

PREM 19/1866



SECRET

Confidential Filing

Gas and Electricity pricing policy  
Gas and Electricity Industries EFL's  
Industrial Energy Policy  
Future of the Gas Industry

NATIONALISED  
INDUSTRIES

PL 1: Sept 1979

PL 12: Dec 1985

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
<del>6.12.85</del>		<del>19.5.86</del>					
<del>10.12.85</del>		<del>22.5.86</del>					
<del>11.12.85</del>		<del>23.5.86</del>					
<del>16.12.85</del>		<del>29.5.86</del>					
<del>23.12.85</del>		<del>6.6.86</del>					
<del>14.1.86</del>		<del>9.6.86</del>					
<del>21.1.86</del>		<del>11.6.86</del>					
<del>24.1.86</del>		<del>17.6.86</del>					
<del>30.1.86</del>		<del>18.6.86</del>					
<del>28.2.86</del>		<del>25.6.86</del>					
<del>4.3.86</del>		<del>26.6.86</del>					
<del>11.3.86</del>		<del>17.8.86</del>					
<del>11.3.86</del>		<del>3.7.86</del>					
<del>4.3.86</del>		<del>7.7.86</del>					
<del>4.3.86</del>		<del>18.8.86</del>					
<del>6.3.86</del>		<del>26.8.86</del>					
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<del>20.3.86</del>		18.9.86					
<del>7.5.86</del>		PT					
<del>9.5.86</del>		12.6.85					
<del>12.5.86</del>							
<del>13.5.86</del>							
<del>15.5.86</del>							

PREM 19/1866



● PART 12 ends:-

SS/ENERGY to CST 18/9/86

PART 13 begins:-

CST to SS/ENERGY 2/10/86









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

01 211 6402

The Rt Hon John MacGregor OBE MP  
Chief Secretary  
Treasury Chambers  
Parliament Street  
London  
SW1P 3AG

NBPN

18 September 1986

ESI'S EFL 1986-87: SUPPLEMENTARY CAPITAL APPROVALS AND TARIFF REVISION FROM 1 OCTOBER

Our officials have been discussing the Area Boards' request for supplementary capital approvals this year totalling £18.6m net of customer contributions.

The need for additional expenditure arises mainly because new business (which must statutorily be supplied) is growing at a faster rate than expected, because distribution systems need further reinforcement to cope with load growth and to improve security of supply and because of the need for extra expenditure on projects such as token meters (to reduce revenue losses), protection against child trespassers and increased efficiency (reorganisation and computer systems).

The case for the additional capital expenditure is, I believe, a strong one; and I should appreciate your agreement to the supplementary approvals being given.

I understand that the Treasury have foreseen a difficulty in that the ESI's Quarterly Progress Report for the quarter ending 30 June forecast a shortfall of about £30m against the EFL of -£1416m (after allowing for different assumptions about the date of consent for Sizewell). I have discussed this with Philip Jones who has assured me that the Industry will meet the EFL, after allowing for the additional capital expenditure by the Area Boards. Given this assurance, I shall be grateful for your agreement to approval of additional expenditure of £18.6m net by the Area Boards.

Philip Jones' assurance has a bearing, too, on the reductions in tariffs from 1 October, averaging 0.9%, about which I wrote to you





on 15 September. His assurance was given after taking account of these reductions. Due to the leaks that have occurred about them, the Electricity Council may decide to make an announcement after its meeting this afternoon.

I am copying this letter to the Prime Minister and members of E(A) Committee.

A handwritten signature in dark ink, appearing to read "Peter Walker". The signature is fluid and cursive, with a large loop at the end of the last name.

PETER WALKER









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

01 211 6402

The Rt Hon John MacGregor OBE MP  
Chief Secretary  
H M Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

Prime Minister<sup>2</sup>

JMF  
15/9.

15 September 1986

REVISION OF ELECTRICITY AREA BOARD TARIFFS: 1 OCTOBER 1986

When the Electricity Supply Industry (England & Wales) (ESI) reduced the price of electricity from 1 July by 0.2p per unit (to take account of the agreement on coal prices), the Electricity Council announced that the industry would be reviewing the impact of lower fuel prices, lower inflation, higher sales growth and improved efficiency with a view to determining tariffs in the longer term.

Philip Jones has now informed me of the results of the review and of the ESI's intentions. All twelve Area Boards are able to consolidate the 0.2p per unit in their quarterly tariffs. (Monthly billed customers receive the reduction automatically through the fuel price adjustment clause.) Eight of the Boards are able to make further reductions, resulting in an average further reduction across all the Boards of 1.2% on quarterly tariffs and 0.5% on monthly tariffs. (The difference redresses further the imbalance which had arisen between monthly and quarterly tariffs and costs, mainly as a result of the over-estimation of fuel costs in recent years.) The average reduction over all tariff groups is 0.9%. As far as the longer term is concerned, the Area Boards will simply say that the tariff revisions will remain in force until further notice.

As your officials are aware, based on the results for the first quarter of the financial year, the ESI is currently forecasting a shortfall (after allowing for different assumptions about Sizewell B) of about £30m on the EFL of -£1416m, due mainly to Area Boards' requests for supplementary approval for capital expenditure. At this stage of the financial year the estimated shortfall is well within the range of uncertainty about the outcome. The EFL prospect does not therefore provide sufficient grounds for me to suggest to the Electricity Council that it should consider deferring the intended further price reduction; and I have no powers to oblige the industry to defer it. I shall however make clear, in replying to Sir Philip, the great importance which the Government attaches to the EFL being met.





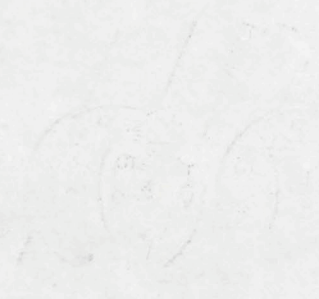
The reduction is to be welcomed as a contribution to the reduction in general inflation and, in particular, to the reduction in industry's energy costs. There are presentational gains here for the Government. We shall be discussing the industry's financial prospects for the IFR period when we meet on 19 September. However it is clear that to urge the industry to defer this reduction would be counter-productive since it would result in even greater over-achievement of their financial target this year, thus compounding the problem for 1987/88.

I am copying this letter to the Prime minister and members of E(A) Committee.

A large, stylized handwritten signature in dark ink, appearing to read "Peter Walker". The signature is written over a faint, larger outline of the same signature.

PETER WALKER









CCBS  
 Prime Minister (2)  
 MCA 27/8

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

26 August 1986

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

Dear Secretary of State,

**BGC PRIVATISATION: CUSTOMER MAIL SHOT**

You wrote to me on 18 August about the content of the letter to be sent to British Gas customers.

I can appreciate the marketing advantages of the content of the mail shot being clear and precise. The problem is that such clarity and precision creates inflexibilities which could damage the success of the Offer for Sale and limit our ability to take the proceeds when we need them.

As regards the minimum application level, I am content to express this as "no more than £150" for 100 shares.

The size of the customer guarantee is more difficult. This scheme is completely novel and, as such, carries with it considerable uncertainty. The scheme is, by its nature, a costless option for customers. As such I would expect a large number of customers to register for the scheme. This will include those with a relatively low interest in the offer. We have no real guide as to how many of those who register will actually make an application.

This creates two dangers. First, we may under-estimate the number who apply. At worst this might involve us in being unable to honour the guarantee. Alternatively we might find we could only honour it by heavily scaling down applications from non-customers. This would cause resentment and would be inconsistent with wider share ownership.

Second, we may over-estimate the number who apply. This would lead to the Offer being under-subscribed.

We have a choice. We could retain flexibility by delaying fixing the size of the guarantee for some time. This would not help the marketing and would, no doubt, be unpopular with BGC. Alternatively we could create more flexibility in the





structure of the Offer than our advisers have so far suggested.

My preference is to create more flexibility in the Offer structure and, if you agree to this, I would be content for the letter to say that the guarantee will be "around £250" and that customers will in addition get some element of preference in allocation. You are not proposing to quantify the latter element. I am sure this is right.

On instalments, I am content for the letter to say that payment will be by instalment but I do not think that it would be prudent to specify the size of the first instalment. We cannot yet be sure that market conditions, and BGC's profit forecast, will enable us to sell 100 per cent of the equity this Autumn. If we had to sell a smaller amount, I would need to have a higher first instalment in order to get the revenue required during the current financial year, 1986-87. As regards the number of instalments I would be prepared to say there will be "at least two".

On vouchers and bonus shares, we ought to alter the balance struck on the BT offer away from vouchers and towards bonus shares. This would give the non-gas customer some compensation for his ineligibility for the Customer Share Scheme. Bonus shares are, in any case, more effective inducements, as the BT flotation showed; and our policy is to promote share ownership, not cut-price gas.

I do appreciate, however, that you face strong pressure in exactly the opposite direction from BGC and, in these circumstances, I am prepared to accept your proposal for the rough value of vouchers and bonus shares. There will have to be maximum allocations on which qualify for vouchers and bonus shares. I look forward to your proposals on this.

I am copying this letter to the Prime Minister.

*Yours sincerely*  
*Alex Allan*

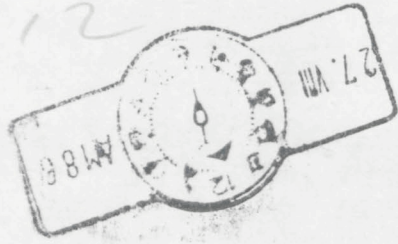
NIGEL LAWSON

*(approved by the Chancellor and signed in his absence)*



NAT IND

CAS  
PT 12







DEPARTMENT OF ENERGY  
 THAMES HOUSE SOUTH  
 MILLBANK  
 LONDON SW1P 4QJ  
 01-211 4391

From the Permanent Under-Secretary of State  
 P L Gregson CB

T M Heiser Esq CB  
 Department of the Environment  
 2 Marsham Street  
 London SW1P 3EB

22 August 1986

Dear Terry

**PRIVATISATION OF BRITISH GAS - DISCLOSURE  
 OF PROMOTERS' INTERESTS**

I am writing to seek your assistance, and that of a wide range of copy recipients, in identifying and describing any dealings between the Crown and British Gas which we will have to disclose to the company when shares in British Gas plc are offered to the public late this autumn. You may remember that DTI undertook a similar exercise two years ago, before the sale of British Telecom, and I understand this worked effectively. I hope that recipients will respond to this request in the same helpful way.

We need to take this action because the Crown is, in law, one of the promoters of the Company and has duties to disclose this information formally to the Company. Sufficient and proper disclosure is needed since otherwise it would be open to the Company, and indirectly its shareholders, to bring proceedings which might result in the rescission of contracts with the Government. Such proceedings could even give rise to Government liabilities to the Company. I am aware that this is a time consuming task - but I fear it is absolutely necessary. I would therefore be grateful if you would provide information about your dealings with British Gas along the lines set out in Annex 1 to this letter. If there are any questions about the details of this letter, I should be grateful if they could be directed to Margaret Jackson, Room 1113, Gas Division, Department of Energy, Thames House South, Millbank, London (01 211 4427). to whom you might also address your replies.

... I would

CCBG

*[Handwritten initials]*

*[Handwritten initials]*

*(Cab. office will take care of No 10's interest in this)*

*Tony Syer of Finance Div. (Cab. office) 23/9/86*

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I would be grateful for your initial response by 22 September 1986, and for notification of any changes as they occur between then and the issue of the prospectus in November.

I am sending a copy of this letter to the Permanent Secretaries, Directors and heads of all bodies listed in Annex 3 to this letter. I would be grateful if you and copy recipients would consider whether there is any associated organisation not listed in the Annex which, to your knowledge, should be regarded as a Crown body and if so to copy this letter to that body, informing this Department that you have done so.

*Yours ever*

*Peter*



PRIVATISATION OF BRITISH GAS: DISCLOSURE OF PROMOTERS' INTERESTS

WHAT NEEDS TO BE DISCLOSED IN THIS TRAWL?

1. All dealings or transactions between the Crown and British Gas during the "promotion period", which are not on standard terms, need to be disclosed.
2. Expenditure by the Crown during the last financial year on gas supplied by British Gas, whether under standard or non-standard terms, also needs to be reported.

DEFINITIONS

The Crown

3. For this purpose, the Crown has a wide definition. It includes all manifestations of the Crown, except Her Majesty in a personal capacity. In essence the Crown includes all Government Departments. It does not, however, include those public bodies which, by reason of their nature or by statute, are not agents or servants of the Crown; it therefore does not include nationalised industries, or commercial companies controlled by the Government such as British Leyland plc.
4. Attached at Annex 3 is a list of bodies each of which we believe is or may be a Crown body, and at Annex 4, a letter sent from the Management and Personnel Office to the Department of Trade and Industry at the time of the sale of British Telecom, which seeks to define what constitutes a Crown body.

The promotion period

5. The promotion period commenced on 25 April 1985 and will end on the date of issue of the Prospectus, which until further notice should be assumed to be no later than 1 December 1986.

Non-standard terms

6. Transactions with British Gas arranged on terms which as far as you are aware are similar to those provided generally for other customers need not be disclosed. All other transactions which are known or believed to be preferential to the Crown should be disclosed in this trawl. Examples of possible non-standard transactions that may exist between the Crown and British Gas are set out in Annex 2.
7. The extent of a disclosure for non-standard transactions depends in part on the facts of each case. In general both the fact that the Crown is interested in the transactions and any "profit" made as a result of the transaction requires to be disclosed. For



these purposes "profit" means any net benefit accruing to the Crown as a result of the transaction and not just a cash surplus, so where the Crown has received some other sort of benefit from the transaction that too must be disclosed. Sufficient details of each transaction should be disclosed in order to enable the buyer of shares in the Company or the Directors of the Company to evaluate the transaction. Where non-standard transactions are identified Miss Jackson in the Department of Energy (01 211 4427) would be happy to advise on the level of detail that needs to be disclosed.

#### ACTION REQUIRED

8. (a) Non-standard transactions For such transactions, including any in the categories identified in Annex 2, we need to know essential details. To help simplify the task, I would be grateful if replies could follow the following pro-forma:-

(1) A statement along the following lines:

"We confirm that, having made due enquiry, this Department [Crown body etc] has had no relationship with British Gas in the promotion period other than:

- (i) the supply of gas or services by British Gas on standard terms;
- (ii) the supply of gas or services under arrangements for which the PSA is responsible;
- (iii) the supply of gas or services by, or any other transaction with, British Gas on terms known or believed to be preferential to the Crown, details of which are set out below."

(2) For each item in (iii) above the following information:-

A Name of Crown body.

B Name of any other Crown body involved in or associated with this contract or transaction.

C Relevant date(s) of contracts or transactions - and the date on which the Crown obtain its interest.

D Description of nature of transaction or contract, including terms which you know or believe to be preferential to the Crown.

E Any "profit" (see paragraph 6 above) arising from the transaction.

F Any further details considered relevant.



G Name, address and phone number of a contact who could supply further details if necessary.

(b) Gas purchases whether standard or non-standard For all gas purchased by you from British Gas (irrespective of whether or not the terms are special) except under arrangements for which the PSA is responsible, you should complete the following statement:

"We understand that, for the purpose of writing the Prospectus, a reasonably accurate estimate of the revenue received by British Gas from the Crown over the year ended 31 March 1986 is required. After taking all due care to check on our gas supply expenses, we estimate the total expenditure on gas supplies during that year for this department [body, etc] (excluding gas supplied under arrangements for which the PSA is responsible) to be £ ".

DP88



## POSSIBLE NON-STANDARD TRANSACTIONS BETWEEN THE CROWN AND BRITISH GAS

## 1. Examples include:

- (a) dealings involving the supply of gas by British Gas on non-standard terms which are known or believed to be preferential to the Crown;
- (b) dealings involving the supply of goods or services by British Gas (eg maintenance contracts) on non-standard terms which are known or believed to be preferential to the Crown;
- (c) dealings involving the supply of special goods or services to the Crown by British Gas;
- (d) dealings under which the Crown supplies for payment, goods or services to British Gas;
- (e) dealings between the Crown and British Gas involving land and/or buildings: this would cover either sale or leases of land and/or buildings and pipeline easements.

2. Dealings to be disclosed should include the entering into a contract within the relevant period even though no action may occur under the contract until after the period has expired. It is not necessary to disclose transactions which although they occur in the promotion period, are in implementation of a contract entered into before that period began.

3. Transactions which merely represent the application of general fiscal or other similar regimes need not be disclosed, eg the payment of taxes or national insurance contributions.

4. The duty of disclosure arises in respect of any transaction and whether the Crown is, broadly speaking, the supplier or the customer. It is necessary to make disclosure in respect of both sides of any dealing (for example, both payment for goods and services supplied and details of the services supplied) and whether goods and services are supplied to the Crown for its own use or for resale.



**CROWN BODIES**

ADVISORY, CONCILIATION AND ARBITRATION SERVICE  
AGRICULTURE, FISHERIES AND FOOD, MINISTRY OF  
AGRICULTURE FOR NORTHERN IRELAND, DEPARTMENT OF  
AGRICULTURE AND FISHERIES FOR SCOTLAND, DEPARTMENT OF  
ARTS AND LIBRARIES, OFFICE OF  
CABINET OFFICE  
CENTRAL OFFICE OF INFORMATION  
CHARITY COMMISSION  
COUNCIL OF TERRITORIAL, AUXILIARY AND VOLUNTEER RESERVE ASSOCIATION  
CROWN ESTATE COMMISSIONERS  
CROWN OFFICE, SCOTLAND  
CUSTOMS AND EXCISE, HER MAJESTY'S  
DEFENCE, MINISTRY OF  
DIRECTOR OF PUBLIC PROSECUTIONS, DEPARTMENT OF  
DUCHY OF CORNWALL  
DUCHY OF LANCASTER  
ECONOMIC DEVELOPMENT DEPARTMENT, NORTHERN IRELAND  
EDUCATION AND SCIENCE, DEPARTMENT OF  
EDUCATION FOR NORTHERN IRELAND, DEPARTMENT OF  
EMPLOYMENT, DEPARTMENT OF  
ENERGY, DEPARTMENT OF  
ENVIRONMENT, DEPARTMENT OF THE  
ENVIRONMENT FOR NORTHERN IRELAND, DEPARTMENT OF  
EXCHEQUER AND AUDIT DEPARTMENT, NORTHERN IRELAND  
EXPORT CREDIT GUARANTEE DEPARTMENT  
FAIR TRADING, OFFICE OF  
FINANCE AND PERSONNEL, NORTHERN IRELAND, DEPARTMENT OF  
FOREIGN AND COMMONWEALTH OFFICE  
FORESTRY COMMISSION  
GENERAL REGISTER OFFICE, SCOTLAND







PARLIAMENTARY COUNSEL  
PAYMASTER GENERAL'S OFFICE  
POPULATION CENSUSES AND SURVEYS, OFFICE OF  
PRIME MINISTER'S OFFICE  
PRIVY COUNCIL OFFICE  
PROPERTY SERVICES AGENCY  
PUBLIC RECORD OFFICE  
QUEEN'S HOUSEHOLD, THE  
RATING OF GOVERNMENT PROPERTY, DEPARTMENT OF  
REGISTRY OF FRIENDLY SOCIETIES  
ROYAL HOSPITAL CHELSEA  
ROYAL MINT  
SCOTTISH COURTS ADMINISTRATION  
SCOTTISH OFFICE  
SCOTTISH DEVELOPMENT DEPARTMENT  
SCOTTISH EDUCATION DEPARTMENT  
SCOTTISH HOME AND HEALTH DEPARTMENT  
SCOTTISH RECORD OFFICE  
SPECIALISTS AND TECHNICAL CO-OPERATION OFFICERS, CORPS OF  
STATIONERY OFFICE, HER MAJESTY'S  
STATUTE LAW COMMITTEE, NORTHERN IRELAND  
STATUTORY PUBLICATIONS OFFICE  
TRADE AND INDUSTRY, DEPARTMENT OF  
TRANSPORT, DEPARTMENT OF  
TREASURY, HER MAJESTY'S  
TREASURY SOLICITOR'S DEPARTMENT  
WELSH OFFICE





CABINET OFFICE

MANAGEMENT AND PERSONNEL OFFICE  
70 Whitehall  
London SW1A 2AS  
Telephone 233 8389

Machinery of Government Division

Mr C Bridge  
Room 511  
Department of Trade and Industry  
1 Victoria Street  
LONDON SW1H 0ET

21 February, 1984

*Dear Charles,*

## DEFINITION OF "CROWN SERVICE"

1 You phoned to ask whether we could provide a list of bodies which perform their functions under the Crown. If I understood you correctly, you need this because the "Crown" is to be a promoter for the flotation of British Telecommunications shares, and a legal requirement is that the prospectus should spell out any interests of the promoter in the business.

2 I explained that it is not possible to provide a definitive list of Crown bodies. "The Crown" is a concept rooted in antiquity, whose significance has changed over time, and which rests on a combination of Prerogative and statutory powers, and interpretation by the Courts. Accordingly, it would be easier for us to start at the other end, by considering which of a list of BT's customers are Crown bodies. However, given that you are unable to provide such a list, I promised to send some guidance.

3 Generally speaking the Courts regard the Crown as representing the "sum total of Government powers", that is, as synonymous with the Executive. Accordingly the Crown includes:

- a) the Royal Household;
- b) Ministerial offices covered by the Ministerial and other Salaries Act 1975;
- c) the Armed Forces; and
- d) Government Departments operating under the direction of Ministers. (This concept has been modified by the practice over recent decades of conferring statutory functions on bodies outside the traditional structure of Government Departments.)

4 Legal opinion is that all bodies included in Schedule 2 to the Parliamentary Commissioner Act, 1967, and in the list published by the Minister for the Civil Service in pursuance of S.17 of the Crown Proceedings Act 1947, perform their functions under the Crown. Other bodies regarded as Crown bodies on the basis of express statutory provision or legal advice include the following:

The Royal Hospital, Chelsea  
Greenwich Hospital Department  
Cabinet Office  
Lord Advocate's Department  
Office of the Parliamentary Counsel  
Office of the Paymaster General  
Prime Minister's Office  
Privy Council Office



Parliamentary Commissioner for Administration  
Northern Ireland Civil Service  
Northern Ireland Court Service  
Corps of Specialists and Technical Cooperation Officers  
Council of Territorial, Auxiliary and Volunteer Reserve Association  
NHS Health Authorities  
Overseas Civil Service (constituted on 1.10.54 under Special Regulations  
by the Secretary of State for the Colonies)  
Metropolitan Police (but not other police authorities)

It follows from what I have said earlier that this is not an exhaustive definition;  
I hope that, nevertheless, it is of some help.

*Yours sincerely  
Helen Leiser*

HELEN LEISER





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P.M.



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

*Handwritten signature*

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

*Handwritten initials*

*Handwritten initials*

18 August 1986

*Handwritten signature: Nigel Lawson*

Our officials have been discussing the content of the letter to be sent to all 16 million domestic gas customers inviting them to consider buying British Gas shares.

I regard this mailing as the most important element of our marketing plans. It offers us a real chance of bringing a large number of first time investors into the offer, exceeding the 2.3 million shareholders achieved by BT, and considerably expanding on shareholder numbers in the UK. If we do not maximise its impact we will have missed a significant opportunity and will have reduced proceeds greatly.

I have therefore added Wundermanns, the direct mailing specialists, to the team of general marketing advisers already employed on the British Gas offer for sale to ensure the most effective finished product. They and our other marketing advisers all agree that the letter will have most impact if it contains specific information about what is on offer to customers. They also believe response will be higher if the letter is signed by the Chairman, and he is only prepared to sign if the letter is specific. I strongly support inclusion of specific information; a vague generalised letter would in effect be a repetition of the stuffer already being sent to customers.

I propose first of all that the letter should indicate the minimum application level and the guaranteed amount. The minimum application level would be described as "no more than £150" for 100 shares, leaving us flexibility to set it somewhat lower later if we wished. I hope there is already agreement between us on such a relatively low minimum so as to enable the widest possible participation in the offer.

I propose a guaranteed amount of "around £250". Anything lower would appear too similar to the minimum entry fee and hence not act as a real incentive for gas customers to apply. I also believe a figure of "around £250" would not reduce our flexibility on the structure of the offer. It is lower than the minimum entry fee for BT (£260) and would only pre-empt £250 million of the offer for

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each one million customers who applied. The top limit of what we could expect might be about 4-5 million customer applications, pre-empting only £1-1.25 billion. At this optimistic level, over £1 billion of the general public part of the offer would remain available for non-customers.

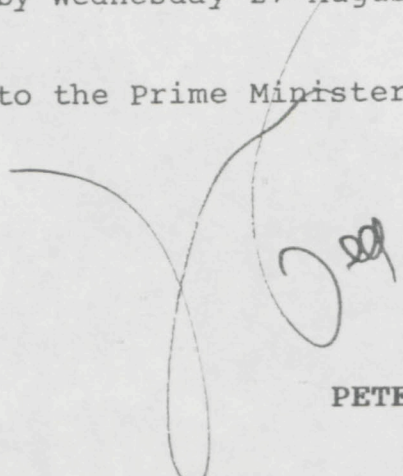
Second, I propose that the letter mention that gas customers will receive some element of preference in allocation policy in the event of every applicant, ie customer and non-customer, receiving £250 worth of shares rendering the guarantee meaningless. But this would be dealt with in general terms, preserving flexibility for us to decide on the level of the preference nearer the time.

Third, all of the marketing advisers strongly advise that marketing impact will be maximised if we can say that there will be instalments and give some broad indication of the size of the first payment. I imagine you will have no difficulty with the first part of this since we will not specify the number of instalments. On the second, I think we can maintain the flexibility your officials have been arguing for by referring to a first payment of "around £50" for the minimum application "of no more than £150". This would leave considerable flexibility since both the initial and total payments could subsequently be set at significantly different levels if necessary (eg initial payment of £60 for £125 worth of shares).

Fourth, there would similarly be clear advantage in setting out the rough value of the vouchers and bonus shares since these are clear financial inducements for customers to apply. I suggest we specify vouchers of £10 for every 100 shares. The bonus shares could be set at one bonus share for every ten bought and held for three years.

The deadline for printing the letter and the information sheet is now extremely tight. The exercise is so large that any slippage would result in production windows being missed and the entire mailing lost. We therefore need to resolve these policy points urgently so that some soundly based drafting of the content can begin. Adequate time must be left for this drafting process so that we can ensure the highest possible quality and impact. I would therefore be very grateful for your agreement to the proposals in this letter by Wednesday 27 August at the very latest, and earlier if possible.

I am copying this letter to the Prime Minister.



PETER WALKER





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

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

7 July 1986

WBP

*John Peter*

**BGC PRIVATISATION: FINANCE BILL**

Thank you for your letter of 3 July.

The Stamp Duty consequential of the British Gas flotation will depend on the precise form that the documentation takes. I understand that your advisers have not yet settled the precise form of this documentation. To that extent - I hope a minor extent - my comments at this stage must be provisional.

Subject to that, your first question is (in broad terms) whether the interim certificates issued by the custodian bank for the British Gas sale are in themselves depository receipts. On the basis of what your advisers have told them, and on the British Telecom precedent, the Board of Inland Revenue is satisfied, on legal advice, that the interim certificates are not in themselves depository receipts. Therefore, the problem foreseen by your advisers does not arise, and no amendment (or new secondary legislation) is required.

Your third question is whether ADR Stamp Duty would be payable on the whole sale price at the outset. Again, the Board of Inland Revenue are satisfied, having taken legal advice, that this is not so. In this case also, therefore, no amendment (or subordinate legislation) is necessary.

As your officials have already been told - and as you acknowledge - the Board of Inland Revenue have offered to provide (for quotation in the prospectus, if you wish) a form of words recording the Revenue's view of how the legislation operates on these two matters. I am satisfied that your anxieties on this are misplaced. We are not talking here about some kind of 'comfort letter', saying (in the words of your letter) how 'officials are prepared to interpret the clause'. We are talking about a formal statement by the Board, on the record, of how they intend to implement the legislation for which they are responsible. In effect, we are talking about a straightforward - and far from unusual - Statement of Practice.





Towards the end of your letter you express a further anxiety that the Courts can and have 'overturned the intended impact of ...tax legislation'. As I have said, I am not persuaded that the doubts expressed by your advisers are well based; and I do not see this problem arising. Nor am I aware of any precedent for anyone taking the Revenue to Court for honouring a commitment to a taxpayer. In any event, however, the Board would regard itself as estopped from changing retrospectively a published statement of this kind, to the detriment of taxpayers who have relied upon it.

This leaves your second question, about the 'double charge'. On the straightforward principles of the ADR tax, there is, and should be, a charge on the transfer of the shares to an ADR shareholder. And similarly there is, and should be, a charge when an interim certificate is issued in ADR form. The problem that has been identified here, in the light of recent discussions with your advisers, is that you propose - unusually - to structure the British Gas flotation in a way that would constitute two chargeable occasions, each involving an ADR charge.

In order to deal with the last point, I have agreed with the Chief Whip that the final day of Report Stage be postponed until 17 July. This gives us time in which to prepare amending provisions for the Bill that will remove the possibility of a 'double charge', and Parliamentary Counsel are now working urgently on them.

I am sending a copy of this letter to the Prime Minister.

A handwritten signature in black ink, appearing to read 'Nigel Lawson', written over a printed name.

**NIGEL LAWSON**



NAT IND Gas PT2





CONFIDENTIAL



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  
H M Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1

CCBG  
NBPR at  
this stage

3 July 1986

BGC PRIVATISATION: FINANCE BILL

I and my advisers remain extremely concerned about the deleterious effects on the privatisation of British Gas of three provisions relating to ADRs.

The three specific issues are:-

- (a) The basic definition of a depositary receipt does not clearly exclude an agreement covering the sale of shares by instalments. There is therefore a risk that 1.5% duty will be payable on the total proceeds of the British Gas sale.
- (b) Clauses 67(1) and 90(1) mean that US purchasers will pay the 1.5% impost not once, but twice.
- (c) Clause 90(5)(a), in Slaughter and May's view, is likely to mean that 1.5% (even if the double charge in (b) is removed) will be payable on the whole of the ADR tranche at the outset, rather than in stages as and when instalments of the share purchase price become payable.

I understand your officials accept that such effects are not intended though no agreement has been reached on a satisfactory way of dealing with them. I am concerned that the combined effect of these problems will seriously damage the British Gas sale.

In relation to (a) I believe your officials may be proposing to rectify matters by relying, in the last resort, on the power in the Bill to amend the definition by Regulation. Giving our opponents the opportunity to pray against Regulations in the run-up to the sale is surely the last thing we should be contemplating. I believe the only sensible solution is to amend the Bill.

As to (b) I believe your officials accept that the defect exists, but I am told that Parliamentary Counsel is unable produce a rectifying amendment to meet the timetable you have laid down. Parliamentary Counsel apparently therefore proposes to draft a



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regulatory-making power which will enable the Revenue to negate the Bill's provision, which is, of course, the effect. This is an absurd state of affairs. It is in no way improved by the Revenue's defence that similar provisions exist elsewhere in the Finance Bill, eg over Inheritance Tax. In any event the points I have made above about the difficulty of relying on Regulations apply again.

As to (c) I understand your officials are prepared to interpret the Clause in question in a manner which avoids the particular problems Slaughter and May have identified. They are prepared to confirm this by letter. I do not believe this achieves anything approaching an adequate degree of certainty. We could not sensibly plan and write the US prospectus relying purely on a Revenue letter, given the advice we have received from Slaughters. As you know, the Courts can and have overturned the intended impact of poorly drafted tax legislation.

It will be quite impossible to persuade investors, notably in the USA, to accept such ill-drafted and damaging provisions. Because of the failure of the Revenue to consult my Department and advisers in reasonable time and with detailed texts, there could well be further problems in the draft Bill. I believe this is a sufficiently serious situation to warrant the Report Stage being delayed until further consultations have taken place. I would be grateful if you could consider the points in this letter with the utmost urgency.

I am copying this letter to the Prime Minister.

PETER WALKER







FROM:

THE RT. HON. LORD HAILSHAM OF ST. MARYLEBONE, C.H., F.R.S., D.C.L.

cc BJA



CONFIDENTIAL

HOUSE OF LORDS,  
LONDON SW1A 0PW

The Right Honourable  
Peter Walker, M.B.E., M.P.,  
Secretary of State for Energy,  
Thames House South,  
Millbank,  
London, SW1P 4QJ.

3 July 1986

NRBM

Dear Peter,

Gas Bill - Commencement

Since I wrote to you on 26th June 1986 in reply to your letter of 25th June about early commencement of the Gas Bill several colleagues, including the Attorney General, have written to me supporting your proposal. I am content to accept that general view.

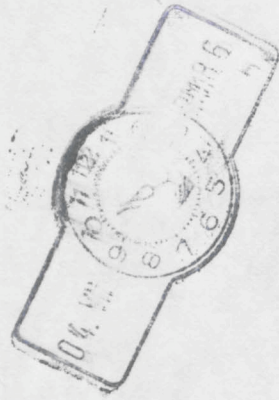
I am copying this letter to John Biffen, Bertie Denham, John Belstead and the other members of E(A) and L Committees and to Sir George Engle and to Sir Robert Armstrong.

Yrs :

LORD HAILSHAM OF ST. MARYLEBONE CH, F.R.S., D.C.L.



NAT. IND: Gas & elec: Pt 12







JU725  
Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY  
1-19 VICTORIA STREET  
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215 5422  
GTN 215 .....  
(Switchboard) 01-215 7877

JCBG

**CONFIDENTIAL**

1 July 1986

The Rt Hon The Lord Hailsham  
of St Marylebone CH  
Lord Chancellor  
House of Lords  
London SW1A 0PW

*Den Quinlan*

*WBM*

**GAS BILL: COMMENCEMENT**

Peter Walker wrote to you on 25 June. I strongly support his proposal to dispense with the usual two months period between Royal Assent and the coming into effect of the Gas Bill.

I am responsible for the various Gas Consumer Councils which the Bill will abolish and the new Gas Consumers' Council which will be set up in their place. Since the latter will be considerably more streamlined than its predecessors and the opportunity is being taken to shake out less effective staff, many of the existing staff are not being recruited to the new body. Staff in this category are already leaving and the morale and effectiveness of the remainder will not be high. The positive presentation of the privatisation exercise as a whole could be put in jeopardy by a prolonged hiatus during which gas consumers were not being well served.

For this reason, I am keen to effect the transition to the new regime no later than late August, as Peter Walker suggests.

I am sending copies of this letter to the recipients of Peter's.

*Yours*

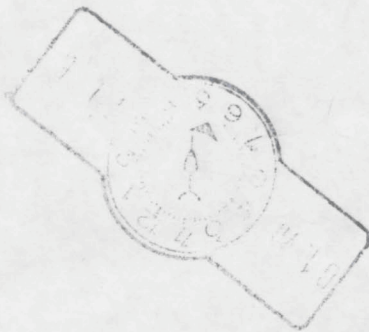
PAUL CHANNON

*Paul*

17  
1986  
BOARD OF TRADE  
BICENTENARY



NAT + IND : Gas : Pt 12





FROM:

THE RT. HON. LORD HAILSHAM OF ST. MARYLEBONE, C.H., F.R.S., D.C.L.



CONFIDENTIAL

HOUSE OF LORDS,  
LONDON SW1A 0PW

26 June 1986

My dear Peter:

GAS BILL: COMMENCEMENT

Thank you for your letter of 25th June 1986 seeking agreement to cutting the normal period of two months between Royal Assent and Commencement to one of two weeks.

Whilst I appreciate your need to maintain momentum towards flotation and whilst I have not been directly involved in your consultations, I would have thought that this proposal is potentially controversial, particularly amongst some of our supporters in the Lords.

A defeat on an amendment would have the effect of postponing the Bill, not accelerating it.

I am copying this reply to John Biffen, Bertie Denham, John Belstead and the other members of E(A) and L Committees and to Sir George Engle and Sir Robert Armstrong.

Yrs:

The Right Honourable  
Peter Walker, M.B.E., M.P.,  
Secretary of State for Energy.



NAT. IND. PT 12.





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*CCB 9*



ROYAL COURTS OF JUSTICE

LONDON, WC2A 2LL

01 X40X X7E44 XEXIX

01-936-6201

26 June 1986

The Rt Hon Peter Walker MBE MP  
Secretary of State for Energy  
Department of Energy  
Thames House South  
Millbank  
LONDON S W 1

*2 PPS*

*TF*

*NBM*

*Dear Peter.*

GAS BILL : COMMENCEMENT

*File with JCN.*

I have seen a copy of your letter of 25 June to  
Quintin Hailsham.

I see no difficulty in dispensing with part of  
the normal 2 month period between Royal Assent and  
commencement as you propose.

I am copying this to recipients of yours.

*Yours Gw.*

*Michael.*

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NAT. IND: Gas & elec A12





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

The Lord Hailsham of St Marylebone  
Lord Chancellor  
House of Lords  
LONDON  
SW1A 0PW

25 June 1986

GAS BILL: COMMENCEMENT

As you know, the House of Lords Committee Stage of the Gas Bill has now been completed, and we are on course for obtaining Royal Assent before the Summer Recess.

We aim to float British Gas before the end of the year; but in order to achieve a successful flotation through an intensive advertising and marketing campaign and to set in place at an early date the new regulatory arrangements we shall need to dispense with the usual two month period between Royal Assent and the Bill's coming into effect. We would hope to appoint formally the Director of OFGAS during the week beginning 11 August which means commencing Clause 1 about 2 weeks after Royal Assent. The setting up of the new regulatory system and the vesting of all BGC's assets and liabilities in the successor company would need to follow quite quickly (and certainly by the end of August) in order to maintain momentum towards flotation in late Autumn.

The two-month delay is of course designed to allow those likely to be affected by the legislation to become familiar with it. The appointment of the Director will have no practical effect until the regulatory provisions are commenced in late August, and this should be about a month after Royal Assent. I believe there will be real advantage for gas consumers in bringing the new arrangements into play as early as possible. We have taken care to consult widely in the gas industry about our proposals, and I am confident that private gas suppliers, and others concerned including trade associations and consumer organisations, will be well aware of the consequences of the new arrangements.

I hope therefore that you and colleagues will see no difficulty in dispensing with part of the normal 2 month period.

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I am copying this letter to Members of E(A), the Lord Privy Seal, Members of L Committee, and the First Parliamentary Counsel. I am also copying this to the Lords Chief Whip, who now has responsibility for supervision of printing of the Bill so that sufficient priority can be given to ensure the text is publicly available as early in August as possible, and to Lord Belstead.

A handwritten signature in black ink, appearing to read "Peter Walker". The signature is stylized with large loops and a long horizontal stroke.

PETER WALKER

CONFIDENTIAL



CJBG



Treasury Chambers, Parliament Street, SW1P 3AG

Geoff Dart Esq  
PS/Secretary of State for Energy  
Department of Energy  
Thames House South  
Millbank  
LONDON  
SW1P 4QJ

18 June 1986

Dear Geoff

NRPN.

**GAS PRIVATISATION**

The <sup>at trap.</sup> Financial Secretary has seen your Secretary of State's letter of 17 June to the Chancellor and is content with the draft announcement.

I am copying this to the private secretaries to the Prime Minister, to the Lord President, to the Lord Privy Seal, to the Chief Whip and to Lord Belstead.

Yours ever  
Vivien

VIVIEN LIFE

CONFIDENTIAL



NAT IND Gas + Electric PT 12





Prime Minister 1

Agree the terms of the  
announcement, subject to  
colleagues?

MR NORGROVE

17 June 1986

JWS  
17/6.

GAS PRIVATISATION - FINANCIAL PACKAGE FOR FLOTATION

The Prime Minister need have no reservations about the financial package developed by Energy and Treasury for the British Gas flotation.

A talented, highly-motivated team of officials is steering an impressive array of professional expertise from the City and advertising. They have their sights firmly set on net proceeds of £8 billion and the participation of five million small shareholders - popular capitalism on an unprecedented scale.

mt JWS

JOHN WYBREW



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

01 211 6402

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

17 June 1986

*Nigel Lawson*

GAS PRIVATISATION

Now that we have settled the financial package for November's British Gas flotation, I need to announce the key features this week to underpin the marketing work now in hand, including preparation of brokers' reports and discussions with the institutions.

I propose to do this on Wednesday 18 June by way of the written announcement enclosed. The text has already been discussed in draft by our officials.

I am copying this letter with enclosure to the Prime Minister, Willie Whitelaw, John Biffen, John Wakeham and John Belstead.

*Peter Walker*

PETER WALKER

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Q. To ask the Secretary of State what progress has been made towards the privatisation of British Gas and if he is able to announce further details.

A. Since my statement to the House about gas privatisation last May, the Gas Bill has received its Third Reading and is nearing Report Stage in another place. I am now able to give the House further details of the basis on which, subject to passage of the legislation, the Government intend to sell the equity in British Gas plc in the autumn.

The new company's balance sheet will contain both debt and equity. This is in line with normal commercial practice. After careful consideration, the Government has decided that the debt element should be fixed at £2.5 billion. This will ensure a properly balanced capital structure while leaving the company full opportunity for business development and growth. The Gas Bill provides the necessary powers for the Government to assume responsibility for the existing British Gas Corporation 3% Guaranteed Stock, which relates to liabilities incurred during nationalisation in 1948. This will be transferred to the National Loans Fund, which will then assume liability for the service and redemption of the Stock. There will be no compensatory payment into the NLF to balance this liability, which will therefore be met from the Consolidated Fund as authorised by the Money Resolution passed by the House on 10 December 1985. The Gas Levy, which is a tax on gas supply from offshore fields not subject to Petroleum Revenue Tax, will decline over time in importance as the proportion of total supply from these fields reduces. The Government has decided that, as provided for in the Bill, the Levy will continue at its present rate of 4p/therm.

The value of X in the regulatory formula relates to the onshore component in the maximum price chargeable to tariff consumers. It is important that X should be set so as to provide a continuing incentive for the company to contain onshore costs directly within its control and to ensure that consumers participate in the benefits of cost containment. After careful examination, I have decided that the appropriate value for the initial five year period of the regulatory formula will be 2. This will ensure that the element of the charge to tariff customers covering the delivery of gas is held





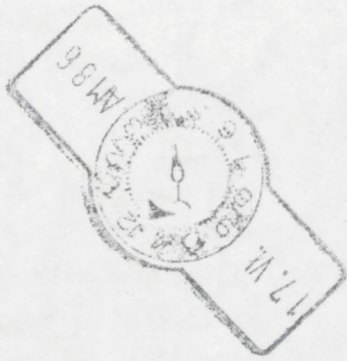
at a level 2% below the rate of inflation, while the gas itself will be charged at prices under long term contracts which are influenced by movements in oil prices, exchange rates and other factors. The formula will set a demanding discipline for the company to meet while leaving opportunities for a profit oriented management to work for still better performance. The regime will be kept under scrutiny by the Director-General of OFGAS.

It is our intention that British Gas employees, past and present, should have every encouragement to take a stake in the new company and the Government will be offering suitably attractive terms. Most employees will be eligible for free shares worth around £70 plus £2 for each year of service. In addition, the Government will provide two free shares for each share purchased by an employee, up to a maximum of £300 of free shares for £150 purchased. It will also be open to employees to purchase up to £2000 worth of shares at a discount of 10%. For British Gas pensioners there will be a free offer worth around £75. Both pensioners and employees will be able to apply on a priority basis for additional shares. The free and matching offers for employees will be available to all in continuous employment from 1 May 1986 who are contracted to work at least 16 hours a week.

The British Gas offer for sale will bring within reach of everyone the chance to share in the fortunes of a major and successful enterprise. Details of the special arrangements for share purchase we shall be making available to small investors will be announced at a later stage. These will include arrangements for domestic gas customers who register their interest in advance to purchase a guaranteed allotment of a certain number of shares.

The provisions I have announced today mark a further step towards realising a historic opportunity which will be good, not only for gas consumers and all who work in the industry, but for the millions of members of the public who will be able to own shares.







JWS  
11/6

GAS REGULATION

It certainly won't help the cause of gas privatisation for Sir Denis Rooke to make intemperate remarks about the feebleness of OFGAS and its Director General. Nonetheless, it may be worth reminding ourselves that the principal curb on Sir Denis' monopolistic tendencies will be competition, either from other private-sector gas producers/suppliers or from competing fuels. The regulators - OFGAS or OFT - may have to blow the whistle from time to time, but they will not need to act as surrogates for real competition:

1. In the procurement of gas supplies from producers

Fortunately, the battle for a liberal gas import/export régime has been won. As indicated by the new Norwegian gas deal, the Continental gas market is again looking buoyant. Moreover, the pipeline arrangements for transporting the Norwegian gas to Continental markets are likely to facilitate the export of British North Sea gas. We have little to fear from British Gas as a monopsony gas purchaser.

2. The industrial contract market (around 30% of BGC's gas sales)

The regulatory framework has been designed to give free play to competitive market forces in this sector. That is what BGC's large contract customers wanted. Competition from private-sector gas producers should be stimulated by the new



arrangements to facilitate third party use of BGC's distribution network on non-discriminatory commercial terms.

Interfuel competition on the margin should be fierce, especially given lower oil prices, lower industrial electricity tariffs and falling coal prices. Gas has a 35% share of the market, compared to 20% for coal, 16% for electricity, 9% for heavy fuel oil and 14% for gas oil. Moreover, for the next decade or more these market shares will be unusually susceptible to change under the influence of competitive forces, since the heavy industrial boilers installed in a wave in the 1960s will be coming up for renewal.

Provision has been made to expose attempts by British Gas to recoup higher margins from 'captive' contract customers in order to offset losses where competition is fierce. The roles of the Gas Consumers' Council and the OFT will be important in this area.

3. In the tariff market for 16 million small consumers (domestic, small industrial and small commercial)

The regulatory arrangements are necessarily more protective in this sector of the market. A ceiling on tariff levels for the first five years (RPI-X+Y) will prevent BGC exploiting its strong established position and should compel the pursuit of efficiency and cost savings.

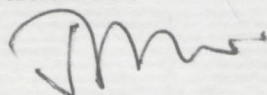


That apart, competition between fuels should be more intense than might be supposed. A large number of decisions is taken each year to invest in new heating systems or appliances, either for the first time or as replacements. Last year, 1.2 million households bought an electric or gas space heater. Gas has a 60% share of the domestic energy market but has been facing considerable competition from electricity. In the cooker market, for example, the introduction of new electric appliances, such as microwave ovens, has led to reduced use of existing gas cookers. In small well-insulated properties, electric storage heaters present real competition to gas heating systems.

The principle of non-discrimination means that, if BGC is forced to make tariff reductions in response to competitive pressure on the margin, the reductions will apply throughout the sector.

### Conclusion

Even if Sir Denis Rooke doubts the firmness of the referees he would be foolish to underestimate the strength of the competition which British Gas will meet on the field. The benefits of vigorous competition on the margin will have to be passed to all customers, either through common tariffs or the arrangements to ensure even-handedness in the contract market.



JOHN WYBREW





10 DOWNING STREET  
LONDON SW1A 2AA

*From the Private Secretary*

9 June 1986

Thank you for your letter of 6 June  
to the Prime Minister. I shall bring this  
to her attention.

(David Norgrove)

Sir Eric Sharp, C.B.E.

GA



PRIME MINISTER

*I think it would be best to have a quick word with Peter Walker - without involving the latter not*

B.G.C.

The report of Sir Eric Sharp's conversation with Sir Denis Rooke in the letter below is very disturbing.

Without mentioning the source, I have told Mr. Walker's Private Secretary that we have had a report of this kind. He was dismayed; but suggested that Sir Denis Rooke is looking for non-executive Directors to join the Board and may have been wanting to persuade Sir Eric Sharp to do so on the basis that B.G.C. was going to be an effective company not constrained by bureaucratic interference.

This seems to me in all probability far too charitable. On substance, there is little or nothing we can do to tighten the regulatory framework at this stage. And the Head of OFGAS is already chosen. (Mr. Hay Davison would anyway be unsuitable because he was the accountant at Arthur Andersen who was in charge of the audit for De Lorean.)

But Mr. Walker should surely discuss with Sir Denis Rooke the presentation of the regulatory framework. We cannot have Sir Denis Rooke running it down. *I don't believe he will do so in public.*

Mr. Walker's Private Secretary thinks that Mr. Walker will need chapter and verse before he will be willing to discuss the presentation with Sir Denis Rooke.

Brian Griffiths would be content for Sir Eric Sharp's letter to be sent to Mr. Walker. We would also need to explain to Sir Eric Sharp the course of action we would intend to take and ask his permission. Subject to that, you could send the letter to Mr. Walker inviting his comments on Sir

*I don't think he can do this.*



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Denis Rooke's remarks and asking him to discuss with Sir Denis Rooke the line to be taken on the regulatory framework arrangements (without of course mentioning the source of the concern).

Agree?

*DN*

DAVID NORGROVE

6 June 1986

CJ2ABH

CONFIDENTIAL





CABLE AND WIRELESS PUBLIC LIMITED COMPANY

MERCURY HOUSE · THEOBALDS ROAD · LONDON WC1X 8RX · TELEPHONE 01-242 4433 · LONDON TELEX 23181 CANDW G

Sir Eric Sharp C.B.E.  
Chairman & Chief Executive

6th June 1986

The Rt. Hon. Margaret Thatcher, MP.,  
Prime Minister,  
10 Downing Street,  
LONDON. SW1

*Dear Prime Minister*

Professor Brian Griffiths suggested that you would be interested in the discussion he and I had on the privatisation of British Gas, with particular reference to the sensitive post of Head of OFGAS - the regulatory body.

Briefly I said

1. Monopolies which move from the public to the private sector need to be regulated.
2. The regulatory authority, apart from its clear duty to supervise the operating licence, has three principal objectives:
  - (a) to protect the consumer (who has no alternative choice);
  - (b) to prevent abuse by the monopoly of its market power;
  - (c) to promote competition wherever possible.
3. Whatever duties and powers the regulatory body has, it is absolutely essential that the man appointed to head the regulatory body must be sufficiently numerate, market orientated and tough to stand up to the entrenched strength (and arrogance) of monopolists who regard loss of market share as an affront.

My personal experience after years of patient, difficult and protracted negotiation with BT over Mercury has confirmed the above views. Fortunately the Government made a brilliant choice in Professor Bryan Carsberg as Director General of OFTEL, who has done an outstanding job in the regulation and liberalisation of telecommunications and the development of competition to the occasional irritation and even anger of BT.

The problem with the privatisation of Gas is that unlike other privatisations the Chairman has not concealed his antipathy towards



The Rt. Hon. Margaret Thatcher, MP.,

6th June 1986

privatisation in general and in particular with Gas and made it plain in discussion with me only a few nights ago that he is well satisfied with what he has secured from Government and he ill concealed his contempt for OFGAS which he now feels will be an innocuous force. The duty to promote competition (i.e., the Portillo amendment) in his words is meaningless.

This did not surprise me as this is a classical response of monopolists. However, it reinforces more strongly that the utmost care must be taken in the appointment of the Head of OFGAS and that in no circumstances should the appointment be 'approved' by the Chairman or sponsored by the Department concerned knowing that the Chairman would find the candidate acceptable (i.e., malleable).

Men who can run a regulatory body dealing with tough monopolists are rare birds but there are one or two about - may I suggest Ian Hay Davison who was until recently Chief Executive of Lloyd's before he fell out with the establishment, i.e., Peter Miller, the Chairman of Lloyd's, because he was disturbing too many traditions and hallowed practices.

I am copying this to Brian Griffiths, who prompted me to pen these thoughts.

*With all good wishes*

*Yours sincerely*

*Ian Hay*







2  
OKS  
6/6

*[Handwritten mark]*

NEW NORWEGIAN GAS DEAL

This week, the Norwegians and a group of gas companies from France, West Germany, Holland and Belgium, surprised themselves and the energy world by signing an outline agreement for the sale of nearly 16 trillion cubic feet of Norwegian gas over the period 1993-2020. The deal is Napoleonic in scale and concept. The volume of gas is comparable to the total quantity so far produced from UK fields - more than double the scope of BGC's aborted Sleipner contract.

Unusually, the agreement relates to a proportion of the reserves of Sleipner and the major Troll field, rather than reserves of a single dedicated field. Much tough negotiation lies ahead for Statoil, the Norwegian State Oil Company, and their partners in Sleipner and Troll. Although the volume of gas is exceptional, the price formula is no more than that prevailing for long-term gas supply contracts in Western Europe. Typically, the base price will be closely indexed against future oil prices.

With the return on such a large risk investment heavily dependent on the vagaries of the oil market, Statoil's partners will require solid assurances about the flexibility of the Norwegian petroleum tax arrangements. Previously, the Norwegians have not been inclined to offer enticing tax terms. Their willingness to conclude the new gas deal suggests a more accommodating approach, no doubt motivated by the desire to



maintain the momentum of oil and gas activity in Norwegian waters. It seems that this coincided nicely with the gas companies' judgement that now is a good time to be buying up new supplies for the 1990s and beyond.

### Comments

1. BGC may be tempted to say "we told you so - the Continental gas companies have now confirmed the soundness of our judgement in wanting to buy a large volume of Norwegian gas". Denis Rooke would be wrong to imply that the Government has damaged BGC's commercial interests by blocking the original Sleipner deal.

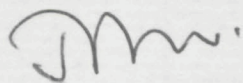
BGC's deal was concluded at a time when the Norwegians still required a premium price for reliability and long-term security; that aspiration has now been dropped. BGC still has an opportunity to contract for uncommitted Sleipner/Troll gas, presumably on the more favourable terms now prevailing in Western Europe.

2. The Norwegian deal looks like marking the start of a new chapter in the European gas market, which has been in the doldrums for the last five years. Although European gas demand is again growing - eg up 4% between 1984 and 1985 - gas buyers have been reluctant to make long-term commitments for new supplies. In arranging to buy nearly 16 trillion cubic feet of high-cost Norwegian gas, the Continental gas companies are in effect saying:



- we foresee a substantial gas supply gap opening up in the 1990s;
  - we would prefer not to increase our dependence on Soviet gas or unreliable Algerian gas contacts;
  - we would rather underwrite the development of a large volume of high-cost Norwegian gas.
3. That should be a stimulus to would-be UK gas explorers and producers - and some relief to our offshore supply industry. Moreover, on current plans, the Sleipner/Troll pipeline could be routed through the UK sector of the North Sea before landing in Belgium. As such, it would facilitate the export of UK gas into the Continental market.

Alternatively, BGC may yet be able to attract the Norwegians with the cost-saving prospect of using the UK as a "land bridge". In any event, awareness of the buoyancy of the European gas market should favourably influence the climate for the flotation of a privatised British Gas.



JOHN WYBREW



SUBJECT

cc master

SECRET



File 5.  
CCBG

10 DOWNING STREET

29 May 1986

From the Private Secretary

Dear Geoff,

GAS PRIVATISATION

The Prime Minister this afternoon discussed with your Secretary of State and with the Chancellor their minutes of 20 May.

It was agreed that the customer share scheme should go ahead in the form proposed by Mr. Walker, bearing in mind the importance of the sale and the great value of securing the widest possible spread of share ownership. It was also noted that to confine the scheme to gas users would give them a feeling of gaining something special and thereby give them a greater incentive to buy shares.

On the employee share scheme, the Prime Minister noted that the cost of generosity would be tiny in relation to total receipts from the sale. It was agreed that the scheme proposed by your Secretary of State should go ahead, save that the generosity of the element for gas pensioners should be reconsidered. Whilst pensioners should arguably be treated more generously than current employees because of the service they had given in building up the industry, they would also - in contrast to employees - be taking no risk because they would be given shares for nothing. The Prime Minister urged the case for generosity and suggested that pensioners might receive shares to a flat rate value of £75. She invited your Secretary of State to consider this.

I am copying this letter to Rachel Lomax (HM Treasury).

Yours,  
David

DAVID NORGRIVE

Geoff Dart, Esq.,  
Department of Energy.

SECRET





DW.

There seemed no point  
arranging for this to go down  
by book tonight. I had  
already told Cab Off that  
we were not expecting anything  
from them, or their  
attendance. MEN 28/5

MR NORGROVE

You asked Brian Unwin for a brief for  
tomorrow's meeting on the BGC floatation. Brian  
and everybody else in the Economic Secretariat  
are on leave this week, but I have prepared  
the attached note which may be of use.

I have agreed with Mark Addison that Cabinet  
Office will not be represented at the meeting.

J E ROBERTS

Cabinet Office

28 May 1986





SECRET

4 ✓ B/UP.

PRIME MINISTER

BGC PRIVATISATION  
(Meeting at 5.15 pm Thursday 29 May)

[Minutes of 20 May from the Secretary of State for Energy and from the Chancellor of the Exchequer.]

MAIN ISSUES

1. Decisions are required on two aspects of the floatation of the British Gas Corporation (BGC):

1. Should there be a preferential scheme for BGC customers, with a guaranteed minimum allotment of shares and preferential treatment above the guaranteed minimum?

2. How generously should the employee share scheme be pitched?

Customer Share Scheme

2. Rothschilds and the other city advisers have proposed a scheme aimed at encouraging BGC's customers to become shareholders. There would be a guaranteed minimum allotment of shares, perhaps of £200, and preferential treatment above the guaranteed minimum. It should be possible to secure a significant level of early registrations from customers in the run-up to the sale. (In addition there will be incentives for small shareholders on the same lines as the BT floatation, but these would be open to customers and non-customers alike and are not at issue.)

3. The proposal is intended to tap the potential for creating a substantial number of new shareholders, to give further impetus to the privatisation programme and to wider share ownership. Treasury Minister have, however, argued that the 22 per cent of

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households who are not gas customers will criticise the Government for putting them at a disadvantage. Of these, 13 per cent in remote areas are unable to get gas. Non-customers will of course be able to apply for shares in the normal way, and indeed will have a degree of priority over the institutions. There will be no direct financial advantage to customers, but on the assumption that the shares will open at reasonable premium (this is particularly likely if the institutions are discriminated against in the initial allotment) the guarantee of a allotment is clearly valuable.

3. In the case of the TSB floatation existing customers are to be given preference. But that case is not on all fours with BGC, because the TSB is a mutual organisation and ownership was unclear. In the case of BGC, the customers are clearly not the owners.

4. The issue for decision is whether the opportunity for stimulating a significant boost to share ownership is worth the possible criticism from the minority who will be excluded from preferential treatment.

#### Employee Share Scheme

5. Annex B to the Energy Secretary's minute sets out the alternative packages proposed by the Treasury and by the Department of Energy for the employee share scheme. Treasury Ministers are concerned that the more generous package proposed by DE represents a substantial increase on what was offered to BT employees, and will effectively bid up what has to be offered for future privatisations. The Energy Secretary argues that it is crucial to create a sizeable employee shareholding, to undercut union opposition to privatisation and to ensure workers' commitment to the future prosperity to the company.

SECRET





SECRET

6. In practice there is only £70 difference in the maximum value per employee between the two departments, and only £60 in the cost per employee. The sums involved are small in relation to the total proceeds from privatisation. The main structural difference is that the DE proposal provides more free shares for each year of service, whereas the Treasury proposal has a flat-rate offer. The DE proposal is substantially more generous to pensioners, offering £70 free shares plus a further £2 for each year of service, compared with a flat-rate offer of £50 suggested by the Treasury.

7. There is clearly every advantage in securing support from the workforce for privatisation, but not at such a price that the Government's hand will be weakened in future floatations. The water industry is the clearest parallel case (the unions are the same), and what applies for Gas will be argued for here also.

HANDLING

8. You will wish to invite the Secretary of State for Energy to introduce the discussion, and the Chancellor of the Exchequer to respond.

J E ROBERTS

Economic Secretariat  
Cabinet Office

28 May 1986

SECRET



*CBG*



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

23 May 1986

G S Dart Esq  
Principal Private Secretary to the  
Secretary of State for Energy

*DW - wrote o/r.*

*NBP*

*Sean Giff,*

**BGC PRIVATISATION: SELLING COMMISSIONS**

The Chancellor has seen your Secretary of State's letter of 22 May.

In the Chancellor's view, the City case is arguable, but he is prepared to accept your Secretary of State's judgement.

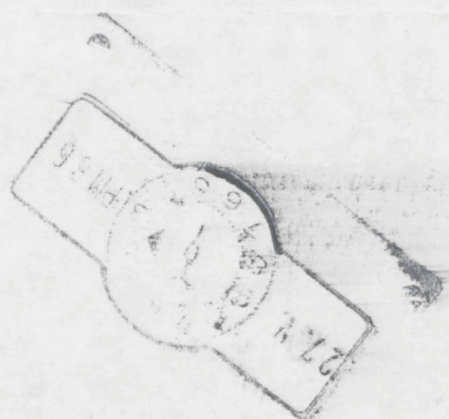
I am copying this letter to David Norgrove (No.10).

*Yours ever  
Rachel*

MRS R LOMAX  
Principal Private Secretary



NAT. IND : Gas & elec : Part 12





CONFIDENTIAL

PRIME MINISTER

BGC PRIVATISATION

You are holding this meeting with Mr. Walker and the Chancellor to try to resolve the differences between them about the employee and customer share schemes for the BGC privatisation.

Mr. Walker, supported by the merchant banking and other advisers, wants to be more generous than the Treasury. He regards this as important to the success of the privatisation, and also useful in ensuring the widest possible spread of shareholders. The Policy Unit support Mr. Walker.

The Chancellor is concerned about the precedent for future privatisations. But, as I understand it, his main concern is political. He fears that people in rural areas who are unable to buy gas would resent their exclusion from the customer scheme, and he points out that they would include disproportionate numbers of the Government's supporters.

I understand from Department of Energy that the receipts foregone by the Government if Mr. Walker's scheme is adopted would be very small. But they could not give me a figure and you will want to confirm that this is in fact the case.

Otherwise, the question is in essence political rather than financial.

*DN*

(DAVID NORRGROVE)

23 May 1986

VC4AHN





## 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

NBP.1.

22 May 1986

## BGC PRIVATISATION: SELLING AND DISTRIBUTION COMMISSION

Our officials have had a number of discussions with our advisers on the rate of commission to be paid to selling agents (brokers and licensed dealers), intermediaries (eg solicitors and accountants) as well as distribution agents (ie the clearing banks).

We have pressed Rothschilds and Cazenoves very hard to improve on the rates applied in the British Telecom sale. They have done this, as you will see from the enclosed letter jointly from Michael Richardson and Anthony Forbes. They recommend a reduction in the distribution commission for clearing banks from the 2% paid in BT's case to 0.375% for BGC. They further recommend a reduction for the rate to be shared between selling agents and intermediaries from 2% to 1.75%. They calculate that, although the BGC sale could be about twice the size of BT, the likely cost of commissions will be £9.3 million against £11.6 million.

You will note that they advise in very strong terms against a further reduction. Having considered this advice very carefully, I feel bound to accept it. It is vital to motivate all those concerned with the sale, who will have to work much harder for their commission than in the case of BT as:

- (a) The BGC sale will be much bigger than BT, not to mention secondary issues such as Cable and Wireless and Britoil;
- (b) BGC will intrinsically be a much more difficult stock to market than BT, lacking its high-tech attractions and overshadowed by the fall in oil prices and hence BGC's profits;
- (c) Rothschilds and our other advisers are committed to much finer pricing than the BT issue. It would be folly to have to accept a higher premium in the after market because we had demotivated the whole sales campaign;
- (d) Market conditions were ideal for the BT sale. Unfortunately we cannot be confident that we will be in a bullish market situation in November;





- (e) We are trying to expand the number of new shareholders very dramatically, which will involve a great deal of extra effort by all the selling agents and intermediaries.

Your officials have suggested that we should pay rates similar to those offered in recent secondary and tertiary issues. These issues are very much smaller than BGC - less than 10% of the size in the case of Britoil. The stocks are known and have established market prices. Indeed our advisers have questioned whether there was in fact any need to pay such commissions at all in these secondary and tertiary issues. It is therefore not surprising that, as your officials have pointed out, the regional brokers involved have not complained about commission levels in those very different circumstances.

I should add that we have consulted our independent (unpaid) adviser on fees, who helped us obtain such fine rates for Rothschilds and Cazenoves own appointments. He is of the firm opinion that we would all be in danger of being penny wise and pound foolish if we tried to squeeze the 1.75% rate further on this occasion.

I accept that you are concerned to reduce the commission rates not only for BGC but for other future primary privatisations, eg Rolls-Royce and British Airways. Michael Richardson has made the point that many of these are much smaller than the BGC issue and intrinsically more attractive. Moreover, having successfully reduced the rates for BGC it should be easier to reduce the rates further on future occasions.

There will be a major meeting of regional brokers at the Salters Hall on 27 May. It is very important to be in a position to tell them the rates at that meeting. It would get the whole marketing campaign off to a very bad start if we are unable to do so. It would almost certainly get into the Press. I therefore propose to authorise Rothschilds to announce the rates set out in the joint letter from Rothschilds and Cazenoves at that meeting.

I am sending a copy of this letter and enclosure to the Prime Minister.

PETER WALKER



N M Rothschild & Sons Limited

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New Court  
St Swithin's Lane  
London EC4P 4DU

(Registered Office)

Telephone 01-280 5000

Fax 01-929 1643

Telex 888031

Direct Line:

our reference C21/10/MJdeRR/NHTW  
your reference (1545R)

J. R. S. Guinness, CB,  
Department of Energy,  
Thames House South,  
Millbank,  
London SW1P 4QJ.

21st May, 1986

Dear John,

Selling and Distribution Commissions

We have, in conjunction with Cazenove's, given further consideration to the levels of selling and distribution commissions we would recommend.

This matter has now become a matter of utmost urgency in view of the regional co-ordinators briefing on Tuesday 27th May, 1986 where we are committed to divulging details of selling and distribution commissions. It is now too late to postpone this briefing and we are concerned that our inability to provide the expected information will become public knowledge, result in adverse comment and stunt the whole thrust of the marketing campaign at its inception.

Selling Commission

When considering selling commissions it is important to differentiate between the element retained by the selling agent and the element reallocated to the intermediary. In each of the four previous privatisations, where selling commissions have been paid, the element retained by the selling agent has been fixed at 0.75 per cent. The element which has varied is the amount reallocated to the intermediary which was 1.25 per cent. in the case of British Telecom and 0.5 per cent. in the case of the three recent secondary and tertiary issues. I think it is worth touching separately on both elements.



- 2 -

The critical role of selling agents, and regional co-ordinators in particular, in informing and educating potential investors and intermediaries should not be under-estimated. Given the desire to attract a much larger number of applicants than was the case in British Telecom it is imperative that selling agents are strongly motivated and thereby generate a large and favourable response. It must be remembered that regional co-ordinators are not receiving a fee and the extent to which their expenses will be reimbursed is limited to £7,500 which is only a proportion of their anticipated total marketing expenditure.

The variation in the amounts reallowable to intermediaries reflects the very different circumstances surrounding the marketing of a primary issue such as British Telecom and the marketing of a further tranche of an already listed security as was the case in the other three issues. It is important to recognise that an intermediary, in his role as financial adviser, is required to exercise a much greater degree of judgement in a primary issue as there is no market price to act as a benchmark against which to evaluate the offer for sale price.

We are concerned, therefore, that there must be a suitable incentive for intermediaries so as to persuade them to set aside the required time to analyse BGC and evaluate its suitability as an investment to recommend to their clients. The intermediaries initial reaction to the level of commission will be critical in determining their support. We believe this reaction will be based partly on a comparison with the rates of commission paid in British Telecom (rather than the levels in the three other issues) and also by comparison with commissions payable on other investments such as unit trusts, i.e. up to 3 per cent. Therefore we must ensure that the commission rates declared do not disappoint intermediaries - this is particularly important given that HMG's allocation policy has resulted in relatively small allocations and therefore restricted amounts of commission per application.

However, we recognise HMG's desire to reduce costs where this is cost effective and therefore we have sought to establish the minimum acceptable level of selling commissions to ensure getting the issue away without prejudicing the success of the flotation. We believe that with careful presentation selling commissions can be reduced from the British Telecom levels and our recommendation is a rate of 1.75 per cent. of which 1.0 per cent. is reallowable to the intermediaries on allocations up to £10,000 - the 1.0 per cent. payable to intermediaries has the benefit, from a marketing perspective, of being an easily ascertainable figure.



At your request we have considered whether we could recommend a figure below 1.75 per cent. but we have concluded that the risk associated with any further reduction is not justified by the consequent cost saving. As you know we have always stressed that the key to a successful flotation lies in generating a strong retail demand. With such a demand we believe it may be possible to persuade U.K. institutions to pay a premium price for their firm allocation and, in addition, to persuade overseas investment houses to take shares at the same price as U.K. institutions. We are anxious to maximise this premium and believe it would be foolish to jeopardise it for a relatively small saving on selling commissions.

Treasury officials yesterday suggested certain ways of reducing or restructuring the level of proposed commissions without affecting the motivation of intermediaries and selling agents. They have proposed three ideas in particular and we have considered each in turn:-

- 1) To reduce selling commissions from 1.75 per cent. to 1.25 per cent. and compensate regional co-ordinators by increasing their expenses from £7,500 to a figure of, say, £12,000 to £15,000. The proposed level of expenses is likely to be only a relatively small portion of the expenses incurred by regional co-ordinators - it would still not cover the advertising expenditure of the actual example of one regional broker's expenses set out in Appendix III. More importantly however it is essential for the success of the offer that all selling agents are fully motivated. Therefore we would have serious reservations concerning any scheme which attempts to compensate regional co-ordinators for a reduction in selling commissions but does not extend to other selling agents. Accordingly, it is our belief that the level of selling commissions must be set at a level which motivates a wide range of selling agents - we would draw your attention to the fact that 76 per cent. of total commissions in British Telecom were paid to firms who were not regional co-ordinators - in Cable & Wireless this figure was 65 per cent. Furthermore this Treasury proposal does nothing for selling agents who bring much of the business to the brokers. Whilst any increase in the levels of expenses would be beneficial it is our view that the additional expenses incurred by regional co-ordinators are compensated for partly by the amount reimbursed and partly by their positioning in the offer.
- 2) To review the whole concept of selling commissions and, in particular, that of reallowance. The proposals envisage selling commission being paid directly to the



intermediary rather than, as present, the intermediary receiving a portion of the commission by way of reallowance. We have already made clear the importance we attach to the role selling agents play in informing and educating intermediaries. A critical part of their task is to combat the inertia of intermediaries who are by and large very conservative - this is achieved in various ways but the most important are through the provision of professional investment advice and logistical support to ensure accurate and timely submission of applications. Furthermore most solicitors and accountants will want to rely on the professional market assessments of the brokers. They would be imprudent not to do so and HMG should think very carefully about encouraging, say, solicitors to offer market advice without consulting brokers.

The Treasury's proposed structure would, as a minimum, eliminate the incentive for selling agents to involve intermediaries. This would not only have a serious impact on retail demand but would undermine the concept of roadshows aimed at intermediaries as the regional co-ordinator, who is charged with promoting the roadshow, would have no interest in involving intermediaries.

- 3) To introduce negotiable rates of reallowance. We believe that the introduction of negotiable commissions will only serve to complicate the offer and that given the limited time available for the submission of applications we should strive to keep the system as simple as possible. The emphasis in the selling period must be to maximise the selling effort to produce a successful subscription and this will not be served by introducing a whole series of negotiations between selling agents and intermediaries.

Accordingly, we do not believe these methods enable us to recommend a reduction in the rate of the minimum selling commission and we would reiterate our opinion that selling commissions are essential in generating a retail bandwagon with all its consequent impact on institutional and overseas demand.

We have also reconsidered the level of selling commissions on applications over £10,000. I think we are all agreed that we should encourage applications in excess of £10,000 and that this will not be easy given the widely held view on HMG's allocation policy. Whilst we may be able to make noises that larger applications are worthwhile we believe that the selling commissions must be made suitably attractive to persuade selling agents and financial intermediaries to recommend sizeable applications to their clients. Accordingly,



we would stand by our earlier recommendation that selling commissions on allocations over £10,000 should be at a rate of 1.75 per cent. on the first £10,000 and 0.5 per cent. on the balance. However, we do believe that it would be appropriate to introduce a maximum commission for each application so long as the maximum represented a sufficient incentive. We would suggest a cap of £375 which, on the above format, would be effective on any application over £50,000.

#### Distribution commissions

We have also reconsidered our earlier recommendations on the level of selling commissions and believe that the rate of 0.375 per cent. applicable in the recent Britoil and Cable and Wireless issues should be retained.

However, we recognise that the clearing banks through their role as distributors of prospectuses are not as influential as the selling agents in determining the size of applications. Accordingly, we believe that it would be acceptable to cap the distribution commission at £37.50 per application - being 0.375 per cent. on £10,000. Accordingly we would recommend a distribution commission of 0.375 per cent. or £37.50 whichever is the lower.

#### Summary

We have summarised the proposals in the attached Appendix I.

Finally, we have compared the possible cost of the commission structure we are proposing with the actual cost for British Telecom. This comparison is obviously heavily dependent on certain assumptions, notably the size of the offer, the portion available to the U.K. public, the number of forms actually stamped and the impact of any customer share scheme. However, based on the assumptions set out in the attached Appendix II, we believe the likely cost may well be below that of British Telecom even though the size of the offer is significantly increased. This is partly the result of the reduced level of selling commissions (1.75 per cent. from 2 per cent.) and partly because of the changed treatment for the clearing banks (0.375 distribution commission compared to 1.5 per cent. selling commission).

We have also obtained a breakdown of the commissions received and reallocated by one of the regional co-ordinators in the British Telecom issue. These are set out in Appendix III



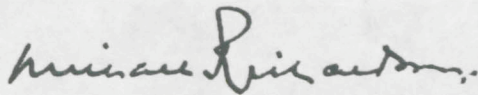
21st May, 1986

- 6 -

and they are informative not only for giving an indication of the return, net of expenses, for regional co-ordinators but also for indicating the number of intermediaries involved and their average level of commissions - £73.

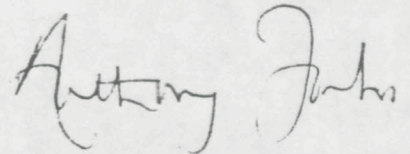
As we agreed, this letter represents the joint views of ourselves and Cazenoves and therefore both Anthony Forbes and I have signed this letter. It has also been discussed with both Kleinwort, Benson and Hoare Govett who are in agreement.

Yours sincerely,



Michael Richardson

Yours sincerely,



Anthony Forbes  
Cazenove & Co.

Attachment



Selling and Distribution Commissions

SUMMARY

Selling Commissions

	<u>Total</u>	<u>Re-allowable</u>
0 - £10,000	1.75%	1.00%
above £10,000	1.75% on first £10,000 and 0.5% on the balance subject to a maximum of £375.	1.00% on first £10,000 and 0.25% on the balance subject to a maximum of £200.00.

Distribution Commissions

The lower of 0.375% or £37.50



Selling and Distribution Commissions

Assumptions

1. £6 billion equity offering.
2. 30 per cent. allocated to U.K. public.
3. 40 per cent. of U.K. public applications stamped (compared to 41 per cent. in BT).
4. Of stamped forms 1/3rd are stamped by banks, 2/3rd's by selling agents (compared to 34.5 per cent. banks and 65.5 per cent. others in BT).
5. No allocations over £10,000.

Commissions paid/payable

B.T. - actual	<u>£11.6 million</u>	(0.77 per cent. of the public issue)
BGC - estimate	<u>£9.3 million</u>	(0.52 per cent. of the public issue)

Note: No account has been taken of a possible customer share scheme and its impact on the number/amount of applications which are stampable.



Selling Commission from British Telecom issue1. Split of Gross Selling Commission

		<u>£</u>	<u>£</u>
Amount retained	- 69		69,000
Amount reallocated	- <u>31</u>		<u>31,000</u>
Total	<u>100</u>		<u>£100,000</u>

2. Brokers' income/expenditure

		<u>£</u>
Retained commission		69,000
Fees/expenses reimbursed		<u>15,000</u>
		84,000
Less expenses incurred:		
Direct advertising	18,400	
Printing	10,000	
Travel	4,000	
Mailing	<u>9,600</u>	
		<u>43,000</u>
Surplus		<u>£41,000</u>

3. Intermediaries

425 intermediaries introduced 9,900 applications representing an average of 23 applications each and commission of £73 per intermediary.

Note: All figures supplied by a regional co-ordinator with the exception of the amount of gross selling commission which is in accordance with the approximate figure indicated at the meeting on 14th May, 1986.







Re BGC Privatisation



10 DOWNING STREET

Prime Minister

To be aware of this  
agreement between Mr  
Walker and the Chancellor  
about employee and  
customer shares in BGC.

The merits are very  
unclear, and a meeting  
will be needed. There  
is no need to read the  
papers ~~about~~ at this stage.

DLW

21/5.

I mention it to you in case  
the Chancellor raises it  
at your bilateral.

(papers' back in box 27/5  
S:U)



BGC PRIVATISATION

We are six months from the world's largest equity flotation. In spite of lower oil prices and more competition in the energy market, we are on course for proceeds close to £8 billion. The regulatory framework for British Gas plc is almost complete - and attracting growing interest and favourable comment from initially-critical commentators in the US. BGC's management are enthusiastic and the staff are mostly positive.

Following recent difficulties over the privatisation of BL and BA, the Government has the chance of a record-breaking success to restore the reputation of the privatisation programme and re-awaken popular interest in share ownership. From now on, the difference between success and triumph depends on the marketing of the flotation. That is primarily what lies behind the two outstanding issues covered in Peter Walker's paper.

Customer Share Scheme

The proposed scheme should appeal to the public's nose for a bargain and stimulate early interest in the flotation. How could a Government committed to popular capitalism pass up the opportunity to sell British Gas shares to 5 million small shareholders rather than 3 million?



In practice, the 24% of non-gas customers should not be significantly disadvantaged in the final allocation of shares. They won't be able to set BT-type vouchers against future gas bills, but they will have the equally valuable option of bonus shares (or perhaps premium bonds). Resentment should be minimal.

### Employee Share Scheme

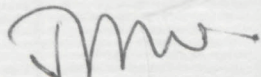
BGC have 90,000 staff, who view the prospect of privatisation with anything between indifference and enthusiasm. Mobilised by an attractive employee share scheme, they will effectively become an additional sales force for the flotation; and the value of their contribution to the market effort should outweigh the cost. Moreover, the higher the take-up of shares by employees the better will be the prospects for the business.

The Treasury are worried about the precedent of generous terms for future privatisations. The best precedent we can have is an eager scramble for shares by 5 million small shareholders and 90,000 motivated British Gas staff.


### Conclusion

We would support Peter Walker on both the customer share scheme and the more generous version of the employee share scheme.

JOHN WYBREW





  
PRIME MINISTERGAS PRIVATISATION

Substantial progress has been made since we last discussed gas privatisation at E(A) before Christmas. The Gas Bill is well into Committee Stage in the House of Lords and is on target for Royal Assent during July. The financial package for the new company has been settled in line with my earlier proposals to colleagues. We are on course for flotation in November with good prospects of realising a capital value around the top end of the £6-8 bn range I held out.

It is just six months to impact day. Nigel Lawson and I are agreed on referring to you two issues which have particular importance for the marketing campaign now getting underway. These concern customer shares and employee shares.

The British Gas flotation is, as we have been clear from the outset, a unique opportunity to extend and consolidate the property owning democracy. If we organise carefully, it should be possible during the campaign to build up and cater to unprecedented levels of response from small investors.

Michael Richardson, who is leading the Rothschilds' team, believes that the key to this is through capturing the interest of British Gas' 16 million customers with an approach similar to that adopted for the TSB issue. Rothschilds have devised, with my Department, British Gas and our other advisers, a customer share scheme which is described at Annex A. The main features are a guaranteed minimum allotment for gas customers, a separate customer register alongside the general register and reliance on British Gas' ability - with the guarantee - to attract a significant level of early registrations from the customers (76% of homes in Great Britain) they serve. Our City advisers are all clear that with this scheme - and a good parallel response from other small investors through the general register - we stand real chances of securing up to 5 million shareholders.





The totality of the package we offer to small investors must be highly attractive. Nigel Lawson and John Moore rightly point to the minority who have opted not to have gas or who live beyond the grid, many of whom will not be easily persuaded into share purchase and with whom we shall need to work hard. It will be our intention to give preference to non-customers over the institutions and to offer attractive incentives for all small investors. Rothschilds have identified no alternative means of building up the personal shareholding that promises to be as cost effective as the customer share scheme. Without it, a considerably enhanced range of incentives would probably be needed to carry the shareholding beyond the 2 million or so achieved in the BT sale.

The Treasury's suggestions for the employee share scheme are set out, together with my own Department's latest, revised proposals, at Annex B. Nigel Lawson and John Moore are reluctant to go beyond BT plus a small allowance for the two year interim. But this is, I believe, false economy with a privatisation of this magnitude and in relation to the importance of creating a sizeable employee shareholding. We have made clear on a number of occasions that provision for employee participation will be on a generous scale. BGC have relied squarely on this in the successful job they have so far made of undercutting the union anti-privatisation campaign. It would be a real pity at this stage to allow disappointment with the announced terms of the scheme to breathe new life into that campaign and to weaken workforce commitment just when we want to rally it.

It has taken much persuasion to bring Denis Rooke to acceptance of the financial package Nigel Lawson and John Moore wanted. He is now putting this to his Board this Wednesday and I need to be able to tell him urgently what we intend for the customer and employee share scheme to ensure agreement and to enable work to go ahead on putting through the sale.

I am copying this minute to Nigel Lawson, John Moore and John Wakeham.

A handwritten signature in blue ink, appearing to read 'Nigel Lawson'.

Secretary of State for Energy





SECRET

ANNEX A

CUSTOMER SHARE SCHEME

The proposed customer share scheme has been devised by Rothschilds working with D/Energy, British Gas, Kleinwort's (BGC advisers), National Westminster (registrars), Dewe Rogerson (PE advisers), Cazenoves and Hoare Govett.

2 The scheme turns on a simplified system of pre-registration for British Gas customers. They will be offered a succession of opportunities to register their interest and will be invited in the run-up to the sale to put in for

- (a) a guaranteed minimum allotment
- (b) preferential treatment above the guaranteed minimum.

3 British Gas have some 16 m. domestic customers (76% of homes in Great Britain). Rothschilds advise that the guaranteed minimum can be set at a level which generates significant response from customers but short of producing so many applications as to exceed the capacity of the system. There would be a separate customer register maintained by National Westminster and the combined capacity of the customer and general UK registers would be up to 6 m. applications. If necessary Ravensbourne could be brought in as additional registrars to increase capacity to 7 m. Subject to further assessment, the guaranteed minimum might be around £200. If 3.5 m. customers applied, this would account for up to 15% of the equity.

4 Non-customers would be invited to apply through the general register and their applications would be given preference over the institutions. There will, in addition, be arrangements for shares placed with institutions to be clawed back in the event of very strong demand from small investors.





SECRET/2

5 There will be incentives for both customers and other small investors. As in the Telecom sale, these will take the form of vouchers or bonus shares. We are considering whether the voucher should be made convertible into premium bonds to broaden its appeal to all small investors.

6 The two registers will be consolidated into a single register following the sale.





SECRET

ANNEX B

EMPLOYEE SHARE SCHEME

Treasury Proposals

- |   |      |
|---|------|
| (1) maximum value per employee                              | £530 |
| (2) actual cost per employee                                | £300 |
| made up of:   |      |
| (3) free offer - £75-80                                     |      |
| (4) matching offer - 2 shares<br>for 1 up to £125 purchased |      |
| (5) discount offer - 10% up to<br>£2000.                    |      |

There would be a £50 free offer for industry pensioners.

D/Energy Proposals (reduced from £745 max. value per employee)

- |  |      |
|--|------|
| (1) maximum value per employee                                   | £600 |
| (2) actual cost per employee                                     | £360 |
| made up of:  |      |
| (3) free offer - £70 plus<br>£2 p.a. for each year of<br>service |      |
| (4) matching offer - 2 shares<br>for 1 up to £150 purchased      |      |
| (5) discount offer - 10% up to<br>£2000.                         |      |

There would be a free offer of £70 plus £2 p.a. for each year of service for industry pensioners.





2.

M

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

PRIME MINISTER

GAS PRIVATISATION

with ORN?  
↓

Peter Walker copied to me his minute to you of 20 May, with his proposals for special provisions for customers and employees in the British Gas flotation. These proposals have political and financial implications.

On the employee share scheme, it really seems unnecessary to pitch the maximum benefit some 28% up on British Telecom and the likely average actual benefit (taking account of the take up of the offer) over 40%. These increases would have substantial repercussions for other sales such as Royal Ordnance, Rolls Royce and BA as well as being likely to upset employees of companies already privatised such as BT. Union opposition to the British Gas sale now seems pretty muted.

John Moore has already suggested to Peter Walker a package which is a significant increase on the BT employee share package. This would provide a maximum benefit some 13% above BT and a likely actual benefit over 18% higher. This package does offer a real improvement on BT despite the fact I am in general keen to avoid the employee benefits being bid up in real terms with each privatisation. I am also prepared to see a free offer of shares to BGC pensioners. This would be quite unprecedented.

Turning to the customer share scheme, there are real problems



SECRET



with the suggestion that there should be benefits exclusively for gas customers.

Some 22% of households do not have gas. These people would be excluded from the scheme. Some of them could get gas if they wanted, but there still remains 13% of households unable to get gas. These households tend to be in rural areas and so are more likely to be our supporters. We are likely to face widespread criticism if we put these people at a disadvantage in applying for British Gas shares. This is not the time for us to be disadvantaging our own supporters.

There are also technical problems with guaranteeing a minimum allotment of £200 to up to 16 million domestic gas customers. We just might not have enough shares to meet all the demands of gas customers.

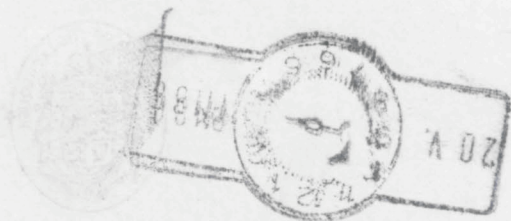
In view of the political nature of these issues, I think we can only resolve them by a meeting. I am copying this to Peter Walker, John Wakeham and John Moore.

*HL*

N L

20 May 1986





11.

NEW YORK



CCBC



DEPARTMENT OF ENERGY  
THAMES HOUSE SOUTH  
MILLBANK  
LONDON SW1P 4QJ  
01 - 211 7301 / 3220

I. T. MANLEY CB  
DEPUTY SECRETARY

19 May 1986

C O N F I D E N T I A L

c. Mr Nargrove (1010)

CONFIDENTIAL

J B Unwin Esq  
Cabinet Office  
70 Whitehall  
LONDON  
SW1A 2AS

Bry Budd

CABINET OFFICE  
P 1839.....  
20 MAY 1986  
FILING INSTRUCTIONS  
FILE No: \_\_\_\_\_

20/5/86

NBSN

Dear Bryan,

ELECTRICITY POWER WORKERS

WILL REQUEST IF REQUIRED

1 Thank you for your letter of 14 May. Although we are only a week away from the threatened start of the overtime ban, we still very much hope that a settlement will even now be achieved. My Secretary of State is in continuous contact with Philip Jones.

2 The ESI is carrying out at our request a full assessment of the likely effect of the ban if it occurs. There is no current prospect of a strike and the unions say that they do not intend this. Their aim is to make things difficult and costly for the management rather than hitting the consumer. As the industry's contingency thinking develops, my Secretary of State will be kept informed.

3 Much depends on exactly how the ban is applied and whether workers on normal time are prepared to undertake work which would otherwise be done on overtime. However, preliminary indications are that generation capacity will not be much affected during the first week of a ban, but the consequences could mount up thereafter. The CEGB might then have to shed some load, since voltage reductions, as envisaged by the unions, would not suffice. Operations by the Area Boards could be affected more quickly as distribution faults would take longer than normal to repair, leaving the customers concerned disconnected for longer. A rough estimate suggests that 10,000-15,000 customers could be off supply at any one time by the end of the first week and the number would be likely to increase thereafter as the backlog of work built up. Of course, 10,000-15,000 is not a very large number out of 22 million customers, but they would be vocal.





C O N F I D E N T I A L

4 It is not easy to see what immediate action CCU could take in response to the situation currently envisaged. We have the statutory powers to authorise any load management which seems likely to be necessary in the short term. We will, of course, keep you in touch.

*Yours  
I T Manley*

I T MANLEY







Prime Minister \*

JWS  
16/5.

MR NORCROVE

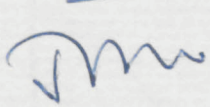
16 May 1986

BGC PRIVATISATION

The legislation is on course and the proceeds forecast is undiminished. Peter Walker and Nigel Lawson are still divided on one or two outstanding points, and may need to consult the Prime Minister at short notice.

Peter Walker wants to use BGC's computerised mailing facilities to invite BGC customers to book an allocation of shares on preferential terms. In a big flotation, the capacity of the registration arrangements constrains the number of shareholders. Peter Walker's scheme would get around this and should appeal to the public's nose for a bargain. With luck, we might end up with an additional two million shareholders.

Nigel Lawson agrees with this but is worried about the political backlash from the 15% of the population who have no access to gas and therefore the bargain offer. We feel that this is a small price to pay for the benefits of increasing the prospect of a successful flotation to a substantially larger number of small shareholders. There are many pros and cons for those living in rural areas. Resentment will be minimal.

  
JOHN WYBREW



010



*ms*

*CEB*

CONFIDENTIAL

*mb*

P 02070

*Prime Minister 2*

From: J B UNWIN  
15 May 1986

MR NORRIS ✓

*DWS  
16/5.*

cc PS/Home Secretary

**THREATENED INDUSTRIAL ACTION BY WORKERS IN THE ELECTRICITY SUPPLY INDUSTRY (ESI)**

As you know, there was some discussion of this in Cabinet this morning and I have separately asked the Department of Energy to keep the Cabinet Office closely informed of developments.

2. If the need arises, I shall consider what role, if any, the CCU might usefully play. I should perhaps, however, register with you the severe limits on the Government's capacity to intervene.

3. The Official Group on Electricity Supplies examined the possibilities in its report to Ministers (MISC 86(83)2) of 22 February 1983. It concluded that it was impracticable to plan for substitute labour (servicemen or contractors) to maintain power supplies; the supply system in Great Britain is far too complex and too interdependent to permit untrained, or even hurriedly trained personnel, to substitute for the normal workforce. Ministers endorsed this conclusion. You may wish to note, however, that in Northern Ireland there is a contingency plan to maintain essential power supplies. This is practicable in the Province because there are only 4 power stations and the distribution system is relatively simple.

4. I shall keep a close eye on any developments with a view to calling the CCU into session - at Ministerial level if necessary - should it become apparent that other essentials of life were under threat and that the implementation of any other contingency plans should be considered. We should also need to consider whether there was any more general coordinating role for the CCU to play.

J B UNWIN





16. V. 1965



SUBJECT  
ce master

SECRET

cc B. ofwin. 1

Pa

NOTE FOR THE RECORD

Mr. Walker today met the Prime Minister for a brief discussion.

Mr. Walker explained that pay negotiations with the electricity supply industry had been suspended for a few days in order to take them past the EETPU Conference. The negotiator for the Electricity Council believed that it should be possible to achieve a settlement with an offer of 6½ per cent. There was, however, a difficult dispute brewing between the EETPU and the EPEA, about the EETPU's efforts to secure the creation of a new grade which would absorb managers who would otherwise have been members of the EPEA. If this dispute became entrenched, there would be little the employers could do about it.

The Secretary of State said that discussions between British Coal and the CEGB had resulted in proposals for a price and coal supply agreement to cover 12 months (rather than 7 months as the Government had hoped) and also principles on which discussions for the next few years might be based. The agreement reached for this year would allow a reduction in electricity prices of some 3 per cent at a cost to British Coal of £270 million. If British Coal was expected to achieve its financial objective, this would require a further 35,000 redundancies. The Government would need to consider the position with great care, particularly in view of the way in which the fall in oil prices would affect oil-related industries in Scotland and the North-East.

DN

(DAVID NORGROVE)  
13 May 1986

SRWADK

SECRET



CC NATIND  
COAL

~~CCBG~~

NSPN.

CONFIDENTIAL

P 02059

From: J B UNWIN  
13 May 1986

NOTE FOR THE RECORD

cc Sir R Armstrong  
Mr Wiggins  
Mr Morgrove - No 10

COAL AND ELECTRICITY PRICES

CONFIDENTIAL

The Secretary of State for Energy was invited by E(A)86 12th Meeting to encourage the ESI and the NCB to negotiate an interim reduction in coal prices to reflect the fall in oil prices. Although no specific time period was set, Ministers had in mind an arrangement covering the summer months and the Energy Secretary himself talked in terms of a rebate of between £150 and £200 million.

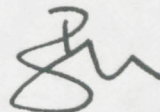
2. According to Department of Energy senior officials, the present position (on which there have been recent press leaks) is as follows. The two Boards have drawn up an agreement, ad referendum to their Chairman, comprising specific arrangements to cover the next 12 months, and a longer term understanding. The Department do not yet know the details of the longer term arrangement; the deal for the next 12 months, however, is expected to add between £240 and £270 million to NCB costs, and to reduce electricity tariffs by 3% over the next 12 months. This reduction would initially be made through the Bulk Supply Tariff (BST) and would thus immediately benefit large industrial and commercial customers; it could then be expected to be passed on to domestic consumers when the next quarterly bills are presented.

3. The cost to the NCB is before taking account of savings by the NCB itself. I have reminded the Department that the Secretary of State was urged by E(A) to put the maximum pressure on the NCB to reduce their costs (particularly the capital investment programme) in 1986-87.



4. Department of Energy officials are about to discuss the proposed arrangements with the Treasury. At first glance, they appear to be within the broad scope approved by E(A), although the 12 month agreement is a good deal longer than E(A) or the Secretary of State himself had envisaged (I understand, however, that it contains appropriate escape clauses related to the price of Heavy Fuel Oil).

5. I have asked the Department of Energy to ensure that the Secretary of State reports the outcome of these discussions to the Prime Minister and other members of E(A) as soon as the full details are known and discussions with the Treasury have been completed. I have been assured that there is no question of any public announcement before collective Ministerial endorsement has been obtained.



J B UNWIN







PRIME MINISTER

ELECTRICITY SUPPLY INDUSTRY PAY

Mr. Walker is coming to talk to you, at your request, about pay negotiations in the electricity supply industry. A letter from him about this is below, though since this was written he has had a talk with the Chairman of the Electricity Council.

There is little doubt but that Mr. Walker is as concerned as you are to avoid industrial action in this area. But you will want to assure yourself that he and others are not resting too much on the good record of the employers on pay negotiations: the clock is now ticking towards a start of industrial action on 25 May.

You could also ask Mr. Walker about the position on the negotiations between the NCB and the CEGB about coal burn and coal prices. The newspapers today have reported that Mr. Walker is considering proposals which would allow a reduction in electricity prices of up to three per cent.

Mr. Walker has not yet reported back to colleagues about this.

DW

ms

David Norgrove

12 May 1986





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

01 211 6402

The Rt Hon John MacGregor OBE MP  
 Chief Secretary  
 HM Treasury  
 Parliament Street  
 LONDON  
 SW1P 3AG

12 May 1986

*RG*

ELECTRICITY SUPPLY INDUSTRY PAY *will request if req'd*

Thank you for your letter of 8<sup>th</sup> May.

I am now in a position to report the outcome of yesterday's meeting with the unions representing the ESI's manual workers. As expected, in the light of the ballot results rejecting the previous offer and endorsing industrial action, the meeting was a difficult and lengthy one and no agreement was reached. The Electricity Council made an improved offer of a 5.8% increase across the board, together with an offer to increase the overtime calculator to 1986 levels as from 1 April 1986. This was rejected as totally inadequate by the unions. The Electricity Council also explored the possibility of offering further money without any impact on scheduled salaries by telling the unions that they would be prepared to consider paying out as a lump sum to staff the money withheld last year as a result of the freezing of the overtime calculator at the previous year's level, but this was also dismissed as inadequate.

As far as the negotiations on matters not concerned directly with the level of the pay increase were concerned the Council believe that they have moved sufficiently, by granting an extra increment to some individual grades eg craftsmen in large and nuclear power stations and agreeing to carry out a review of the salary structure over the next year, to satisfy the unions. However, there was a confused debate over the EETPU's demand for a bridging grade between the industrial staff and the engineers. This is essentially an inter-union dispute between the EETPU and the EPEA as the EETPU want their members to be allowed to do certain work traditionally the preserve of the engineers. This is clearly something that is not in the power of the Electricity Council to deliver as the EPEA would never agree to this. In fact possibilities for advancement for good industrial workers to the engineering assistant grade do exist in the industry, but on promotion they naturally tend to join the EPEA and are therefore lost to the EETPU. There seems no easy way to settle this,





particularly as the EETPU are not even clear what precisely it is that they are asking for, but the Electricity Council hope that the EETPU can eventually be isolated from the other three manual unions.

The unions have refused to give any indication of the level of pay increase necessary to satisfy them. The meeting has been adjourned to 10.30 am on Wednesday 14 May, but the unions are intending on Monday to issue notices to their members calling an overtime ban from midnight on Sunday 25 May and withdrawing all future co-operation with management in discussions aimed at changes in working practices and improved productivity.

At the moment the Electricity Council have not settled their tactics for next week's meeting and I intend to discuss the matter with the Chairman and will then report further.

I am copying this letter to the Prime Minister, the other members of E(PSP), Malcolm Rifkind, Nicholas Edwards, Tom King and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to read "Peter Walker". The signature is stylized with a large loop at the end.

PETER WALKER







010

CCBG



CONFIDENTIAL

P 02057

From: J B UNWIN  
12 May 1986

MR NORGROVE

**ELECTRICITY SUPPLY INDUSTRY PAY**

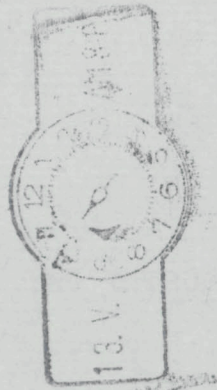
*in meeting  
↓  
folder.*

The Secretary of State for Energy's letter of 12 May to the Chief Secretary reports the latest state of play on these negotiations. The next meeting is to be held on Wednesday morning (14 May), with the unions apparently proposing next Monday to issue notices to their members calling an overtime ban from midnight on Sunday, 25 May and withdrawing all future cooperation with management in discussions on changes in working practices and improved productivity.

2. What the letter does not give, however, is any assessment of whether, in the light of these developments, serious industrial action is likely. At official level, the Department of Energy continue to be optimistic. But the Secretary of State seems to be unhelpfully coy, and you may think it prudent to ask for a judgement in writing from his office. If there is any serious prospect of industrial action, I shall want to gear up the CCU arrangements in the earliest possible time.

J B UNWIN







62/5

CONFIDENTIAL

Prime Minister 2

DRS  
9/5.

Mr Norgrove



010

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Mr Unwin

POWER WORKERS - SITREP

1. I understand that SofS for Energy is being invited by his officials to write today to the Prime Minister and others, reporting on the current state of play in this year's pay negotiations in the ESI. (Talks were adjourned late last evening without agreement and a further meeting is fixed for 1030 am Wednesday 14 May).

2. I also understand that the ESI unions intend to give formal notice to their employers (and the public) on Monday 12 May that they will be calling an overtime ban plus withdrawal of cooperation etc, to begin at midnight Sunday 25 May.

3. D.Energy regard this as a not unexpected negotiating ploy to put pressure on the Electricity Council. There is plenty of negotiating time between 12 and 25 May for a settlement to be reached. Even if action does begin on 25 May D.Energy do not expect anything other than possibly minor interruptions to supplies for some time thereafter.

*[Handwritten signature]*

BRIGADIER J A J BUDD  
9 May 1986

You will wish to note this. We will watch closely.

*[Handwritten signature]*  
9/5.

I don't like this. The whole thing seems to be being treated far too casually. Unless it is tipped in the end 100% we shall be in increasing trouble.

CONFIDENTIAL

*[Handwritten mark]*



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P 02046

FCBG  
From: J B UNWIN  
7 May 1986

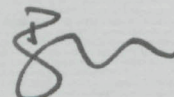
MR NORRGROVE

POWER STATION WORKERS

You will no doubt have seen various recent reports on the electricity workers' pay negotiations which suggest that industrial action is imminent (an example is the attached cutting from yesterday's Daily Mail).

2. We have kept in close touch with the Department of Energy on this, in case the intervention of the CCU should prove necessary. You may like to know that we are still assured by the Department of Energy that they expect pay negotiations to succeed and that they see no imminent prospect of industrial action. It may prove necessary (as Mr Walker has already indicated in correspondence) to settle at a little above 6 per cent, but the Department still believe that a peaceful settlement will be achieved.


3. I am not, therefore, making any CCU dispositions, but we will continue to keep a close eye on this.



J B UNWIN

P.S. The later news reports today, which refer to rejection of the existing pay offer & the resumption of negotiations tomorrow, do not affect this assessment.

Cabinet Office





But she has been given these salaries went up last time."

Daily Mail

# 'Blackout' unions to shatter pay limits

GOVERNMENT pay guidelines are set to take another battering — because of blackout threats by 74,000 power station workers.

They are known to have voted overwhelmingly for disruptive action this summer, although the results of their ballots will not be announced until tomorrow.

Electricity chiefs were

By DAVID NORRIS  
Industrial Correspondent

preparing for a climb-down last night, with their 'final' offer of between 5 and 5.5 per cent certain to be boosted when they meet union leaders on Thursday.

The guidelines demand that wage rises in the public sector remain within inflation, now at 4.2 per cent.

Last week, the Government gave way on another pay claim, and offered 480,000 civil servants rises worth six per cent.

The power workers' tough line, spearheaded by the usually moderate electricians' union, took the State industry bosses by surprise.

The power unions' chief negotiator, Mr. Fred Franks, said there was no doubt that the ballots had produced a strike mandate.

Initially, this would probably mean an overtime ban—but that would cause widespread disruption.

Apart from the pay offer, the power workers have resented what they claim is a widening rift between their wage rises and their managers'.





9237

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

01 211 6402

DN 6 sec

Prime Minister 2

JEN  
6/5

The Rt Hon John MacGregor OBE MP  
Chief Secretary  
H M Treasury  
Parliament Street  
LONDON  
SW1P 3AG

2 May 1986

*Handwritten signature/initials*

ELECTRICITY SUPPLY INDUSTRY PAY

WILL REQUEST IF REQUIRED

As I said in my letter of 8 April the next meeting with the unions representing the ESI's manual workers will take place on Thursday 8 May. The results of the unions' ballots will be known before then and the Electricity Council expects that the unions will receive the mandate for industrial action that they are seeking and that they will be pressing strongly for a substantially improved offer. You will have seen the unions' sabre rattling threats of a strike in the press recently.

In the circumstances the industry sees no chance of achieving a settlement below 6%. The meeting is likely to be a difficult one and the strength of the unions' position will depend on how substantial the majority for industrial action turns out to be. The Electricity Council will be prepared to make an offer of 6% at the meeting, but only if this looks likely to achieve a settlement.

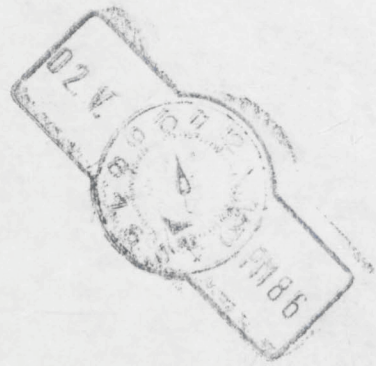
I will keep you informed of further progress.

I am copying this letter to the Prime Minister, the other members of E(PSP), Malcolm Rifkind, Nicholas Edwards, Tom King and to Sir Robert Armstrong.

*Handwritten signature of Peter Walker*

PETER WALKER









## GAS PRIVATISATION

### POINTS TO MAKE

- The Gas Bill represents a major step forward in the Governments policies of freeing economic activity from unnecessary bureaucratic and political interference, and promoting wider share ownership.
  
- By removing the unwarranted public sector restrictions on its freedom to act as a successful commercial business we are giving the new company the opportunity to take up new challenges and to develop its activities to the benefit of consumers, employees and shareholders alike.
  
- We look forward to creating the opportunity for all those working in the industry and its customers to acquire a real stake and interest in British Gas' future success and prosperity.

### DEFENSIVE

#### GAS PRICES

There is no reason to expect higher prices. There is every reason to look for improved commercial performance following privatisation and consumers will benefit accordingly. The emphasis on efficiency in the regulatory system should mean that prices are kept as low as possible.





## JOBS

There is no reason to expect an adverse effect on employment. Releasing the industry from the artificial constraints of the public sector will enable it to approach its task in a fully entrepreneurial way. It will be free to develop others areas of its business and be able to make a more effective contribution to the economy as a whole.

## INTERESTS OF CONSUMERS

The legislation protects the consumer by establishing a new regulatory framework to control the monopoly aspects of gas supply which places a new emphasis on efficiency for the benefit of consumers. The legislation provides for the continuation of the existing obligations to supply gas and protects the consumer against discrimination. The legislation ensures that the consumer voice is effectively in the industry heard after privatisation, by establishing a new body for the handling of consumer complaints - the Gas Users Council.

## SHOWROOMS

The future of individual showrooms is a matter for the new company - the transfer of the industry will offer scope for a more commercial approach generally which should improve the chances of marginal showrooms becoming profitable. It will be in the interest of the new company to ensure that facilities are maintained for contact with customers.

## SAFETY

Safety is a vital issue and I am sure the new company will recognise that it will be in their own interests to maintain British Gas's good record. The Bill provides for improvements in the Gas Safety Regime by bringing it into line with the general requirements of health and safety legislation. The new company will be obliged to continue the emergency service to deal with





escapes of gas - indeed specific obligations are being tightened up; the required response time being reduced from 24 to 12 hours and the obligation to deal with escapes being extended to both sides of the meter.

#### PENSIONS

The industry has its own pension funds, controlled by trustees whose position will not be changed. The new company will take over BGC's obligations to these funds and will continue to provide appropriate contributions. There is no reason why privatisation should affect pension rights.

#### SALES PROCEEDS

Do not wish to estimate now.

#### COMPETITION

The provisions of the Oil and Gas (Enterprise) Act have already opened up the possibility of competition by third parties in industrial sales. These provisions will be carried over to the new situation. History shows that competition in supplies to ordinary households does not make sense. It would be absurd in both practical and economic terms to duplicate the existing supply pipes under every street. We intend, however, to ensure that where no supply exists there are no unnecessary problems for any companies who would wish to offer one.

#### AREA BOARDS

Creating Area Gas Boards would not provide competition for most individual consumer who would still have only a single supplier in their area. Breaking up the present Corporation would also put at risk economies achieved through the integrated transmission and distribution system and the real advantages of central co-ordination which allow best practice to be spread rapidly through all parts of the country.





### SUPPLY IN RURAL AREAS

The present obligation to continue supplying existing customers will be carried over to the new company - and will apply equally to customers in rural areas. It is not economic to lay pipelines to provide gas supplies in some remote and country areas; it will however be in the commercial interest of the company to extend its sales and area of supply as much as possible and I am sure that it will take up economic opportunities.



CONFIDENTIAL

*alg*

Treasury Chambers, Parliament Street, SW1P 3AG

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

*NBRM*

20 March 1986

*Dear Peter,*

ELECTRICITY SUPPLY INDUSTRY PAY

*will request if req'd.*

Thank you for your letter of 12 March.

It is a pity that the Council takes the view that it will be impossible to achieve a settlement below 6 per cent. For the reasons set out in my letter of 6 March I believe there is a strong justification for a lower outcome. And in any case there can be no question of going above the 6 per cent to secure a deal.

I would be grateful to be kept in touch with further developments.

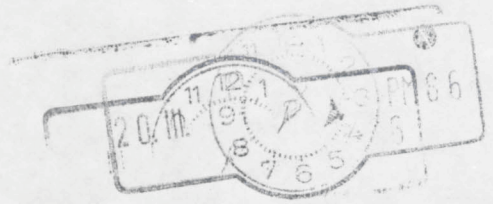
I am copying this letter to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Nicholas Edwards, Tom King and to Sir Robert Armstrong.

*Yours ever,*  
*JG*

JOHN MacGREGOR

CONFIDENTIAL







cc39

01 211 6402

The Rt Hon John Moore MP  
 Financial Secretary  
 Treasury Chambers  
 Parliament Street  
 LONDON  
 SW1P 3AG

J  
 18/3

18 March 1986

*John Moore*

## GAS BILL: AMENDMENTS AT REPORT STAGE

Thank you for your letter of 13 March.

I appreciate your concern about the amendments put down by the members of the Select Committee. I considered these carefully but I decided that it would not be either right or consistent with the position the Government has taken in the Standing Committee and our response to the Select Committee to accept the amendments.

The question of publication of separate accounts is dealt with in para 54 of our memorandum to the Select Committee, cleared with you and other colleagues and released last week. This says:

"The nature of the integrated gas supply business means that it is not possible to associate in a rigorous way specific costs to individual sectors of the market. The objective accuracy of separate profit figures for tariff and contract sectors is not sufficient for regulation to require audited published accounts".

It will of course be open to the Director of OFGAS to obtain information about the various bases on which costs could be allocated and to publish such information as he considers appropriate.

As to the form of BGC's accounts the existing Condition 2 effectively gives the Director control of changes and achieves the necessary degree of regulation. The question of performance indicators came up in Standing Committee and we argued that there was no need for statutory provision for publication of indicators when the Consumer Council will be there to monitor standards achieved and report as necessary to the Director. I do not believe it would have been consistent with our objective of releasing British Gas from unnecessary bureaucratic control to go beyond this, and accept the amendment.

I am copying this letter, as you did yours, to the Prime Minister, Paul Channon and John Wakeham.

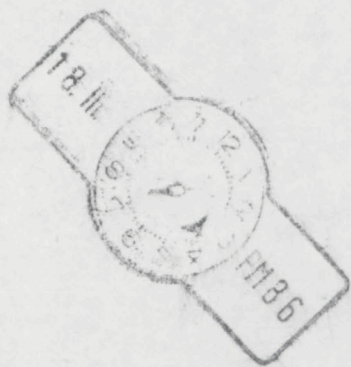
*Peter Walker*

*B.S. to have was no  
 objection*

PETER WALKER



Nat Ind: Gas Pt 12







Treasury Chambers, Parliament Street, SW1P 3AG

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

13 March 1986

*Dear Peter.*

*W  
WR*

**GAS BILL: AMENDMENTS AT REPORT STAGE**

As you are aware, leading members of the Energy Select Committee have tabled a number of amendments for consideration at Monday's Report Stage of the Gas Bill. These have already attracted Press interest, and we could well come under considerable public criticism if the amendments are not dealt with sympathetically.

I have no particular <sup>interest</sup> in the amendments on energy efficiency. But I do have an interest in the two amendments on the accounts of the gas supply business.

The first permits a licence condition to require British Gas to publish separate accounts for the (price regulated) tariff market and the (non-price regulated) tariff market. As you will know from our previous discussion, I have considerable sympathy with this idea. It is important for the efficiency of the business as a whole that cross-subsidies between regulated and non-regulated parts are exposed publicly. I know there is no single objective way of splitting costs because the pipeline system is shared, but the information is important and the Director of Gas Supply is bound to act reasonably in pursuit of his duties. The task is not impossible; British Rail's accounts contain audited profit figures for the different sectors of its business, and the problem of joint costs is if anything worse for BR than for BGC.

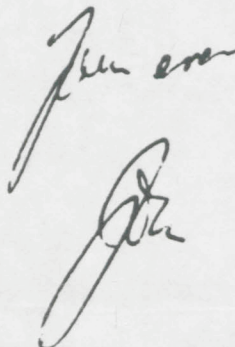
The second amendment requires British Gas to comply with directions given by the Director on the form of their gas supply accounts and on the formulation of service indicators. Again the Director will have to act reasonably, but there may well be information which it is in the interest of gas consumers to have published but which British Gas might not consider it necessary to inform shareholders about. This is certainly the case with service indicators, and we should not underestimate the strength of the consumer lobby.



CONFIDENTIAL

In my view, the amendments would not run counter to the regulatory regime we have agreed. Indeed they would improve it. The amendments have cross-Party support and we should think very carefully before we take on such opposition. I would be grateful to know the line you propose to take.

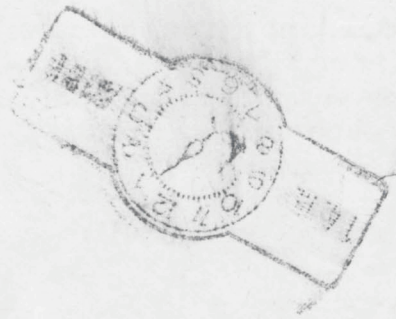
I am copying this letter to the Prime Minister, the Chief Whip and Paul Channon.

A handwritten signature in black ink, appearing to read 'John Moore', written in a cursive style.

JOHN MOORE

CONFIDENTIAL







CC BG



Treasury Chambers, Parliament Street, SW1P 3AG

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

NBM

10 March 1986

Dear Secretary of State

**SELECT COMMITTEE ON ENERGY: REPORT ON GAS PRIVATISATION**

You wrote to Nigel Lawson on 10 March enclosing a draft reply to the Energy Select Committee report on gas privatisation. I had only one significant comment, which my Office has spoken to yours about. This was that the section in the draft reply on competition (paragraphs 7-13) gives a rather gloomy picture of the potential for increases in gas sales in the future. Whilst I recognise that you want to emphasise to the Committee the competitive pressures that British Gas will be under, I think the draft response overdoes it. In order for a successful sale which reflects the true value of the company, we shall need to demonstrate that British Gas has scope for expansion and growth in profits. This will be difficult unless the passage concerned is recast in a more positive direction. I recognise the time constraints you are under, but I think it would be sensible to show this passage to your financial and PR advisers for their views before publication.

I am copying this letter to the Prime Minister and the Secretaries of State for Trade and Industry, Scotland and Wales and Sir Robert Armstrong.

Yours sincerely  
Vinen Life

PP JOHN MOORE

(Approved by the  
Financial Secretary  
and signed in his  
absence)

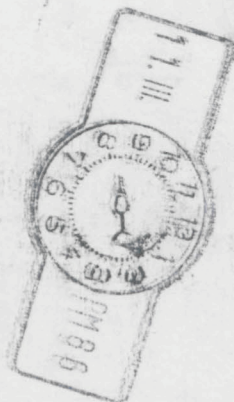


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GRAS

PT 12





*Lebb*

*5/10*



SECRETARY OF STATE FOR ENERGY  
AND POWER  
10, WHITE HALL PLACE  
LONDON, EC4A 3DF

01 211 6402

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

*NBP*

10 March 1986

*As noted*

**SELECT COMMITTEE ON ENERGY: REPORT ON GAS PRIVATISATION**

The Select Committee on Energy published a report on 21 January on our plans for regulation of the gas industry after privatisation. While endorsing the general thrust of our approach it made a number of detailed points on the proposals.

I propose to respond to the Report in a low-key, largely factual, memorandum to the Select Committee, a copy of which is attached. There is little if anything new or likely to attract much attention here. It describes our overall approach - reinforcing competition where this is possible and providing effective regulation where it is not - along the lines I outlined at Second Reading and in my appearance before the Committee. The memorandum describes our proposals in the Gas bill and the draft authorisation published in December and notes the inclusion in the Bill during Committee of a competition duty on the Director. It also covers our new policy on gas imports and exports.

The normal two month period for such responses will be up in the week of the Report Stage of the Bill scheduled for 17 March. It is important that we give the response before this, and I therefore intend to send it to the Committee on Tuesday 11 March and make it public shortly thereafter.

I am copying this letter and the Memorandum to the Prime Minister and the Secretaries of State for Trade and Industry, Scotland and Wales and Sir Robert Armstrong.

*[Handwritten signature]*

**PETER WALKER**



## REGULATION OF THE GAS INDUSTRY

### MEMORANDUM BY THE DEPARTMENT OF ENERGY IN REPLY TO THE ENERGY SELECT COMMITTEE REPORT

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## DRAFT

# REGULATION OF THE GAS INDUSTRY - MEMORANDUM BY THE DEPARTMENT OF ENERGY

## I INTRODUCTION

1. This Memorandum forms the Government's response to the First Report from the House of Commons Energy Committee, Session 1985-86 (HC 15).
2. The Committee's report was directed to the Government's proposals for regulating the privatised gas industry as set out in the Gas Bill and the draft Authorisation which will permit British Gas to operate as a public gas supplier. The reply explains the Government's approach to regulation and then addresses the Committee's observations and recommendations.

### The Government's approach

3. The Government's proposals for regulating the privatised gas industry have been based on two guiding principles. Wherever possible, competition provides the best protection for customers and every opportunity has been taken to open avenues to market forces and reinforce competition. Where this is not possible, there needs to be strong and effective regulation to protect the consumer.
4. The Government has therefore taken a number of steps to reinforce competition between fuels and within the gas market:
  - the authorisation issued under the Bill will require British Gas to make clear the basis on which it prices gas to its industrial and commercial contract customers and to publish a schedule of maximum prices. This is an important step towards improved transparency in the industrial fuel market. Industrialists will be given better information about gas prices and will be better able to judge whether gas or some other fuel best suits their purpose;
  - the arrangements first set out in the Oil and Gas (Enterprise) Act 1982 governing direct supply from private suppliers to customers will continue. The Bill makes clear that the authorisations for such supplies will be subject only to safety related conditions. In



addition it will be open to newcomers to apply for authorisations as public gas suppliers in areas not served by British Gas;

- the common carriage provisions introduced by the Oil and Gas (Enterprise) Act have been reinforced. British Gas will be obliged to publish guidance about common carriage terms, including examples of prices, to assist potential users and to ensure greater transparency for competition within the gas supply market. British Gas will also be obliged to provide back-up supplies of gas to third parties for whom it is carrying gas to enable the third parties to achieve greater security of supply. This facility has particular relevance for customers for whom continuity of supply is important and who may be considering contracting with an independent supplier. In addition British Gas will provide an explicit assurance that it will not discriminate against offers of residual gas from producers who have sold gas from their fields in common carriage deals;
- there will be new freedoms in the offshore gas market. After privatisation British Gas will be able to import gas, and gas producers will be able to apply for waivers of the landing requirement. The Government will continue to ensure that the wider national interest is protected, in particular in relation to continuing security of supply.

5. In other areas the Government has set up a strong and effective regulatory regime:

- there will be a new Office for Gas Supply (OFGAS) headed by a Director-General, to monitor and control the activities of the industry within the framework set out in the Bill and Authorisation;
- the Director of OFGAS will be backed up by a new Gas Consumers' Council (GCC) to advise him on matters concerning consumers and to investigate complaints;
- the Director will have wide ranging powers to enforce the obligations laid down in the Bill and Authorisation, and to take steps to modify the regime to meet new circumstances. He will be fully equipped with information and other powers for these tasks;



- the authorisation provides a range of controls over British Gas's activities in the tariff sector, including a price control formula which will set incentives for increased efficiency and ensure that benefits are shared with customers. The authorisation will require preparation and publication of proper accounts for the gas supply business to ensure full transparency of the activity;
- the Bill provides proper recourse for any complaints in the contract market. These can be pursued through the GCC and if abuses occur, it will be open to the Office of Fair Trading to take action. If necessary, formal regulation could be extended into the contract market within the framework of the authorisation.

6. These proposals provide a comprehensive framework for regulating the industry after privatisation and strike the right balance between competition and regulation. They build on the experience of more than a hundred years of private sector gas in the UK prior to nationalisation, and on experience of regulation abroad. The proposals will provide a firm basis for the gas industry to maintain and improve on an efficient and effective gas supply service to gas consumers in Great Britain, and for British Gas to flourish in the private sector for the benefit of customers employees, shareholders and the nation.

## II COMPETITION

7. The Government believes it is important not to regard the gas supply business in isolation, but to view it in the context of the overall energy market in which it has to compete. The need to compete successfully within the energy market acts as a real curb on any potential monopoly abuse by the gas supply industry. As the Select Committee recognised there is a spectrum of competitive pressures which act on the gas supply business dependent on the alternative fuels available to particular consumers, the relative prices of those fuels and the investment associated with switching at any given time.

### Domestic sector

8. There is strong competition in the domestic market between gas and electricity for cooking and space heating as might be inferred from the resources both industries devote to advertising. While the Committee rightly point to the financial commitment which investment in heating systems and appliances



represents for many individual consumers, a large number of decisions is taken each year to invest in new heating systems or appliances either for the first time, or as replacements. The numbers of people so doing are not insignificant. About 1m decisions are made each year on central heating boilers and in 1984/5 1.2 million households bought an electric or gas spaceheater. At present gas has a 60% (1984/1985) share of the domestic energy market, but has been facing considerable competition from electricity. In the cooker market the introduction of new electric appliances such as microwave ovens has led to reduced use of existing gas cookers and electric storage heaters present real competition to gas central heating systems. But in turn this competition has stimulated the development of more sophisticated gas cookers and more efficient gas central heating systems. In the new housing market, gas faces intensive competition from electricity in today's smaller more highly insulated dwellings. Gas has higher installation costs than electricity, which can make it less attractive to builders, and gas's running cost advantage is reduced in low consumption buildings.

#### Commercial market

9. Gas, oil and electricity each have about 30% of the commercial market and coal's share is just under 10%. Coal has gained in competitiveness for larger central heating needs, for example in the health and education sectors, but the main competition continues to be from oil and electricity. At today's oil prices, competition with gas oil is becoming keener, and if prices stabilise at present levels gas could fail to gain potential customers who were considering conversion from oil to gas. Lower costs and ease of installation make electricity generally attractive in small premises. In larger store premises with significant cooling requirements, combined electric heating and chilling units can be cheaper than separate gas central heating and electric cooling systems.

#### Industrial Market

10. Gas has a 35% share of the market, compared to 20% for coal, 16% for electricity, 9% for heavy fuel oil and 14% for gas oil. Coal has made inroads into the interruptible gas market as technical advances improve the convenience and competitiveness of coal burn. Since 1981 gas has lost, or can expect to lose contracts totalling some 320m/therms a year of sales as a result of decisions by firms to invest in coal burning equipment. This represents some 8% of the interruptible gas market. Conversely gas has taken market share from oil. The



competition between gas and heavy fuel oil (h.f.o.) is especially keen since most interruptible gas customers have facilities for burning both and can respond quickly to price changes. The impact of lower oil product prices is already evident in prices being negotiated for interruptible gas.

11. In the firm gas market the main competition is with gas oil whose price is similarly declining and with electricity, particularly in the specialist industrial process sector.

12. There is active competition throughout the market and the recent falls in oil prices can be expected to give it new impetus and lead to more vigorous sales efforts by all the fuels. The Committee recognises that there is "much evidence of substantial aggregate fuel switches over time". The rapid conversion of industrial equipment from coal to oil in the 1960s and in more recent years to gas burn are only the more notable examples of the market at work and the Government doubts that the Committee has given sufficient weight to the number of investment decisions taken each year. The reality is that each fuel supplier has a commercial interest in pricing to retain customer good will and commercial interest is underpinned by competition law which already contains wide ranging provisions to check anti-competitive practices and monopoly abuse in the energy market.

#### Competition within the gas market

13. The Oil and Gas (Enterprise) Act 1982 created new opportunities for competition within gas supply. These have a direct importance in that they enable large customers to turn to independent suppliers. They also have indirect importance in that their existence influences the terms on which gas is purchased from producers and sold to industry. The improvements which the Government is introducing to the common carriage regime are designed to reinforce these opportunities and their effect on the internal working of the gas market. In addition to independent supply from offshore fields there may be useful scope for onshore gas finds such as that at Hatfield Moors to offer direct competition to British Gas or supply areas which it does not serve.

### III REGULATION

14. The Committee note (paragraph 15) it is generally accepted that supply of gas to small consumers (domestic, small commercial and small industrial users) is a



natural monopoly. It makes neither economic nor practical sense to lay two or more pipelines down each street to supply small premises.

15. The Government is introducing effective regulatory arrangements to protect these small consumers and to oversee gas prices and terms and conditions of supply. These arrangements will be applied to all consumers who take under 25,000 therms a year who will have specific rights of supply and must be charged on the basis of a published tariff. There is provision for the regulatory regime to be adjusted to take account of market developments, through modifications to the authorisation, and for the price control formula to be reviewed after an appropriate interval. The importance of gas's monopoly in supply to small consumers will vary with changing terms of competition between the fuels and account will need to be taken in any adjustments to the regime of the way the market develops.

16. Customers who take more than 25,000 therms a year negotiate individual contracts with British Gas, and industry has made it clear, in consultations with Government and in evidence to the Committee, that it wishes this to continue. The Government's proposals concentrate accordingly on promoting freer and more transparent competition in the industrial contract market. As a condition of the authorisation permitting the new company to act as a public gas supplier, British Gas will be required to publish a schedule of maximum prices payable for gas by contract customers, together with a general policy statement about its approach to price negotiations. In addition, the authorisation will require the company to publish general guidance for those wishing to arrange alternative common carriage supplies, including examples of prices chargeable for conveying this gas. These measures are designed to provide a more open market and to assist customers in conducting their negotiations for fuel supplies.

17. The contract market will be subject in the normal way to competition law and the legislation provides for complaints to be taken up by the Gas Consumers Council. The Company will also provide a statement about its intentions for contract market prices over the next three years and will make clear it will not set prices in such a way as to restrict, distort or prevent competition. The legislation provides, as a final safeguard, the possibility of including the contract market within the overall framework of control under the authorisation.

18. The gas appliance market is not a natural or a statutory monopoly and the Government does not believe it would be right to subject it to the regulatory system designed for gas supply. There is intense and growing competition in the



retailing of both gas and electricity appliances and appliance retailing is itself only one aspect of competition between the fuels. There are now considerably more private sector outlets for gas appliances than British Gas showrooms. Gas appliance retailing, installation and servicing are already the responsibility of the Office of Fair Trading under existing competition legislation and action can be taken against British Gas or any other person active in the market for anti-competitive practices or monopoly abuse.

19. The Government considered carefully whether regulation of gas prices at the well-head was likely to assist the working of the gas market offshore or provide protection for consumers. Experience of regulating well-head gas prices elsewhere has demonstrated that price control can lead to serious long term distortion; in the U.S. artificially low well-head prices drastically reduced the level of gas exploration activity while greatly stimulating consumer demand. Competitive pressures from other fuels and the profit incentive will ensure that British Gas continues to have a strong incentive to buy its supplies cheaply. The present instability in the oil market demonstrates the extent to which the price of competing fuels may vary without notice, and the commercial risks to British Gas if it is unable to meet such a challenge by containing costs wherever appropriate. Bureaucratic intervention to secure what, in effect, would be an administered gas price would not assist this process. There will however remain an important continuing role for Government in ensuring that momentum is maintained in the UKCS and that national interest considerations such as security of supply are safeguarded.

20. The Government shares the Committee's concern to promote competition wherever possible but does not believe that this will be achieved by giving the Director of OFGAS a duty to promote competition in all areas where British Gas conducts, or may in future conduct, activities (paragraph 69). The Government has, however, accepted an amendment to the Bill which will lay a duty on the regulator to enable persons to compete effectively in the supply of gas to industry and large commercial customers (those taking over 25,000 therms a year.)

21. The Committee also recommend that private suppliers wishing to supply up to 2 million therms a year to individual consumers should not have to apply for authorisations. As mentioned above in paragraph 4, such authorisations will be subject only to safety related conditions. The legislation ensures that wherever private suppliers can safely be authorised they will be; the authorisation procedure will not represent as a constraint on competition.



#### IV THE REGULATORY STRUCTURE

22. Regulation of the gas industry will be the responsibility of the Director of OFGAS who must ensure that gas suppliers comply with the requirements laid down in statute and in their authorisations. Where the Director believes that the conditions of an authorisation are inappropriate or inadequate in any respect, he may seek the suppliers' agreement to a modification. If this is not forthcoming the matters can be referred to the Monopolies Commission. Where the Commission concludes that modifications should be made, they will be added to the authorisation.

23. The Director will have power to make references to the Monopolies Commission on all matters affecting tariff consumers. Matters affecting industrial and other contract customers will fall to the Director-General for Fair Trading (DGFT), who has the necessary powers and expertise to address the industrial energy market as a whole and to investigate anti-competitive practice or other abuse by gas or its competitors at any point in the market.

24. It will be similarly open to the DGFT to make reference to the Monopolies Commission. The Government is strengthening the existing provisions of competition legislation as they affect the public gas suppliers, and is providing for suppliers' authorisations to be modified by the Secretary of State, where he considers this appropriate, on this basis of recommendations from the Monopolies Commission. Such modification could extend existing gas-specific regulation into the contract market.

25. The Office of Fair Trading is also the appropriate body to deal with wider aspects of inter-fuel competition and it would not be right to charge the Director of OFGAS, as the Committee suggest, with responsibility ranging across the energy market (paragraphs 58, 76, 77, 81). Nor does the Government see a need to set up a separate Gas Commission to take on the role already envisaged for the Monopolies Commission (paragraph 83). The approach outlined at paragraphs 3-6 above calls for the active promotion of competition alongside suitable regulation of gas supply. OFT and the Monopolies Commission have an integral part to play in achieving this aim and their involvement is, in the Government's view, better calculated to improve the working of the market than regulation centred on gas.

26. The New Gas Consumers' Council will have an important role in the structure. In addition to advising OFGAS on tariff matters. The Council will be able to investigate complaints from both tariff and contract customers. In any



matter where it appears to the Council that it would be appropriate for OFGAS or OFT to exercise their statutory functions, the Council will be under a duty to refer the matter to the appropriate Director.

## V THE OFFSHORE MARKET

27. In its Seventh Report, Session 1984/85 (HC 76-I), the Committee recommended that exports should be permitted when the ratio of gas reserves to production exceeded an appropriate security margin. The Committee argued that Government must retain an over-view of gas imports but that any qualifications to commercial freedom in the national interest should be publicly declared. In its First Report Session 1985/6 the Committee recommends that Government should remove all restrictions on both gas imports and exports (paragraph 53).

28. The Government has decided that a more open regime for gas imports and exports should now be introduced. British Gas will be able to import gas subject to the normal consent requirements for laying pipelines on the UK Continental Shelf and, where appropriate, the conclusion of inter-Governmental treaties. British Gas has given an explicit assurance that it will consult the Government on its import plans as these develop. On exports the Government will in future be prepared to consider, on a case by case basis, applications for waiver of the requirement to land gas in the UK. but in doing so, it will take into account security of supply considerations.

29. The Committee express concern that BGC might discriminate, in purchasing, in favour of its own fields and recommended that OFGAS should be charged with ensuring that discrimination does not occur. Competition legislation, and particularly the provisions of the Fair Trading Act 1973, already provides statutory protection against significant cases of preference or discrimination including the possibility of reference to the MMC. In addition, the Government, through the Department of Energy, obtains full information on the development status and potential of all UKCS fields and is well placed to ensure that projects are not set back by discriminatory behaviour. The Government does not believe that OFGAS could add importantly to existing protections or that it would be the appropriate body to undertake regulation offshore.

30. The Government notes the Committee's concern that some smaller oil companies fear take-over by British Gas. The Government wishes small independents to prosper since they have important contributions to make on the



UK Continental Shelf. The opportunities open to British Gas for interest acquisition will be the same as that which already exists for all other major companies in the UKCS.

31. The Government welcomes the Committee's support for Clause 61 in the Gas Bill which provides for the Secretary of State to issue directions to ensure that British Gas does not make unfair use of confidential information supplied during gas sales negotiations.

## VI COMMON CARRIAGE

32. The Government has extended significantly the provisions of the Oil and Gas (Enterprise) Act for the carriage of gas for third parties through British Gas's supply network, enhancing the opportunities for competition in supply to larger customers.

33. If a prospective third party supplier is not satisfied that he has been offered reasonable terms for common carriage in negotiations with British Gas he may take the matter to the Director. The right of appeal is detailed, as the Committee recommend (paragraph 42), in Clause 19 of the Bill. This allows those who wish to use a public gas supplier's pipelines for delivery of gas to apply to the Director to determine whether pipeline capacity can be made available and on what terms it should be provided. The Director will be in a position to make a determination if normal commercial negotiations have failed to reach a satisfactory conclusion.

34. The Committee also recommend that the right of appeal permitting the Director to set the terms of the supply of back-up gas, should be clearly defined (paragraph 43). The Government accepts this and is considering the position.

35. A potential difficulty for a producer attempting to sell direct to customers is that he may not be able to place the whole of his field. Residual gas of this kind is already subject to the safeguards described at paragraph 29 above and as the Secretary of State explained to the Committee (Q.326 page 79) it would not be appropriate to impose an obligation on British Gas to make specific purchases. British Gas has, however, given an explicit undertaking that it will not discriminate against offers of residual gas from fields where gas is sold to common carriage users.



36. The Committee suggest that for a "transitional period" the Director should have the right to require British Gas to charge for common carriage in existing pipelines on a basis reflecting short run marginal costs (paragraph 47). The principles laid down in clause 19 of the Bill require the Director to set charges giving third parties access to British Gas's pipeline system on the same terms as British Gas itself. This will ensure that independent users of British Gas's supply system are treated on a basis of equality with British Gas, and the Government believes this is the right approach. Clause 19 does not preclude marginal cost charging, provided this is the basis of charge being applied generally for the supply system.

37. The Committee invited the Government to consider whether an obligation should be placed on British Gas to guarantee supplies to customers whose alternative supplies had been terminated (paragraph 48). It will be open to such customers to approach British Gas for a supply in the normal way. Public gas suppliers are generally obliged under clause 9 of Bill to meet any reasonable demand for gas where it is economical to do so. An unreasonable refusal to supply would be a matter for the Director of OFGAS who can enforce the supply obligation.

## VII THE PRICE REGULATION SYSTEM

38. The Government welcomes the Committee's recognition (paragraph 25) of the advantages of price rather than profit control.

39. As it has previously stated, the Government believes that the price control formula set out in Condition 3 of the draft Authorisation will provide real protection for tariff customers, both in respect of the price for gas and the standing charge. Through the X-factor it will also ensure that British Gas has a continuing incentive to achieve real reductions in the costs under its control. It also ensures that costs genuinely outside the Corporation's control may be reasonably reflected in charges to customers.

40. In its detailed examination of the formula, the Committee proposed that the Director be given the right to refuse any tariff increase in circumstances where the actual price already charged had exceeded allowable thresholds. This is already provided for.

41. If in any one year British Gas has overshot the Maximum Price by more than 4% it has to provide an explanation to the Director, and may not increase prices



in the next year unless it can demonstrate to the satisfaction of the Director that it would not be likely to overshoot the maximum again. Should the cumulative excess over two years amount to more than 5%, then the Director may step in to determine the price (such that in his judgement it would not exceed the maximum in the next year). The Condition therefore already produces the effect the Committee was seeking, and provides powerful and effective safeguards for consumers.

42. In paragraph 35, the Committee also asked for an explanation of the principles which will be adopted for deciding how Condition 3 will be replaced after it lapses.

43. The Government believes that a decision about the possible continuation of price control after the initial five year period must properly be addressed in the circumstances prevailing at the time. In technical terms, when the Condition lapses, it will require a modification of the authorisation to continue the formula, or to continue price control in a revised form. The procedures for modification are set out in the Gas Bill. Clause 23 provides for modifications to be made by agreement between Director and British Gas. Alternatively, the Director may make a reference under Clause 24 to the Monopolies and Mergers Commission. Clause 26 provides for modifications to be made following a report by the MMC.

44. In assessing how or whether price control should be modified or reset, the Director will be guided by his duties set out in Clause 4. In any reference to the MMC, the Commission must similarly have regard to the duties in Clause 4. These provide the appropriate framework against which the future of price control must be judged. In addition, the Director will have full powers to call for any information he believes may be necessary for his consideration of what should replace Condition 3 after it lapses.

45. In paragraph 29, the Committee sought examples of the operation of the formula based on different forecasting scenarios. Future trends will reflect factors as diverse as the rate of inflation, exchange movements and oil prices which cannot be forecast with any accuracy. However, the Government confirms that the illustrative figures in the Appendix to the Committee's report correctly show how the formula would operate in the particular circumstances chosen (provided that table 5 is taken to be based on the inflation assumptions set out in table 6).



### The Y Factor

46. The Committee recommended (paragraph 37) that Condition 3 of the draft Authorisation be amended to require the Director to satisfy himself that the Allowable Gas Cost was prudently incurred to meet the requirements of regulated tariff customers, and that he should have the power to disallow any costs not so incurred.

47. As noted in paragraph 19 above, British Gas has a strong incentive to buy its supplies cheaply. Signing up long term contracts at unnecessarily high prices would be damaging for the company. It would jeopardise long term competitiveness, and since about 40% of gas is sold in the contract market costs have to be met from contract sales, profitability of supply to that sector would be put at risk. Moreover 90% of the gas for the period up to 1992, has already been contracted or will be produced by British Gas. The Government does not accept that the Director has a role here.

48. In paragraph 37 the Committee expressed the view that "if expensive gas is purchased to satisfy demand outside the regulated market, the full marginal cost should be recovered within that quasi-competitive market".

49. The effect of the price control formula in Condition 3 is to relate changes in the maximum average price to changes in the actual cost of gas. The Government believes this a fair and straight-forward way of controlling changes in price in the tariff sector. The suggestion that particular tranches of gas should be reserved to particular customers or classes of customer, and that some but not others should meet the full marginal cost of new supplies could not be accommodated in a practical regulatory mechanism. Nor would it be fair.

### Standing Charges

50. The Committee asked for assurance (paragraph 38) that in calculating the revenue per therm for the purpose of establishing whether the price formula has been adhered to, standing charges will be taken into account. The Committee also asked for consideration to be given to whether any rewording of the draft Authorisation was necessary to make the point indisputable.

51. The Government confirms that standing charges are within the overall control of the price formula. The average price controlled by the formula is the Tariff Revenue in the year divided by the Tariff Quantity supplied. The



definition of Tariff Revenue set out on page 13 of the draft Authorisation explicitly includes standing charges.

#### VIII ACCOUNTING POLICIES

52. Condition 2 of the draft Authorisation requires British Gas to draw up accounts for the gas supply business as a whole, and gives a clear role to the Director in scrutinising the allocation of cost between the gas supply business and any other business British Gas undertakes. The purpose is to ensure British Gas draws up proper accounts which represent a true and fair view of the profitability and financial position of the gas supply business.

53. From the start, the Director will be able to use his powers to call for all necessary information covering the tariff market and he will therefore have access to information about the possible bases on which costs and revenue can be related to the tariff market. The Director also has discretion to publish information he considers appropriate. Against this background, the Government has considered the Committee's recommendation (paragraph 33) that Condition 2 of the draft Authorisation be amended to require British Gas to publish the profits that arise from tariff sales, and that the Director should certify the figures to be a fair reflection of revenues and costs ascribable to the market.

54. Any requirement to publish detailed profit figures must be compatible with the nature of the business. The nature of the integrated gas supply business means that it is not possible to associate in a rigorous way specific costs to individual sectors of the market. The objective accuracy of separate profit figures for tariff and contract sectors is not sufficient for regulation to require audited published accounts. The same problems of shared costs arise within the gas supply business in disaggregating costs and profits between different regional activities (Committee recommendation in paragraph 72).

55. The Committee also recommended (paragraph 58) that the Director should have full and open access to the accounts of British Gas, and in particular to ascertain what judgements have been made in the apportionment of costs between the regulated and unregulated markets. The Government accepts the importance of this, and the provisions of Condition 7 of the draft Authorisation have been framed such that the Director is able to call for any information which may be necessary for him to carry out his functions. This would include information on apportionment of costs in addition to that provided regularly under Condition 2.



56. In paragraph 74 the Committee recommended that the Director be given a power analogous to that presently held by the Secretary of State to give directions as to the information required to be given in the annual accounts of public gas suppliers, over and above the minimum legal requirements of the Companies Act.

57. The Government agrees with the Committee's view that the Director should be able to publicise information. There is therefore specific provision in the Bill - Clauses 34 and 38 - to enable him to publish appropriate information, advice and reports. A power to issue directions relating to information in the Companies Act accounts is in these circumstances unnecessary.

#### IX CONSUMER REPRESENTATION

58. The privatisation proposals provide comprehensive protection to gas consumers' interests and represent an advance on the present position. The new Gas Consumers' Council (GCC) which will act as the consumers' voice has been given new powers compared to the current National and Regional Councils; it will be able to require information from British Gas on complaints concerning gas supply to both domestic and industrial consumers, and will be able to refer such complaints to the OFGAS Director or the DGFT as appropriate for possible action. It will therefore be properly equipped to carry out the tasks.

59. Ministers have made clear that the GCC will not be restricted to complaints on gas supply only. As is the practice with the current Councils, it is the Government's intention that the GCC should be able to consider representations from gas consumers on all gas-related matters concerning gas appliance sales and safety, installation and service. The Government recognises the concern of the National and Regional Gas Consumers Councils and the Committee that the legislation should cover explicitly the GCC's functions outside the area of gas supply (paragraph 60) and in the Standing Committee undertook to introduce appropriate amendments to the Bill at the House of Common's report stage, to clarify the scope of the GCC's remit.

60. The Committee also notes the NGCC's concern that the level of funding proposed for the new GCC is inadequate. As Ministers have explained in Standing Committee (21 January p.166) the figures set down in the Financial Memorandum are an initial estimate. It is the Government's intention that the GCC will be provided with the resources it needs to carry out its tasks effectively. The



necessary funding will be provided by British Gas and any other public gas suppliers though a fee required to be paid under authorisations on an annual basis.

61. The Government agrees with the Committee that it is important that the regional network of the GCC should be effective (paragraph 62) but that it should also be efficient. Ministers have also explained in Standing Committee that while the Government considers it inappropriate to enshrine rigidly in primary legislation a specific local organisation for the GCC based on British Gas's regional structure, there will be a member of the Council appointed to represent each of the twelve British Gas regions. Employees of the Council working with these representatives will staff offices in the regions, so that complaints can be taken up at a local level to ensure that the new Council keeps in close touch with consumers' views and needs.

62. The Committee suggests that gas suppliers should be obliged to distribute publicity for the GCC with their bills (paragraph 62). This is not a requirement laid upon British Gas at present, although British Gas does voluntarily publicise the current Gas Consumers Councils in their billing material. The Government considers it should be for the Council itself to decide how best to publicise its activities.

63. The Committee comments on Condition 12 of the authorisation dealing with the Codes of Practice on gas supply service and payment of bills (paragraph 61). It would not be appropriate to subject any breach of the Codes to an enforcement order by the Director. Those services which the Government believes British Gas should be required to provide are set out in the Bill, in particular, in the "public gas supply code", schedule 5, and in the authorisation (e.g. obligations to supply, free emergency service). The Director should not be expected to lay down in detail what services British Gas should offer beyond these statutory obligations. It is important however that both the Director and customers should be aware of the services they can expect of British Gas. British Gas is therefore required to publish Codes of Practice and to consider representations made by the Director and the GCC on their operation. The Government considers it right that the obligation to publish should fall on the supplier, although the Director is free under clause 34 of the Bill to publish information and advice for tariff consumers if he thinks it would be helpful.

64. The Committee also recommends that the Director should require British Gas to develop a set of performance objectives against which to measure standards of



service (paragraph 75). Again, the Government does not believe this is appropriate within the regulatory framework proposed. The fundamental responsibility for maintaining standards of service must be with the supplier who manages the gas supply business. British Gas fully recognises its obligations to its customers in this area and has stated publicly that care for the consumer is fundamental to the future success of its business. The GCC will be able to monitor standards of service on the basis of the representations it receives from consumers, and to advise the Director of any shortcomings in gas supply services to tariff customers. If any action appeared to the Director to be necessary he could as outlined above (paragraph 22) propose modifications to the authorisation to maintain standards and, if British Gas did not agree, refer the matter to the Monopolies Commission.

## X ENERGY EFFICIENCY

65. The Select Committee refer to their two recent Reports, on the Energy Efficiency Office and on the Development and Depletion of the United Kingdom's Gas Resources. The Government has already given the Committee its observations on these Reports and would refer the Committee to the parts of those responses which are relevant to the Recommendations made in those Reports (paragraphs 28-31 of the Response on Gas Depletion; paragraphs 64-66 of the Response on the Energy Efficiency Office).

66. The Government believes that the imposition on the energy supply industries of a statutory duty to help all consumers improve their energy efficiency, and to submit an annual report on energy efficiency for approval by the Secretary of State for Energy (paragraph 67), would add little to the industries' already extensive energy efficiency activities.

67. A major aim of privatisation is to release industry from interference by Whitehall and generally to remove public sector restrictions on finance and on managerial initiative. In returning British Gas to the private sector, the Government would not want to impose upon it unnecessary statutory obligations which go beyond those that apply to normal Companies' Act companies. The Gas Bill places upon the Director a duty to carry out his functions in such a way as to promote the efficient use of gas. The Government believes it is right to provide this kind of broad guidance for the Director, and for the Director and the industry to work out how best to achieve the objective, without creating any unnecessary bureaucratic systems of reporting or control.



## XI ROLE OF THE SECRETARY OF STATE AND OTHER MATTERS

68. Commenting on the role of the Secretary of State in regulation the Committee recommended that the Secretary of State should be obliged to seek the advice of the Director on any matter affecting the operation of the gas market, and that the Director should report to Parliament actions by the Secretary of State which he believed affected his duty to promote competition (paragraph 88). In the specific case of issuing authorisations for public gas suppliers under the Bill the Secretary of State is obliged to consult the Director. In addition the Director is required under clause 33 of the Bill to advise the Secretary of State either upon request or where he considers it expedient to do so. The Secretary of State, will, of course, be able to consult the Director, when he wishes to, on other matters, and the Government does not consider it appropriate to define further the relationship between the Secretary of State and the Director. The Director is already required to report annually on his own activities, and developments on matters which fall within the scope of his functions. Any significant actions by the Secretary of State would be included in this annual report, which the Secretary of State is required to lay before Parliament. The Committee's recommendation is therefore already fulfilled.

69. The Committee also recommended that any directions made by the Secretary of State under Clause 33 of the Bill should be laid before Parliament (paragraph 87). The Secretary of State explained in his evidence to the Committee (p 83 Qu 351) that the Bill only permits directions of a general nature on the considerations which the Director should take into account in ordering his or her priorities or to which the Director should have particular regard. The Government agrees with the Committee that any such directions should be notified to Parliament, and has accepted an amendment to the Bill so that any directions given by the Secretary of State are to be included by the Director in his annual report.

70. The Committee also suggested that it was excessive for the Secretary of State (who in this case will be the Secretary of State for Trade and Industry, since he is the Minister responsible for consumers affairs) to vet the appointments of principal officers of the Gas Consumers' Council (paragraph 87). The Bill in fact only requires that the Secretary of State be consulted on the appointment of the most senior officer. This officer will have executive responsibility for the staff employed by the GCC and be Accounting Officer for the Council. The consultation will allow the Department of Trade and Industry



which has experience of many consumer bodies to advise on whether prospective candidates have suitable qualifications and experience.

71. The Committee asked that the method of funding should guarantee the independence of OFGAS (paragraph 89). As the Secretary of State said in response to the Chairman's question (p 83 Qu 350), the Government agrees that OFGAS should be financially independent. As the Director will head an independent non-Ministerial Government department, its funding must be accountable to Parliament, and the presentation of a Vote is the most effective and appropriate means. The Director will be the Office's Accounting Officer, and will be responsible for ensuring that funds are sought each year sufficient to allow the Office to perform its duties, and that those funds are spent properly in pursuit of these duties. Expenditure will be covered by authorisation fees payable by British Gas and other suppliers. These fees are not a revenue raising device.

72. The Committee further expressed surprise that the privatisation of British Gas was likely to result in no more than a small reduction in Department of Energy staff numbers (paragraph 87). Setting aside the additional staff resources temporarily allocated to privatisation, Gas Division's complement should reduce substantially over the next two years. The remaining posts will be particularly concerned with upstream matters where the work load will continue. Reduction in staff numbers will be small in terms of the Department's overall complement (currently just over 1000), but significant in terms of the resources allocated to the gas industry.

73. The Committee recommended that the Government should consider in depth the merits of the US system of regulation adapted to the UK system and that the Government should also publish the material it has collected generally on foreign experience of regulation. In framing its proposals the Government has taken into account US practice as well as that of other countries. The Department's information on overseas experience has been gathered from a variety of sources including advice from H M posts; discussions with foreign experts, annual reports, journals, academic reports and other publications. The broad conclusions were submitted to the Select Committee as annex 2 of the Department's memorandum to the Committee of 30 October 1985. Because of the diversity of sources the information is not in a form which could readily be made available to the Select Committee. The Government will bear in mind the Committee's recommendation that



it should publish a White or Green Paper in advance of any further proposals for energy utility privatisation.

74. The Committee asked for reassurance on two matters not strictly related to "economic" regulation (paragraph 11):- rights of entry and competence of gas fitters.

75. The principle of rights of entry for private gas companies is well established; similar powers of entry to those in the Bill existed before nationalisation and some date back to legislation last century. In framing the privatisation proposals the Government has reviewed the rights of entry carefully, and they have been rationalised to remove any possible ambiguities. The rights of entry which remain are essential for public gas suppliers with statutory duties to supply gas. Entry without the occupier's consent can be effected only with the authority of a magistrate's warrant or in an emergency for safety reasons.

76. The Government recognises concern about installation of gas appliances and the Health and Safety Commission and Executive are drawing up a Code of Practice for gas installers in consultation with British Gas, the Confederation for the Registration of Gas Installers and others which will give practical guidance on training requirements and provide standards against which to assess competence. The draft code will be published in the Spring to allow for further consultation. The Government believes this is the right way forward at this stage.



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 Caxton House Tothill Street London SW1H 9NF  
 Telephone Direct Line 01-213...5949.....  
 Switchboard 01-213 3000

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

NBP7,

7 March 1986

*Mr Peter,*

**ELECTRICITY SUPPLY INDUSTRY: MANUAL WORKERS PAY**

I have seen your letter of 28 February to John MacGregor about the proposed offer in the electricity supply industry. I am concerned that your proposed offer is higher than last year's settlement of 5.8%. I would have thought that in the light of the predictions for lower inflation, and that settlements in the private sector are stable or possibly edging down, a lower offer should be seriously considered. I am unaware of any major problems concerning recruitment and retention.

Already in this round the settlement in the Gas industry, and the proposed settlement for coal, are higher than last year. If the electricity industry follows suit, then it may be impossible to prevent a general drift upwards in the level of settlements in the public trading sector. This will damage our attempts to encourage lower settlements in the private sector which are essential if we are to see a better trend in employment.

I would urge you to consider requesting the electricity supply industry to seek a final settlement at least no higher than last year and preferably a little lower.

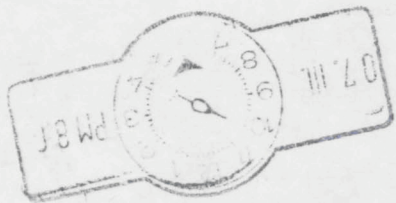
I am copying this letter to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Nicholas Edwards, Tom King, and to Sir Robert Armstrong.

*J. L.*

KENNETH CLARKE

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Public Sector Policy  
Economic Policy  
Pt-173.





cc B5  
Paine <sup>4</sup>

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Treasury Chambers, Parliament Street, SW1P 3AG  
The Rt Hon Peter Walker MBE MP  
Secretary of State for Energy  
Department of Energy  
Thames House South  
Millbank  
London  
SW1P 4QJ

MW

6 March 1986

Dear Peter,

ELECTRICITY SUPPLY INDUSTRY PAY

Thank you for your letter of 28 February.

The Electricity Council's proposals for a settlement as high as 6 per cent worry me. As I mentioned in my letter of 24 January about the gas manuals' negotiations, there is a danger of 6 per cent being perceived as the going rate for pay increases in the public sector. This will be even more acute if the ESI manuals are seen to settle for the same figure. The fact that other groups have settled around 6 per cent does not mean, of course, that the ESI settlement has to be at that level.

I recognise that pay negotiations in the electricity supply industry will be influenced by the settlements in the coal and gas industries. However, there is a good case for a settlement below 6 per cent. The annual rate of increase in the Retail Prices Index is 5.5 per cent at the moment and is set to fall during the year. And the gas manuals' settlement was 5.6 per cent on average earnings. Since the electricity manuals achieved a higher settlement than the gas manuals last year, the Electricity Council should be able to aim for a lower settlement this year. The ESI's financial forecasts imply that 5 per cent would be a more sensible outcome than 6 per cent. I would therefore urge you to press the Council to seek a settlement around this level and hopefully no higher than 5.6 per cent on average earnings.

Last year following the ESI manuals' settlement there was a chain reaction for settlements for the other ESI groups. I would be grateful if you could let me know the consequences for the other groups which you expect to follow from the negotiations with the manuals.

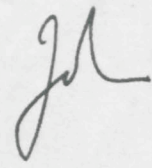


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I am sending copies of this letter to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Nicholas Edwards, Tom King, and to Sir Robert Armstrong.

Yours ever,



JOHN MacGREGOR



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PRIME MINISTER

GAS IMPORTS AND EXPORTS

You will remember Mr. Walker's reluctance to allow a more liberal gas export regime. He now seems to have changed direction, and proposes to announce tomorrow that the Government would consider applications for waiving a requirement that gas may be landed in the UK, on a case-by-case basis, taking into account the need to safeguard the security of the UK's gas supplies. Mr. Walker would make it clear that there was no presumption against exports in present circumstances.

The reference to the need to safeguard the security of the UK's gas supplies would provide a basis, consistent with our EC obligations, to allow the Government to prevent particular export deals.

On imports, Mr. Walker proposes that BGPLC should be allowed to import gas subject to the normal pipeline consents and to the conclusion of treaties where appropriate. He has been assured by Denis Rooke that the new company will consult the Government on its import plans.

The Solicitor General is content with the announcement, as are the Chancellor of the Exchequer, the Foreign Secretary and the Secretary of State for Trade and Industry. The Policy Unit are also content.

Agree to the proposed announcement subject to any further comments from colleagues who have not so far reacted to the proposal?

Yes mt

DW

DAVID NORGROVE

5 March 1986

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CSG

10 DOWNING STREET

5 March 1986

*From the Private Secretary*

Dear Geoff,

GAS IMPORTS AND EXPORTS

The Prime Minister has seen your Secretary of State's minute of 28 February and the draft of an announcement dealing with imports and exports of gas. She has also seen letters from the Department of Trade and Industry and the Treasury agreeing to the proposals, and I understand also that the Foreign Secretary is content.

The Prime Minister is also content with the proposed announcement.

I am copying this letter to the Private Secretaries to members of E(A) and to Len Appleyard (Foreign and Commonwealth Office), Henry Steel (Solicitor General's Office), Joan MacNaughton (Lord President's Office) and to Michael Stark (Cabinet Office).

Yours

David

David Norgrove

Geoff Dart, Esq.,  
Department of Energy.



GAS IMPORTS AND EXPORTS

Hitherto, gas imports - and even more so gas exports - have been presumed guilty of conflicting with the national interest until proved innocent; little Englanders have prevailed. Peter Walker's apparent intention to keep it this way has exposed the Government to the charge that the Thatcherite goal of freeing up markets and promoting competition has been subordinated to the short-term imperative of maximising the proceeds from gas privatisation. This has worried some of the Government's staunchest supporters.

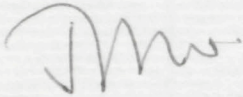
Peter Walker's proposed announcement on gas imports and exports is a welcome volte face. Ironically, the new factors which presumably have made this decision easier for him also make it less likely that UK gas will be exported to the Continent. Continental gas prices - partially indexed to oil prices - have recently fallen sharply, eliminating the price step between the UK and North West Europe. Nervousness over oil prices will tend to delay the development of UKCS gas associated with oil or condensate, probably increasing our gas supply deficit in the 1990s.

Apart from the presentational benefits, the liberal spirit of the proposed gas import/export régime should arouse the commercial creativity of the oil and gas industries, to the advantage of the UK economy. For example, one interesting



idea is to use the UK as a "land bridge" for transporting the large reserves of Norwegian gas in the northern North Sea to continental gas markets.

We would endorse the proposed announcement.



JOHN WYBREW





From the Minister of State for Industry

DEPARTMENT OF TRADE AND INDUSTRY

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239

THE HON PETER MORRISON MP

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

4 March 1986

NBPM

**GAS IMPORTS AND EXPORTS**

I am writing in Paul Channon's absence in Brussels in response to your minute of 28 February to the Prime Minister.

I welcome the more liberal import and export regime reflected in the draft announcement, which seems to achieve a balance between the need to promote competition in the supply of gas on the United Kingdom Continental Shelf and security of supply considerations.

As you know, DTI is guardian of the UK's obligations under GATT, which like the EC Treaty may bear on our freedom to restrict the import and export of products. In this context I welcome the emphasis placed in the statement on security of supply, which seems a helpful consideration in this context. It is not, however possible to say in advance that the exercise of the announced policy will in all circumstances be compatible with our obligations under Article XX of the GATT - much will depend on the circumstances of individual cases in which it is proposed not to grant a waiver of the landing requirement. It will therefore be necessary for my officials to be involved in the consideration of any such cases.

There would be something to be said for explicit reference in the statement to our having regard to our international obligations, for example at the end of the penultimate sentence of paragraph 3

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of the draft. This would disarm those who might seek to argue that our policy was incompatible with them. If however you feel that this would be inappropriate for other reasons I would be content for the statement to issue as drafted, on the understanding that DTI officials would be consulted on individual cases as above.

I am sending copies of this letter to the Prime Minister, to members of E(A) and to Geoffrey Howe, Patrick Mayhew, William Whitelaw and Sir Robert Armstrong.

PETER MORRISON



1MOBUD





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

The Rt Hon Viscount Whitelaw CH MC  
Lord President of the Council  
68 Whitehall  
LONDON SW1

4 March 1986

*John Walker*

*N. B. M.*

**GAS BILL: HOUSE OF LORDS**

Peter Walker sent me a copy of his letter to you of 28 February.

I am sure Peter is right in saying that any extra time we can obtain between the Bill reaching Statute Book and the Offer for Sale will be of great value to the success of BGC privatisation. I would, therefore, welcome anything you can do to bring the Bill before the Lords as speedily as possible.

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

*John Walker*  
*Nigel Lawson*

**NIGEL LAWSON**



INDI. POL. Gas. Peta.







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

David Norgrove Esq  
10 Downing Street  
London SW1

4 March 1986

Dear David

**GAS IMPORTS AND EXPORTS**

The Chancellor has seen the minute of 28 February from the Secretary of State for Energy to the Prime Minister. The Chancellor is content with the terms of the draft announcement. *WITH DEN*

2. I am copying this letter to the Private Secretaries of other members of E(A) and the Private Secretaries of the Foreign Secretary, of the Lord President and of Sir Robert Armstrong.

Yours ever

*Tomy*

A W KUCZYS

*Pls to have content.  
5/3.*

*DLW*



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GAS

PT 12





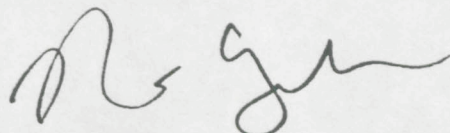
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Prime Minister<sup>2</sup>

The Rt Hon John MacGregor OBE MP  
 Chief Secretary to the Treasury  
 Treasury Chambers  
 Parliament Street  
 LONDON  
 SW1P 3AG

DRS  
 3/3

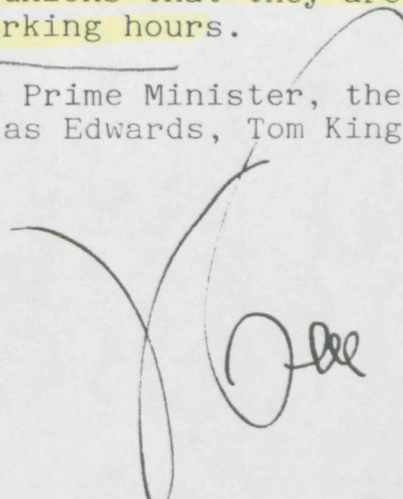
29 February 1986


**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 6 March.

Given the present level of settlements the industry sees little chance of achieving a settlement much below 6%. In view of this, if it seems likely that it would be possible to reach a quick settlement without a ballot, the industry will be prepared to offer up to 6% to achieve this. If, however, the unions make it clear that it is their intention to ballot their membership on any offer then a somewhat lower offer would be made. Coupled with this the industry expect to come under strong pressure to increase the overtime calculator, which for the last two years has been frozen at the previous year's level, so that it applies to the agreed 1986 pay rates. While the industry expect to have to concede this, they believe that, by careful control of overtime working, it should be possible to ensure that the effect on average earnings is broadly neutral. The industry have already made clear to the unions that they are not prepared to contemplate any reduction in working hours.

I am copying this letter to the Prime Minister, the other members of E(PSP), Malcolm Rifkind, Nicholas Edwards, Tom King and to Sir Robert Armstrong.



PETER WALKER







CJBo

PRIME MINISTER

## GAS IMPORTS AND EXPORTS

<sup>attach</sup>  
E(A) on 9 December asked me to consider whether a more liberal gas export regime, compatible with the Treaty of Rome, could be constructed on the basis of United Kingdom Continental Shelf (UKCS) licensees giving British Gas a right of first refusal of gas they wish to export, at the negotiated price.

I have considered carefully ways in which we might meet the second part of this remit, a right of first refusal for BG: Patrick Mayhew has however advised that giving BGC such a right would be likely to be incompatible with the EC Treaty.

I have therefore considered whether a more liberal export regime, compatible both with our EC obligations and with our need to retain control of UKCS strategy, could be constructed in some other way. In the light of legal advice, I have concluded that the best way of doing this is to base an export regime around the concept of security of supply.

I attach accordingly the draft of an announcement dealing with both imports and exports that I would like to make as a PQ answer before the end of the Committee Stage of the Gas Bill on 6 March. This has been cleared with officials in the Treasury, the Foreign and Commonwealth Office, the Department of Trade & Industry, the Cabinet Office and the No 10 Policy Unit.

On imports, BG plc would be able to import gas subject to the normal pipeline consents and to the conclusion of Treaties where appropriate. As we agreed in E(A), I have obtained Denis Rooke's assurance that the new company will consult the Government on its import plans. I intend to ensure that these consultations are full and timely.

On exports, we would consider applications for waivers of the landing requirement on a case-by-case basis, taking into account the need to safeguard the security of the UK's gas supplies. We would make it clear that there was no presumption against exports in present circumstances.





The announcement also makes clear that BG will not discriminate against indigenous gas supplies; and that UKCS gas producers will not be permitted to put the UK's security of supply at risk. My Department will keep a close watch on the position to ensure that abuses do not occur.

I believe that these proposals enable the Government to keep control of UKCS strategy, and preserve our ability to step in if important national interests are at risk. At the same time, they represent a substantial liberalisation compared with the present position on exports (which is that the Government will consider exports at some future date, depending upon the reserves position). As such they will be welcome to many of our supporters. The new position will of course require careful presentation and we will need to confirm where necessary that we regard the policy as being in line with our international (especially EC) obligations.

Patrick Mayhew has confirmed that the draft announcement is acceptable to him.

I am copying this minute to the other members of E(A), Geoffrey Howe, Patrick Mayhew, William Whitelaw and Sir Robert Armstrong.

A handwritten signature in blue ink, appearing to read 'Geoffrey Howe', written in a cursive style.

Secretary of State for Energy  
25 February 1986



**GAS IMPORTS AND EXPORTS: DRAFT ANNOUNCEMENT**

1 I wish to make clear the position on gas imports and exports, and on the development of UKCS gas resources, following the privatisation of the British Gas Corporation.

2 Gas imports and exports can have a major effect on the rate and pattern of the development of UKCS resources, and hence on wider national interest. The Government intend to ensure that this interest is adequately protected and that continuing gas supplies are available to customers in the UK. Substantial gas resources are available, or potentially available, both from the UKCS and from overseas sources to enable the new company to meet the needs of its customers for many years ahead. The company will be able to import gas subject to the normal consent requirement for the laying of pipelines across the UKCS and, in appropriate cases, the conclusion of inter-Governmental treaties. In addition Sir Denis Rooke has assured me that the new gas company will consult the Government regarding its import plans as these develop.

3 There are at present only limited opportunities to sell new gas into Continental markets and access to these markets may add little in the short term to the boost which the Government's policies have already given to UKCS exploration and development. The Government is prepared, nonetheless, to consider applications for waivers of the landing requirement on a case-by-case basis. In doing this, it will take into account considerations relating to the security of the UK's gas supplies, without any presumption that exports should not take place in present circumstances.

4 The Government remains firmly committed to maintaining the pace of UKCS development and intends to ensure, as it has since 1979, that adequate market incentives exist for the exploration, appraisal and development of new gas. There will be no question of the new company discriminating against indigenous gas supplies; or of UKCS gas producers putting at risk the UK's security of supply. The Government will keep close watch on terms of trade between suppliers and the new company and will stand ready to act as necessary.



CONFIDENTIAL - SECURITY INFORMATION







## GAS PRIVATISATION

### INTERNATIONAL SAFETY COMPARISONS

#### Line to Take

- Do not believe any conclusions can be drawn from international comparisons of statistics on gas safety about the effect of privatisation of British Gas on gas safety in Britain. In any event do not accept that international statistics support the view that private sector industries are less safe.
  
- British Gas already has an excellent safety record and we and British Gas' management are determined this will continue after privatisation.
  
- The Gas Bill now before Parliament will strengthen the safety regime in a number of ways. The broad range of powers available to the Health and Safety Executive will be extended to gas safety matters. We are also tightening up on the requirement to British Gas to deal with escapes of gas - extending it to customers appliances and reducing the maximum response time from 24 to 12 hours.
  
- There is no justification in the scare stories which have been put around that gas safety will suffer as a consequence of privatisation. There are of course already many other private sector companies such as ICI or BP who deal with equally dangerous substances as gas who also have excellent safety records - and it is a nonsense to suggest that they have paid no attention to safety.
  
- We believe that with the strengthening of the safety requirement we are putting in place to reinforce British Gas' own commitment to safety, the present trend of increased safety will continue in future to make gas an even safer fuel.





### Background Note

International comparisons of gas safety are not relevant to the question of the effect of privatisation on gas safety. Since the level of safety in different countries depends on a number of different factors, eg local regulation of safety, experience of utilities in safety and reaction of emergency services.

2. British Gas has a good safety record according to international comparisons - see attached table. It has the lowest figure for fatalities from explosions of 5 Northern European countries and the middle ranking figure for deaths from carbon monoxide poisoning. The statistics do not support the view that private sector industries are less safe than publicly owned ones.

3. The Gas Bill will reinforce the safety regime in a number of ways:

- gas safety will be brought within the general scope of the Health and Safety at Work Act which will give the HSE wider powers, eg in enforcing the safety regime.
- the specific provisions on dealing with gas escapes have been tightened up creating a new obligation to deal with escapes from customers appliances, and reducing the maximum response time from 24 hours to 12 hours.



## CAUSE OF DEATH - International Comparison (Latest Available Year)

Gas Industry ownership

	Public	Publicly owned	Private Industry	Public/ Private	Public/ Private
	Great Britain (1982)	France (1978)	West Germany (1982)	Netherlands (1982)	Belgium (1978)
<u>Cause of Death Category and Number of Fatalities</u>					
Total accidental deaths	15,551	36,341	26,578	4,095	5,695
Road transport deaths	6,096	10,964	11,265	1,718	2,462
Accidental poisoning by:					
(a) gas distributed by pipelines	77	12	9	)	34
(b) LPG distributed in mobile containers	6	10	)110	) 22	5
(c) Other Utility gas	17	5	)	)	1
Deaths from accidents caused by explosive material	18	48	61	9	11
Suicides and self-inflicted poisoning by gases in domestic use	6	45	16	5	17
<u>Death Rate Per Million Population</u>					
Total accidental deaths	283.9	682.1	435.7	286.4	578.7
Road transport deaths	111.3	205.8	184.7	120.1	250.4
Accidental poisoning by:					
(a) gas distributed by pipelines	1.4	0.2	0.1	)	3.5
(b) LPG distributed in mobile containers	0.1	0.2	)1.8	) 1.5	4.1 0.5
(c) Other Utility gas	0.3	0.1	)	)	0.1
Deaths from accidents caused by explosive material	0.3	0.9	1.0	0.6	1.1
Suicides and self-inflicted poisoning by gases in domestic use	0.1	0.8	0.3	0.3	1.7
Population (million)	54.8	53.3	61.0	14.3	9.8
Number of domestic gas customers (million)	15.1	8.1	8.3	4.6	1.7
Length of distribution main (000 km)	216	81	111	76	24

new  
in  
oxide  
sensing

SOURCE: Mortality Statistics, Office Public Census and Statistics



CAUSE OF DEATH - International Comparison (Latest Available Year)Gas Industry ownership

	Public	Publicly Owned	Private Industry	Public/ Private	Public/ Private
	Great Britain (1982)	France (1978)	West Germany (1982)	Netherlands (1982)	Belgium (1978)
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(b) LPG distributed in mobile containers	6	10	)	) 22	5
(c) Other Utility gas	17	5	)	)	1
Deaths from accidents caused by explosive material	18	48	61	9	11
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Length of distribution main (000 km)	216	81	111	76	24

SOURCE: Mortality Statistics, Office Public Census and Statistics

Including  
Carbon  
Monoxide  
poisoning





Country (Year)	Length of distribution main (000 km)	Population (million)	Number of domestic gas consumers (million)	Population (million)	Number of domestic gas consumers (million)
Great Britain (1982)	216	54.8	15.1	289.9	111.3
France (1978)	81	53.3	8.1	682.1	202.8
West Germany (1982)	111	61.0	8.3	432.7	184.7
Netherlands (1982)	78	14.3	4.6	286.4	120.1
Belgium (1978)	24	9.8	1.7	278.7	250.4
<b>Deaths from accidents caused by:</b>					
poisoning by gas in domestic use					
suicides and self-inflicted					
explosive material					
Deaths from accidents caused by:					
(c) Other Utility gas					
containers					
(p) LPG distributed in mobile					
(a) gas distributed by pipelines					
Accidental poisoning by:					
Road transport deaths					
Total accidental deaths					
and Number of Fatalities					
Cause of Death Category					

including  
Carbon  
monoxide  
poisoning





SECRETARY OF STATE FOR ENERGY  
 THAMES HOUSE SOUTH  
 MILLEANK LONDON SW1E 4QJ

01 211 6402

NBP n.

The Rt Hon John MacGregor OBE MP  
 Chief Secretary to the Treasury  
 Treasury Chambers  
 Parliament Street  
 LONDON  
 SW1P 3AG

30 January 1986

Thank you for your letter of 24 January. I am pleased to say that the unions have accepted the BGC offer; GMBATU (82% of the manuals) at its delegate conference on Friday, 24 January, and TGWU on Monday 27 January. The Corporation are now awaiting a formal letter from the Union Side.

In each of the last three years, first Nigel Lawson and now yourself, have expressed concern over the short period of notice which BGC have been able to give. I had hoped that by now BGC's skills and modus operandi in pay negotiations would be understood and appreciated. The union claim is normally complex and typically it does not quantify the increase in basic rates which the manuals have in mind. BGC's approach, which is traditionally tough, yet which has consistently managed to avoid industrial dispute, is to negotiate at official level by concentrating initially on everything other than the basic increase. Only after supplementary issues have been disposed of do they bring their focus to bear on the central pay rate. They always attempt to do so in such a way that the negotiations lead to a figure which is likely to be accepted by both sides as final. This year that number took shape in an official level meeting which concluded at 9 o'clock on Friday 17th. When I wrote to you the figure had still to be considered by the employers' side (basically the regional chairmen) and in effect they received little more notice than did you and other colleagues.

The only ways by which a period of seven days' notice to Ministers could be guaranteed by BGC would be for them to either circumscribe their negotiating position before talks began or to insist that any offer was ad referendum to Ministers. We could not justify either.

In the event, I believe BGC have achieved as good a settlement as we could possibly have expected and in my view the BGC's industrial relations negotiators should be congratulated for their success in



CONFIDENTIAL



yet again achieving a realistic settlement. As far as the future is concerned I expect BGC to be outside the public sector before the next pay round.

I am copying this letter to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Nicholas Edwards, Tom King and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'P Walker', written in a cursive style.

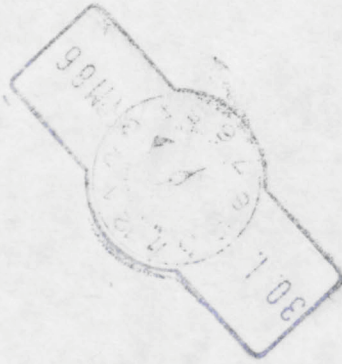
PETER WALKER

CONFIDENTIAL



NAT IND PT12

Gas Industry





CONFIDENTIAL



Prime Minister 4

DWS

24/1

Treasury Chambers, Parliament Street, SW1P 3AG

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

24 January 1986

Dear Peter,

**BGC: MANUALS PAY NEGOTIATIONS**

Thank you for your letter of 21 January to Nigel Lawson.

I understand that pay negotiations have effectively been concluded. In the circumstances, this was always going to be a difficult set of negotiations to influence. But I am worried that we did not have an indication of the sort of figure in mind (and 6 per cent is potentially a dangerously repercussive figure for other public sector settlements) until it was practically impossible to react before the negotiations concluded. What can we do to avoid this happening again?

I am copying this letter to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Nicholas Edwards, Tom King and to Sir Robert Armstrong.

We have of course already  
 had local Authority manuals  
 at 8.2%.

Yours,

JOHN MacGREGOR

CONFIDENTIAL



NAT IND: Gas & elec: Pt 12.



24.1 186



21 January 1986

REGULATION OF THE GAS INDUSTRY

Today's publication of the Commons Energy Committee report on Regulation of the Gas Industry is likely to trigger fresh criticism of the Government's plans for gas privatisation. My reading is that the Committee have not succeeded in providing the Government's critics with substantial ammunition for their attack.

The report does not reopen the question of whether competition in the energy market might have been stimulated by breaking up BGC into competing regional elements. A liberal gas import/export régime is strongly advocated, but doesn't feature in the summary of recommendations because the Government have yet to make a decision. If the Government opts for continued controls, the Committee propose that the regulator should intervene in the market between gas producers and a monopsonist BGC. It is difficult to think of anything which would have a more dampening effect on exploration and appraisal for UK gas. The oil companies will see the spectre of a regulated lowest common denominator rate of return, and see little reward for exploration success or for ingenuity and efficiency in developing new fields.

Otherwise, the essential design of the regulatory régime for a privatised BGC is endorsed, including the decisions to:

- regulate on price rather than adopting a US-style regulated rate of return on an approved asset base;

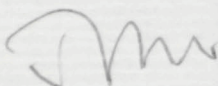


- create a tightly-regulated, protective régime for the 16.5 million small domestic and business consumers, and keep the lid on gas price increases through the RPI-X+Y formula;
  
- rely primarily on interfuel competition - hopefully complemented by competition between gas suppliers - in the contract market with large industrial consumers.

As regards the latter, some concern is expressed for BGC's more captive intermediate contract customers, but they should be protected by various assurances, especially BGC's undertaking to be even-handed in contract pricing across the industrial sector. The suggestion that OFGAS should closely police the contract market will please neither BGC nor their large industrial customers.

For the rest, the Committee's recommendations amount either to "motherhood" (the overriding virtue of competition wherever practical, and independence of the regulator) or the need for a privatised BGC to be subject to a high degree of disclosure and transparency.

The Committee have had to work hard to come up with a number of recommendations, none of which challenge the basic design of the regulatory régime.



JOHN WYBREW



CONFIDENTIAL



SECRETARY OF STATE FOR ENERGY  
TRAFALGAR HOUSE SOUTH  
MILBANK LONDON SW1P 2QB

01 211 6402

Prime Minister 2

dk

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

21 January 1986

*Nigel*

**BGC: MANUALS PAY NEGOTIATIONS**

After lengthy negotiations at "official" level about the shape of this year's pay and conditions package which were concluded late last Friday evening, BGC have hammered out a proposal which is now being submitted to the formal negotiating teams. Both sides are now considering their positions and expect to discuss the proposal at a meeting of the National Joint Industrial Council (the formal negotiating body for the Gas Manuals) on Wednesday 22 January. BGC officials believe that the proposal will be agreed by the employers' side (principally the regional chairmen), but they have serious doubts about the reactions of the trade union side. The core of the proposal is a 6% increase on basic wage rates which would raise average earnings and paybill by 5.6%. The other elements of the package have no appreciable effect on either earnings or the pay bill.

Negotiations this year have been much harder than previously; but the employers' side have told me that they have conceded as little as they could while still trying to achieve a settlement. They have resisted claims for reduced working hours, for enhanced eligibility to bonus and for other improvements.

Against the background of the relatively modest settlements which BGC have achieved in recent years, I believe that if BGC can agree an increase of the size proposed it is the best we could hope for. I am particularly conscious of concern which BGC management have expressed about the intention of some factions among the unions who wish to use privatisation as a bargaining counter.

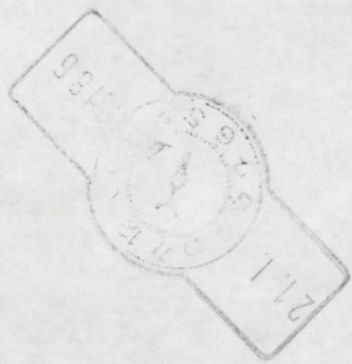
I am copying this letter to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Nicholas Edwards, Tom King and to Sir Robert Armstrong.

*Peter Walker*

CONFIDENTIAL

PETER WALKER





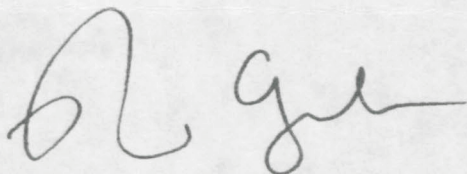


01 211 6402

The Rt Hon John Moore MP  
Financial Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AG

✓ BPN

14 January 1986



**GAS PRIVATISATION: SPECIAL SHARE AND RELATED ISSUES**

Thank you for your letter of 16 December.

I entirely agree that it must be possible for institutional shareholders to put real pressure on British Gas should this be necessary to improve on an inadequate performance. A BT-type 15% limitation on shareholdings would allow for this. It would prevent any one individual or connected group who co-operate in the buying of shares from owning more than 15%. But it would not prevent shareholders acting together after acquiring their shareholdings in order to influence the British Gas Board. For example, it would be possible for a group of institutional shareholders to get together to bring about Board changes as has sometimes happened with private sector companies in recent years. A BT-type special share, while protecting against takeovers, would therefore not inhibit general shareholder pressures on British Gas to perform efficiently.

I also appreciate your argument that the Government should have some flexibility to agree to an acceptable takeover. But I do not accept that such flexibility does not exist with a BT-type special share since it is always open to the special shareholder to agree to a change in the Articles to modify or abolish the 15% limit. The support of shareholders owning 75% of the shares represented at the general meeting called to consider such a change would also be needed. But Rothschilds believe this support would be likely to be forthcoming given that such a change would, particularly in the context of a proposed takeover, be likely to be to the shareholders' financial advantage.

The Britoil/Enterprise approach involves the special shareholder gaining a voting majority, and hence temporary control of the company, in the event of someone acquiring, or intending to acquire, more than 50% of the shares. This is entirely appropriate when the trigger limit is 50%. But it clearly becomes completely inappropriate, and highly draconian, with a trigger of 15% and would be particularly severe for the general shareholder who would be suddenly deprived effectively of his general voting rights by the action of another, without any of the





protections which apply under the Panel Rules. I cannot see, therefore, how we could adopt the kind of approach you suggest without also adopting a 50% shareholding limitation, rather than one of 15%. I could not agree to such a higher limitation for a company of the nature of British Gas since it would offer inadequate protection against an oil company building up a substantial shareholding in order to seek to influence British Gas' affairs.

Finally, outside commentators will compare what we do on the British Gas offer with what was done in the case of BT, not Britoil or Enterprise Oil. So there are presentational arguments for following the BT precedent.

Drafting of the special share provisions now needs to proceed urgently so that I can be in a position to table them, if necessary, when the Commons Committee reaches the relevant part of the Bill. I hope therefore that, in the light of the points made above, you are now able to agree to this being on the basis of the approach set out in my letter of 26 November.

I am copying this letter to the Prime Minister and other members of E(A), Geoffrey Howe and Patrick Mayhew.

A handwritten signature in dark ink, consisting of a large, stylized 'P' followed by a 'W' and a flourish.

PETER WALKER



NAT IND

CAS

PT 12





You may have seen that the first electricity sale  
by a private company to an industrial concern  
has now been agreed. CONFIDENTIAL  
It's small but would be useful presentationally.

PRIME MINISTER 2

DFW  
20/12

20 December 1985

GAS PRIVATISATION

Peter Walker's gas privatisation package has had a critical reception, particularly from serious commentators.  
The fact that the most hostile criticism emanates from our own supporters is not helpful. Moreover, the evident unease in Whitehall has given journalists the opportunity to portray the Government as divided. Now the City is picking up the bad vibrations and becoming concerned about the climate of public opinion surrounding the world's largest equity flotation. If things go on in this vein, there is a danger that we will end up making the worst of a potentially-good job.

Put starkly, the charge is that the Government has subordinated its belief in freeing up markets and promoting competition to the short-term goal of maximising the proceeds from gas privatisation. Given more time for a comprehensive, balanced presentation of the gas privatisation package, this charge can be refuted:

- The system devised to protect 16.5 million small, domestic and commercial customers receiving gas under tightly-controlled tariffs can be defended as appropriate and more protective than that for BT.
- Regulation is much lighter for large industrial consumers on individually-negotiated contracts, but in that market,

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CONFIDENTIAL

- 2 -

we and they want to rely primarily on competition - both between fuels and between alternative gas suppliers.

Being considered for the following the E(A) discussion.

Our Achilles heel is liberalisation of gas imports and exports. The lack of a pro-competitive line on this issue is a shortcoming, not because free-flowing imports and exports would transform the market - the scope is limited - but because it has come to assume symbolic importance; the touchstone of the Government's commitment to competition.

Within Whitehall, we are not as far apart on this issue as might appear. It is recognised that the Secretary of State for Energy already has well-established powers for regulating the development of UK oil and gas resources - and the system is working well. We all want to prevent BGC putting a damper on UK gas exploration and development by discriminating in favour of large, expensive gas imports.

What, in practice, is at issue is the Government's attitude to small-scale gas exports. Future gas discoveries of a size which might entail large exports are most unlikely in the heavily-explored southern North Sea. The potential probably lies outside the North Sea in areas such as the waters west of the Orkneys and Shetlands. Any gas found in this area will be expensive to develop and, logistically, the natural market would be the UK.

Peter Walker would prefer to block exports unless there are manifest benefits. The Treasury and ourselves would

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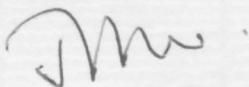


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- 3 -

prefer freedom to export, except where there is a manifest conflict with the national interest. In an EC context, we must appear to be even-handed as between exports and imports. The gap should be bridgeable, perhaps building on Nigel Lawson's suggestion of giving BGC the right of first refusal on potential exports.

If you have any opportunity to urge an early resolution of this issue in a way which gives a positive signal to the pro-competitive lobby, it would be worth taking. Then the Government and its supporters can unite in advocating the virtues of gas privatisation.



JOHN WYBREW

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Treasury Chambers, Parliament Street, SW1P 3AG

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

*NSP*

*16* December 1985

*Dear Peter...*

**GAS PRIVATISATION : SPECIAL SHARE AND RELATED ISSUES**

Thank you for your letter of 26 <sup>P11</sup> November to the Chancellor. I have also seen Norman Tebbit's letter to you of 27 November and Leon Brittan's letter of 10 December. *← P12* *← P11*

I do of course recognise the strategic importance of the gas transmission system and the need to avoid foreign control of British Gas. But so far as the threat of takeover or undue pressure by large UK shareholders are concerned, the best way of avoiding this must surely be for British Gas management to maintain a level of efficiency and profitability which ensures an adequate market price for British Gas shares. I am concerned that an automatic limit on individual shareholdings would mean that it would not be possible for institutional shareholders to put real pressure on British Gas should this be necessary to improve on an inadequate performance.

It is clearly right to have a special share to avoid undesirable influence or control being exerted on British Gas. I however would prefer a share which leaves the Government some flexibility as to whether to activate its voting rights. A special share of the type used with Britoil and Enterprise would permit the Secretary of State to outvote a shareholding above a certain level (50% in the two companies in question). The Secretary of State would not, however, be required to trigger the special share whenever a shareholding reaches a critical size. This means the door is kept open for an acceptable takeover. I believe we need an arrangement of this sort to help keep up the pressure for efficiency on BGC.



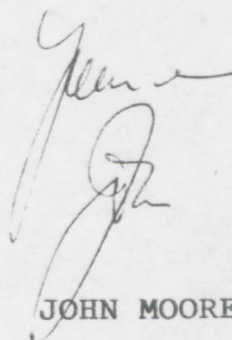
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As to the level at which the powers of the special share come into play, I am prepared to go along with 15 per cent as Leon and Norman suggest. Patrick Mayhew considers that this would seem to be safe under the Listing Directive. I certainly see no reason for going below 15 per cent.

I appreciate that this represents a departure from what we did with British Telecom. You have said yourself that there is limited scope for competition to develop in much of BGC's business. This means we need to look for other ways of promoting efficiency.

Subject to any further views of the Law Officers, I am content with your other proposals on time limits, nationality of directors and Government directors.

I am copying this letter to the Prime Minister and other members of E(A), Geoffrey Howe and Patrick Mayhew.



JOHN MOORE

CONFIDENTIAL



Not ind; Gas; Pr/12







Treasury Chambers, Parliament Street, SW1P 3AG

PRIME MINISTER

NBPN.

GAS BILL : DRAFT LICENCE

with DN?

I have seen a copy of Mr Wiggins' minute to you to 9 December.

I am content to proceed on the basis he describes. The fundamental change to the draft licence condition dealing with "back-up" supplies of gas brings this condition into line with E(A)'s decisions on November 14.

It is important that the further work and material described in Mr Wiggins's minute is made available to Ministers collectively in time for full and proper consideration before the relevant clauses of the Bill is discussed in the Committee Stage debates.

I am copying to members of E(A), the Lord President, the Solicitor General and Sir Robert Armstrong.

JOHN MOORE

11 December 1985





Faint, illegible text or markings, possibly bleed-through from the reverse side of the paper.

COMPTON





CCBG



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

Secretary of State for Trade and Industry

Rt Hon Peter Walker M.P.  
Secretary of State for Energy  
Department of Energy  
Thames House South  
Millbank  
LONDON SW1

10 December 1985

Dear Peter,

NBM

PRIVATISATION OF BRITISH GAS

A 11

Thank you for sending me a copy of your letter of 26 November to Nigel Lawson, about measures to safeguard British Gas' independence after privatisation. I have also seen Norman Tebbit's letter of 29 November.

*will request if required*

I am content with what you propose but, like Norman, believe you should insist on a 15% limit on individual shareholdings which is not only the figure for BT but for previous privatisations as well.

I am sending a copy of this letter to the Prime Minister, Geoffrey Howe, other members of E(A), to Patrick Mayhew and to Sir Robert Armstrong.

*Leon*

LEON BRITTAN

KJLABX



NAT IND

GAS + ELECTRIC

LT 12.







CONFIDENTIAL

CS

cc BGA

Prime Minister 2

No need to read in detail. Note that the Treasury's concerns were justified, even if not dramatically so.

PRIME MINISTER

ms

Gas Bill: Draft Licence

DBW  
10/12

At E(A) this morning, doubts were expressed about the adequacy of some of the provisions of the draft Licence for BGC as Gas Supplier. In view of the need for the terms of the draft Licence to be available to Parliament in advance of the Second Reading of the Gas Bill on 10 December, you asked officials to consider urgently how these doubts could be resolved.

2. The problems centred on the arrangements to ensure even-handed treatment of contract customers, and on the effect of the common carrier provisions in facilitating direct sales of gas by UKCS licensees to industrial customers.

Condition 5: Pricing for Contract Customers

3. Concern was expressed that the licence required no more of BGC than that they should publish, within three months of receiving the licence, a general statement of their policy as regards their willingness to enter into negotiations for prices for gas supplied to contract customers: nothing was said about the terms of the statement, where the Government and contract customers would in effect be entirely in the hands of BGC. Officials agreed that it would be appropriate for BGC's assurance on contract prices to take effect at the same time as the issue of the Licence; this can be achieved by substituting 'at the time' for 'within three months of the date' in line 1 of Section 1. Officials noted that it was the intention of the Secretary of State for Energy to agree the terms of the draft assurance with his Ministerial colleagues in time for the text to be published at the relevant point during the Committee Stage of the Gas Bill. The other Departments involved should thus have a full opportunity to ensure that the terms of the assurance are sufficient to meet their concerns.



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Condition 9: common carriage

4. Concern was expressed that too much might be left to the discretion of BGC, and in particular that the arrangements might not deal effectively with situations in which the rate of output from a field did not correspond exactly with the direct industrial customer's off take. Officials noted that it was again the intention of the Secretary of State for Energy to clear with his colleagues, in advance of the relevant Committee Stage discussion, the draft of the guidance to be given by BGC. Since under the Bill the Director is responsible for policing the use of BGC's lines for the common carriage of gas, the definitive text has formally to be cleared with the Director after the Licence has entered into force; but BGC will have in practice to keep to the arrangements set out at the time of the Committee Stage discussion. Meanwhile the Department of Energy will be seeking a legal opinion on whether the term 'conveyance of gas' is sufficiently broad to give the Director jurisdiction to settle the common carriage terms (including the use of BGC's storage facilities) in cases where a field's production and a customer's off take correspond only over an extended period (i.e. not on an hourly, or even a daily basis). Officials noted that pressure differences are inevitable as between the point where gas is landed and the point where it is drawn from the distribution system by the industrial customer, and that it would be necessary to ensure that the definitions are drawn widely enough to take account of this.

Condition 10: supply of back-up gas

5. Concern was expressed that - unlike the common carrier provisions - there was no explicit obligation either in the Bill or in the Licence under which BGC would be required to provide back-up gas, and no means of resolving disputes about the terms on which such gas would be supplied. Officials agreed that it would be appropriate to revise the draft of this condition to make clear the obligation on BGC, and to empower the Director to resolve disputes. The attached revised draft text specifically requires BGC to 'stand ready to supply back-up gas on reasonable terms to a third party Supplier', and this should have the desired



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effect both in terms of the obligation and of the role of the Director. (As in the case of the common carrier provisions, BGC are only required to supply back-up gas where they can do so without prejudice to the rights of their existing customers.) Again the terms of the draft statement by BGC will be cleared collectively by Ministers in advance of the relevant Committee Stage Debate.

Purchase by BGC of residual gas in directly-sold fields

6. Officials noted that it would not be possible to incorporate in the Licence provisions relating to the terms on which BGC would buy the residual gas in directly-sold fields, since the Licence is confined to BGC's position as seller of gas. The Secretary of State for Energy would, however, make clear at Second Reading on 10 December the Government's intention that BGC would buy such gas on equitable terms; further consideration would need to be given to the form in which BGC might subsequently give binding effect to such an assurance, and to the possible means of providing safeguards and enforcing it. It will also be necessary to consider possible broader assurances to be given by BGC about non-discriminatory treatment of different UKCS producers, in the context of the further work to be done on policy towards future imports and exports of gas.

CONCLUSION

7. Officials noted that the Secretary of State for Energy would make clear the Government's willingness to consider suggestions for improvements in the terms of the draft Licence. I understand that the Secretary of State for Trade and Industry and the Financial Secretary, Treasury are now content for the draft Licence to be published today, subject to the amendments set out above. They emphasise the importance of ensuring that there is ample time to consider the texts of the statements or assurances to be given by BGC well in advance of the relevant Committee Stage Debates.





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8. I am sending copies of this minute to the other members of E(A), the Lord President, the Solicitor General and Sir Robert Armstrong.

*J.W.*

A J WIGGINS

Cabinet Office

9 December, 1985

CONQUEROR

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PRIME MINISTER  
\_\_\_\_\_

*This makes it unnecessary  
to read Mr Walker's paper.  
ARN*

Gas Industry Privatisation: Gas Imports and Exports

E(A)(85)71

BACKGROUND

1. E(A)(85)17th Meeting on 31 July noted that the Secretary of State for Energy, in consultation with the Chancellor of the Exchequer and the Foreign and Commonwealth Secretary, would put a paper to the Sub-Committee on gas imports and exports before the Second Reading of the Gas Industry Privatisation Bill. The paper before the Sub-Committee responds to this remit, although it does not reflect an agreed approach with the Chancellor and the Foreign Secretary. Second Reading is now scheduled for Tuesday 10 December.
2. The present position is that all gas produced under UKCS Petroleum Production Licences is required to be landed in this country. (The same applies to oil, but waivers of the requirement are readily given in the case of offshore loaded fields.) The landing requirement is justified in terms of the contribution it makes to UK security of supply of a strategic commodity; legal advice has been that it would not be consistent with the Treaty of Rome to seek to impose such a requirement on economic grounds. So far as imports are concerned, there is no specific control; indeed, any overt economic control of gas imports would equally be contrary to the Treaty of Rome.
3. BGC's interest in the 1960s and 1970s lay in increasing its share of the energy market. Following the initial surge of development in the Southern North Sea, BGC contracted to buy the gas from the very large median line Frigg field (60 per cent Norwegian), which now supplies about 30 per cent

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of the UK market. The result of this, combined with the operation of landing requirement, was that there was for a considerable period in the later 1970s no market for fresh UKCS gas supplies - BGC did not need them, and they could not be exported. The prospective decline of the first generation fields, and encouragement given by the Oil and Gas Enterprise Act 1982, have led to a substantial resumption of UKCS gas exploration and production activity; and the refusal last year to permit the import of the Norwegian Sleipner gas has ensured the maintenance of the momentum of that activity, although BGC now have more than enough gas to satisfy the UK market in the years immediately ahead.

4. Present declared Government policy of gas exports rests on the statement made by Mr Lawson as Secretary of State for Energy in February 1982, to the effect that the question of gas exports would be considered if new exploration resulted in very substantial additional gas discoveries on the UKCS. Effective control of gas imports has been secured by informal pressures on BGC, buttressed by the need for inter-governmental treaties and submarine pipeline authorisations.

5. Privatisation means that the present defacto controls of imports and exports of gas cannot continue quite as before. BGC will no longer be subject to the same informal pressures as hitherto on the question of imports, and the UKCS licensees will be concerned that privatisation should not lead to the reinstatement of the Sleipner purchase and so the recreation of the 1970s situation in which there was no market for new UKCS supplies. On the other hand, BGC's position, and the prospects for the flotation, could be significantly damaged if the landing requirement were lifted, so providing for unrestricted exports, while the Government managed to maintain a ban on imports; at the least, BGC's negotiating position with the UKCS producers would be substantially weakened. This ground will inevitably require careful treatment in the eventual Prospectus.



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MAIN ISSUES

6. The main issues before the Sub-Committee are

- (i) what policy to follow on gas imports and exports;
- (ii) how to present that policy, in the context of the Second Reading of the Privatisation Bill and in the subsequent Committee Stage Debates.

Demand and Supply

7. Projections of future gas demands and supply are inevitably subject to considerable margins of error. There is an element of unpredictability about the performance of gas fields, even after they have come into production; and the size of the UK market will depend to some extent on future levels of economic activity, as well as on the supply of competing fuels. However, there appears to be little further scope for gas to penetrate the domestic market, while the industrial market will be influenced by the increasing competitiveness of coal and by the fact that economic growth tends to be concentrated in less energy-intensive industries. It is clear that supplies from the UKCS, together with Frigg (which is likely to run out in the early 1990s), will be sufficient to meet total UK demand at least until the mid-1990s, but that some relatively modest new imports are likely to be needed before the year 2000. Thereafter there would be an increasing need for imports unless new discoveries - probably in a new part of the UKCS - transform the situation. The implication is that BGC are likely to need to start negotiating for fresh imports by 1990, if they are to be confident that supplies will be available in time to meet any possible evolution of UK demand.

Government Objectives

8. In determining policy on gas imports and exports, the Government has three basic objectives, which may to some extent point in different directions:



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(i) to maintain the momentum of UKCS exploration and production, which contributes substantially to tax revenue, economic activity and technological development;

(ii) to assure UK gas consumers of supplies at competitive prices; and

(iii) to ensure the successful flotation of BGC.

Policy Options

9. The Secretary of State identifies four possible options:

(i) maintain the present effective ban on imports and exports;

(ii) unrestricted exports, but with a continuing ban on imports;

(iii) unrestricted imports and exports; and

(iv) the Government 'holding the <sup>ring</sup> ~~ring~~ keeping open the options of permitting individual imports and exports in the light of the circumstances at the time.

In practice, option (iv) is little more than a repackaging of option (i).

10. The Secretary of State argues against option (ii) on the grounds that it would undermine BGC's assurance of supplies, and tend to push up prices to UK consumers, thus damaging the flotation in the eyes both of investors and of the general public. He argues against option (iii) on the grounds that this would put the UK Government in a uniquely powerless position - as compared with other Western European governments - to influence trade in gas, while at the same time prejudicing future exploration and production on the UKCS because of the threat of the revived Sleipner deal. So he opts for some



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repackaging of the present situation, although it is not yet clear how far Ministers could go - consistently with the Treaty of Rome - to establish overtly a selective control of imports and exports.

11. The Treasury position, as we understand it, is that there should be unrestricted exports, with BGC being permitted to import gas provided the Corporation does not discriminate in the prices it offers against UKCS producers. This would be the 'market' solution, and would provide the best assurance of continued successful exploration and production on the UKCS. In practice, however, there could be some problems; it is not clear how 'non-discrimination' would work to prevent the reinstatement of the Sleipner purchase, given that not all the gas which is potentially producible can be absorbed at the same time - would the courts interpret it to require BGC to take small percentages of the output of several fields rather than permit the fields to be developed and produced successively in accordance with the requirements of the market? There is also a possible problem about tax leakage; UKCS licensees selling to the European Continent would have as their customers companies in which they have substantial shares, so that the transactions would not be at arms length, and there would be a risk of prices being set below the 'market' in order to transfer the profits into corporations not subject to UK PRT.

12. All these conflicting considerations have some force, and there is no ideal arrangement which can be guaranteed to meet all the Government's objectives. However, the argument may to some degree be academic. The market for gas has a number of peculiar features, essentially deriving from the nature of the commodity and the means of delivery. It cannot be freely traded like oil, and we cannot run a policy which would provide for all UKCS gas discoveries to be developed and produced as quickly as physically possible. For the foreseeable



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future - and with substantial supplies on offer from the USSR and Norway - there is always likely to be a queue of fields awaiting development, and prices will have to be set at the outset for a substantial part of the life-time of each field in order to assure the recovery of the development costs. With other European governments, both producers and consumers, exerting a substantial measure of control over imports and exports of gas, and with the international oil companies participating in different countries in both the production and the distribution of gas, the normal conditions for a free market do not exist. On the other hand, there are some effective constraints on the Government, UKCS licensees, and BGC; if exports were permitted, while imports were restricted, and BGC were unable to secure new UKCS supplies at 'reasonable' prices, the Corporation could negotiate an import from Holland and appeal to the European Court if UK Government sought to prevent it. On the other hand, if BGC sought on the basis of a revived Sleipner deal to force down the prices paid to UKCS licensees, the Government would be bound to make life as difficult as possible for the Corporation, while an unrestricted export regime would undoubtedly have to be introduced. As matters currently stand, these effective constraints have produced a situation in which BGC is paying for new UKCS supplies prices very similar to those paid by Continental purchasers for new supplies from Norway or the USSR. So although there is not physical free trade in gas, market forces are making themselves felt, albeit in a round-about way.

13. In all the circumstances, the best course may be to say as little as possible about future policy on imports and exports of gas, subject to the need to give some minimum reassurance to UKCS licensees, and to BGC and potential investors, that the scales will not be loaded unfairly in favour of either side. The fact that BGC itself will have substantial interests as



  
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a UKCS licensee as well as a supplier of gas to consumers, with the offshore business probably representing the main scope the Corporation will have for growth, is likely to further inhibit the Corporation from seeking to exploit its position as effective monopsony purchaser to the disadvantage of UKCS producers.

Presentation

14. Because of the perceived interests of UKCS licensees and of potential investors in BGC in future Government policy on gas imports and exports, questions are bound to be asked about this at Second Reading of the Privatisation Bill, and subsequently. Mr Walker sets out at Annex 3 to his paper the possible text of a Government Statement. If Ministers decide that a policy of unrestricted exports should be announced (with the implication that BGC would then have considerable freedom to import gas), of course a rather different statement would need to be prepared. However, if Ministers prefer to try to maintain effect of present arrangements, it is for consideration whether so detailed a statement needs to be made, at any rate as early as Second Reading. We understand that officials are still considering possible forms of words which might be used to describe a policy of selective controls on exports and imports, and it may be that a formula will be found which does not fall foul of EC rules. Meanwhile it may be sufficient on 10 December to point out that, despite the complexity of the forces, arising from both Governments and multinational companies, acting on the gas market, prices paid for new supplies of gas are broadly comparable throughout North West Europe, while UKCS exploration and development is going ahead as fast as the UK market can absorb the gas produced.

HANDLING

15. You will wish to invite the Secretary of State for Energy to introduce his paper. The Chancellor of the Exchequer, the Foreign and Commonwealth Secretary and the Secretary of State





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for Industry will all wish to state their positions. The Attorney General may need to comment on some of the legal questions, notably affecting the EC. A number of other Ministers (e.g. the Chancellor of the Duchy of Lancaster) will also wish to take part in the discussion, given the exceptional economic and political interest of the subject matter.

#### CONCLUSIONS

16. You will wish the Sub-Committee to reach conclusions on

1. The nature of the future UK regime for gas imports and exports (the effective choice seems to be between some version of the present arrangements and relatively unrestricted exports and imports);

2. What should be said at Second Reading of the Privatisation Bill on 10 December.

J B UNWIN  
Cabinet Office.  
6 December, 1985



GAS IMPORTS AND EXPORTS

The response of the media and independent commentators to Peter Walker's Gas Bill was adverse. The liberalisation of gas imports and exports has come to assume a wider symbolic importance - a test of the Government's commitment to free markets and competition. The failure to liberalise gas imports and exports threatens to bring the whole privatisation programme into disrepute.

The Essential Difference

No-one is suggesting a totally unregulated free market. The established regulatory régime governing the exploration and development of UK oil and gas resources is working well. The point at issue is the way in which the Secretary of state will use his regulatory powers as regards gas imports and exports. Peter Walker wants to keep the door on imports and exports shut until he is convinced that there is a good case to open it. We and the Treasury want to keep the door open unless there are specific cases where the prospective gas contract would conflict with the national interest.

Peter Walker will use two arguments:

- i. If he now opens the door to exports, little if any use will be made of it. He may well be right. Probably for most of the next decade, UK producers face a glutted European market which, currently at least, offers no



price advantage. (Nonetheless, there may be good sense in smallish quantities of associated gas from northern North Sea oil fields being sold into Europe via Norwegian pipelines.) But in that case, why does he make such a fuss?

- ii. He will also argue that the Treaty of Rome is a constraint. To open and close the door in a discriminatory way - for example, because you trust BP, but not Esso - would certainly contravene the Treaty of Rome. But that is not the intention. We only want to close the door in specific cases where there is a substantial conflict with the national interest (eg a dampening effect on exploration, or reduced recovery of economically recoverable reserves). Without such a clear conflict, the door should remain open anyway.

Peter Walker may also claim that not even the oil companies are pressing for exports. The truth is that they would rather forego freedom to export than allow BGC freedom to import in a discriminatory way, eg 30p per therm for Sleipner v. 20p-odd per therm for new UK North Sea gas.

### The Scope for Compromise

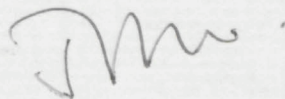
Peter Walker has been trying to reach a compromise with Nigel Lawson. To balance the bargaining strength between a monopsonist BGC and UK producers, he is suggesting incorporating, either in BGC's licence or the legislation, a



provision sanctioning the freeing-up of gas exports if BGC threatens to impede UK gas expenditure and development through a discriminatory import policy.

### Conclusion

Even if such a compromise were to prevent BGC abusing its monopoly purchasing power, it would fail on presentational grounds. It is important that, at this stage in the privatisation programme, the Government should signal its overriding commitment to free markets and competition. We therefore strongly recommend an open door policy, subject to ad hoc exceptions only in those rare cases where there is a substantial, demonstrable conflict with the national interest. Let's back consumers and "UK Limited" rather than Denis Rooke.



JOHN WYBREW



01 211 6402

Ms Vivien Life  
PS/Financial Secretary to the Treasury  
Treasury Chambers  
Parliament Street  
LONDON

6 December 1985

Dear Vivien,

#### OIL COMPANY VIEWS ON GAS IMPORTS AND EXPORTS

My Secretary of State promised to send the Financial Secretary a note of yesterday's meetings with Mr Peter Holmes of Shell, and Sir Peter Walters of BP.

Mr Holmes said that Shell would be content with a post-privatisation position which maintained a balance as between British Gas and the oil companies. If the Government relinquished control over imports there was a serious risk that British Gas's successor company would enter into huge contracts with Norway thus "backing out" indigenous North Sea gas and causing stagnation on the UKCS. This would be bad for both the oil companies, the offshore industry and the taxpayer. This control should, as now, be exercised by the Government.

Mr Holmes was also content that the Government should retain control over exports, which was the other side of import control. Shell were already in the international gas market, unlike various other oil companies, who had not thought through their views carefully enough. In practice, he did not expect that exports were likely to be commercially viable, because there was too much cheap gas around, for example in Norway, USSR and Algeria.

Sir Peter Walters said that BP's main concern was that there should be a safety valve to prevent British Gas discriminating against the oil companies and screwing down the price of gas from the UKCS. One way of achieving this would be to free exports, but he accepted the force in my Secretary of State's argument that it would unduly handicap British Gas to adopt such a course whilst imports remained under Government control. Freeing both imports and exports had been BP's preferred answer. But it seemed very likely the result would be British Gas signing up large quantities of Norwegian gas, to the detriment



of UKCS producers. BP, with its worldwide interests, could live with such consequences. However he accepted that this would not be the view of smaller UK oil companies and the offshore industry, who would face very serious difficulties indeed.

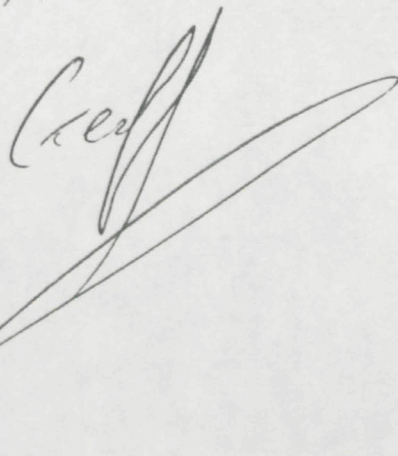
Sir Peter went on to say that Britoil's idea that OFGAS should have a role in British Gas' purchasing policy was nonsense. OFGAS's interest would be in low consumer prices, and hence in low returns to the producers. This would eventually lead to North Sea gas drying up.

Taking account of all these factors, Sir Peter concluded that BP's fears would be largely allayed by a robust and politically durable regime which exposed British Gas to the threat that unrestricted exports would immediately be imposed if they discriminated unfairly against UKCS producers; there was in fact very little likelihood that any significant quantities of gas would actually be exported even if there were an early liberalisation.

Finally, Sir Peter expressed his appreciation that BP's other concerns, that British Gas should no longer be able to make use of privileged access to producers' confidential geological information in their role as an explorer, and that there should be much tougher safeguards against discrimination by British Gas against private suppliers in setting common carriage terms and conditions, had been met.

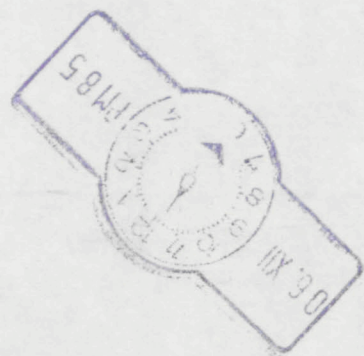
I am copying this letter to David Norgrove in the Prime Minister's office, and to Rachel Lomax in the Chancellor's office, since the Chancellor expressed a particular interest in seeing BP and Shell's views to my Secretary of State.

*Yours ever,*



G S DART  
Private Secretary









C.C. PS/FST  
Mr Moxik  
Mr Moore  
Mr Robson  
DL B. 23  
Mr H. DAVIES

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

6 December 1985

Geoff Dart Esq  
PS/Secretary of State  
Department of Energy  
Thames House South  
Millbank  
London SW1

Dear Geoff

#### GAS EXPORTS

Your Secretary of State came to discuss this subject with the Chancellor this morning in advance of E(A) on Monday.

The Chancellor said that freedom to export gas was essential to maintain confidence in the North Sea, and ensure continued exploration and development. He accepted that the counterpart of this was freedom to import, provided imports were competitive. This could be ensured through a non-discrimination mechanism and the need for government-to-government treaties.

Your Secretary of State said he was completely at one with the Chancellor on the need to maintain confidence in the North Sea. But he had spoken to the oil companies, and with the exception of Britoil they did not want freedom to export. BP were "prepared to live with" free exports, and Shell were firmly opposed. He had already promised to send the Financial Secretary copies of the minutes of his discussions with the oil companies, and would arrange for the Chancellor receive them this morning.\* He suggested that the Chancellor might like to talk directly to the oil companies himself. The Chancellor said he would be very interested to see the minutes and might take up your Secretary of State's suggestion. This was certainly not what the oil companies had said to him when he was Energy Secretary.

\*Received at 6.00pm





Your Secretary of State made the following further points:

(i) BGC would strongly oppose freedom to export. They would present it as leading to higher prices, and endangering the security of supply - and the public would see it that way;

(ii) on imports, while he accepted that he had very considerable powers in this area, he did not believe they were sufficient to prevent uneconomic deals like Sleipner;

(iii) it would be necessary to state the policy clearly in the BGC prospectus, and Rothschilds' advice was that this would adversely affect the sale;

(iv) freedom to export was a dramatic policy change and introducing it at the same time as privatisation would have adverse affects on the sale. But there would be a case for it at some stage in the future if there were a surplus of North Sea gas and BGC were not prepared to buy it at a reasonable price.

In response, the Chancellor made the following points:

(i) it was not true that exports would lead to higher prices, and the Government should be able to get this across;

(ii) your Secretary of State should not allow BGC to make public attacks on Government policy;

(iii) he agreed that the policy on exports would have to be stated in the prospectus: but the aim was to maximise the economic benefits, not merely the price obtained for BGC;

(iv) allowing exports would not be a dramatic change of policy: during his time as Energy Secretary we had already been moving towards this position;

(v) to allow exports only once a gas surplus arose would be too late.






Your Secretary of State stressed that he did not want to be soft on BGC. He was prepared to make a very tough statement now that, in appropriate circumstances, the Government would allow exports. The Chancellor pointed out that, if the decision to allow exports were at the Secretary of State's discretion, this would not reassure the oil companies, since they could not be sure that future Energy secretaries would use it. He asked, therefore, whether a commitment could be enshrined in legislation. Your Secretary of State said he would accept this: indeed, he wanted to take a very firm position in relation to BGC.

Yours sincerely  
Tony Kuczys

A W KUCZYS



C/1/55  
ce b/1/1



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MR NORGROVE

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GAS BILL

The Energy Secretary has circulated, under cover of his minute of 6 December to the Prime Minister, the draft of the licence which it is proposed should be issued to BGC under the provisions of the Gas Bill. Since much of the policy on the privatisation is defined in the licence rather than on the face of the Bill, he is anxious to publish the terms of the former in advance of Second Reading, so as to head off the sort of criticism the Government faced in the context of BT.

2. We have not had time to study this material in any detail, but it appears that the proposed licence terms fully reflect the agreement reached following the last E(A) discussion. In particular, the licence provides for the publication of maximum prices for contract customers, together with a statement of BGC's policy in negotiating with such customers; it provides for the publication of specimen tariffs for the use of BGC's lines for the transmission of 'third party' gas; and it provides for BGC to state in advance the prices to be charged for 'back-up' gas where the Corporation's lines are being used to deliver other producers' gas to industrial consumers.

*They do.*

3. It is possible that the Treasury will still feel that it does not go far enough (I have been unable to establish their attitude). In particular they may want some reference to 'non-discrimination' by BGC in purchasing gas from UKCS licensees and others (particularly Norway). They may also





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ask questions about the nature of the assurances to be given by BGC about movements in contract prices over the initial period post-privatisation. If possible, such differences should be settled immediately\*, so as not to delay publication of the licence. If this proves impossible, it may nonetheless be better to go ahead with publication, making clear that the document is very much a draft, and that the Government will be looking to improve and amend it in the light of discussions both of the Bill and of the licence terms.

4. I attach a copy of a background note prepared by the Department of Energy which guides people through the main provisions both of the Bill and of the draft licence.

)W

\* outside E(A)!

A J WIGGINS  
Cabinet Office  
6 December, 1985

Attachment:

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## BACKGROUND NOTE

### REGULATION

#### 1. THE GOVERNMENT'S APPROACH

##### Objectives

The objectives of regulation are:-

- to provide a clearly defined framework for the supply of gas to the public;
- to ensure proper protection for customers;
- to provide incentives for efficiency, and to ensure customers can share in the benefits of this.

##### Regulatory Framework

The Gas Bill opens the way for private sector companies to supply gas to the public. The key features are:-

- suppliers of gas will have to be authorised (Clauses 7, 8);
- a Director will be appointed to head an Office of Gas Supply which will regulate the gas supply business (Clauses 1, 4, Schedule 1);
- a Gas Users' Council will be created to advise the Director on consumer matters and to deal with customers' complaints (Clauses 2, 32, 39, 40 Schedule 2);
- the legislation will put certain key obligations



directly on gas suppliers (including the need to comply with safety regulations) (Clauses 9, 10, 14, 15, 18, Schedule 5);

- conditions may be attached to authorisations for suppliers and these will set out further obligations (Clauses 7, 8);
- power for the Director of the Office of Gas Supply to enforce obligations on Suppliers in the Bill and under their authorisation (Clause 28-30);
- procedures for adaptation of the regulatory regime, where necessary, in the light of experience (Clauses 23-27);
- enhanced opportunities for competition through improved "common carriage" provisions (Clause 19-22).

## 2. THE DRAFT LICENCE

The proposed draft authorisation (licence) for British Gas under Clause 7 of the Gas Bill contains the following provisions:

### Price Control for Tariff Customers

The price of gas to tariff consumers (those taking up to 25,000 therms pa) will be regulated by:-

- an obligation on British Gas to publish tariffs and sell at these tariffs (Gas Bill Clause 10)
- a requirement that British Gas shall not unduly discriminate between customers (Gas Bill Clause 9)
- condition 3 of the authorisation which restricts the average price of tariff gas sold by British Gas



- although standing charges are included in the average price of tariff gas controlled by condition 3, condition 4 separately restricts the rate of increase in standing charges alone to no more than inflation

The maximum price tariff customers will pay will be strictly controlled. The control formula is set out in condition 3 of the authorisation.

### Other Features

Other features of the authorisation are:

- a requirement for BGC to publish separate accounts for their gas supply business (Condition 2).
- a requirement for the basis of connection charges to be published (Condition 6), together with a provision in the Bill which limits the extent to which costs can be recovered (Clause 10).
- an incentive for efficiency through the RPI-X+Y component of the formula, and a mechanism to ensure that the consumer will gain from the likely improvements (Condition 3).
- a requirement for British Gas to publish maximum prices for industrial contract customers (Condition 5).
- a requirement for BGC to give all necessary information to the regulator, and to give information to the Gas Users' Council for the investigation of complaints (Conditions 7, 8).
- a requirement for British Gas to publish typical prices for the conveyance of gas for third parties (Condition 9).



- a requirement for British Gas to make clear the circumstances in which it is prepared to make gas supplies available as a back up for those using the common carriage provisions (Condition 10).

- a requirement for British Gas to continue to provide a telephone service for reports of gas escapes, and to publish codes of practice for tariff customers on quality of service and payment of bills (including advice to customers who have difficulty in paying) (Condition 11, 12).



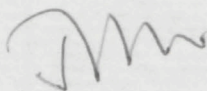
PRIME MINISTER

6 December 1985

GAS BILL - DRAFT BGC LICENCE

At E(A) on Monday, Nigel Lawson will probably suggest that we should not be rushed into publishing the Draft BGC Licence before Second Reading on Tuesday. Rightly, he will argue that this important element of the package needs to be carefully scrutinised, particularly the precise terms of the hard-fought assurances covering the industrial contract market, and use of common-carriage access to the industrial market by independent producers.

There may be a compromise. At the same time, Peter Walker is proposing to publish a layman's outline of the Draft Licence. This will define the assurances and the supporting regulation. Why not let this suffice for the Second Reading debate, and undertake to publish the Licence in full before the Christmas Recess? Better take time to get a complex draft right than have to amend it in key areas.



JOHN WYBREW



a Bg  
cc Bkup

FROM: S A ROBSON

DATE: 6 DECEMBER 1985

CHANCELLOR OF THE EXCHEQUER

cc Financial Secretary  
Sir P Middleton  
Mr Monck  
Mr Moore  
Mr Bird  
Mr H Davies

## GAS BILL: E(A) MEETING

This submission recommends you to oppose publication on Monday 9 December of the draft licence attached to Mr Walker's minute of 6 December to the Prime minister.

2. It is pretty intolerable to circulate a draft at this notice. But its content is even worse than its timing. I have not had time to go through it in detail but here are some samples:

(i) Condition 5 on pricing for the contract market. This deals with the assurances BGC is to publish. These are meant to include an assurance on "even handedness" ie non-discrimination and predatory pricing. This is not mentioned in condition 5.

(ii) Common <sup>carriage</sup> ~~carriage~~ - Mr Walker's last E(A) paper said BGC would provide gas storage facilities and back up supplies to third parties and would purchase residual portions of gas fields. The relevant licence conditions - 9 and 10 - provide only for BGC to publish information on third party use of pipelines and to publish a statement on back up supplies. A licence condition which relates to publication alone is pretty useless. It means the content of publication, is entirely in BGC's control and



its implementation cannot be policed by OFGAS. What is more, even the publication process does not extend to cover storage and residual fields.

(iii) Condition 4 on standing charges - in the original version of this condition, these charges were to be controlled below the RPI. Now they can rise with the RPI.

No doubt other points may arise as we go through the licence.

3. The question is what to do. The options are:

(i) to delay publication;

(ii) to let publication go ahead on Monday on the basis that we are not happy with the licence, that we will want it amended and that publication will not prejudice acceptance of our amendments.

4. Mr Walker will make a big fuss about delay. On merits he has nobody to blame but himself. He sprung the licence on us at this short notice.

5. I have discussed the position with the No.10 Policy Unit. They are briefing the Prime Minister to support you in delaying publication. The aim will be to improve the licence and publish it before the Christmas Recess. I recommend you press for this, with 3(ii) above as a fallback, at the E(A) meeting on Monday.

SA

PP S A ROBSON





cc B6  
return

PRIME MINISTER

GAS BILL

As you know, the Gas Bill has its Second Reading on Tuesday. I have been encouraged by the reaction of our supporters and the helpful line taken by the CBI.

We are likely to be severely criticised if we do not have on the table for that Debate fuller details of our proposals for protecting customers by means of the price control system and through other specific terms and conditions. I, therefore, propose to publish on Monday the attached draft Licence. This is in accordance with the proposals set out in E(A)(85)65 which were discussed at E(A)(85)20th meeting.

I intend to make clear to the House that views expressed during the passage of the Bill both by Parliament and by interested outside bodies will be carefully considered before the Licence is finalised. I will probably also make clear in general terms in my Second Reading speech that BGC have agreed to give undertakings on matters such as the contract market.

I am copying this minute to E(A) colleagues and to Sir Robert Armstrong.

SECRETARY OF STATE FOR ENERGY

6 December 1985



DEPARTMENT OF ENERGY

PROPOSED AUTHORISATION

to be granted by

THE SECRETARY OF STATE FOR ENERGY

to

THE BRITISH GAS CORPORATION

under

SECTION 7 OF THE GAS BILL



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PROPOSED AUTHORISATION TO BE GRANTED TO THE BRITISH GAS CORPORATION TO  
SUPPLY GAS THROUGH PIPES AS A PUBLIC GAS SUPPLIER UNDER SECTION 7 OF  
THE GAS BILL

1. The Secretary of State, in exercise of the powers conferred on him by section 7 of the Gas Bill (in this Authorisation referred to as "the Act"), hereby authorises the British Gas Corporation (in this Authorisation referred to as "the Supplier") to supply gas through pipes to any premises in Great Britain during the period specified in paragraph 2 below, subject to the Conditions set out in Schedule 1 hereto and to revocation in accordance with Schedule 2 hereto.
  
2. This Authorisation shall come into force on the day appointed under section 3 of the Act for the purposes of Part I of the Act and shall continue in force for a period of 25 years and thereafter unless determined at or after the expiry of that period of 25 years by notice in writing served by the Secretary of State on the Supplier on a day at least 10 years before the notice is to take effect.

, 1986.

SECRETARY OF STATE FOR ENERGY



SCHEDULE 1: Conditions of Authorisation

Condition 1: Interpretation and Construction

1. Unless the contrary intention appears words and expressions used in these Conditions shall be construed as if they were in an Act of Parliament and the Interpretation Act 1978 applied to them and references to an enactment shall include any statutory modification or re-enactment thereof after the date when this Authorisation comes into force.

2. Any word or expression used in these Conditions shall, unless the contrary intention appears, have the same meaning as it has in Part I of the Act.

3. In these Conditions unless the context otherwise requires -

"associated company" shall include any subsidiary of the Supplier and any body corporate which would be treated as controlled by the Supplier for the purposes of paragraph 38(4) of Schedule 2 to the Petroleum and Submarine Pipe-lines Act 1975.

"Auditor" means the Supplier's auditor or auditors for the time being holding office in accordance with the requirements of the Companies Act 1985.

"gas" means, in Conditions 2 and 3 and in Annex "A", any substance which is or (if it were in a gaseous state) would be gas within the meaning of Part I of the Act.

"Gas Supply Business" has the meaning given by Annex "A".

"Point of Delivery" means the point at which gas, whether acquired by the Supplier from another person or produced or manufactured by it is, after such treatment as may be necessary to render it of suitable quality for entry into the Transmission



System, first metered by the Supplier upon entry into the Transmission System.

"Relevant Year" has the meaning given in Condition 3.

"Retail Price Index" means the General Index of Retail Prices compiled by the Department of Employment in respect of all items provided that if there is a material change in the basis of the Retail Price Index there shall be substituted such basis to take account of the change or such other index as the Director, after consultation with the Supplier, may determine to be appropriate in the circumstances.

"Tariff Revenue" has the meaning given in Condition 3.

"third-party supplier" means a person for whom the Supplier is conveying gas through its pipelines.

"Transmission System" has the meaning given in Annex "A".

4. In construing these Conditions the heading or title of any Condition shall be disregarded.
5. Where, in these Conditions, any obligation of the Supplier is required to be performed within a specified time limit that obligation shall be deemed to continue after that time limit if the Supplier fails to comply with that obligation within that time limit.



Condition 2: Separate Accounts for Gas Supply Business

1. This Condition applies for the purpose of ensuring that the Supplier maintains accounting and reporting arrangements which enable separate accounts to be prepared for the Gas Supply Business showing the financial affairs of that business.
2. The Supplier shall -
  - (a) keep proper books of accounts and records in such a form that the transactions, assets and liabilities of, or reasonably attributable to, the Gas Supply Business are separately identifiable in the books of the Supplier from any other business of the Supplier;
  - (b) prepare on a consistent basis from its accounting records in respect of -
    - (1) the first six months of each financial year of the Supplier a report on the profit or loss of the Supplier's Gas Supply Business; and
    - (2) each financial year of the Supplier accounting statements (comprising a profit and loss account and a statement of assets and liabilities with the details reasonably necessary to reconcile the net assets shown in that statement at the beginning and at the end of that year), setting out and fairly presenting the costs (including depreciation), revenue, assets employed and liabilities, all as may be reasonably attributable to the Gas Supply Business and showing separately and in appropriate detail the amounts of any revenue, cost, asset or liability which has been either -
      - (i) charged from or to any other business of the Supplier; or



- (ii) determined by apportionment between the Gas Supply Business and any other business of the Supplier

together with a description of the basis of the charge or apportionment;

- (c) procure, in respect of each set of accounting statements prepared in accordance with this Condition in respect of each financial year of the Supplier, a report by the Auditor and addressed to the Director stating whether in his opinion that set of accounting statements is adequate for the purposes of, and is in compliance with, this Condition and represents a true and fair view of the profit or loss and financial position of the Gas Supply Business; and
  - (d) deliver to the Director a copy of the reports referred to in sub-paragraph (b)(1) and (c) above and of the accounting statements referred to in sub-paragraph (b)(2) above as soon as reasonably practicable and in any event not later than two months after the end of the period to which it relates in the case of the report referred to in sub-paragraph (b)(i) and six months after the end of the financial year to which they relate in the case of the accounting statements and Auditor's report.
3. Save with the prior written approval of the Director, which shall not be unreasonably withheld and which shall be deemed to be granted unless refused within two months after an application from the Supplier, the Supplier shall not in relation to the accounting statements in respect of a financial year change the basis of charge or apportionment respectively referred to in paragraph 2(b)(2) above from that used in respect of the previous financial year.
4. Accounting statements in respect of a financial year prepared under paragraph 2(b) above shall, so far as reasonably practicable having regard to the purposes of this Condition -



- (a) have the content (in relation to the Gas Supply Business) and be prepared in accordance with the general rules and format and shall use the same accounting principles and rules applicable to the annual accounts of the Supplier prepared under section 227 and, if appropriate, section 229 of the Companies Act 1985;
- (b) state the accounting policies used; and
- (c) (with the exception of the amounts and the basis of charge or apportionment respectively referred to in paragraph 2(b)(2) above) be published either with the annual accounts of the Supplier or in such other way as will bring its contents to the attention of customers and prospective customers of gas generally.



Condition 3: Restriction of gas prices to tariff customers

1. The Supplier shall in setting its prices for tariff customers take all reasonable steps, having particular regard to the interests of those customers, to secure that in each Relevant Year its Average Price per therm shall not exceed the Maximum Average Price per therm calculated in accordance with the following formula -

$$M_t = \left( \frac{1 + \text{RPI}_t - X}{100} \right) P_{t-1} + Y_t - K_t$$

where

$M_t$  = Maximum Average Price per therm in Relevant Year t;

$\text{RPI}_t$  = the percentage change (whether of a positive or negative value) in the Retail Price Index between that published with respect to October in Relevant Year t and that published with respect to the immediately preceding October;

X = [value to be determined];

$$P_{t-1} = P_{t-2} \left( 1 + \frac{\text{RPI}_{t-1} - X}{100} \right)$$

but, in relation to the first Relevant Year,  $P_{t-1}$  (and, accordingly, in relation to the second Relevant Year,  $P_{t-2}$ ) shall have a value of [ ] per therm;

$Y_t$  = Allowable Gas Cost per therm in Relevant Year t;

$K_t$  = the correction per therm (whether of a positive or negative value) to be made in Relevant Year t (other than the first Relevant Year) which is derived from the following formula -



$$K_t = \frac{T_{t-1} - (Q_{t-1}M_{t-1})}{Q_t} \left( 1 + \frac{I_t}{100} \right)$$

in which

$T_{t-1}$  = Tariff Revenue from Tariff Quantity in Relevant Year t-1;

$Q_{t-1}$  = Tariff Quantity in Relevant Year t-1;

$Q_t$  = Tariff Quantity in Relevant Year t;

$M_{t-1}$  = Maximum Average Price per therm in Relevant Year t-1;

$I_t$  = the interest rate in Relevant Year t which is equal to, where  $K_t$  (taking no account of  $I_t$  for this purpose) has a positive value, the Specified Rate plus three per cent. or, where  $K_t$  (taking no account of  $I_t$  for this purpose) has a negative value, the Specified Rate.

The subscript t represents the Relevant Year and the first Relevant Year shall be the year ending 31st March [198 ].

2. In this Condition -

"Allowable Gas Cost" means the aggregate of the following amounts namely -

(1) the amounts paid or payable by the Supplier at any time to each vendor of gas (not being an associated company) -

(a) for, and wholly and exclusively related to, the quantity of gas delivered to the Supplier in the Relevant Year for the Supplier's Gas Supply Business (being payments of purchase price in pounds sterling, or, if not in pounds sterling, converted to pounds sterling at the spot rate of exchange in London for purchasing the relevant foreign currency as quoted by



Barclays Bank plc at the close of business on the date of payment thereof); or

(b) as Capacity Charges in respect of the Relevant Year,

but -

(i) excluding any payments of interest and of any other amount payable by the Supplier because of any failure by the Supplier to perform its obligations or make any payment to vendors under its contract to purchase the gas so delivered;

(ii) deducting, where payment for gas is due more than 30 days after the end of the month of its delivery, a sum equal to the interest on the price of the gas for the period from 30 days after the end of the month of delivery to the date of payment, at the Specified Rate.

(2) (a) where, under the terms of a contract with a vendor of gas (not being an associated company), the Supplier has made a payment ("initial payment") with respect to gas not taken by it before the Relevant Year and, in that Relevant Year, the Supplier either takes gas by reason, wholly or partly, of that initial payment or, having taken gas in that Relevant Year for which consideration has been paid or would otherwise be payable, is allowed a credit by reason, wholly or partly, of that initial payment (provided that the consideration which has been paid, or which would otherwise be payable, has not been included under paragraph 2(1) above):-

(i) the amount of that initial payment to which the gas so taken is attributable; and

(ii) an amount representing interest on that payment compounded annually from the date of payment



calculated at the Specified Rate for the period beginning with that date and ending on the last day of the month in which the gas is taken or, as the case may be, the credit is allowed (and for this purpose payments and gas taken by reference to them shall be treated on a first in/first out basis);

- (b) where any initial payment has been made by the Supplier and, in the Relevant Year, either the terms of the contract have the effect, or it is shown to the reasonable satisfaction of the Director, that any gas will not be available for delivery, or credit which might otherwise have been allowed to the Supplier by reason wholly or partly of that payment will no longer be allowed, such amount over such period as the Director, after consultation with the Supplier, shall determine is a fair amount to be included in respect of any one or more Relevant Years;
- (3) where any gas which is delivered to the Supplier is purchased by it for a consideration which is not wholly pecuniary or where gas and anything other than gas are purchased as part of the same transaction or arrangement by the Supplier, the amount which the Supplier demonstrates to the reasonable satisfaction of the Director would be the pecuniary consideration for the gas if negotiated at arm's length as between a willing vendor and a willing purchaser;
- (4) where gas is purchased otherwise than at the Point of Delivery, such amount as is demonstrated to the reasonable satisfaction of the Director is or would be payable by the Supplier under a third party contract negotiated at arm's length for transporting the gas to the Point of Delivery and for any processing or treatment of the gas which is necessary to render it of suitable quality for entry into the Supplier's Transmission System;



- (5) (a) where the Supplier in a Relevant Year appropriates to the Gas Supply Business gas which it produced itself or which it acquired from an associated company ("Own Gas"), the Supplier shall furnish to the Director as soon as practicable after the end of that year a written statement of the amount which the Supplier shall certify to the best of its information, knowledge and belief represents no more than the market value (as defined in the Oil Taxation Act 1975) of such gas, together with an explanation of how any such amount has been arrived at and the amount so certified may be included as an Allowable Gas Cost on an interim basis provided it is not greater than the amount with respect thereto included or to be included (either on a provisional or final basis) by the Supplier or associated company in its return to the Oil Taxation Office of the Inland Revenue (or such other department of the Inland Revenue as is appropriate) but if it is greater, the lower amount shall be included;
- (b) in the event of it being ascertained by the Oil Taxation Office of the Inland Revenue in agreement with the Supplier, or determined in legal proceedings, that the market value of any Own Gas for the purposes of the Oil Taxation Act 1975 (or, in the case of Own Gas the subject of a tax exempt contract, as defined in section 1(3) of the Gas Levy Act 1981, by any department of the Inland Revenue in agreement with the Supplier, or in legal proceedings, that the market value of any Own Gas for any other tax purposes) is different from the amount permitted by sub-paragraph (a) above to be included on an interim basis for the purposes of the Allowable Gas Cost, the difference shall be reflected in an appropriate manner in the Allowable Gas Cost for the purposes of the formula described in paragraph 1 above and reported by the Supplier to the Director promptly after it has been ascertained or determined;



- (6) an amount equal to the gas levy payable to the Secretary of State by the Supplier under the Gas Levy Act 1981 in respect of the aggregate quantity of gas of which account is to be taken for the purposes of calculating the amounts referred to in sub-paragraphs (1), (2), (3) and (5) above;
- (7) any amount (whether or not similar to or different from expenditure of the kinds or amounts previously mentioned) which, after written application by and consultation with the Supplier is determined by the Director to be a cost of gas acquired by the Supplier for the Supplier's Gas Supply Business or to be a cost otherwise fairly related to the gas acquired,

but no amount shall be a component of Allowable Gas Cost both under sub-paragraph (7) above and any other of the preceding sub-paragraphs or under more than one of those sub-paragraphs and for the purposes of this definition of "Allowable Gas Cost", the delivery of gas shall be treated as taking place at the Point of Delivery.

"Allowable Gas Cost per therm" means the Allowable Gas Cost in the Relevant Year divided by the Relevant Quantity in the Relevant Year.

"Average Price per therm" means Tariff Revenue in the Relevant Year divided by the Tariff Quantity of gas supplied in that Relevant Year.

"Capacity Charges" means any amounts which are of a recurring nature and are paid or payable by the Supplier in respect of the Relevant Year to a vendor of gas in order to reserve the availability to the Supplier of deliveries of gas in the year to which the amounts relate but not being any amounts which would fall to be treated in whole or in part as an advance payment (directly or indirectly) for gas.



"Relevant Quantity" means the aggregate of the following namely -

- (1) the quantity of gas in therms delivered to the Supplier in the Relevant Year and purchased by it (otherwise than from an associated company) for the Supplier's Gas Supply Business being calculated where the price of gas is fixed by reference to an agreed calorific value, using that value, but if the agreed calorific value used in determining the price of the gas differs from the calorific value as measured, the Supplier shall give written notification to the Director of the amount of the difference;
- (2) the quantity of Own Gas in therms appropriated by the Supplier in the Relevant Year to the Supplier's Gas Supply Business other than gas from the Rough reservoir.

"Relevant Year" means each complete financial year of the Supplier ending on 31st March in respect of which the Supplier is required to deliver to the Director a copy of each of the accounting statements referred to in paragraph 2(b) of Condition 2.

"Specified Rate" means the average of the Treasury Bill Discount Rate (expressed as an annual percentage interest rate), published weekly by the Bank of England, during the period in respect of which the calculation falls to be made.

"Tariff Quantity" means the aggregate quantity of gas, in therms, supplied by the Supplier to tariff customers in the Relevant Year and taken into account for the purposes of determining Tariff Revenue.

"Tariff Revenue" means the turnover (measured on an accruals basis and including standing charges) derived from the supply of gas in the Relevant Year to tariff customers falling within the ordinary activities of the Gas Supply Business, after deduction



of value added tax (if any) and any other taxes based directly on the amounts so derived.

3. (1) If in respect of any Relevant Year the Average Price per therm exceeds the Maximum Average Price per therm by more than 4 per cent. of the latter, the Supplier shall furnish an explanation to the Director and in the next following Relevant Year the Supplier shall not effect any increase in prices unless it has demonstrated to the reasonable satisfaction of the Director that the Average Price per therm would not be likely to exceed the Maximum Average Price per therm in that next following Relevant Year;
  - (2) if, in respect of any two successive Relevant Years, the sum of the amounts by which the Average Price per therm has exceeded the Maximum Average Price per therm is more than 5 per cent. of the Maximum Average Price per therm for the second of those years, then in the next following Relevant Year the Supplier shall, if required by the Director, adjust its prices such that the Average Price per therm would not be likely, in the judgement of the Director, to exceed the Maximum Average Price per therm in that next following Relevant Year;
  - (3) if in respect of each of two successive Relevant Years the Average Price per therm is less than 90 per cent. of the Maximum Average Price per therm, the Director, after consultation with the Supplier, may direct that, in calculating  $K_t$  in respect of the next following Relevant Year, there shall be substituted for  $T_{t-1}$  in the formula set out in paragraph 1 above such figure as the Director may specify being not less than  $T_{t-1}$  and not more than  $0.90 (Q_{t-1}^M)_{t-1}$ .
4. (1) Where the Supplier publishes any change in the price of gas (which shall include any change in standing charges) which it proposes to make to tariff customers, the Supplier shall



not later than the time of such publication provide the Director with -

- (a) a written forecast of the Maximum Average Price per therm, together with its components, in respect of the Relevant Year in which the change of price of gas is to take effect and also in respect of the next following Relevant Year; and
  - (b) a written estimate of the Maximum Average Price per therm, together with its components, in respect of the Relevant Year immediately preceding the Relevant Year in which the change in price of gas is to take effect unless a statement complying with paragraph 4(5) below in respect of that first mentioned Relevant Year has been furnished to the Director before the publication of the proposed change in gas price;
- (2) if within three months of the commencement of any Relevant Year the Supplier has not published or effected any change in price as is referred in sub-paragraph (1) above the Supplier shall provide the Director with a written forecast of the Maximum Average Price per therm, together with its components, in respect of that Relevant Year;
  - (3) any forecasts as aforesaid shall be accompanied by such information as regards the assumptions (such as economic growth, exchange rate changes and energy prices) which are critical features thereof as may be necessary to enable the Director to be reasonably satisfied that the forecasts have been properly prepared on a consistent basis;
  - (4) not later than 6 weeks after the end of a Relevant Year the Supplier shall send to the Director a statement as to whether or not in its opinion paragraph 3(1), (2) or (3) applies in respect of that Relevant Year and its best



estimate of what K is likely to be in the following Relevant Year;

(5) not later than 3 months after the end of a Relevant Year the Supplier shall send to the Director a statement, in respect of that Relevant Year, showing -

(a) Allowable Gas Cost;

(b) Relevant Quantity;

(c) Tariff Revenue;

(d) Tariff Quantity;

(6) The statement referred to in sub-paragraph (5) above shall be -

(a) accompanied by a report from the Auditor that in his opinion such statement fairly presents Allowable Gas Cost, Relevant Quantity, Tariff Revenue and Tariff Quantity in accordance with the requirements of this Condition and that the amount of Tariff Revenue and, so far as applicable, the amount included as Allowable Gas Cost are in accordance with the Supplier's accounting records which have been maintained in accordance with Condition 2; and

(b) certified by a director of the Supplier that no amount included within Allowable Gas Cost represents other than bona fide consideration for gas delivered for use in Gas Supply Business or an amount permitted under this Condition to be so included;

provided that where any element of Allowable Gas Cost requires to be determined by, or to the satisfaction of the Director or is subject, under paragraph 2(5)(b) of this



Condition, to adjustment, and the determination or adjustment has not been made by the date when the statement under this paragraph is sent to the Director, that statement and the report and certificate in respect of it may be qualified accordingly.

5. (1) This Condition shall apply so long as this Authorisation continues in force but shall cease to apply if -
  - (a) the Supplier delivers to the Director a written request ("disapplication request") made in accordance with sub-paragraph (2) below and the Director agrees in writing to the disapplication request; or
  - (b) its application is terminated by notice given by the Supplier in accordance with either paragraph (3) or paragraph (4) below;
- (2) any disapplication request shall be in writing, addressed to the Director, and shall state the date ("disapplication date") from which the Supplier wishes the Director to agree that this Condition shall cease to apply, but the disapplication date therein stated shall not be before whichever is the later of 1st April 1992 and any date which is less than 18 months after the date upon which the disapplication request is delivered to the Director;
- (3) if the Director has not made a reference to the Monopolies Commission under section 24 of the Act relating to the modification of this Condition before the beginning of the period of 12 months which will end with the disapplication date, the Supplier may deliver written notice to the Director terminating the application of this Condition with effect from the disapplication date or a later date;
- (4) if the Monopolies Commission makes a report on a reference made by the Director relating to the modification of this



Condition after a disapplication request and such report does not include a conclusion that the cessation of the application of this Condition, in whole or in part, operates, or may be expected to operate, against the public interest, the Supplier may within 30 days after the publication of the report by the Director deliver to him written notice terminating the application of the Condition with effect from the disapplication date or a later date.



Condition 4: Standing charges

1. The Supplier shall use its best endeavours to secure that from [1 April 198 ], the standing charges payable by tariff customers in any Relevant Year do not exceed the standing charges payable by such customers in the first Relevant Year as increased by the percentage increase in the Retail Price Index from [1 April 198 ] to the beginning of the Relevant Year.
2. This Condition shall apply mutatis mutandis to any change in or imposition of charges having a similar effect on a tariff customer to a standing charge.
3. This Condition shall cease to apply if Condition 3 ceases to apply.



Condition 5: Pricing for contract customers

1. The Supplier shall within three months of the date when this Authorisation enters into force publish:

- (a) a schedule of the maximum prices payable for gas supplied at that time to contract customers and shall publish further statements at the time of any changes to those maximum prices; and
- (b) a general statement of the Supplier's policy as regards its willingness to enter into negotiations for prices for gas supplied to contract customers.

2. This Condition shall not apply to prices for the supply of gas in the circumstances to which Condition 10 relates.



Condition 6: Connection charges

The Supplier shall -

- (a) from time to time publish the principles upon which the connection charges payable by any person desiring to become a tariff customer will be established; and
- (b) make available to any such person upon request details of those principles.



Condition 7: Provision of information to the Director

1. Subject to paragraphs 2 and 3 below, the Supplier shall furnish to the Director, in such manner and at such times as the Director may reasonably require, such documents, accounts, estimates, returns or other information (collectively "Information") as he may reasonably require or as may be necessary for the purpose of performing the functions assigned to him by or under the Act.
2. This Condition shall not apply in respect of any function of the Director under section 23, 33 or 34 of the Act, but the Supplier shall, if requested by the Director, give reasoned comments on the accuracy (so far as it relates to the Gas Supply Business) and text of any information or advice which the Director proposes to publish pursuant to section 34 of the Act.
3. This Condition shall not require the Supplier to furnish any Information in relation to an enforcement matter which it could not be compelled to produce or give under section 37 of the Act.
4. Where, under any other Condition of this Authorisation, the Supplier is or can be required to provide Information to the Director there shall be a presumption that the provision of that Information in accordance with that Condition is sufficient for the relevant purposes of that Condition but this presumption shall be rebutted, and shall not limit the right of the Director to call for further information pursuant to paragraph 1 above, if he states in writing that in his opinion such Information is or is likely to be necessary to enable him to exercise those functions.



Condition 8: Provision of information to the Gas Users' Council

1. The Supplier shall, within three months after the coming into force of section 2 of the Act, give to the Gas Users' Council details of its policies for the conduct of its business of supplying gas through pipes and of the general arrangements for the implementation thereof and shall inform the Council, not later than the time of publication or announcement or implementation (if no publication or announcement is made), of -
  - (a) any significant change in any of such policies and general arrangements; and
  - (b) any change in the price of gas (including standing charges), or any change in the principles of other charges for gas supply, which it proposes to make to tariff customers.
2. The Supplier shall furnish to the Gas Users' Council, at such times as the Council may reasonably require, such information on matters which are the subject of a representation to it as the Council may reasonably request for the purposes of exercising the functions assigned to it under section 32 of the Act.
3. This Condition shall not require the Supplier to furnish any information or documents in relation to an enforcement matter which it could not be compelled to produce or give to the Director under section 37 of the Act.



Condition 9: Conveyance of gas for others

1. The Supplier shall, within three months after the date on which this Authorisation enters into force, and after consulting the Director, publish by such means as it considers appropriate to bring it to the attention of persons who might wish to have gas conveyed by the Supplier's pipelines, general information for the guidance of those persons in negotiations with the Supplier for the conveyance of gas, giving examples of the prices which the Supplier would expect to be paid for such conveyance in typical circumstances, and a general description of the principal matters which the Supplier would expect to be the subject of those negotiations in such circumstances.
2. In the event of any material change in such prices and other matters, the Supplier shall, after consulting the Director, publish revised information incorporating the changes.
3. The Supplier shall make available to any person on request, and on payment of a reasonable charge, a copy of the information published from time to time pursuant to this Condition.



Condition 10: Supply of back-up gas

1. The Supplier shall, within three months after the date on which this Authorisation enters into force, publish, by such means as it considers appropriate, a statement setting out the circumstances in which the Supplier would be willing to supply gas ("back-up gas") to a third-party supplier if that third-party supplier's gas was temporarily not available.
  
2. The statement referred to in paragraph 1 above shall also set out the method by which the Supplier proposes to calculate the charge for supplying back-up gas, and a general description of principal matters which the Supplier would expect to be the subject of negotiations for a supply of back-up gas in the circumstances mentioned above.



Condition 11: Emergency service

1. The Supplier shall provide an effective and continuously attended service for the receipt, by telephone, of reports of escapes of gas supplied, or believed to be supplied, by the Supplier. Effective arrangements shall also be made for the receipt at the Suppliers' showrooms during their normal working hours of such reports made in person. The Supplier shall, by appropriate means secure that adequate publicity is given of the ways in which it can be contacted for the purpose of reporting such escapes.
2. The Supplier shall make available when required by any person details of its emergency service, stating that the Supplier will make safe whether by cutting of the supply of gas or otherwise free of charge all escapes of gas which it supplies and the extent to which a customer may be liable for the costs of repairs associated with an escape.
3. Where an escape of gas reported to the Supplier relates to gas supplied by any other gas supplier authorised under the Act, the Supplier shall take all reasonable steps to notify that other gas supplier of the escape as soon as practicable after the escape is reported to the Supplier.



Condition 12: Codes of Practice for tariff gas supplies and payment of bills

1. The Supplier shall, within three months after the date on which this Authorisation enters into force, publish by means it considers appropriate to bring them to the attention of tariff customers generally:-
  - (a) a Code of Practice describing the nature of service available to tariff customers in relation to gas supplied by the Supplier; and
  - (b) a Code of Practice concerning the payment of gas bills including guidance to domestic consumers if they have difficulty in paying.
  
2. The Supplier shall consult the Gas Users' Council and the Director about the presentation of each such Code, and about any proposed substantive revision of its presentation, prior to its publication and shall consider any representations made by the Director or the Council about the operation of the Codes.



Condition 13: Supply to public lamps

The Supplier shall supply gas to any public lamp to which, immediately before the appointed day for the purposes of section 3 of the Act, the British Gas Corporation was supplying gas under the duty imposed on it by paragraph 5 of Schedule 4 to the Gas Act 1972 in such quantities as the authority by or for whom the lamps are maintained may from time to time require.



Condition 14: Payment of fees

The Supplier shall pay the following amounts to the Secretary of State for Energy at the times stated -

- (a) on 31st March, 1987, or such earlier date as the Secretary of State shall determine upon giving the Supplier not less than [4] weeks' notice, the sum of £[ ] million; and
- (b) on 1st April, 1987 and on each anniversary thereof (the year beginning on each such date being hereinafter referred to as a "fiscal year") a renewal fee which shall represent a fair proportion of the costs -
  - (i) estimated by the Director as being likely to be incurred in that fiscal year in the regulation and enforcement of public gas suppliers' authorisations and in the exercise of his functions under the Act; and
  - (ii) estimated by the Director (in consultation with the Secretary of State for Trade and Industry) as being likely to be incurred by the Gas Users' Council in that fiscal year in carrying out its functions under the Act; and
  - (iii) estimated by the Director as having been incurred by the Monopolies and Mergers Commission in the preceding fiscal year following references made under section 24 of the Act concerning this Authorisation.

The renewal fee will be determined each year by the Director according to methods and/or procedures that have been disclosed in writing to the Supplier, save that the renewal fee for the fiscal year beginning 1st April, 1987 shall not exceed £[ ]m. and for any fiscal year beginning on or after 1st April, 1988 shall not exceed [ ] per cent. of the Tariff Revenue in the Relevant Year ending in



the calendar year preceding the date upon which the fee falls due for payment.



SCHEDULE 2: Revocation of Authorisation

1. The Secretary of State may at any time revoke this Authorisation by 30 days' notice in writing given to the Supplier at its registered or principal office in any of the following circumstances -
  - (a) if the Supplier agrees in writing with the Secretary of State that this Authorisation should be revoked;
  - (b) if any amount payable under Condition 14 of this Authorisation is unpaid 30 days after it becomes due and remains unpaid for a period of 14 days after the Secretary of State notifies the Supplier that the amount is overdue such notification not to be given earlier than the sixteenth day after the day on which the amount payable became due;
  - (c) if the Supplier fails to comply with a final order (within the meaning of section 28 of the Act) or a provisional order (within the meaning of that section) which has been confirmed under that section and such failure is not rectified to the satisfaction of the Secretary of State within 3 months after the Secretary of State has given notice in writing of such failure to the Supplier provided that no notice under this sub-paragraph shall be given by the Secretary of State before the expiration of the period within which an application under section 30 of the Act could be made questioning the validity of the final or provisional order or before any such application, if made, is finally adjudicated upon;
  - (d) if the Supplier fails to comply with any order made by the Secretary of State under section 56, 73, 74 or 89 of the Fair Trading Act 1973 or section 10 of the Competition Act 1980 which relates to the Gas Supply Business;



- (e) if the Supplier ceases to carry on its business as a public gas supplier;
- (f) if the Supplier, being a company formed and registered under the Companies Act 1985, -
  - (i) is unable to pay its debts (within the meaning of Section 518 of the Companies Act 1985, but subject to paragraph 2 below) or makes any agreement with its creditors generally for the composition of its debts;
  - (ii) has a receiver of the whole or any material part of its assets or undertaking appointed;
  - (iii) passes any resolution for winding up other than a resolution previously approved in writing by the Secretary of State; or
  - (iv) becomes subject to an order by the High Court for winding up.

2. For the purposes of sub-paragraph (1)(f)(i) of this Schedule, section 518(1)(a) of the Companies Act 1985 shall have effect as if for "£750" there was substituted "£250,000" or such higher figure as the Director may from time to time determine and the said section 518(1)(a) shall not apply if the demand therein referred to is being contested in good faith by the Supplier with recourse to all appropriate measures and procedures or if the demand is satisfied prior to the expiry of the notice given to the Supplier by the Secretary of State.



ANNEX "A": Gas Supply Business

1. Subject to paragraph 3 below, the Gas Supply Business means the procurement, treatment, storage, transmission and distribution by the Supplier of gas for sale and safe delivery through pipes to customers in Great Britain and the conveyance of gas for third-party suppliers and in this paragraph -

"procurement" means the acquisition of gas by the Supplier from other persons and the taking into the Transmission System of gas produced or manufactured by the Supplier;

"treatment" means the cleansing, odourisation, heating, cooling, compression, and decompression of gas and any other operation necessary to transmit gas safely through pipes to customers or to render it suitable for consumption;

"storage" means all storage of gas after its procurement by the Supplier including, after procurement, its storage by the Supplier in offshore installations;

"transmission and distribution" means the conveyance, including the provision and installation of meters and associated controls, of gas belonging either to the Supplier or to other persons;

"Transmission System" means the facilities used by the Supplier for the conveyance of gas in a gaseous state, including the storage of gas in the course of its conveyance, either within Great Britain or between any of the Supplier's offshore gas storage installations and its first place of receipt onshore Great Britain, but specifically excluding facilities for the conveyance of gas in a liquid state or for its conversion into a gaseous state.



2. For the avoidance of doubt there shall be included in the Gas Supply Business if, and to the extent that, they are undertaken by the Supplier for the purpose of such business, the following activities namely -
- (i) the design, procurement, installation, testing, commissioning, maintenance, repair, replacement and operation of any plant and machinery, including pipework and transport;
  - (ii) research and development;
  - (iii) commercial and administrative functions including -
    - planning;
    - purchasing and stores;
    - marketing and promotion of gas;
    - selling;
    - accounting and finance;
    - personnel management;
    - any other general management and administrative activities to the extent that they are undertaken by the Supplier for the purpose of the Gas Supply Business.
3. For the avoidance of doubt there shall not be included in the Gas Supply Business the following activities namely -
- (i) installation of gas appliances or supplies (from the outlet of the meter on the customer's premises) or work undertaken under the terms of a repair, maintenance or installation contract with gas customers, except for safety checks and emergency and all other work related to the Supplier's safety obligations and in pursuance of its statutory safety duties;
  - (ii) trading in gas appliances;



(iii) exploration for and production or manufacture of gas;

(iv) consultancy unless solely related to the requirements of gas supply in Great Britain.



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889  
cc: Prof. Griffiths

10 DOWNING STREET

*From the Private Secretary*

6 December 1985

PRIVATISATION

The Prime Minister has seen and noted without comment your Secretary of State's undated minute about privatisation of British Gas which commented on the Secretary of State for Transport's minute to the Prime Minister of 19 November.

I am copying this letter to Richard Allan (Department of Transport).

David Norgrove

Geoff Dart, Esq.,  
Department of Energy.



CCBU

PRIME MINISTER

GAS INDUSTRY PRIVATISATION

E(A) is meeting at 0930 on Monday morning to discuss this. The formal item on the agenda is policy towards imports and exports. But Mr. Walker has circulated today the licence he proposes to issue to BGC under the provisions of the Gas Bill. He aims to publish this on Monday. The Treasury will object vehemently.

I suggest you avoid all discussion of the licence until imports and exports have been sorted out and, indeed, for tactical reasons not to mention it before imports and exports have been dealt with.

Imports and Exports

The papers are:

- A ✓ Cabinet Office brief
- B ✓ Policy Unit brief
- C ✓ Letter reporting oil company views on gas imports and exports, from the Department of Energy
- D ✓ Note of a meeting between the Chancellor and Mr. Walker which the Treasury have sent me privately
- E ✓ Mr. Walker's paper

This is likely to be a very difficult decision. The Treasury feel very strongly that Mr. Walker must not be allowed his way on this, after the decision on the industrial contracts market, and I expect that Mr. Brittan and Mr. Ridley at least will agree.

The Cabinet Office think the discussion is to some extent academic because almost whatever is said BGC in their view will be under the pressure of quasi-market forces. The Treasury do not agree: they fear that BGC will abuse its



monopoly power to hold down the prices it pays for North Sea gas. The Policy Unit strongly recommend an open door policy, subject to ad hoc exceptions, emphasising the need at this stage in the privatisation programme for the Government to signal its overriding commitment to free markets and competition.

Reading the papers I have found it extremely hard to assess the merits of the arguments on substance. But the argument about the effect of perceptions of the privatisation programme must be given weight.

The Chief Whip has discussed this with Mr. Walker and represented to him how difficult it will be if he were to expect you to over-rule in his favour all the other Cabinet Ministers concerned in this area. Mr. Walker seems to have taken this on board, but in the Chief Whip's view is still likely to fight his corner to the end (of the meeting - no talk of resignation).

BGC Licence

The papers here are:

- F Cabinet Office brief
- G Policy Unit brief
- H Internal Treasury submission which I have obtained
- I Mr. Walker's minute

The Treasury minute (Flag H) points to a need for very careful scrutiny of the licence. There may well be more in it than immediately meets the eye.

But to delay publication would clearly lead to substantial criticism. If colleagues feel that it is impossible to delay, the licence would have to be published as a draft. This is a high risk, but with the saving grace that all the public comment is likely to point in the direction of a tightening of the terms of the licence.



The Policy Unit compromise of publishing Mr. Walker's proposed layman's outline of the licence could risk the worst of both worlds: immediate publication of something which would tend to restrict the internal discussions, but inadequate to allow scope for public comment to push Mr. Walker in the right direction. Nevertheless, it would be worth considering if neither of the other options stands up.

Dev

DAVID NORGROVE

6 December 1985

VC3AIK



cc BG

**CONFIDENTIAL**



2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434  
My ref:

Your ref:

5 December 1985

*Dear Peter,*

*NB17*

PRIVATISATION OF BRITISH GAS

Thank you for sending me a copy of your letter of 26 November to Nigel Lawson.

I am content for you to proceed as you propose.

I am sending copies of this letter to the Prime Minister, other members of E(A), Geoffrey Howe, Patrick Mayhew and Sir Robert Armstrong.

*Kenneth Baker*  
*[Signature]*

KENNETH BAKER

The Rt Hon Peter Walker MP



NAT IND: Gas & elec. PE 11





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CCBG



ROYAL COURTS OF JUSTICE  
LONDON, WC2A 2LL

01-405 7641 Extn

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

NBP

4 December 1985

*Dear Peter,*

PRIVATISATION OF BRITISH GAS

FILE WITH DEN

Thank you for sending to me a copy of your letter of 26 November to Nigel Lawson.

I have considered the question of compatibility with the EEC Admission Directive of a percentage limitation on the holding by any individual or group of individuals acting in concert of shares in British Gas. In the very short time available I have only been able to conclude that there are very respectable arguments that a limit of 15% would not be contrary to the requirement in the Directive that the shares must be "freely negotiable". (This conclusion has been expressed in detail to your officials). I have also indicated that it is not possible for me to specify the lowest percentage limitation on the size of individual or group shareholding which would still avoid the jeopardy of infringing the requirement of free negotiability or of non-disturbance of the market (the criterion for the grant of a derogation by The Stock Exchange). All I can say on the basis of past precedent is that a limit of 15% would seem to be safe. The further one moves downwards from this percentage the greater will be the jeopardy.

I note that your Legal Advisers believe that a provision in the Articles requiring the Chairman, or a majority of the BG plc Board, to be British nationals would be unlikely to be compatible with the requirements of the Treaty of Rome. My initial reaction to this, on the basis of what you say, is that the advice seems to be correct; but you will appreciate that I do not have detailed information as to the .../nature

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- page two -

nature of BG plc or of the circumstances surrounding the BT exemption, and consequently cannot express any firm view.

I am copying this letter to the Prime Minister, Members of E(A) and Geoffrey Howe.

*Samson*

*J. L. H.*

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NATIND  
~~RESEARCH~~

GAS

PT 11





PRIME MINISTER

GAS

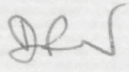
A further conflict between the Treasury and Department of Energy is in prospect, this time over exports and imports of gas.

Mr Walker is playing this long. Second Reading of the Gas Bill is scheduled for next Tuesday and Mr Walker was proposing that a discussion of exports and imports should be postponed until after it. Treasury and Cabinet Office were unhappy, naturally enough.

I have asked the Cabinet Office provisionally to fix a meeting of E(A) for next Monday, before Second Reading, against resistance from the Department of Energy.

The meeting is likely to be difficult and possibly inconclusive. But it seems important not to allow this to slip.

Content?

  
David Norgrove  
3 December 1985

Yes mb



*cc: BG*

*Prime Minister 2*  
*Yes*  
*ms*  
*Agree to write?*  
*DLR*  
*5/12*

PRIME MINISTER

PRIVATISATION

Although we have now decided our approach to the regulation of British Gas, I would like to comment on the concerns Nicholas Ridley expressed about separate companies in his letter of 19 November to me, and his minute of 27 November to you.

We are well past the point where breaking up BGC into many separate companies is an option. But the existing subsidiary companies (eg for exploration and production) will continue, and our licence condition on separate accounting is designed to prevent hidden cross subsidy from the core gas supply business into the ancillary activities.

I believe this arrangement is appropriate to the realities of the gas business, including the Corporation's statutory safety responsibilities which straddle activities such as gas supply and servicing. Nicholas' proposals would be unlikely in practice to achieve more, but would risk precipitating a showdown with the unions. This is precisely what our opponents would like to see.

I think Nicholas is mistaken in the analogy he draws with BAA. Clearly separate airports - which are local monopolies - should be formed into separate PLC's. But the correct analogy with the British Gas arrangements would be that, within each airport PLC, the core business and ancillary activities such as baggage handling and duty-free retailing would need to be separately distinguished through a system of separate accounting. I do not believe there need be any real difficulty in explaining that there are genuine differences in the BGC and BAA situations.

If Nicholas or his officials would find it useful I will gladly arrange for them to see the advice on separate accounting which my Department has received from Touche Ross.

I am copying this minute to Nicholas Ridley.

*[Handwritten signature]*

Secretary of State for Energy  
December 1985



NAT. IND  
GAS  
PT 12



COMPTON



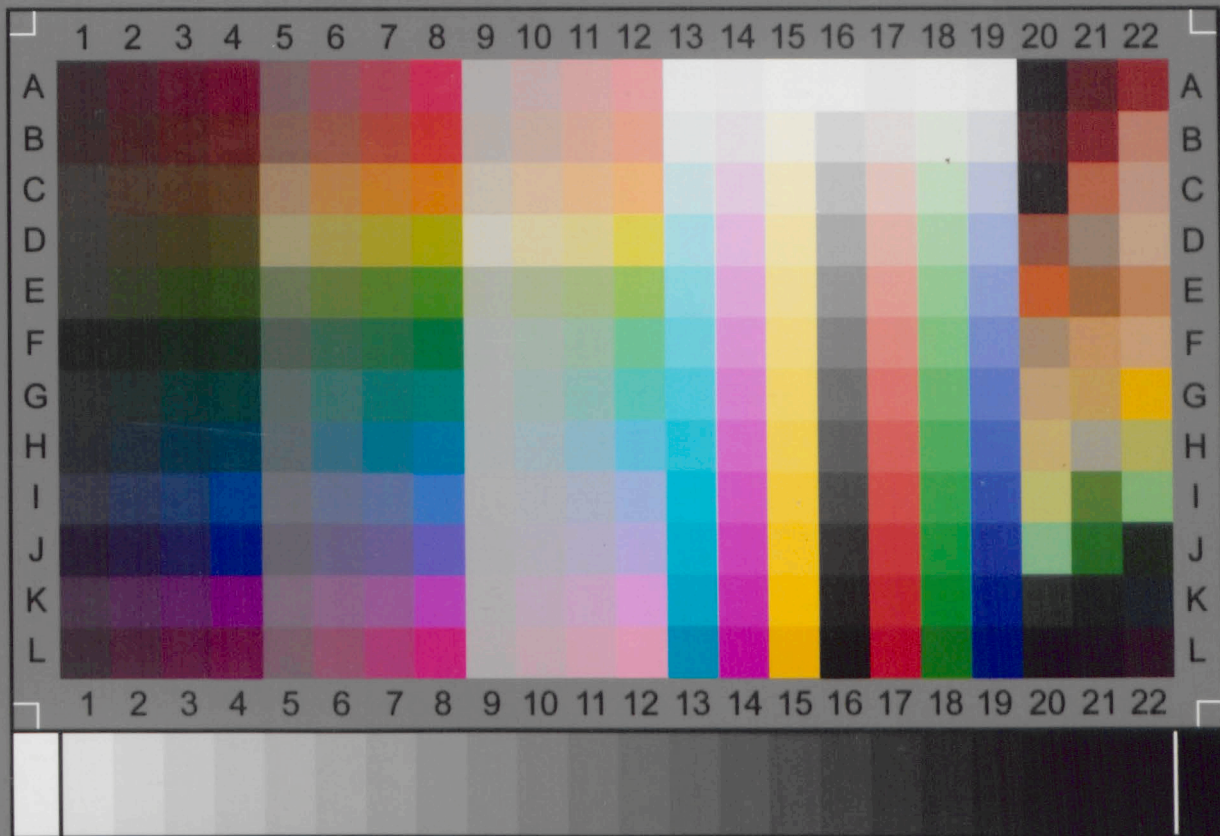
PART 11 ends:-

SS/Transport to PM 27/11/85

PART 12 begins:-

SS/Energy to PM <sup>uld</sup> (December)





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