trillion cubic feet, for supply of gas to the British market. Any deal resulting from the negotiations required the endorsement of Her Majesty's Government and I had made this clear to the parties concerned.

The British Gas Corporation approached me during 1984 with the terms of a provisional agreement under which delivery of gas would start in the early 1990s, reaching a plateau in the mid-1990s at a rate which would be sufficient to meet up to 30 per cent of UK requirements and continuing at that level well into the 21st century. The Government immediately examined the details of the contract from the point of view of the broader national interest and thereafter entered into discussions with the Norwegian Government. We explained to the Norwegians that at the rate of delivery proposed, there was a serious risk that prospective development of gasfields on the United Kingdom Continental Shelf would be held up. We accordingly sought agreement that the rate of delivery provided for in the draft contract should be reduced. Discussions with the Norwegians on this and other matters continued throughout the remainder of 1984 and good progress was made.

The Government has now reviewed the proposed puchase in the light of the situation which has developed during the period of these discussions. In particular the Government has been impressed by the results of the recent record levels of exploration and appraisal activity. As a result the estimates of proven and probable gas reserves remaining in the United Kingdom Continental Shelf, as shown in the Brown Book published in April 1984, have increased by 6.4 trillion cubic feet. As a consequence the Government has concluded that it will no longer be necessary to import gas in the 1990s on the scale anticipated even last summer. Accordingly the Government has decided not to endorse the draft contract negotiated by the British Gas Corporation for the purchase of gas from the Sleipner field. The Norwegian Government and the British Gas Corporation have been informed of this decision. We recognise that the Government's decision will cause disappointment to our Norwegian friends. I emphasise that we shall continue to value the relationship which has developed between our two countries through our common interest in oil and gas matters.

The Government welcomes the fact that current and prospective developments on the United Kingdom Continental Shelf now seem likely to provide sufficient gas to meet the needs of the British market well into the 1990s. However, it recognises that the British Gas Corporation has clear obligations in regard to the security of gas supply. The Government, in consultation with the Corporation, will therefore keep under review the likely availability of supplies to meet demand in the coming decades.

The improved prospects for the development of our own offshore gasfields over the next few years will have important and welcome implications for the generation of additional orders and employment in the offshore supplies industry as well as reducing expenditure on imports in the 1990s.

GAS PRICES

17 FEB 1985

CONFIDENTIAL FILE DCAALW

bc JR

cc MASTER SET

10 DOWNING STREET

From the Private Secretary

5 February 1985

Dear Michael

Sleipner

The Prime Minister has seen your Secretary of State's minute of 31 January and the comments from the Foreign Secretary and the Chancellor of the Exchequer. She agrees that it is right not to proceed with the present Sleipner purchase. She is concerned, however, with the recommendation that BGC should be instructed to open negotiations immediately with potential suppliers of gas. There appears to be no reason for BGC to rush into signing up new supplies and its attitude should be more one of "shopping around". BGC should then be asked to present a number of options to Ministers.

The Prime Minister hopes that the decision on Sleipner can be announced as soon as possible. She feels, however, that more time is needed for departments to consider the arguments your Secretary of State has put forward on a controlled gas regime. She does not wish the announcement to be delayed while this is going on and has suggested, therefore, that when your Secretary of State makes the announcement he should, if pressed, give a holding reply along the lines that the Government has at present no plans to change the gas export regime but that it will consider this issue in the light of the way the gas market develops following the Sleipner decision.

The Prime Minister has noted the advice given by the Foreign Secretary and agrees that our relations with Norway need to be handled carefully.

I am copying this letter to Peter Ricketts (Foreign and Commonwealth Office), Rachel Lomax (HM Treasury), Callum McCarthy (Department of Trade and Industry) and Richard Hatfield (Cabinet Office).

Yours sincerely

Andrew Turnbull

Andrew Turnbull

Michael Reidy, Esq.,
Department of Energy.

CONFIDENTIAL

10 DOWNING STREET

1

Prime Minister

Attached are the replies of the Chancellor and Foreign Secretary. Their comments are consistent with your reaction at the weekend.

AT
4/2

Mr

4.11 CONFIDENTIAL

010 cc HO

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

SLEIPNER

with AT?

I have seen a copy of Peter Walker's minute to you of 31 January.

2. In the light of the latest projections of supply and demand, I am sure Peter is right in proposing that we should reject the present Sleipner contract.

3. But I do not think it would be sensible to ask BGC to open immediate negotiations with other potential suppliers of imports. The Corporation will clearly need time to consider the situation they face in the light of this decision. As we have seen, the figures for proven and probable reserves have increased by some 15 per cent over the past year and the Department of Energy supply projections for the mid 1990s have risen by a similar amount. There may be a further revision in another year's time. The position on the Frigg field should certainly become clearer.

4. I therefore suggest BGC might aim to come back to us in about a year to set out, as Peter proposes, the options they see available. It is important that they should not again present us with a single case which we must either accept or reject. Insofar as their options include imports, I would agree with Peter that they should not exceed 200bcf a year.

5. Turning to exports, I do not think we can leave matters as Peter suggests. The latest central projections show a surplus of supply over demand through the 1990s. A refusal to permit gas exports for the present would have a deadening effect on UKCS activity in just the same way as in the late 1970s. (Incidentally, I had some difficulty in following Annex C to Peter's paper, as much of its argument seemed to be based on the assumption that the present Sleipner contract would go ahead. This is not, of course, the position we now face.)

6. I therefore suggest officials should prepare urgently a statement on a controlled export regime, drafted in a legally defensible manner. We could then consider the position in the light of that draft.

7. I am copying this minute to Geoffrey Howe, Peter Walker, Norman Tebbit and to Sir Robert Armstrong.

NL

N.L.

4 February 1985

PM/85/10

PRIME MINISTER

Sleipner

1. I agree with the Secretary of State for Energy that, in the light of the changed estimates of United Kingdom Continental Shelf gas reserves given in his minute to you of 31 January and the rise in the dollar, we should not endorse the contract negotiated between the British Gas Corporation (BGC) and Statoil.

2. There must, though, be serious concern that the announcement of the cancellation of this contract will damage our relations with the Norwegian Government and possibly with the US Government which, as you know, has supported the early development of the large Norwegian gas fields for strategic reasons. We have to handle this carefully.

3. I suggest therefore that the priority should be to tell the Norwegians that while we cannot endorse the existing BGC/Statoil Agreement, we would wish to pursue a number of alternatives, foremost among which would be an agreement with Statoil for a smaller volume of gas. This would permit the development of part of the Sleipner field, whilst the possibility of a larger volume and of a land-bridge is actively explored. For a number of reasons, including the views of the US, I am strongly against an approach from our side being made to the Soviet Union as a potential alternative supplier. The position would be different if the Soviets approached us, but it would still be right to be very cautious.

/4.

4. There is no doubt that we must avoid a repetition of our experience with Sleipner, which does harm to our relations with a long-standing friend and NATO ally. I therefore hope that BGC will be instructed to keep the Department of Energy informed of their negotiations so that there is no question of our having to intervene again after a very large commercial agreement has been all but signed.

5. Perhaps the most important lesson to be learned is that friendly governments have had to become involved in this subject. Because they are not commercial organisations, it has inevitably taken a long time to reach a conclusion. I cannot help wondering whether there are not ways in which we could do more to liberalise and de-monopolise the gas industry so as to reduce the risks of such a situation recurring.

6. I am copying this minute to the Secretary of State for Energy, the Chancellor of the Exchequer, the Secretary of State for Trade and Industry and Sir Robert Armstrong.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
4 February 1985

E.R.

PRIME MINISTER 1 February 1985

SLEIPNER GAS CONTRACT

Markets do work! Sir Dennis Rooke saw the Sleipner contract as a means of covering 30% of UK gas demand in the 1990s. As a monopoly buyer, he could have kept UK suppliers under his thumb and cost us £2 billion pa on the balance of payments and countless lost jobs.

Dramatic - but nonetheless predictable - developments have been taking place on the UKCS to forestall that ambition. Around 1980 BGC came back into the market perforce offering higher prices for the next generation of UK gas supply contracts. That stimulated the producers to explore for new gas, appraise earlier finds and dust-off development plans for gas already found. The gas supply/demand outlook has been transformed. Energy's revised forecast of UKCS gas availability (for the mid-1990s, up 16% since last May's estimate) would be sufficient to cover their best estimate of demand throughout the 1990s.

This makes it easy to concur with the first of Peter Walker's proposals - inform BGC and the Norwegians that HMG is not prepared to endorse the Sleipner contract.

The second proposal smacks of the interventionist hand of Sir Dennis Rooke:

"open <u>immediate</u> negotiations with potential suppliers with a view to securing a smaller import on the best competitive terms available, up to about 200 bcf a year (or 10% of likely demand in the 1990s);"

The one thing that is certain is that gas supply and demand in the 1990s are highly uncertain. Department of Energy views have changed markedly - and favourably - over the last few months. We are close to the major gas market place of continental Europe. For perhaps a decade - maybe more - that market will be a bargain basement. The Russians, the Algerians, the Dutch, the Danes and the Norwegians are all competing for business. There is no need to move quickly to line up half a Sleipner. As and when the need for gas imports is clearly foreseen - and that may be post 2000 - we can quickly tap into the continental European supply system. Meanwhile, if the Norwegians want to mount ambitious schemes, like using the UK as a "land bridge" into Europe, let them entice us with the economic benefits to the UK.

Peter Walker's conclusions do not cover the concept of a controlled gas export regime which is analysed in his paper. His primary reason for rejecting it is potential conflicts with the Treaty of Rome. However, his footwork may be a bit fast, since the legal advice was predicated on the Sleipner contract being concluded and thereby releasing UKCS gas for export.

That apart, we feel that there are other reasons why one would now feel less comfortable with such a regime. With Sleipner rejected, we will probably need all the UKCS gas we can get to sustain self-sufficiency through the 1990s. As noted above, Europe will be a bargain basement for at least a decade. Only low-cost Southern Basin gas could find a niche in that market - for bargain basement prices. To replace that export, we would require either imports or more expensive UKCS gas. Politically and logistically that looks odd.

Conclusions

i) Reject Sleipner.

ii) Reject BGC's efforts to rush back into the market for gas imports. By all means explore for bargains, but not urgently.

iii) First, see what the stimulus of market-related prices will do for UKCS supplies. So far the signs are encouraging.

(iv) Do not change rules on exports yet; leave that as a future option if we develop a big gas surplus. The Sleipner statement may need to refer to the export regime still being under consideration, since Treasury will not want to be hustled on this point.

JW

JOHN WYBREW

CONFIDENTIAL

PRIME MINISTER

Sleipner

Mr. Walker seeks early agreement to his proposal not to proceed with the Sleipner purchase. FCO and Treasury are likely to agree. FCO will probably minute on Monday offering advice on how to handle the disengagement from Norway.

Treasury will argue:-

(i) that BGC need be in no hurry to sign up other imported supplies but should shop around.

(ii) that Treasury have not been given adequate time to consider the arguments on the export regime. They will point out that the Law Officers' advice was on the assumption that Sleipner would be purchased which is no longer proposed. Would their advice be any different in present circumstances?

It is important to get the Sleipner announcement out of the way quickly. This will put an end to uncertainty and allow all parties to start thinking and planning on new assumptions. But we do not want to delay the announcement while further argument goes on about the export regime. Mr. Walker, on the other hand, needs to have a line as he will certainly be asked about exports when the announcement is made.

One way forward would be a holding reply along the following lines:-

"The Government has taken no decisions on whether to change the regime for exports but will, of course, keep the matter under review in the light of how the market for gas develops following this decision on Sleipner."

Treasury and other Departments can then argue at some length.

CONFIDENTIAL

Agree:-

(i) We do not proceed with Sleipner? Yes

(ii) BGC be in no hurry to find alternative imports? Yes - but Holland is the obvious one and they have some capacity if needed

(iii) Mr. Walker gives a holding reply on exports? Yes

(iv) That you await FCO advice on the diplomatic handling of the decision?

Yes - but not too late. The announcement should be early next week or it will leak

AT

1 February 1985

CF - any pp's
CRNO

PRIME MINISTER

SLEIPNER

Pt 9

For the past six months or so, following the remit I was given by ES on 20 June, Alick Buchanan-Smith and I have been negotiating with the Norwegians about aspects of the proposed Sleipner gas deal which we regarded as unsatisfactory. There have, however, been a number of important developments which have fundamentally altered the case for proceeding with the proposed purchase. The attached memorandum sets out my current assessment, in the light of the re-negotiation, and concludes that we should now turn down the present Sleipner deal whilst instructing the British Gas Corporation to pursue options for an alternative smaller gas import.

I hope that we can agree these conclusions in correspondence. The Norwegians are, of course, pressing for an early decision and I have promised to let them have our answer with the minimum delay.

I am copying this minute to the Secretary of State for Foreign and Commonwealth Affairs, the Chancellor of the Exchequer, the Secretary of State for Trade and Industry and to Sir Robert Armstrong.

SECRETARY OF STATE FOR ENERGY
31 January 1985

PROPOSAL TO PURCHASE SLEIPNER GAS: A REASSESSMENT

INTRODUCTION

1. ES(84) 2nd Meeting considered proposals for the possible purchase by BGC of gas from the Norwegian Sleipner field on the basis of the memorandum I circulated with my letter of 2 May 1984 to the Chancellor of the Exchequer. The main feature of BGC's proposals was that they should enter into a contract with the Norwegians to import Sleipner gas from 1991 until at least 2010 at a plateau rate of up to 550 bcf/year (representing 30% of total UK gas requirements) and at a balance of payments cost of between £1.4 billion and £2.4 billion/annum (1983 prices).

2. One of the main problems with the draft contract drawn up between the BGC and the Sleipner Group was this high maximum rate of delivery which could have had the effect of delaying developments on the UKCS. ES therefore invited me to open negotiations with the Norwegians with a view to reaching agreement on a lower rate of delivery (430 bcf/year) which would not be exceeded without HMG approval. In so far as there was opportunity to do so without prejudicing this principal objective, an attempt was also to be made to:-

(i) secure agreement to Sleipner liquids being landed in Britain on acceptable terms;

(ii) obtain a commitment from the Norwegians to give genuine full and fair opportunity on the Sleipner project for the UK offshore supplies industry;

(iii) secure agreement that the Sleipner Treaty should grant control over the 25% spare capacity in the Sleipner gas pipeline to the UK Government and control over the use of the 75% capacity dedicated to Sleipner gas to the UK and Norwegian Governments jointly.

3. ES also agreed that when the Sleipner proposal was brought back to the Committee for final decision, proposals for introducing a controlled gas export regime should be considered at the same time.

NEGOTIATIONS WITH THE NORWEGIANS

4. Negotiations with the Norwegian Government have proved difficult. Initially they refused to negotiate on any of the changes sought by the UK on the grounds that the two Governments should not interfere in an essentially commercial matter. However after six months of discussion we have finally won most of the concessions we sought. In particular it has been agreed that gas deliveries should be limited to 430 bcf per year unless HMG approves a higher figure. On other matters:-

(i) Sleipner liquids would be landed in the UK but the Norwegians insist on using a Norwegian-owned pipeline to Teesside rather than a UK-owned pipeline to Flotta; the Norwegians are offering compensation to HMG of £150 million (which might be capable of improvement in further negotiation) for loss of tax revenue that would have been due on tariffs on the UK-owned route. But we would still prefer the Flotta option since it would help extend the economic life of the Piper oil 'gathering' system and would result in up to £100 million additional orders, compared to the Teesside route, for the UK process plant and offshore supplies industries;

(ii) the Norwegian Government have offered UK industry full and fair opportunity but on a basis which in our view lacks 'teeth' and could result in Norwegian industry winning the lion's share of the orders. Such an arrangement would be difficult to defend politically, particularly given the expectation expressed by the Energy Select Committee that the Government would rigorously examine the terms of the deal to ensure that UK firms were allowed fair opportunities. It would quickly become apparent that the arrangements were deficient and that they would not enable us to verify that UK companies had been given an opportunity to compete or provide means of appeal if there was discrimination against them (as there almost certainly would be);

(iii) draft Treaty clauses have been negotiated which secure UK Government control over the use of the 25% spare capacity and joint UK-Norwegian control over the remainder.

A more detailed account of the outcome of the discussions with the Norwegian Government is at Annex A. The outcome is satisfactory except in the case of full and fair opportunity.

5. When I met Mr Kristiansen, the Norwegian Minister of Petroleum and Energy, in December, he made it clear that the Norwegians saw little scope for further concessions. He asked for an early decision whether or not we wish to proceed with the Sleipner purchase on the terms at present on offer.

6. There have however been three developments since May 1984 which in sum bear more importantly on the Sleipner decision than the detailed points covered in negotiation. First there have been new discoveries on the UKCS, leading my Department and BGC (in common with all the major oil companies) to revise upwards their estimates of UK gas supply in the 1990s to a greater extent than we previously envisaged. Secondly, the dollar has strengthened, pushing up sterling prices for gas and oil. Thirdly, the Law Officers have reviewed the likelihood of our being able successfully to defend challenge under the Treaty of Rome to a controlled export regime.

UK GAS SUPPLY AND DEMAND

7. BGC's decision a few years ago to increase their offer prices for UKCS gas, coupled with the incentives in the 1983 Budget, has led to an upsurge in exploration and appraisal drilling, which accelerated during 1984 and has in turn led to a significant increase in known reserves. In the April 1984 "Brown Book" my Department estimated remaining gas reserves in the proven plus probable categories at 41 trillion cubic feet (tcf). This estimate has now been raised to 47 tcf or about 26 years supply at the present rate of UK consumption.

8. Partly as a result of the increased reserve estimates and partly due to further appraisal work on previously existing finds, my Department have made substantial upward revisions to their forecasts of gas supply potential of the UK continental shelf. These have been offset to some degree by increases in forecast demand. Studies by my own Department and Sussex Univeristy confirm the BGC's view that they will be able to expand gas sales to industry during the 1990s as well as retaining interruptible sales beyond 2000. Earlier BGC had expected their interruptible sales to be reduced by over half by the year 2000, because of price competition from coal.

UK GAS SUPPLY AND DEMAND

(Bcf/year - May Estimates bracketed)

	1996*	2001
Supply		
Fields in production or under under development	790 (630)	350 (350)
New UKCS developments:		
- existing finds	1070 (980)	1500 (810)
- future finds	120** (100)	200** (240)
Total UKCS supply	1980 (1710)	2050 (1400)
	230 shortfall	460 shortfall.
UK Demand	1960 (1940)	1990 (1860)

i.e. shortfalls of 230 bcf in 1996 and 460 bcf in 2001 have now disappeared on the central estimates

* The previous forecasts for 1996 shown here differ from those quoted to ES last year because we have put the earlier estimates and the present ones onto a common forecasting basis so that valid comparisons can be made.

** Our estimate of recoverable reserves in future finds has been raised significantly but we now expect most of this gas to be produced after 2001.

9. Details of the supply and demand forecasts are set out in more detail in Annex B. In effect, there is now a smaller risk of deficit in UK gas supplies in the 1990s. However, since the supply and demand forecasts each fall within a range, there are still risks of a supply shortfall in the 1990s. For example Figure 3 in Annex B shows a highly plausible downside-risk case in which UK gas consumers would depend from as early as 1992 on a substantial and growing contribition of gas supplies coming from uncertain sources: gas fields which have not yet been discovered and gas condensate fields with many development problems yet to be solved.

INTERNATIONAL GAS SUPPLIES

10. There are no reliable indices of trends in natural gas prices. Unlike oil, there is no single price for internationally traded gas. Major deals are few and far between and details of terms are normally kept confidential both for commercial and political reasons (particuarly where important side deals, not directly reflected in the price of the gas, are struck as part of the package). Even so, it is widely reported that prices for new gas imports into Europe have fallen from a high of $4.70 - $5.50/MMBTU 3 years ago to between $3.80 - $4.20/MMBTU at present. This is in part due to falling oil prices (affecting old as well as new contract prices), slack demand and the readiness of the Soviets to undercut prices to expand market share (important new deals with the FRG and Italy are priced at $3.80/MMBTU).

11. Competition between suppliers to the European market has also increased. In addition to the Soviets, Norwegians and Algerians, the Dutch have, after 10 years, re-entered the export market with major new supplies firmly on offer. With demand from their existing customers not particularly strong, the Dutch appear keen to widen their market to include the UK. An opening offer in March was estimated to be priced 20% above Sleipner, due mainly to the construction of the price escalator. Understandably, having provisionally agreed to buy Sleipner from the Norwegians, BGC were not in a position to pursue alternative offers, but contacts with my officials suggest that the Dutch would be keen to negotiate on the basis of a revised offer, competitive with Sleipner.

THE DOLLAR-STERLING EXCHANGE RATE

12. The dollar price of oil remains a dominant influence on the development of gas prices, through its impact on producer expectations and escalation clauses incorporated in contracts and on competition between gas and other fuels in final markets. Weakening oil prices have depressed dollar prices for all fuels internationally. A weaker pound - which may or may not recur in the 1990s and after 2000 - has enhanced the value of indigenous resources and a greater degree of reliance on them.

13. The sterling cost of Sleipner gas, which is priced in dollars, has risen sharply in recent months due to the rise in the value of the dollar. This rise has been offset to some extent by falls in the dollar price of oil in the Sleipner escalator. But the overall effect has been an increase in the price of Sleipner gas from 28.9 pence per therm in the last quarter of 1983 to 34.7 pence per therm at the end of 1984, or 33.1 pence after allowing for the lagged effects of oil price changes to work through. This represents an increase in the sterling price of Sleipner of some 15 per cent. This increase should not however be viewed in isolation. The prices which the BGC is paying for new gas supplies from the UKCS have risen to a similar extent over the same period because they too are linked through escalators to oil prices. Should the pound recover against the dollar, the trend would be reversed. For example an exchange rate of $1.60 to the £, similar to that at the beginning of 1983, would reduce the present sterling price of Sleipner gas by 25% to 26 pence per therm, on the basis of present oil prices.

CASE FOR SLEIPNER

14. The case for HMG agreeing to the Sleipner purchase as currently proposed has weakened over the past few months. In the light of recent exploration and appraisal work it now appears more likely that UKCS gas supplies, supplemented until the early 1990s by imports already under contract, could meet Britain's gas requirements until the end of the century. It follows that if Sleipner

imports were to start in 1991, there would be a distinct risk that the development of some UKCS gas fields would be delayed by several years, with consequent delays in employment opportunities and tax revenues.

15. The price of Sleipner gas looks less attractive now following the downward movements of international gas prices and recent weakening of sterling. But I would not want to make too much of these factors. Both would be liable to further change before any actual payments were made for the gas in the 1990s and the Sleipner price, as negotiated, would be expected in any event to maintain broadly its present relationship to the price of oil.

CASE FOR LIMITED NEW IMPORTS

16. The main reason for the weakening of the case for buying Sleipner is the improvement in our prospective supply position relative to demand. There is always much uncertainty in forecasting supply availability so far ahead and in the case of our present forecasts there is considerable downside risk associated with two areas in particular:-

(i) the extent of reserves in the Frigg area. The BGC believe that recoverable gas in the main Frigg reservoir could prove to be as much as 1.3 tcf below the operator's (upper) estimate and could come off plateau as early as 1988, some 2 to 3 years earlier than the operator's least pessimistic forecast. The Department's reservior engineers take a middle view.

(ii) The increasing proportion of forecast UKCS gas output in the 1990s (about 25% by the end of the decade) derived from condensate fields in the central North Sea (ie fields containing very light oils and gas). Experience in developing such fields is very limited and there are considerable technical and economic uncertainties, which cannot be resolved until a late stage of appraisal, about the timing and size of the gas contribution.

The risk that supply will not be sufficient to meet demand is still significant and provides a sound case for taking a limited tranche of new imports in the 1990s. The political importance of ensuring that the gas industry meets its obligation to supply the need of its 16m domestic and smaller customers as well as the requirements of large industrial and commercial companies makes it essential to ensure supplies are available.

17. A policy of, effectively, restricting BGC to UKCS gas purchase would also be liable to overcorrect for the problems we inherited in 1979, going further than is necessary to maintain incentives for UKCS gas exploration and development and shifting the balance of negotiating strength too far in the oil companies' favour. A captive customer facing a sellers' market and possibly a producers' cartel in UK gas might generate additional tax revenues for the Exchequer but the consequences for gas prices and perhaps gas availability to more than 16 million consumers would be very damaging politically. It would also be contrary to our philosophy on competition.

18. Taking a modest level of import during the 1990s would guard against these risks. It would also provide a strategic hedge against an otherwise rapid prospective rate of decline in UKCS production in the early years of the next century.

OPTIONS FOR LIMITED IMPORTS

19. If the Sleipner deal is not pursued in its present form there are a number of possibilities for alternative imported supplies on a smaller scale, ie equivalent to some 10% of consumption in the 1990s:-

(i) the Sleipner field comprises two main reservoirs. The smaller of these, Gamma, could possibly be developed on its own, supplying about 200 bcf of gas per year at plateau;

(ii) the Sleipner field could be developed as proposed but the gas shared between BGC and, say, Ruhrgas and/or Gaz de France. The UK would, in effect, provide a land bridge for conveying gas from Norwegian waters, via a cross-Channel link, to the Continent. This would be constructed as an entrepot deal rather than export (paras 25-28 below) from the UK;

(iii) the whole Sleipner field might be capable of development at a still further reduced rate of delivery;

(iv) Dutch gas;

(v) Soviet gas.

20. It would not be possible to pursue these options in detail until Sleipner has been formally turned down. There are important strategic and wider international advantages in continuing to look to Norway and working to bring about the real contribution which the Norwegians are able to make, from their enormous gas reserves, to containing Western European dependence on Soviet gas. The US Government has recently again underlined the importance of the strategic considerations. An initial purchase of, say, Sleipner gas could well lead on to further developments harnessing other, more northerly Norwegian reserves and the general approach should command strong US backing. We do not know how quickly the Norwegians will be prepared to resume negotiations nor have we yet explored the extent of interest in France and Germany, though the French have made some informal overtures. Both countries are, in principle, adequately supplied into the 1990s but both have a strong strategic interest in broadening their base of supply and France may have some incentive to rein back on its high cost purchases from Algeria.

21. The Dutch option also has potential advantages. The gas could be supplied with more seasonable variation than Sleipner gas, possibly saving expenditure on new sources of peak supply. It could also be supplied on a shorter lead time than Sleipner and could be available by 1989 to offset any shortage from an early decline in Frigg supplies (Sleipner would not start production until two years later). But it might be subject to interruption if there were a serious supply shortage in Europe.

22. It is inconceivable that we would contract with the Soviet Union to cover, say, 10% of UK supplies in the 1990s. But I would not want, at this stage, to rule out exploring the terms the Soviets - as European price leader - have on offer, as part of the negotiating process with others.

CONTROLLED EXPORT REGIME

23. Without Sleipner. the question of a controlled export regime is not immediately at issue. I have, however, considered in consultation with interested Departments possible objective criteria on which to base a controlled gas export regime and have received further advice from the Law Officers on the legal standing of such a regime. The purpose of such a regime would be to safeguard the security of our gas supplies whilst avoiding unnecessary delays to gas field developments.

24. The main difficulty identified is that a controlled regime would not be compatible with the Treaty of Rome. The very concept of a control on exports is contrary to the Treaty. However, a total ban, where all are at least treated equally, is easier to maintain than a selective ban, with the discriminations inherent in allowing some to export and others not. Two possible defences to a challenge of a controlled regime have been identified. The first would involve a long term commitment to inflexible gas depletion objectives which are no part of our present policy and which would be difficult to demonstrate in practice. The second, the need to protect security of supply to British gas consumers, would have been undermined by the very fact of contracting a major secure source of imports (and could not be used with any guarantee of success to defend individual refusals to export which would, by definition, have only a marginal impact on future security of supplies).

25. The original objections to the remaining option of an uncontrolled export regime still stand. We would be powerless to determine the rate of exports, to prevent non-arms length deals (on a corporate or national basis) or to ensure that export developments were undertaken fully in the national interest. These arguments are spelled out in greater detail in Annex C. Above all, however, the

prospect of exports will no longer be required as a stimulus to UKCS developments, at least for the time being, given the closer correlation we now see between potential supply and demand in the 1990s. We can return to this question in a few years time if circumstances change, although clearly there would be serious risks in introducing a controlled export regime and fundamental objections to the introduction of an uncontrolled one.

26. Many of our oil and gas policies are vulnerable under the Treaty but have avoided serious challenge so far because they have been in place and undisturbed for many years. To attempt to introduce a gas export regime could well attract unwelcome and unnecessary attention to our policies, crucially affecting the development of the UKCS as a whole.

CONCLUSIONS AND RECOMMENDATIONS

27. In the light of all the changes in circumstances since the contract was first negotiated, I cannot recommend that we now agree to BGC proceeding with the Sleipner purchase. I am concerned, however, that alternative arrangements should be made as quickly as possible for the UK to import a smaller quantity of gas during the 1990s, to guard against supply shortfall and to avoid putting undue pressure on what remains, on latest estimates, a limited gas resource in the UKCS.

28. I, therefore, invite my colleagues to agree that I should:

(i) inform BGC and the Norwegians that HMG is not prepared to endorse the present Sleipner contract;

Why immediate?

(ii) instruct BGC to open immediate negotiations with potential suppliers of gas (paragraphs 21-24) with a view to securing a smaller import on the best competitive terms available, up to about 200 bcf a year (or 10% of likely demand in the 1990s);

(iii) make an early public announcement to this effect.

I shall report back on the outcome in due course.

Secretary of State for Energy

31 January 1985

ANNEX A

OUTCOME OF NEGOTIATIONS WITH THE NORWEGIAN GOVERNMENT

Rate of Delivery of Gas

1. The BGC and the Sleipner Group have agreed to revisions in their draft agreement which allow for annual contract quantities to be held down to 430 bcf per year unless HMG approves a higher figure. This was achieved without increase in the price despite the lower rate of delivery.

2. UK and Norwegian officials have also negotiated a draft Treaty article which specifies that when HMG grants authorisation for a Sleipner pipeline it will limit the throughput of Sleipner gas to 430 bcf per year.

Sleipner Liquids

3. The Norwegian Government is adamant that the Sleipner liquids should be landed at Teesside though a Norwegian-owned pipeline. The Sleipner Group would prefer that route for commercial reasons and tax revenue on the pipeline tariffs would go to Oslo.

4. The UK would gain substantial benefits if the Sleipner liquids were sent to shore by a UK-owned pipeline to Flotta in the Orkneys. The Exchequer would receive up to £180 million in tax revenue on tariffs (1984 net present value). The Flotta route would also be likely to result in up to £100 million more orders for the UK process-plant and offshore-supplies industries than the Teesside option. And the project would help extend the life of the Piper oil pipeline system, aiding eventual "gathering" of oil from a number of small fields in that area of the North Sea. The total economic advantage to the UK of the Flotta route is estimated at £250-300 million (1984 net present value).

5. The Norwegian Government has offered the UK compensation of £150 million if the Sleipner liquids go to Teesside. We believe that scope remains for negotiating this figure upwards to some extent.

Full and Fair Opportunity

6. The Norwegian Government has offered arrangements to help ensure that UK companies have the opportunity to bid for work on the £5000 million Sleipner project. Full details are attached. But the offer falls far short of the negotiating objectives of the Offshore Supplies Office (OSO) of the Department of Energy. In particular OSO would not have access to bid-assessment documentation and there would be no arrangements for appeal against contract awards which appeared to be discriminatory. Past experience suggests that under these circumstances there is a danger that UK industry might get a low percentage of Sleipner orders and Norwegian industry a high percentage, even in areas where UK firms have a strong competitive advantage. As an alternative the possibility of the Norwegians giving an informal undertaking that, say, 60% of the orders would come to British companies was considered, but the Norwegians saw insuperable difficulties with such an approach.

Draft Treaty Clauses

7. Norwegian and UK officials have negotiated draft Treaty Articles for inclusion in a written agreement between the two Governments which would have to be concluded before approval was given to the Sleipner deal. The Treaty articles cover gas transmission, taxes and charges, pipeline construction and operation, gas measurement, inspection of facilities, safety, and civil and criminal proceedings.

8. Among the many topics included in the draft Articles are provisions that:-

(i) Sleipner gas deliveries shall be limited to 450 bcf per year;

(ii) transmission of gas through the 25% spare capacity in the Sleipner pipeline shall be subject to HMG approval;

(iii) regulation of the construction and operation of the pipeline, and of measurement and safety matters shall rest with the UK on the UKCS and Norway on the Norwegian shelf (but inspectors of both countries shall have access to all parts of the pipeline system as necessary for safety and technical reasons);

(iv) civil and criminal proceedings with respect of the Sleipner pipeline shall be determined in accordance with UK laws on the UKCS and Norwegian laws on the Norwegian shelf.

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FULL AND FAIR OPPORTUNITY IN RESPECT OF THE SLEIPNER DEVELOPMENT

I. The following items have been suggested by MPE to be included in a memo of understanding between our governments.

1. It is the declared intention of both Governments that UK companies have a full and fair opportunity to compete for goods and services required for the development of the Sleipner field.

2. Accordingly, the Norwegian Government expects that UK companies will be invited to tender based on technical and commercial considerations by the operator.

3. It is in the interest of both Governments to continue and strengthen the regular contacts and consultations between OSO and MPE on questions concerning North Sea related procurement matters such as time schedule for major contract enquiries, relevant technical information, contract strategy etc.

4. MPE will ensure that OSO regularly receives information on UK-companies invited to bid.

   MPE will, based on submitted bids, inform OSO of the competitive status of UK-suppliers. Such information will be given as documentation in regular meetings between MPE and OSO.

II. In a meeting between OSO and Statoil on 7 November, Statoil presented their plans to ensure UK companies full and fair opportunities to compete for goods and services required for the development of the Sleipner-field. The main items are;

1. Statoil is willing to arrange seminars for UK industry in the same way as for Norwegian industry in order to review the project and allow the companies to be prepared to tender.

2. UK companies will be included on all bidders lists (possibly with the cooperation of OSO).

3. Evaluation of bids on an exclusively technical and commercial basis.

4. UK companies submitting unsuccessful bids may in the same way as Norwegian companies ask for a briefing on their competitive status.

III. Statoil has earlier expressed their willingness to send BGC a letter with the following content:

"In connection with our discussions concerning the manufacture and supply of the Sleipner Pipeline, we write to confirm that we will ensure that British Steel Corporation is given a full and fair opportunity to tender for and manufacture and supply the Sleipner Pipeline.

We also confirm that we, considering the time schedule for the Sleipner Project, will ensure the periods to be allowed for tendering and delivery will be such as will give interested suppliers, including those who have not previously manufactured pipe of the specification and size required for the Sleipner Pipeline, a fair opportunity for competitive bidding."

ANNEX B

UK GAS SUPPLY AND DEMAND

1. The Department of Energy has recently prepared an updated central forecast of UK gas supplies to 2005. The latest estimates are substantially higher than those prepared early in 1984 prior to the last ES discussion of the Sleipner question. Total UK gas supplies are now expected to be 240 billion cubic feet (bcf) per year higher on average in the 1990s than had been predicted previously. Comparisons between the new and old forecasts are shown in Table 1 below and, as graphs, in Figure 1 at the end of this Annex. Figure 2, following Figure 1, shows the make-up of the new forecast over time, as gas from existing developments is successively replaced by new supplies, initially from known fields and latterly, to an increasing extent, from less certain sources.

TABLE 1 - UK GAS SUPPLY

(bcf per year - previous forecast in brackets*)

	1986	1991	1996	2001
UKCS fields				
(i) In production or under development	1440 (1290)	1090 (1120)	790 (630)	350 (350)
(ii) Discovered but not yet under development	10 (140)	600 (760)	1070 (980)	1500 (810)
(iii) Future finds	0 (0)	0 (0)	120 (100)	200 (240)
Imports				
(i) Existing contracts	480 (500)	360 (180)	0 (0)	0 (0)
Total supplies from UKCS and already-contracted imports	1930 (1930)	2050 (2060)	1980 (1710)	2050 (1400)

* The 1996 figures shown here for the previous forecast differ from those quoted to ES last year because we have put the earlier estimates and the present ones onto a common forecasting basis so that valid comparisons can be made.

2. The main changes between the two forecasts can be summarised as follows:

(i) UKCS fields in production or under development

Expected output in the period 1985-2005 has increased in total by 1.7 trillion cubic feet (tcf) due to a number of fields (Esmond, Forbes, Gordon and Victor) having moved to the development stage during recent months.

(ii) Existing import contracts

Supplies from the Frigg area in the years 1985-1995 are now expected to be 0.8 tcf higher because additional satellite fields are being tied in to the system (East and South East Frigg and Odin);

(iii) UKCS finds not yet under development

Record levels of exploration and appraisal activity in the southern and central North Sea (combined with sustained success rates) have contributed through new discoveries and further proving-up of old finds a further 4.2 tcf of expected gas output between 1990 and 2005;

(iv) Future finds

Reassessment of the prospects for future discoveries has confirmed earlier assumptions that an additional 7.0 tcf of recoverable reserves may be found in the Southern Basin of the North Sea by the year 2000. Much of this gas, assuming that it is found, will take many years to appraise and develop. The new forecast assumes that gas from new finds will be rather more delayed in contributing to UK supplies than had previously been assumed. No allowance is made for gas supplies from future finds in the central and northern North Sea or elsewhere on the UKCS.

3. The new supply forecasts are of course subject to uncertainty and are most unlikely to prove to be correct, even though they are based

on the best information available to the Department of Energy. The most serious risks arise if they are in reality over-estimates and if policy decisions taken on the basis of them result in the 1990s in gas shortages or enforced rationing.

4. The BGC have also revised upwards their forecasts of UK gas supplies since early 1984, in their case by about 250 bcf per year on average in the 1990s. However the BGC started with a lower supply forecast than the Department and their central case remains on average 170 bcf per year below the Department's forecast in the 1990s. The principal reason for this difference is a 1.2 tcf gas find in the central North Sea which has not been announced publicly; the Department has information on this field but BGC do not. The other main source of difference arises on the Frigg field. This reservoir has natural water-drive and output from the main development will decline from plateau to zero over 18 months or so in 4 or 5 years time. The operator, Elf Norway, and BGC have not yet established the extent of remaining recoverable reserves, nor the timing of the final plunge in output. The Department of Energy has adopted a middle position between the operator's and BGC's estimates in the new forecast. BGC forecast that Frigg output could start to decline in 1988, a year earlier than the Department has assumed, and will finally contribute 0.4 tcf less gas than in the Department's forecast. Elf Norway are carrying out further appraisal of the reservoir to clarify the position but the results will not be available until the end of the year.

Demand

5. The Department has also updated its assessment of UK demand for gas up to 2005, and the new estimates are higher than the early 1984 demand forecast, although not to such a marked degree as on the supply side. Overall UK demand is now expected to be over 100 bcf per year higher by the end of the 1990s than had previously been forecast.

The new and old forecasts are compared in Table 2 below:-

TABLE 2 - UK GAS DEMAND

(bcf per year - previous forecast in brackets)

	1991	1996	2001
Domestic	1030 (1030)	1050 (1050)	1050 (1050)
Commercial	310 (310)	310 (310)	310 (310)
Industrial:			
Regional Firm	220 (240)	230 (240)	240 (240)
Regional Interruptible	230 (210)	270 (180)	200 (100)
HQ Sales	160 (170)	20 (100)	20 (100)
[Total Industrial	610 (620)	520 (520)	560 (440)]
Own Use and Losses	90 (70)	80 (60)	70 (60)
Total Demand	2040 (2030)	1960 (1940)	1990 (1860)

6. The main change between the two forecasts is that the Department now takes the view that the BGC will be able to increase interruptible sales to industry during the 1990s. (In the May 1984 paper the Department mentioned that it was possible that BGC could retain interruptible sales in the 1990s but in the demand forecast itself it was assumed that price competition from coal would squeeze the BGC out of this part of the industrial market by 2000). The Department's latest views on interruptible gas demand are based on the results of research by the Science Policy Research Unit at Sussex University carried out on behalf of the Department.

7. The Department's demand projection (Table 2) is based on an assessment of the BGC's latest forecast. It falls near the centre of a range of approximately 150 bcf in 2001 on the assumption that current BGC pricing policy is continued. In nearly all respects there

is close similarity of view on demand but the BGC are more optimistic than the Department about the outlook for gas sales to petrochemical and fertiliser manufacturers in the 1990s. ICI are currently supplied with cheap gas under a contract which will expire in 1989. There are doubts about whether BGC would retain this business in the 1990s at Sleipner-level prices; continued sales could be dependent on cross-subsidisation to lower the feedstock price. The Department's forecast assumes that BGC's petrochemical sales would be reduced by about 130 bcf/year between 1990 and 1995 whereas the BGC assume a drop of only 40 bcf/year.

SUPPLY-DEMAND BALANCE

8. The increase in the level of UK gas supplies which the Department is forecasting for the 1990s is expected to be only partly offset by increased demand. As a result there now seems to be a fair chance that the widening gap which had previously been predicted to open up between supply and demand in the absence of new imports in the early 1990s will not start until rather later. Table 3 below and Figure 1 at the end of this Annex compare the balance between forecast UK gas supply and demand on the new basis with our expectations in early 1984.

TABLE 3 - UK GAS SUPPLY AND DEMAND

(bcf per year - previous forecast in brackets)

	1991	1996	2001
Total supplies from UKCS and already-contracted imports	2050 (2060)	1980 (1710)	2050 (1400)
Total UK demand	2040 (2030)	1960 (1940)	1990 (1860)

9. But Table 3 makes no allowance for downside risk. Table 4 below and Figure 3 at the end of this Annex show what could happen to the Department's forecast of demand/supply balance if output from the

Frigg area proved to be lower than is assumed in the Department's central case and if demand from the petrochemical industry was higher than assumed:-

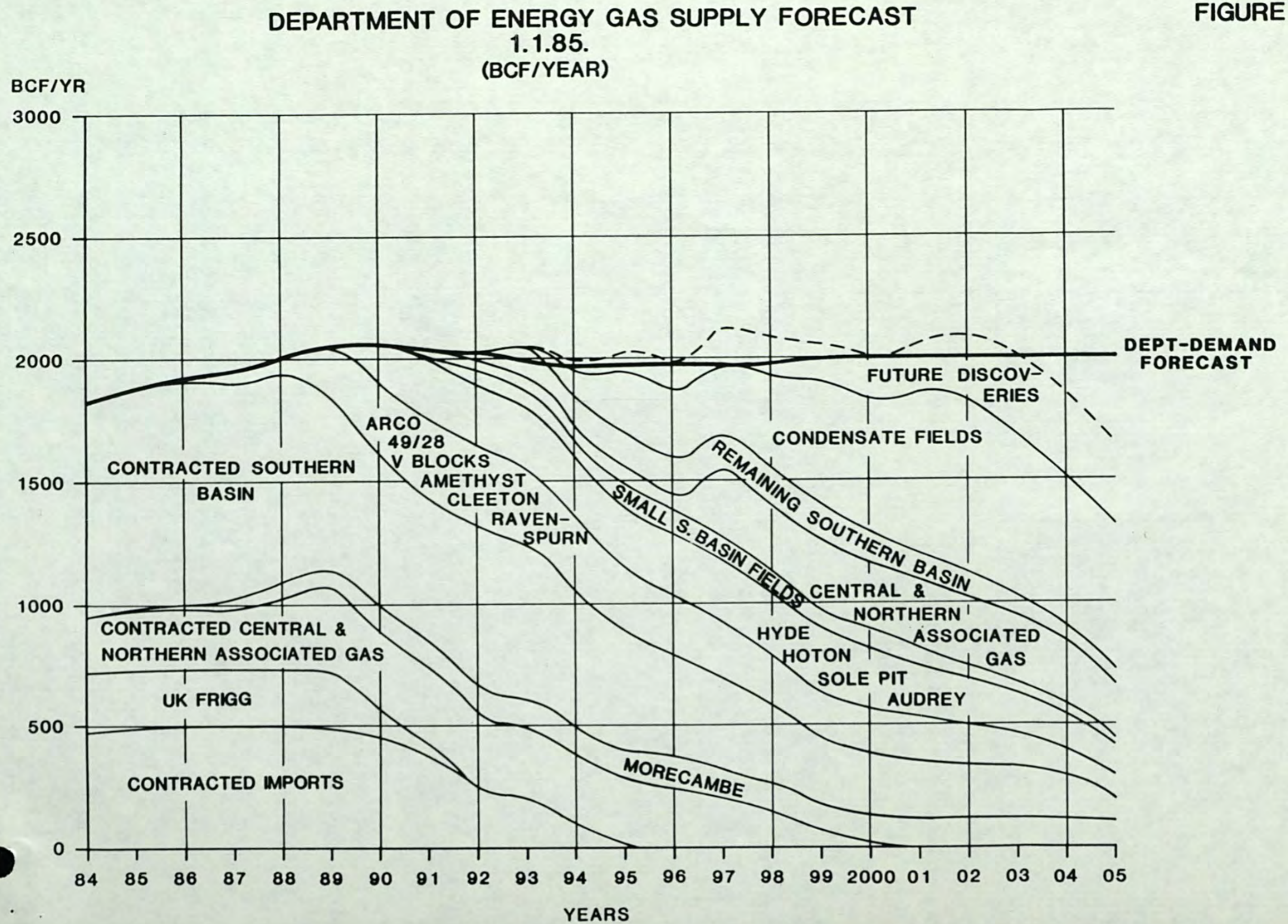
TABLE 4 - UK GAS SUPPLY AND DEMAND COMPARISON BETWEEN RISK MODIFIED AND CENTRAL CASE

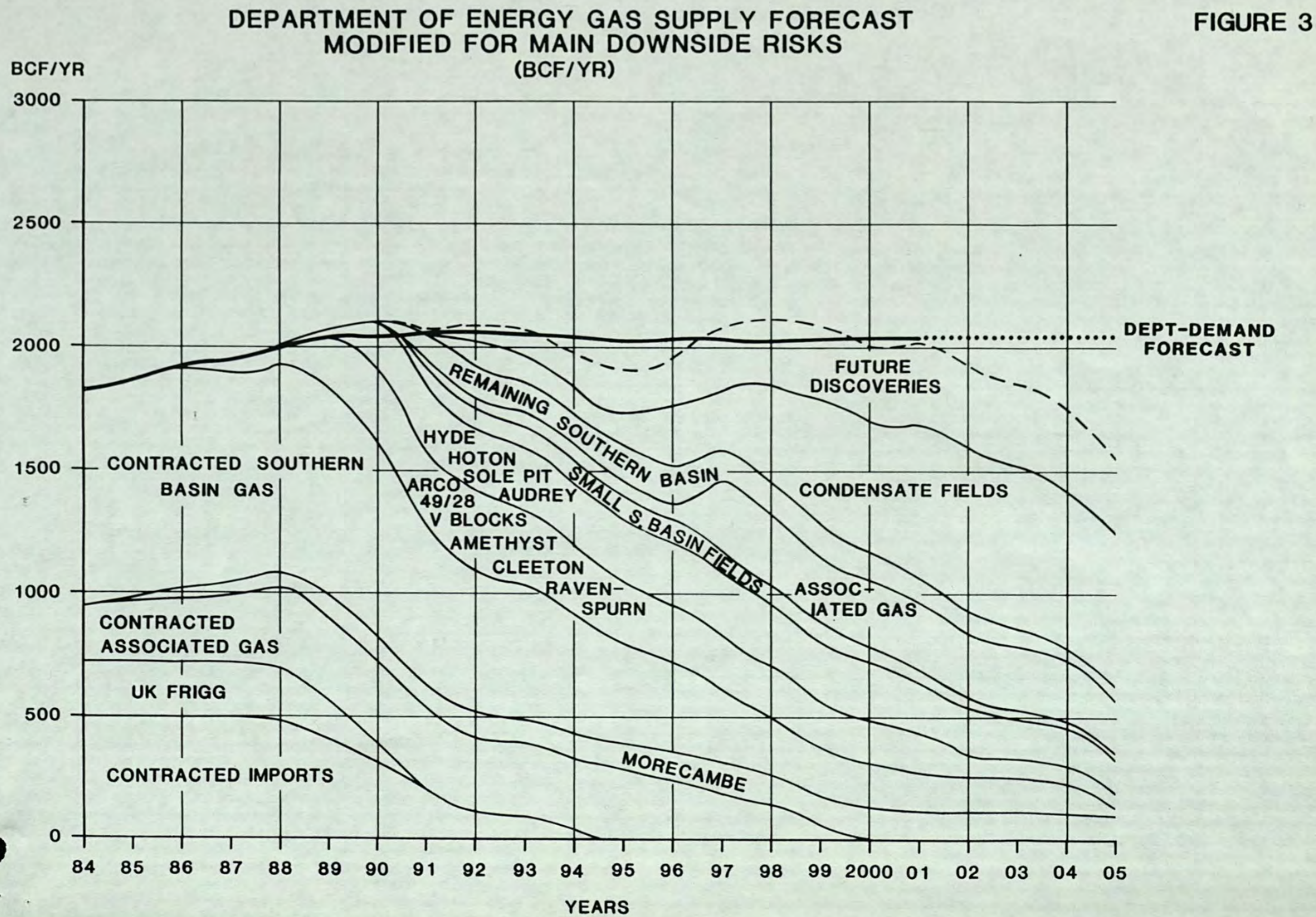
(bcf per year - central case in brackets)

	1986	1991	1996	2001
UKCS Fields:				
(i) In production or under development	1430 (1440)	1060 (1090)	720 (720)	270 (350)
(ii) Discovered but not yet under development	10 (10)	790 (600)	1030 (1070)	1420 (1500)
(iii) Future finds	0 (0)	10 (0)	220 (120)	320 (200)
Imports				
(i) Existing contracts	490 (480)	190 (360)	0 (0)	0 (0)
Total supplies from UKCS and already-contracted imports	1930 (1930)	2050 (2050)	1970 (1980)	2010 (2050)
Total Demand	1930 (1930)	2060 (2040)	2040 (1960)	2040 (1990)

10. Table 4 and Figure 3 show that a real risk remains that gas consumers could go short of gas if the UK relies on indigenous supplies alone from the mid-1990s. And dependence both on gas not yet found and on condensate fields could start as early as 1991. Some degree of insurance against these risks would clearly be prudent and Figure 4 shows the effect of introducing a limited supply of new gas imports from 1991 onwards, reaching plateau at 180 bcf per year in 1993 (about 40% of the Sleipner plateau or 10% of UK demand). As Figure 4 indicates this strategy would leave ample scope for development of new UKCS gas fields but would reduce considerably the risk of shortfall in supplies to UK consumers.

FIGURE 2


DEPARTMENT OF ENERGY GAS SUPPLY FORECAST
1.1.85.
(BCF/YEAR)
BCF/YR
3000
2500
2000
1500
1000
500
0
84
85
86
87
88
89
90
91
92
93
94
95
96
97
98
99
2000
01
02
03
04
05
YEARS
DEPT-DEMAND FORECAST
FUTURE DISCOVERIES
CONDENSATE FIELDS
REMAINING SOUTHERN BASIN
SMALL S. BASIN FIELDS
CENTRAL & NORTHERN ASSOCIATED GAS
HYDE
HOTON
SOLE PIT
AUDREY
ARCO 49/28
V BLOCKS
AMETHYST
CLEETON
RAVEN-SPURN
CONTRACTED SOUTHERN BASIN
CONTRACTED CENTRAL & NORTHERN ASSOCIATED GAS
UK FRIGG
CONTRACTED IMPORTS
MORECAMBE


DEPARTMENT OF ENERGY GAS SUPPLY FORECAST
MODIFIED FOR MAIN DOWNSIDE RISKS
(BCF/YR)
FIGURE 3
BCF/YR
3000
2500
2000
1500
1000
500
0
84
85
86
87
88
89
90
91
92
93
94
95
96
97
98
99
2000
01
02
03
04
05
YEARS
DEPT-DEMAND FORECAST
FUTURE DISCOVERIES
REMAINING SOUTHERN BASIN
CONDENSATE FIELDS
SMALL S. BASIN FIELDS
ASSOCIATED GAS
HYDE
HOTON
SOLE PIT
AUDREY
ARCO 49/28
V BLOCKS
AMETHYST
CLEETON
RAVEN-SPURN
CONTRACTED SOUTHERN BASIN GAS
CONTRACTED ASSOCIATED GAS
UK FRIGG
CONTRACTED IMPORTS
MORECAMBE

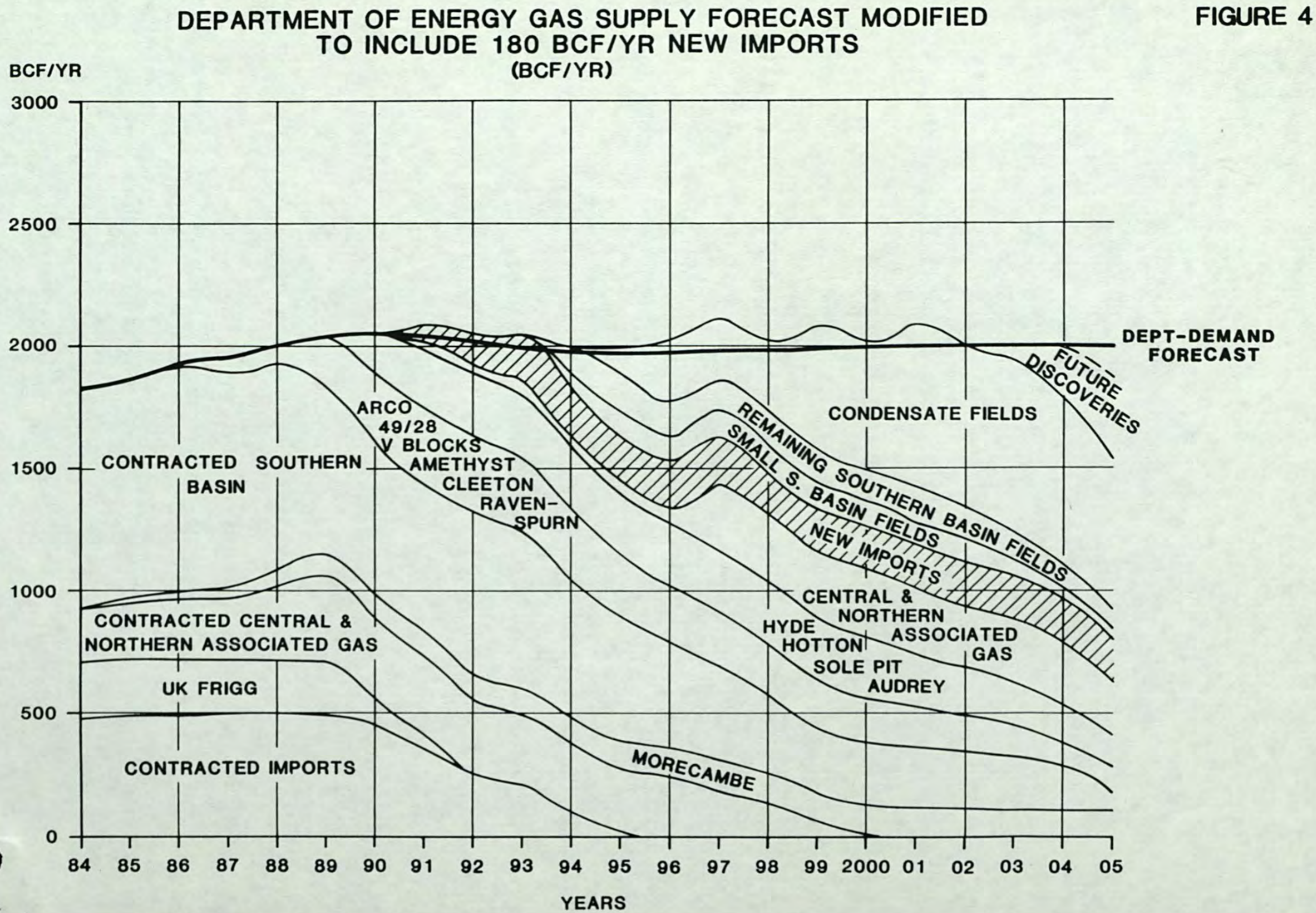
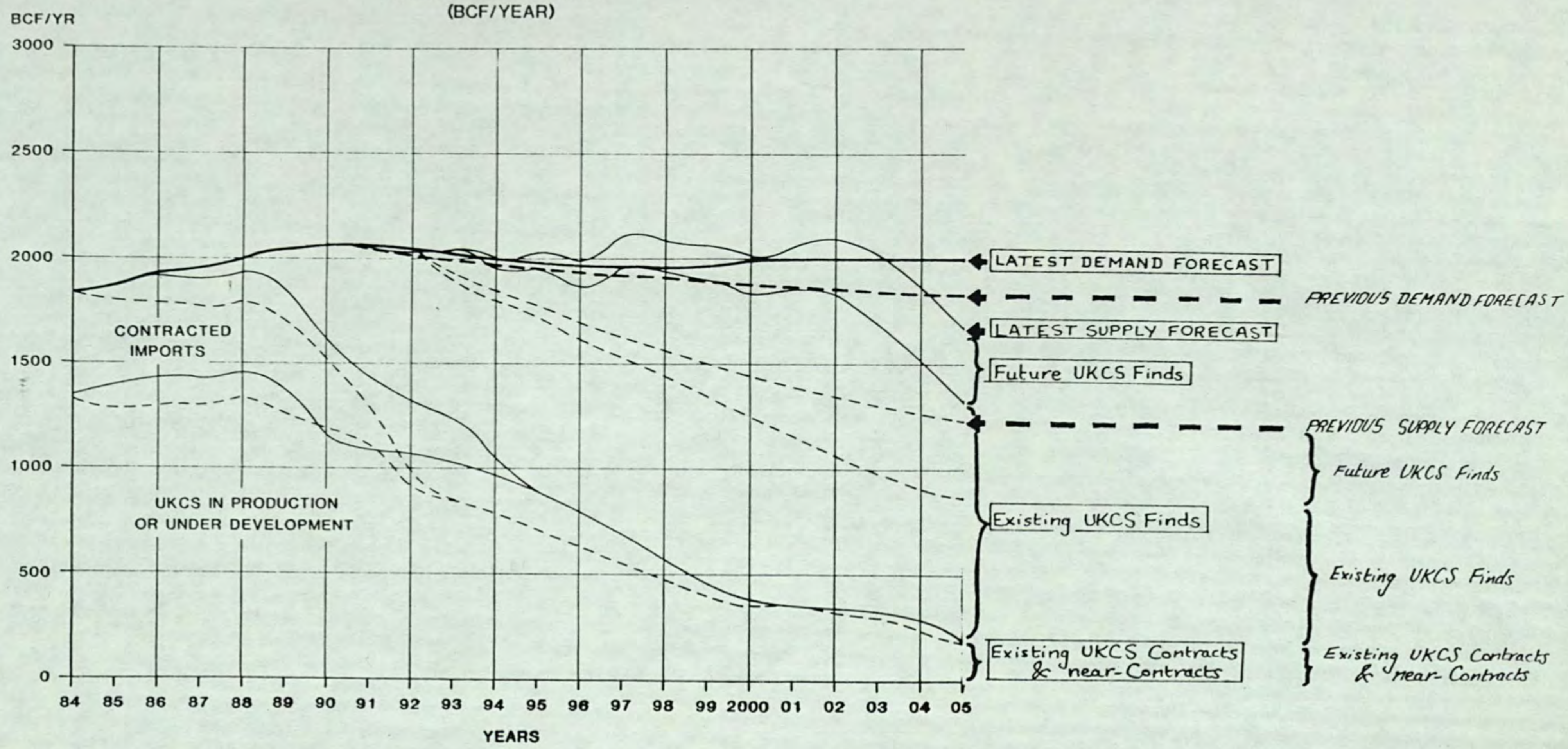


FIGURE 4
DEPARTMENT OF ENERGY GAS SUPPLY FORECAST MODIFIED
TO INCLUDE 180 BCF/YR NEW IMPORTS
(BCF/YR)
BCF/YR
3000
2500
2000
1500
1000
500
0
84
85
86
87
88
89
90
91
92
93
94
95
96
97
98
99
2000
01
02
03
04
05
YEARS
DEPT-DEMAND FORECAST
FUTURE DISCOVERIES
CONDENSATE FIELDS
REMAINING SOUTHERN BASIN FIELDS
SMALL S. BASIN FIELDS
NEW IMPORTS
CENTRAL & NORTHERN ASSOCIATED GAS
HYDE HOTTON SOLE PIT AUDREY
ARCO 49/28 V BLOCKS AMETHYST CLEETON RAVEN-SPURN
CONTRACTED SOUTHERN BASIN
CONTRACTED CENTRAL & NORTHERN ASSOCIATED GAS
UK FRIGG
CONTRACTED IMPORTS
MORECAMBE

FIGURE 1

DEPARTMENT OF ENERGY FORECASTS OF GAS SUPPLY & DEMAND TO 2005 (BCF/YEAR)



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A GAS EXPORT REGIME

ANNEX C

1 ES(84)2nd meeting agreed that in parallel with pursuing the Sleipner negotiations, proposals should be considered for introducing a controlled gas export regime based on objective criteria.

2 A wide range of criteria were subsequently identified (some 20 in all) for possible inclusions in a regime. These were considered against the prime objectives of avoiding delays to UKCS developments as a result of the prospect of surplus gas arising from the Sleipner purchase and the maintenance of security of supply to British gas consumers. Out of the full list of possible criteria, four were regarded as best suited to these objectives.

a) the rate of return available to developers (if the BGC offer price was inadequate to justify development);

b) whether firm supplies were available over a future period (eg. 5 to 10 years ahead) and the extent to which these assured security of supply.

c) whether a development would have to be delayed for a long period if the export were not allowed;

d) the gains or losses to the offshore gas gathering infrastructure.

3 Fumdemantal to any controled regime is its defensibility against challenge under the Treaty of Rome. The implications of this for the criteria as a whole as well as for a regime based on the preferred short list were therefore considered in consultation with interested Departments before obtaining the Law Officer's advice. Earlier advice had suggested that

there were reasonable prospects of defending a controlled regime based on ensuring continued security of gas supplies (criteria (b) above). However at that stage the Law Officers had not been asked to consider the effect on the defensibility of a regime that the Sleipner purchase itself might have, nor the defensibility of other criteria such as (a) and (c) above more directly based on economic and fiscal discrimination in favour of the UK. The earlier advice was also subject to the outcome of the Whitegate Refinery case then before the European Court.

Issues put to the Law Officers

4 In the light of these developments, the Law Officers were asked to consider the degree to which a regime, now more closely defined and directly linked to the purchase of Sleipner, could be defended under the Treaty.

5 The argument centres on Article 34 which states that "Quantitative restrictions on exports, and all measures having equivalent effect, shall be prohibited between Member States" and how far an exemption in Article 36, "The provisions of Article 34 shall not preclude prohibitions or restrictions on ... exports ... justified on grounds of public morality, public policy or public security ...", can be applied to gas exports. The specific issues put to the Law Officers were:

i) the strength of the argument that gas supplies are essential to the public security of the State and hence the degree to which security of supply can be maintained through controls on exports under Article 36;

ii) the extent to which each of the 20 or so criteria identified in the full list for possible inclusion in a regime were defensible;

iii) whether a mixture of defensible and indefensible criteria would weaken or negate the overall acceptability of a regime. A two tier mechanism was suggested, with decisions justified in public against defensible criteria while in private additional (indefensible) criteria were taken into account;

iv) the degree to which it was possible or desirable to publish the details of a regime and the terms in which any announcement should be made.

Advice was also sought on the impact on a controlled gas export regime of the recent Whitegate Refinery Judgment by the European Court.

Advice on Defensibility of a Regime

6 The Law Officers have obtained Counsel's opinion on the defensibility of a regime the outcome of which as endorsed and qualified by the Law Officers, is summarised as follows:

a) Risk of challenge. There is a significant risk that any form of controlled regime will be held to infringe the Treaty. The very notion of an authorisation to export is, on the face of it, contrary to the Treaty. It can of course be argued that the current complete ban on exports is harder to defend and that a partial ban might be easier to justify. However, this advantage could be offset by the greater risk of challenge to a partial ban. It would create the general expectation that exports were allowed, so that a particular refusal to export might be more likely to challenge than if there had never been any prospect of exports.

In addition to disrupting the status quo for the gas landing requirement, there is the risk of a challenge to the landing requirement for oil as a consequence of liberalising the gas regime.

b) A general defence of the regime. A distinction is drawn between the defence of the regime as a whole and that of individual decisions taken under it. Counsel's Opinion introduces the argument that a State is entitled to formulate a depletion policy for its own natural resources and if, purely as a consequence of this policy, one result is to limit the resources available for export then the Treaty could be held not to apply. To be successful it would be necessary to:

i) identify a viable depletion policy which had nothing to do with limiting exports;

ii) demonstrate clearly that the refusal of a particular export was designed to meet depletion policy objectives and was not simply a disguised restriction on exports;

iii) show that reserving a substantial share of UKCS production to the home market was justified on security of supply grounds and did not involve arbitrary discrimination between producers, Member States or in favour of the UK on price or economic grounds.

The Law Officers have endorsed this argument as the main overall defence of a regime, having expressed doubts about the strength of the original security of supply argument, brought about by the prospect of purchasing Sleipner.

c) <u>Security of Supply.</u> The Law Officers regard the very fact of purchasing Sleipner, with the major increase in firm supplies available to Britain, as weakening the security of supply defence. The more comfortable the supply position, the greater the difficulty in demonstrating that genuine hardship would result from exports. The argument is nonetheless thought capable of use in two ways; as a secondary defence of the regime as a whole, and as a partial justification of individual refusals to export. But its use in individual cases is further weakened by the difficulty of justifying any particular security threshold adopted and the ability to dispute the estimates on which it was based.

d) Publication. Any regime should be presented as a depletion policy based on certain principles (rather than carefully defined criteria which would encourage disputes about their validity and application), emphasising the need for flexibility. The Law Officers also strongly advise against attempting to operate a two tier mechanism: "it would be particularly unwise to publish criteria or guidelines governing the decision-making process and then employ other criteria or guidelines in fact". They also point to the possibility of claims for damages (which in the case of gas exports could be considerable) being made if a refusal were successfully challenged.

d) Disclosure. The Law Officers warn that a refusal to export, if challenged, could lead to disclosure of the documents relating to the decision-making process. Demands for disclosure might be limited to those documents relating to the individual decision, although further disclosure of documents relating to the whole policy (if the need for justice was held to outweigh public interest immunity) could not be ruled out.

7 Lastly, on a point of domestic law, the Law Officers advise of the need not to fetter the exercise of Ministerial discretion. Objective criteria could not therefore be framed so as to apply automatically; there must always be flexibility to take account of the particular circumstances of each case.

Conclusions on the Law Officers' Advice

8 The advice casts considerable doubt on the ability to operate successfully a controlled export regime defensible under the Treaty. It gives rise to three main difficulties.

9 First, while in strictly legal terms the risk of challenge may not be significantly greater between a total and a partial ban, in practice the risk is considerably increased. Under a total ban all producers are treated equally. But discrimination is inherent in a controlled regime; some would be allowed

to export, others not. Those refused permission would inevitably regard the decision as arbitrary and hence unreasonable. While producers with a future on the UKCS may hesitate before challenging HMG, potential continental customers for the gas would not be under the same constraint.

10 Moreover, many of our UKCS policies are questionable under the Treaty (indeed, four of the published criteria for the 9th Round of Licensing are currently the subject of correspondence with the Commission). But these have escaped serious challenge so far mainly because the policies have been in place and undisturbed for many years. The major disruption to the status quo resulting from the introduction of a controlled regime could trigger an investigation into our UKCS policies which went beyond gas.

11 Secondly, the requirements of the <u>depletion</u> <u>policy</u> argument, now regarded as the primary defence, have serious drawbacks both on policy and practical grounds. For the argument to work it would involve a high degree of commitment to a restrictive depletion policy openly designed to constrain the pace of gas developments in the longer term. This is not part of the Government's economic philosophy and is contrary to the greater reliance now being placed on the UKCS to meet future demand. It would also be unwelcome in the practical sense. To be convincing it would, for example, necessitate refusing at least one development needed to satisfy home demand simply to illustrate that the depletion policy applied equally to developments destined for the home and overseas markets (and hence was distinct from a control on exports).

12 Thirdly, the reservations now expressed about the <u>security</u> <u>of</u> <u>supply</u> argument reinforce earlier doubts about the strength of this defence. These particularly concern the ability to show that a shortage of gas would have the same dire consequences for the country as a shortage of oil; whether a sudden shortage, which would not permit alternative supply measures to be taken, could in fact arise as a result of a particular export; and

whether it could be argued that it was reasonable to seek to protect a high level of supply (eg. 100% or 75% of current demand) 5 or 10 years into the future. This last point would be particularly difficult to demonstrate in the case of individual refusals to export. The size of future gas developments is likely to be small and by definition each would have only a marginal impact on the level of total available supplies.

13 There is thus not a single criterion or group of criteria which could provide a reasonable defence under the Treaty and meet the objectives of a controlled regime. The best available option would be to attempt to present exports as part of a far reaching depletion policy based on broad principles without reference to objective criteria. Even if acceptable on policy grounds, there would be considerable difficulty in formulating a depletion regime which successfully disguised the true intent of controlling exports. The Law Officers have advised against operating a two tier regime with decisions defended against certain public guidelines while different and indefensible criteria were applied in private. They also warn of the risks of disclosure and compensation. The original defence, security of supply, is now held to be of secondary importance in justifying a regime and an incomplete defence of individual decisions taken under it. There is therefore little certainty that a challenge could be defended successfully and the risk of provoking a challenge would be greatly increased by the introduction of a controlled regime as opposed to maintaining the present status quo.

<u>Uncontrolled Gas Exports</u>

14 The only remaining alternative to the status quo would be to remove completely all controls over the export of gas. Although ES has decided against this, it is worth summarising the main objections to this option:

a) the door to gas exports could be jammed open. Once an uncontrolled regime was introduced there would be no prospect of re-imposing either a partial or total ban;

b) the introduction of an uncontrolled regime would be a more significant disruption to our offshore policies as a whole than that represented by a controlled regime. The sharp distinction between a free regime for gas and the controls retained over oil would be bound to provoke a Commission investigation into our remaining UKCS policies.

c) the UK would be powerless to determine the rate of exports, irrespective of the security of supply position in the home market.

d) the European gas market is itself far from free. Contract negotiations are subject to open political direction. European gas purchasers are either nationalised or heavily influenced by government and a European consortium operates as a buyers' cartel. Similarly, many UKCS gas producers have substantial interests in Continental gas industries and some are state controlled.

e) in the absence of a free market, UKCS gas could be exported at below its true value and it would be impossible effectively to police deals involving UKCS producers with vested Continental interests. (A deal between Elf/ Total and Gaz de France for example could deny tax or price value to the UK to the advantage of the French economy).

f) demand for new gas supplies in the UK and Continental markets are unlikely to match. A bout of purchasing for export one year (when UK prospects might be slack) could leave the UK market short or forced to purchase at a premium the next.

g) a measure of control over the development of UKCS gas fields would be lost. Producers would submit development applications only after export negotiations were complete and in accordance with the export contract. The development of the UK gas gathering infrastructure would also be impaired.

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SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

4 January 1985

Dear Peter

FINANCIAL TARGET FOR THE ELECTRICITY SUPPLY INDUSTRY

I find myself at a loss to understand your letter of 20 December about the Electricity Supply Industry's financial target.

I have made my position clear throughout, and in particular in my letters of 12 and 13 November to you. You knew from my letter of 12 December that I was committed to confirming the target and the performance aim underlying it to the Chairman of the Electricity Council before the Council met on 20 December. That was the package deal I had reached with Philip Jones, in line with my letter to Willie Whitelaw of 24 October, that enabled me to bring about such a satisfactory outcome to the IFR, as far as electricity was concerned. You knew that no other option was open to me that did not involve a breach of faith.

As you requested, my officials discussed with yours the figures supporting the financial target and the performance aim. They agreed that there were detailed points, about the coverage of the performance aim in particular, that could reasonably be discussed with the industry. But my officials stressed to yours that I was, as I had explained, committed to confirming the financial framework by 20 December.

Against this background, I find it astonishing that you should record in your letter of 20 December that you regard the Treasury as not committed to, or constrained by, the framework I on behalf of the Government have now announced in confirmation of an agreement which colleagues knew I had reached with the industry during the IFR.

CONFIDENTIAL

This is, indeed, "a most unfortunate way of doing business". However you describe the Treasury's attitude, I shall continue to regard my announcement as the Government's position.

I am copying this letter to the Prime Minister.

PETER WALKER

NAT IND: Electricity

4 JAN 1985

010/106

CCNO

CONFIDENTIAL

NBPM

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

20 December 1984

Dear Secretary of State

FINANCIAL TARGET FOR THE ELECTRICITY SUPPLY INDUSTRY

— with A17

Thank you for your letter of 18 December.

In my letter of December 17 I made clear my reservations about announcing the financial target at present and I set out the further work that was needed before the performance aim could be announced. In an effort to be helpful I said that, on certain conditions, I would be prepared to see the target announced now.

You have felt unable to meet these conditions but, instead of discussing the matter with me, you have simply gone ahead and announced both the target and the aim. This is a most unfortunate way of doing business. I must make quite plain that, as you have proceeded without my agreement, the Treasury does not see itself as in any way committed to, or constrained by, the target and aim you have announced.

I am copying this letter to the Prime Minister.

Yours sincerely

J Broadbent

for PETER REES

[Approved by the Chief Secretary]

CONFIDENTIAL

NAT. IND PT 10

GAS ELECTRIC

20 DEC 1984

CEND 2

01 211 6402

Prime Minister

19/12

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

18 December 1984

Dear Peter

FINANCIAL TARGET FOR THE ELECTRICITY SUPPLY INDUSTRY

Thank you for your letter of 17 December about the electricity supply industry's financial target and performance aim. I have now confirmed to Philip Jones, before his Council meeting this week, the understandings I reached with him during the IFR.

As to any Scargill surcharge, I have made it clear publicly on many occasions that no decisions have yet been taken on meeting the costs of the strike and that we shall return to that subject when it ends. I have made the same point to Philip Jones and have done so again in informing him of the agreed financial target. I cannot however make a public statement to the effect that the esi target we are only just setting will be reviewed when the strike ends without being widely seen as implying that we have already decided to impose a Scargill surcharge. That would, in my judgement, be politically inept and damaging to the stance we have adopted on this issue for many months now. Moreover, it is very early to say that we must review a three year Financial Target to take account of strike costs which may not continue into 1985/86, and in doing so to leave the industry without any firm financial guidelines. In any event, it would be open to us to deal with extra costs and a surcharge raised to meet them as a separate matter outside the financial targets if we so decided.

As for the performance aim, I understand that my officials have already dealt with the queries raised by yours. I must tell you that Mr Jones, correctly regards the performance aim as part of the package I agreed with him and considers it to be a very demanding one. Of course, we must encourage nationalised industries to pursue improved efficiency to the maximum possible extent. But I cannot demand a "best endeavours" element in a performance aim that I know is very demanding, as indeed is the whole financial framework I negotiated during the IFR. I am confident, however, that the management of the industry will, in practice, use their best endeavours to surpass the performance aim we are now setting.

My officials have already agreed to consider with yours and with the industry whether it is possible to devise performance aims in areas not covered by the existing one. I am sure that is the best way to proceed.

I am copying this letter to the Prime Minister.

Peter

PETER WALKER

NAT IND : Gas prices : Pt 10

TdM

019/110

CONFIDENTIAL

CENO

NBPM

05/12/12

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London
SW1P 4QJ

17 December 1984

Dear Peter

FINANCIAL TARGET FOR THE ELECTRICITY SUPPLY INDUSTRY

Thank you for your letter of 12 December.

As you say, your officials have been over the proposed performance aim with mine. They have recently sent some further information and I understand my officials have raised some queries in this. Until these are resolved I will not be clear how the proposed aim does relate to the savings you agreed with Philip Jones.

Beyond that, I think we need to consider whether it is enough to set a performance aim that reflects only the level of efficiency assumed in the external financing limit and requirements which came out of our recent IFR discussions. The last performance aim for the electricity industry contained an element for efficiency over and above this level. The element was accepted by the industry on a "best endeavours" basis. The current aims for the Scottish Boards contain a similar element.

I see advantage in setting aims with this additional element of challenge in them. I am sure it is common ground between us that we should do everything to encourage these industries to pursue improved efficiency. I suggest our officials should discuss with the industry an appropriate size of such an element.

I think we also need to consider whether it is enough to have a performance aim restricted to part, but not all, of the industry's revenue costs. Efficiency does not end at this point. It also extends into the areas of capital expenditure and working capital. We need to consider additional performance aims in these areas. Again I suggest our officials discuss this and report back to us.

CONFIDENTIAL

As regards the financial target, as I explained in my letter of 14 November, I am concerned that an announcement at this stage could importantly restrict our freedom of manoeuvre in relation to the Scargill surcharge.

That said, I recognise the pressure on you at the moment. One possibility would be to separate the announcement of the financial target from that of the performance aim. If you were prepared to agree to the further work described above in the performance aim and in particular to the inclusion of a best endeavour element in the aim, I would be prepared to see the financial target announced now on the understanding that this is not seen by you as prejudicing a Scargill surcharge and that the terms of the announcement make it clear the target will be reviewed when the coal dispute is over. Our officials can discuss the terms of the announcement.

I am copying this letter to the Prime Minister.

Yours ever
Peter

PETER REES

GAS & Elec NAT IND. Pt10.

CONFIDENTIAL

cc NO

NB PM 12/12

01 211 6402

The Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

12 December 1984

Dear Peter

FINANCIAL TARGET FOR THE ELECTRICITY SUPPLY INDUSTRY

You know from my letters of 12 and 13 November that I must now confirm to Philip Jones the Financial Target for the electricity supply industry that I agreed with him, as part of a package, during the IFR.

Your letter of 14 November suggested that it was first necessary to settle the performance aim. My officials have now explained to yours how the performance aim falls naturally out of the agreement I reached with the Chairman of the Electricity Council.

The Electricity Council is meeting on 20 December, and must have confirmation of the Target by that date in order to be able to settle the financial objectives of individual Boards. I am therefore writing to Philip Jones to indicate the Government's agreement to the Financial Target of 2.75% average return on net assets over the next three years, coupled with a performance aim of reducing unit costs by 6.1% by the end of the financial year 1987/88. Simultaneously, I propose to announce the new Target and performance aim in a Written Parliamentary Answer.

I am copying this letter to the Prime Minister.

Yours
Peter

PETER WALKER

CONFIDENTIAL

Nat hd : Cor A10.

12 DEC

subject ce master.

file

EL3AAT 4.

COPY NO. 3 OF 3 COPIES

10 DOWNING STREET

From the Private Secretary

11 December 1984

GAS PRIVATISATION

The Prime Minister held a meeting today to discuss gas privatisation. Present were your Secretary of State, the Chancellor of the Exchequer, the Financial Secretary and Mr Redwood.

The Prime Minister asked your Secretary of State to report on progress since the last meeting in July towards the objectives of bringing private capital into BGC's retail operations and of floating off the upstream assets. Your Secretary of State said he had agreed with Sir Denis Rooke that BGC should put its retail operations on to a more commercial footing using a combination of joint venture and franchise arrangements. This would represent a substantive response to the 1980 report of the Monopolies and Mergers Commission on the showrooms.

The Secretary of State for Energy said he hoped to persuade BGC to float off its upstream assets, including Morecambe and Rough, with BGC retaining a minority interest. This would be very much easier if it were done with BGC's agreement, but it would require careful and patient negotiation. While the coal strike was on and the Sleipner issue was unresolved, his ability to negotiate such an outcome was weakened. He hoped that both obstacles would be removed early in the New Year. If an agreement were secured with BGC it would be possible to privatise both retail and upstream assets during the present Parliament.

In discussion, it was recognised that it would be premature to pursue the question of the upstream assets while the coal strike continued. Nevertheless, the time should be used for preparatory work, particularly on the approach to be followed should it be necessary to operate without BGC's agreement.

It was noted that the Secretary of State for Energy's concept did not envisage transfer of any part of the appliance installation and servicing to the private sector. The manpower engaged in these operations was very large and the scope for improved service to the public was substantial. The Secretary of State for Energy argued, however, that an attempt to privatise servicing operations

SECRET

would meet with very great opposition, particularly from the unions.

Summing up the discussion, the Prime Minister said BGC should be encouraged to press ahead with the development of its retail operations in conjunction with the private sector. While no attempt should be made to negotiate sale of the upstream assets while the coal strike was on, preparatory work should continue. The Secretary of State for Energy was invited to provide the Treasury with two papers in the New Year, the first on the implications of privatising BGC's servicing operations, and the second on the strategy for disposing of the upstream assets in the face of opposition from BGC. It was agreed that the Treasury would nominate a single official to receive and work on these papers.

I am copying this letter to David Peretz (HM Treasury) with the request that it is circulated only to the Financial Secretary's Office and to the person designated to work on this subject.

(Andrew Turnbull)

Michael Reidy, Esq.,
Department of Energy.

MR TURNBULL 4 December 1984

GAS PRIVATISATION

Peter Walker's attitude to the Gas Board is to let sleeping dogs lie.

By doing so, he is throwing away a unique opportunity to improve the service to the customer, to increase competition in a core industry, to encourage more offshore and onshore UK exploration and development for gas, and to raise cash for the state through asset sales - to say nothing of forgoing the opportunity to widen share ownership and make more employees part owners of their business.

Previous meetings rejected privatising wholesale. Peter Walker's filibuster is succeeding; the whole policy is driven by the towering personality of Sir Dennis Rooke, who disagrees with almost everything this Government stands for.

In the privatisation of gas showrooms, there is no need for BGC to remain the owner of the sites. They can negotiate perfectly satisfactory agency arrangements with new owners, or alternatively could make agency arrangements with other retailers. Service and contracting should be included in these proposals.

BGC's offshore gas assets are very similar to their oil assets. If joint venture means introducing a substantial proportion of private equity into assets that BGC already owns and has developed, then two cheers for that. If it means a very cautious embarking on new ventures, using part private capital, then nationalisation of the offshore gas industry carries on, but at a slightly slower pace.

Tactically, it would be best to welcome Peter Walker's effort, and to ask him to prepare proposals to sell off significant chunks of BGC's existing gas assets. Rough and Morecambe would need slightly different contractual arrangements before sale.

Disposals of producing gas interests would only raise prices to the customer if the contracts for sale of gas to BGC permitted, and if the tax régime was such that higher prices were required. What we should be trying to do is to create a range of competing suppliers of gas to establish a market price to BGC - a price that is available to UK producers as well as to Norwegians. Waiting for Sleipner is yet another part of the delaying tactics.

Conclusion

This matter now needs bringing to E(A) and a decision taking quickly. Gas privatisation is delaying electricity, as it was always agreed gas would be taken first. On the current timetable, we are going to see the whole Parliament elapse with practically nothing being achieved for either of the major energy industries.

There is just enough in Peter Walker's paper to be able to ask him to prepare proposals, stretching his intention as suggested above.

JR

JOHN REDWOOD

cc JR
Please ensure this is seen by only yourself and John Wybrew.

COPY NO 1 OF 3

3

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01-211-6402

Andrew Turnbull Esq
Private Secretary to the Prime Minister
10 Downing Street
LONDON SW1

28 November 1984

Rearranged for 11/12 at 1630

Dear Andrew

GAS PRIVATISATION

Thank you for your letter of 12 November.

My Secretary of State is much concerned, for the reasons I give in the following paragraphs, that discussion of this matter and the range of the options discussed should not reach any wide circle in Government.

We have, in particular, to be very careful indeed to see that no references to further privatisations in gas or electricity reach the press or the trade unions while the coal strike continues. You will recall the fuss which NACODS has made about investments in British Telecom by the NCB Pension Fund. We do not want to stir up other energy unions just now, or to have John Lyons or Eric Hammond calling in to demand assurances about electricity privatisation. News of more gas privatisation could have that effect.

Second, there is the problem of Sleipner. My Secretary of State is clear that it would be very unwise politically to get into dispute with the gas industry on Sleipner and on partial privatisation of gas assets at the same time. The effect would be to rally the gas industry behind Sir Denis Rooke in total opposition, and to extinguish all co-operation on either subject. We hope the Sleipner issue - on which we are updating all the alternatives - will be resolved, one way or the other, in the near future; but whichever way its goes, it will be better to get it out of the way and gain as much public support as we can for the decision before locking horns with the BGC on partial privatisation.

It remains the view of my Secretary of State that the best, clearest and least contentious way forward would be to go for a radical change of ownership for the gas industry as a whole, on the lines of his earlier paper - proposals which have already been very carefully worked out. He still believes this offers the most for the Government (including the Exchequer) and for the industry; and that nothing that has yet emerged on British Telecom demonstrates the contrary.

However, it may help if I outline my Secretary of State's present thinking on the more limited options he undertook to explore.

He regards action on the gas showrooms as a priority, whether or not the industry as a whole is privatised. He envisages a substantial advance towards a more competitive and consumer oriented market in gas appliances. Drawing in High Street retailers would ensure a more thoroughly commercial approach and release resources, at present locked up in the gas-dedicated outlets, for a more diverse range of retailing. Further work would be needed on the precise the way experienced High Street retailers were brought into the business, but the accent would be on increased involvement of the private sector, both as competitors and through joint ventures at existing sites. A suitable combination of joint venture and franchise arrangements could ensure that the present network of consumer enquiry and bill paying points continues. This whole approach would also be a substantive response to the 1980 report of the Monopolies and Mergers Commission on the showrooms.

On BGC's offshore gas assets, he hopes it may prove possible to evolve a similar joint venture approach. Most of BGC's offshore gas assets are already minority interests in joint ventures with oil companies, who would have pre-emption rights in the event of disposal. The wholly owned assets, Rough (a form of offshore gasometer) and Morecambe (a peak lopping supply), have a more limited appeal to the private sector.

Unlike oil disposals, disposals of producing gas interests would raise prices to gas consumers. BGC's resistance to disposals of gas assets would be bitter and tenacious. There is not the same scope for concentrating these gas assets in a single company for flotation as there was with BGC's oil assets because we would be forming a company with, effectively, a single customer - BGC. In practice, we would have to sell the gas assets individually to oil companies against the background of the existing pre-emptions rights. This is not a particularly promising area for separate privatisation, either in terms of the trouble it would cause the Government or of the benefits to competition and consumer choice it would achieve. The Secretary of State believes that there is, nevertheless, a chance - once the Sleipner decision has been taken one way or the other - of persuading Sir Denis Rooke to co-operate in achieving a solution.

He expects to make good progress during this Parliament with BGC's remaining oil assets and has made this clear to the Corporation. He is now considering further how these remaining interests might best be handled.

We will make a further report on the options as soon as possible after the coal strike and the Sleipner decisions are out of the way. Meanwhile I hope the material in this letter will prove a sufficient basis for discussion. If some limited circulation of it is necessary, however, my Secretary of State hopes that the risks referred to in the second paragraph can be kept to an absolute minimum.

Copy no 2 of this letter goes to David Peretz in the Chancellor's office, and copy no 3 is retained here.

Yours sincerely
Michael Reidy.

M F REIDY
Private Secretary

Nat Ind : Cos Pt 10

.010/109

CONFIDENTIAL

N BPM

AT 14/11

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London
SW1P 4QJ

14 November 1984

Dear Secretary of State,

THREE YEAR FINANCIAL TARGET FOR ELECTRICITY SUPPLY INDUSTRY

Thank you for your letter of 13 November.

I am sorry you have difficulty with my proposal. I certainly did not intend it to involve a breach of faith. I cannot recall any mention of the electricity savings being conditional on a 2¾ per cent financial target. The record of the meetings of MISC 106, the MISC 106 report, the record of your meetings with the Prime Minister and the Cabinet conclusions certainly do not suggest this was the case. I do however recall that in the MISC 106 discussion - MISC 106 (84) 20th that the savings were consistent with the ESI's proposal for a new target, but that is a rather different matter. I cannot accept the view that targets should determine EFLs, rather than the other way round. As always, we have decided on EFLs and now need to work out targets consistent with these.

The line I proposed for the Chairman of the Electricity Council's appearance before the Select Committee was simply based on the formulation used in public on several occasions by Ministers -namely that decisions on recovering the cost of the strike will be taken when the strike is over. I find it hard to see how this could cause the problems you suggest. Problems are much more likely to arise if Mr Jones said anything else.

My concern here is that we do not foreclose options. Any Scargill surcharge could be levied in a range of ways. At one extreme there could be an explicit supplement for a defined period. At the other extreme it could be more unobtrusively incorporated in general price increases. I fear that setting a precise financial target now would largely foreclose the latter option.

CONFIDENTIAL

I agree that we should seek to finalise a performance aim. Officials should work to that end. I suggest we return to the financial target when their work is completed. In the meantime Mr Jones could say that decisions on the target and the aim will be announced in due course by Ministers.

I am copying this letter to the Prime Minister.

Yours sincerely

Paul Pegler

pp **PETER REES**

(approved by the Chief Secretary and signed in his absence)

NAT IND Pt 10

Gas + Electricity

CONFIDENTIAL

~~CCFT~~ 2

File

Prime Minister

To be aware of this row in case you are brought into it tomorrow morning.

FERB

13.11

01 211 6402

The Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

13 November 1984

Dear Peter, below

Your letter of 13 November about the financial target for the electricity supply industry is totally unacceptable to me.

I made it clear throughout the IFR discussions that the savings I hoped to achieve from the electricity industry were conditional upon a three-year target. I cannot be a party to the breach of faith with the Chairman of the Electricity Council which your letter seeks to impose on me. The Chairman of the Council will, of course, rely on the understanding which has already been reached with him when he speaks to the Select Committee tomorrow, and under no circumstances will I seek to dissuade him.

On your points of detail, it is a nonsense to suggest that we could defer settling the three-year target until we know for certain whether the £215 million of additional savings in 1987/88 will in fact be achieved by reductions in Corporation Tax. It may well be a very long time before agreement is reached between the industry and the Inland Revenue on the industry's Corporation Tax liability for 1987/88. It is one of the unavoidable absurdities which arises from defining Corporation Tax payments as public expenditure that we cannot really foresee how the EFL will operate as a management instrument several years ahead. In this situation we must adhere to the basis I have proposed.

In your last two paragraphs you suggest that we defer setting a target until decisions have been taken on recovering the costs of the coal strike and inform the Energy Select Committee tomorrow that this is our intention. The whole basis of our IFR discussions, and of my discussions with both the NCB and the electricity industry, has been that effects of the strike would be put on one side for the purposes of this IFR. I could not in any event accept responsibility for setting off a new round of public discussion about a "Scargill surcharge" at this stage in the coal dispute and when the electricity unions have expressed to me their vehement opposition to it.

I am very happy to settle the performance aim for the industry as swiftly as possible. Some further definitional work is, I understand, necessary to achieve this; but it would be quite wrong to expect from this work efficiency savings going beyond those I have already achieved and which would therefore affect the 2.75 per cent target. There is therefore no ground here for holding up the financial target.

Delay in settling this target would not only put at risk the savings so painfully achieved with the industry. The whole course you are proposing invites the Select Committee and others to look for differences in Government and to exploit them as they did last year; and to renew their criticism of our whole process of managing the finances of these nationalised industries, including their strong view that targets should determine EFLs, not EFLs targets.

I am copying this letter to the Prime Minister.

PETER WALKER

Andrew Turnbull

CHIEF SECRETARY TO THE TREASURY

Already received 13/11 - went in box

With the Compliments

of the

Chief Secretary to the Treasury's

Private Secretary

This is ~~letter~~ PM Walker is referring to in his letter of 13/11.

Richard Broadbent 13/11

Treasury Chambers,
Parliament Street,
SW1P 3AG

020/106

CONFIDENTIAL

cc: Chancellor
Sir P Middleton
Mr Bailey
Mr Monck
Mr Burgner
Mr Scholar
Mr Gray
Mr Webb
Dr Bird
Mr Robson
Mr Lord
Mr Ridley

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

13 November 1984

Dear Peter

THREE YEAR FINANCIAL TARGET FOR THE ELECTRICITY SUPPLY INDUSTRY

Thank you for your letter of 12 November.

I am afraid I cannot agree that you should confirm a three year target of 2¾ per cent for the industry, or that the Chairman of the Council should mention this to the Energy Select Committee on November 14.

You say that such a target would be consistent with Cabinet's decisions. This will only be clear when we see a list detailing the savings produced by the industry. For example, the £215 million additional savings in 1987-88 which you offered at your meeting with the Prime Minister on 7 November were described as reductions in corporation tax or "savings from some other source for example increased efficiency". If these savings were to take the form of reduced operating costs, the rate of return in 1987-88 would rise from the 3.1 per cent you quote to something over 3½ per cent and the average return over the three years would rise to almost 3 per cent.

I also consider it necessary to set the industry's performance aim at the same time as its financial target. We are, I am sure, at one on the need to put maximum pressure on the industry to improve its efficiency. Again, we are in no position to take a decision on a performance aim until we know in detail the savings the industry is making.

Even when this information is available, I find it hard to see how we can set a financial target until we have taken decisions on recovering the costs of the coal strike. This would clearly affect electricity prices and the industry's rate of return. This points to delaying setting the target until the strike is over.

CONFIDENTIAL

As regards the appearance by the Chairman of the Council before the Energy Select Committee tomorrow, I suggest he says that no decisions have yet been taken as to recovering the costs of the coal strike, that the EFL for 1985-86 has been set on this basis and that the financial target will be set in the light of decisions on recovering the costs of the strike.

Yours ever Peter

PETER REES

FILE

2

RJ

10 DOWNING STREET

From the Private Secretary

12 November, 1984

The Prime Minister last discussed gas privatisation with your Secretary of State and the Chancellor in July. Since then it has, understandably, been difficult to make progress, given your Secretary of State's close involvement with the coal strike and the difficult negotiations with BGC over public expenditure. With the latter issue now settled, the Prime Minister would like to resume work on this issue. She would like to hold a meeting in about three weeks' time to discuss development of the ideas which emerged from the July meeting. Could your Secretary of State produce a paper by 30 November for discussion at a meeting in the following week?

I am sending a copy of this letter to David Peretz (HM Treasury) and to Helen Goodman (Financial Secretary's Office, HM Treasury).

(Andrew Turnbull)

M. Reidy, Esq.,
Department of Energy.

TNS.

01 211 6402

The Rt Hon Peter Rees QC MP
Chief Secretary
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

12 November 1984

Peter

THREE YEAR FINANCIAL TARGET FOR THE ELECTRICITY SUPPLY INDUSTRY

You will know that the savings which I told MISC 106 I would try and achieve from the electricity industry - and which I am pleased to say I have now definitely manged to obtain - are conditional upon a corresponding financial target for the same three years 1985/86 - 1987/88.

The target which corresponds to the Cabinet decisions is 2.75 per cent average return on net assets on a CCA basis over the three year period. This is twice the CCA return of 1.4 per cent set by my predecessor in the current two year target period. Moreover as I pointed out to MISC 106, the industry anticipate they will reach 3.1 per cent in 1987/88.

I will be confirming the three year target to the industry, in conjunction with my confirmation of their EFLs, and the Chairman of the Electricity Council will have to deal with both these matters when he appears before the Energy Select Committee on 14 November.

Peter

PETER WALKER

GR . pl type attached letter

PRIME MINISTER

GAS PRIVATISATION

At the last meeting of this subject in July Mr. Walker agreed to consider proposals for floating off all or part of BGC's upstream assets, and for operating retailing and servicing as joint ventures. This would leave the gas network within the public sector for the time being.

While Mr. Walker has been heavily engaged in the conduct of the coal dispute and while the public expenditure negotiations have been in progress, you have not sought to press him to carry this work further. With the public expenditure now settled and coal, for the time being, not generating such immediate pressures, the time now seems right to take this subject forward.

I believe Mr. Walker still hankers after selling BGC as a single monopoly, subject to regulation. He believes that the success of the BT floatation will prove his point. In this instance I think the Treasury is right in arguing for structural change before privatisation. The ideas sketched out in July represent a reasonable balance between selling as one entity andthe Treasury's more radical proposals which would involve privatising the gas network as well.

Agree I send a letter along the lines of the attached draft?

Yes - you will recall that I mentioned this in the PESC bilateral.

MT.

Duty Clerk

pp. Andrew Turnbull
9 November 1984

CONFIDENTIAL

N BPM
AT 31/10
CO/NO

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

David Peretz Esq
Private Secretary to the
Chancellor
HM Treasury
Parliament Street
LONDON
SW1P 3AG

29 October 1984

Dear David

PROPOSED BGC FARM-IN

Thank you for your letter of 16 October.

In present circumstances this proposed farm-in raises a number of problems. The one you mention was certainly very much in our minds. The Corporation have not yet discussed their proposal with the Department in any detail.

I am copying this letter to Andrew Turnbull.

Yours sincerely
Michael Reidy

M F REIDY
Private Secretary

CONFIDENTIAL

Nat Ind: Gas Prices Pt 10

7.54 CONFIDENTIAL

CC/NO

NBPM

AT 17/10

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

16 October 1984

M Reidy Esq
Private Secretary to the
Secretary of State for Energy

Dear Michael

BGC PRIVATISATION

The Chancellor has seen a report, which he understands may be broadly correct, that BGC are interested in acquiring a stake in North Sea block 22/5b.

As you know, it was agreed at the Prime Minister's meeting on 14 June -1989 that your Secretary of State should ask BGC to prepare plans for the disposal of its gas interests, while retaining a minority stake. Against this background, the Chancellor thinks it would be difficult for the Government to permit BGC to acquire new interests. Given the implications for privatisation, I should be grateful if you could let us know if there is any possibility that BGC will be allowed to make this acquisition.

I am copying this letter to Andrew Turnbull at No.10.

Yours ever
David

D L C PERETZ
Principal Private Secretary

NAT IND PT10

Gas + Electricity

CONFIDENTIAL

LC NO 2

Foreign and Commonwealth Office

London SW1A 2AH

AT to see

4 October 1984

Prime Minister AT

CDP

4/10

Dear Andrew,

Sleipner

Please refer to your letter of 17 September to Michael Reidy on this subject, and his reply of 27 September.

The Foreign Secretary was glad to hear of the prospect of further movement shortly in the negotiations. When he met the Norwegian Prime Minister briefly in New York last week, Mr Willoch took the opportunity to complain about delays over our response on Sleipner, about which he was clearly very concerned. We have considerable interests in Norway as a major NATO partner, not least in the defence field, and the sooner this irritant in our relationship can be settled, the better.

The Foreign Secretary also hopes that the question of a satisfactory gas export regime can be quickly resolved. It would be extremely damaging if the negotiations with the Norwegians were to be successfully completed and we were then to find ourselves in difficulties over an export regime. Sir Geoffrey Howe realises that the hearing by the European Court of Justice of the Bulk v Sun oil case in the next few months is a potentially awkward time to be approaching the Commission about a gas export regime. This is a point which we shall be discussing with other Departments concerned.

I am sending copies of this to the Private Secretaries to members of ES, to John Graham (Scottish Office), Michael Saunders (Attorney General's Office) and Richard Hatfield (Cabinet Office).

Yours ever,

Peter Ricketts

(P F Ricketts)
Private Secretary

Andrew Turnbull Esq
10 Downing Street

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NAT IND

GAS + ELECTRIC
PT10

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wAO

NBPM

AT 27/9

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON SW1

27 September 1984

Dear Andrew

SLEIPNER

Thank you for your letter of 17 September. My Secretary of State shares the Prime Minister's hope that Sleipner and gas exports can be considered by ministers again in the near future.

The commercial negotiations on Sleipner are still in train. The Norwegians have made a number of major concessions but the possible package has not yet fully crystallised and the next move lies with them. We hope for further movement shortly.

As to the possible form of a gas export regime, my Secretary of State has been in touch with the Law Officers since the beginning of August. He hopes to receive their Opinion shortly, though the exact timescale is dependent upon the progress of their consultations with other interested departments. Mr Walker nevertheless expects to be in a position to put proposals to colleagues simultaneously with his recommendation on the Sleipner deal.

Mr Walker agrees that these issues must be considered in the context of UKCS gas reserves and availability.

I am sending copies of this letter to the private secretaries of members of ES, to John Graham (Scottish Office), Michael Saunders (Attorney General's Office) and Richard Hatfield (Cabinet Office).

Yours sincerely
Michael Reidy

M F REIDY
Private Secretary

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NAT IND
Gas
Pt 10

27 SEP 1984

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SUBJECT FILED ON: ENERGY : Oil Prices Pt2

24 September 1984

MR TURNBULL

cc NAT IND : Gas & Elec.

BNOC PRICES

We agree with the analysis set out in Peter Walker's letter to the Chancellor.

The agonising over price differentials and BNOC's term custom just underlines the undesirability of keeping BNOC in its current form.

The Prime Minister might write approving the approach and reminding Energy of the need to examine BNOC's future again in the light of recent problems.

ELECTRICITY: NEXT FINANCIAL TARGET

Peter Walker's letter on this subject also has considerable justice in it. The replacement cost of assets in an industry as over-provided with plant as the electricity industry is a very academic concept.

What matters politically is:

a. a reasonable level of price increase for electricity, so that we do not incur the disopprobrium of back-door taxation;

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b. an effective means of applying pressure to the cost base of the industry, so that more profit and more cash flow can be generated for the public sector for a given level of revenue;

c. the Treasury are not undermined in their energy bilateral which is seeking substantial cash benefits from the electricity EFL.

The debate concerning all of the nationalised monopolies, including electricity, gas and water, should concentrate on the systems in place for enforcing detailed unit costings, for exerting pressure for greater economies of scale to be delivered, more asset sales, and better control of working capital.

JOHN REDWOOD

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CCWY

NBPM

AT

24/9

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

21 September 1984

Dear Nigel

ELECTRICITY: NEXT FINANCIAL TARGET

Thank you for your letter of 13 September about the next financial target of the electricity supply industry.

I am afraid I am far from convinced by your proposition about using a 5% rate of return on all assets as a basis for pricing in the electricity supply industry. As I said in my letter of 15 August, I do not believe that the asset valuations which are essential to your proposition can bear the weight you are trying to put on them.

I believe we have to look at what would be the situation in an industry like the electricity supply industry in a private sector competitive market. As you know, the industry has heavy over-capacity which is likely to continue for many years to come. Against a peak winter demand of 41-42 Gigawatts it has a plant capacity of 58-59 Gigawatts. Even after allowing a 28% planning margin on top of peak demand, there is a surplus of 6 or 7 Gigawatts through the 1980s which is likely to decline only slowly in the early 1990s.

We have seen similar situations of over-capacity in other capital intensive process industries in recent year eg steel, bulk chemicals, oil refining. While over-capacity persists in these competitive situations, there is very little scope for valuing even the newest plant at replacement cost and then earning the opportunity cost of capital on it. Replacement cost accounting in such a situation exaggerates both earning power and value on disposal, often dramatically. Like electricity now, these have been industries which were not in an equilibrium situation.

It is only by exercising monopoly power, and not by any analogy with the private sector, that the electricity supply industry could attempt to earn 5% on all its existing assets, even as written down in their accounts. When undertaken at the direction of the Government this would in fact be taxation. You make the point that setting nationalised industry prices below economic levels is not part of our strategy, but I hope that setting them above economic levels for taxation purposes is not part of it either.

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Of course it was recognised in 1982/3 that the electricity industry is not on an equilibrium basis but in a situation of over-capacity when it was decided to base prices on avoidable costs following the Coopers and Lybrand Report. It was then said that the change in price levels resulting from the application of the avoidable costs principle "would of course accord with a normal commercial response to such a situation" (minute to the Prime Minister of 18 October 1982). I think that was quite right. There was then no proposal for a 5% return on all capital. I think we are at some risk of appearing to develop new "economic principles" simply as a means of raising prices.

You will recall that we discussed the question of a 5% rate of return on the existing assets of the water industry in E(NI) of 26 July. The proposition was not then accepted and officials were asked to do further work, bearing in mind the consequences for charges to the consumer. In the electricity supply industry, given its over-capacity, the case seems to me even weaker.

I am copying this letter to the Prime Minister, George Younger, Patrick Jenkin, Norman Tebbit and Nicholas Ridley.

PETER WALKER

NAT IND Pt 9

Electricity

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File

bc: John Redwood

10 DOWNING STREET

ES
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From the Private Secretary

17 September 1984

SLEIPNER GAS

Following the meeting of ES on 20 June, the Minister of State at the Department of Energy has been conducting negotiations with the Norwegians to scale down the quantities of gas which would be supplied from the Sleipner field. At the same time your Department has been considering the form of an export licensing regime which would allow exports of gas while preserving security of supply. The Prime Minister hopes that both these issues will soon be brought back to colleagues.

The Prime Minister has commented that there have recently been a number of favourable reports of gas finds on the UKCS. When the Sleipner issue is brought back to ES, she would be grateful if the paper could include a reassessment of UK reserves in the light of these developments and an appraisal of the implications of this for policy on gas imports.

I am sending copies of this letter to the Private Secretaries to the members of ES, to John Graham (Scottish Office) and Richard Hatfield (Cabinet Office).

Andrew Turnbull

Michael Reidy, Esq.,
Department of Energy.

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File

10 DOWNING STREET

From the Private Secretary

Prime Minister ①

The Chancellor raised the issue of gas reserves with you. Agree I put the points at X to Mr Walker?

On gas privatisation, I can understand why Mr Walker has not made much progress, given his other preoccupations. Agree nevertheless that I chase him up on this?

AT

14/9

Not next week - at least until we see how the 'coal' situation is going.

MT.

Prime Minister
The Chancellor raised this with you.

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MR ~~TURNBULL~~ 14 September 1984

NORTH SEA GAS RESERVES

In recent months there have been several public announcements of new gas finds.

BGC have announced the first commercial discovery of gas off the South coast of England and have also announced a significant gas field West of Shetland. The latter is the first important gas discovery in this area. Fields have also been announced by Ultramar and Zapex in the Southern basin and by Conoco in the Northern basin of the North Sea.

In addition, BP have discovered a significant field in the Northern basin, although this information is still commercially confidential. We also think that Mobil, Shell and Esso are sitting on gas fields which they have not yet announced.

BP have also recently reassessed their estimate of UKCS reserves in light of this activity. This shows significant increases in both the discovered, but undeveloped, and the yet to be discovered in mature areas categories.

The increase reflects the industry's exploration success in the past year and improvements in appraisal drilling techniques, particularly in the Southern North

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Sea. All of this has been stimulated by the increased prices offered by BGC although these do not compare with the price we are proposing to pay for Sleipner.

These developments have strengthened BP's view that the import of Sleipner gas is not necessary. It is, of course, in their commercial interests to oppose Sleipner and the Department of Energy are suspicious of these latest estimates. Nevertheless, there do seem to be significant grounds for re-opening the question of whether we need Sleipner at all.

<u>Conclusion</u>

<u>We recommend</u> that the Department of Energy should be asked to comment:

X

- on whether the recent announcements of gas fields in the North Sea have changed the reserve estimates upon which the case for Sleipner rests;
- on the progress of the Sleipner negotiations.

Peter Walker should also be pressed to bring forward his proposals on gas privatisation. The Prime Minister's last meeting on this subject asked for a report by the end of July.

DLP

<u>DAVID PASCALL</u>

4.1

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CNO

NBPM

AT 14/9

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

13 September 1984

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy

Dear Peter

ELECTRICITY: NEXT FINANCIAL TARGET

Thank you for your letter of 15 August. You will also now have seen Norman Tebbit's letter to me of 5 September. I am pleased you agree that we need to look hard at the ESI's costs and that officials should discuss the scope for savings.

Both you and Norman express some doubts about a 5 per cent target. You point out that the required rate of return (RRR) for new investment has only been in place since the 1978 White Paper, and question whether it should apply to pre-1978 investment.

But the crucial point, of course, is that in monopoly industries the 5 per cent RRR on new investment is as important in determining prices charged for output as in determining the quantity of new investment. These prices apply to all the industry's output, whether it comes from new or from old plant. It follows that the RRR should produce a 5 per cent return on all assets, new and old, providing the older assets are valued at replacement cost, and that any underused assets have been written down in value as they should be. The ESI's CCA accounts are, I understand, drawn up on this basis.

Perhaps I could comment briefly on two of the other points which you made.

First, your reference to the 1978 White Paper and the sectoral, social and counter-inflation policies pursued by the last Labour Government. Our own strategy against inflation is, of course, quite different and holding nationalised industry prices below economic levels has no part to play in it.

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Secondly, while I agree that revenue account gains of about £1 billion a year would be needed to achieve a 5 per cent return I wonder whether you are right to equate this with a reduction of 33 per cent in controllable costs. Since £1 billion is equivalent to about 12 per cent of the ESI's operating costs, this would imply that some two-thirds of the ESI's costs were outside its control. I wonder whether this is plausible? I accept that the price of some inputs, like coal, is determined externally but even there it should certainly be possible over time, by increasing efficiency, to exercise control over the volume used.

I am copying this letter to the Prime Minister and to Norman Tebbit.

Yours
Nigel

NIGEL LAWSON

NAT 'IND

Electricity

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c/CNO

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

NBPM
AT 6/9

5 September 1984

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The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

D Nigel,

ELECTRICITY : THE NEXT FINANCIAL TARGET

I have seen your letter to Peter Walker of 2 August and also Peter's reply of 15 August, on my return from holiday.

2 I agree with you that every effort should be made to reduce the industry's costs. However I share Peter's concern about the implications of imposing a required rate of return as high as 5 per cent, in current cost terms, on the total net assets of the industry. Setting a rate of return at this level will result in further upward pressures on prices for both domestic and industrial consumers because reductions in controllable costs of the magnitude required to meet such a target return are most unlikely to be achievable.

3 I am copying this letter to the Prime Minister and to Peter Walker.

Yours
Norman

NORMAN TEBBIT

JH5AHO

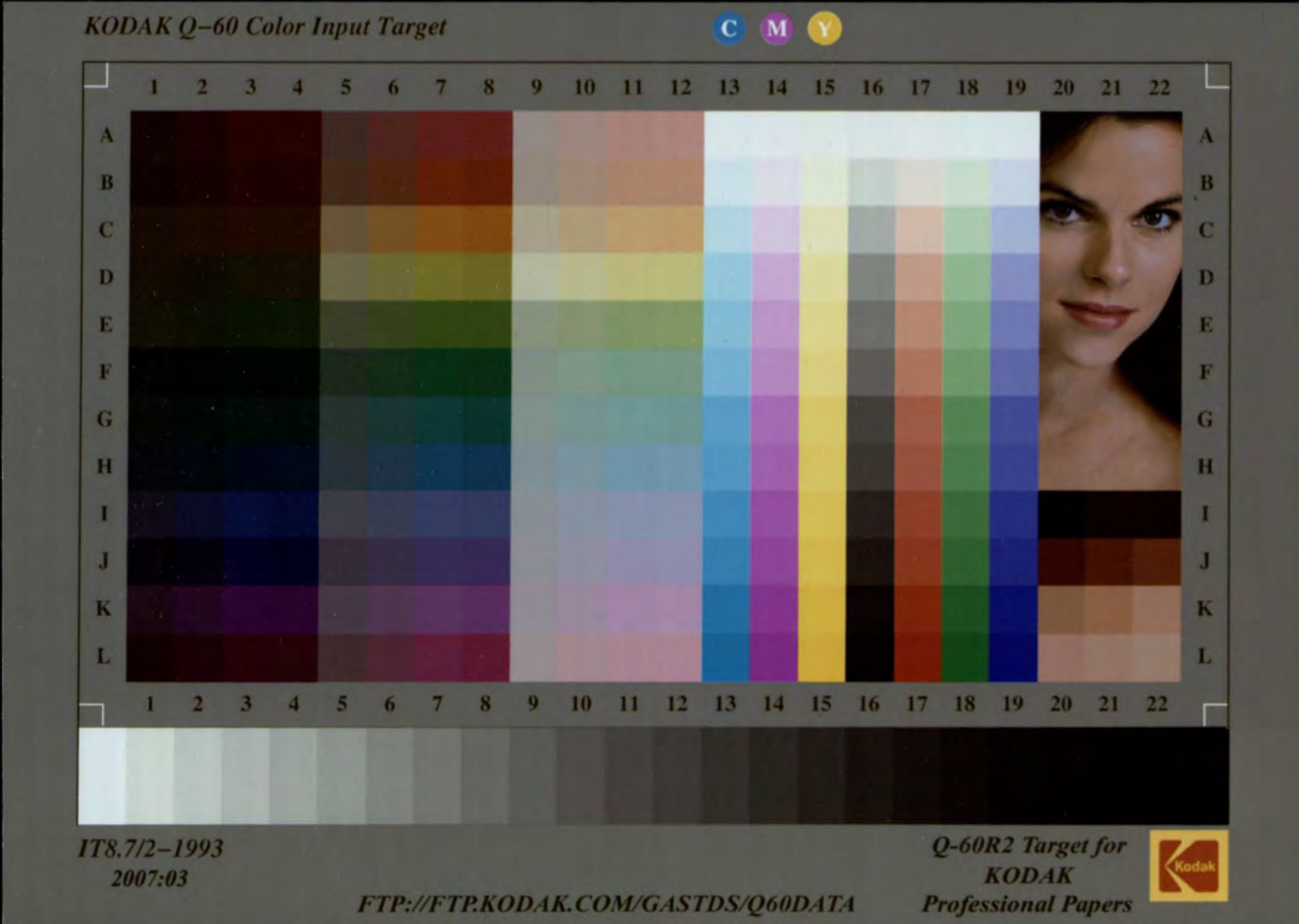
Nat Ind Gas & Elec
Pt 9

PART Pt 9 ends:-

S/S Energy to Ch/Ex 15/8

PART Pt 10 begins:-

S/S DTI to Ch/Ex 5/9.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