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SECRETARY OF STATE FOR ENERGY
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Pami Anishti

✓ In Progress

To note : the electricity
industry are likely to
over-spend their cash
limit for 1979/80
because of fuel stock -
building and higher
fuel prices.
24 January 1980

The Rt Hon John Biffen MP
Chief Secretary
HM Treasury
Parliament Street
London
SW1P 3HE

Dear Sir

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24/1

At our meeting on Monday with Sir Francis Tombs and Mr England the industry explained that the prospective breach of their cash limit could now - almost entirely - as a result of fuel stock build and fuel price increases - amount to £300m. The effect of the steel strike could lead to a further deterioration which the industry are not yet in a position to quantify, but their direct losses in sales to BSC are running at £4m per week. Tombs has now written, as he promised, summarising actions which the industry could take to reduce the size of the breach. I attach a copy of his letter.

As Tombs points out, fuel stocks have increased considerably. Under pressure from the Department, the Generating Board were of course throughout much of last year taking every possible measure to build up stocks in anticipation of possible industrial action by the miners. This exercise has been more successful than the industry itself anticipated, not least because of the successful effort of the NCB and British Rail to shift coal to the power stations (including some coking coal which became available as a result of reduced demand by the steel industry). When the CEGB took stock of the position in late December they estimated that they would end the financial year with 2.7 mt more coal than was anticipated. Their latest forecast is that a further 1½ mt of coal will be added to stock by end-March, given that coal deliveries are still running at a high level.

Oil stocks have also risen, and this - together with the considerable increase in oil prices, has been a further important contributory factor.

Because it takes three months before a revised tariff begins to yield extra revenue from domestic consumers, there will be an under-recovery of fuel costs from these customers in this financial year. Tombs has told us that £73m of the deterioration is largely due to this factor.

My views on the possibilities of remedial action which have been put forward by the industry are as follows:

(i) Defer payments to the NCB

Because of improvement in the NCB's external financing position it seems likely that deferment of payments of £50m - and possibly a little more - could be accommodated without breach of the NCB limit. There would of course be no net benefit to the PSBR if this action were taken, but it would demonstrate that we attach importance to individual industries taking action to live within their limit. As you know, I have already invited the CEGB to discuss the possibility with the NCB. A further possibility would be to adjust the EFLs' of the NCB and the electricity supply industry in equal and opposite directions. I would welcome your views on this.

(ii) Defer payments to oil companies (industry estimate of £25m)

I invited the industry to take no action with the oil companies until I had given this further thought. I agree with Tombs that it is important not to damage the CEGB's good relations with the oil companies, whose co-operation may be essential in any future emergency. But on reflection I am sure that the CEGB ought to press the oil companies on this and report back on their reactions. Another possibility, on which I am seeking further advice from the industry, would be to defer until next year some deliveries of oil due this year, though there would be the risk that later deliveries would come in at higher prices. These discussions could of course become public knowledge, but since they would be without prejudice to our final decisions, I doubt, subject to your views, if any harm would be done. On the contrary it would demonstrate the seriousness of our endeavour to control the industry's borrowing.

(iii) Defer payments to CEGB plant and other suppliers
(industry estimate of £25m)

Similar considerations arise here, and I propose to invite the industry to consider further, where necessary in consultation with its suppliers, what can be achieved.

(iv) Area Board action to defer payments and increase income (£20m)

I propose to endorse action along the lines indicated, subject to further advice from the Council on the potential effect on equipment and appliance manufacturers.

(v) Reduce 'cash in transit' (£30m)

This is eminently desirable.

I have given careful thought to whether additionally we might invite the industry to reduce fuel deliveries during the rest of the year. The industry's projected end-year stocks, though much higher than originally predicted, are by no means excessive in historical terms, and it would be contrary to all our earlier efforts to improve the stock-holding position to take such action. Moreover, in respect of coal, there would be no net advantage to the PSBR. In respect of oil, Tombs has indicated that this could give rise to problems through upsetting refinery balances and schedules, and prejudice relations with the oil companies. I am pursuing this further with him but in any event I am sure that it would be imprudent to take any action which would result in approaching next winter, with its early NUM settlement date, with reduced fuel stocks.

Action under (i)-(iv) above will of course have consequences for 1980/81. Whether the industry can accommodate this extra expenditure within their existing EFL without increasing tariffs is not clear, and I have sought further information from them on the scope for economies in next year's capital programme. As Tombs has mentioned however there are growing uncertainties eg on fuel prices and electricity demand in 1980/81 which will also need to be considered.

On Tombs' question about the nature of the EFL, there is I think little to add to what we said at the meeting. This is no doubt a question which will arise again in NICG. The point which I have been at pains to emphasise is that if there is risk of a breach Ministers must be informed immediately, and options for remedial action discussed. Boards have now agreed to provide the Council with better and more frequent returns.

I am copying this letter to the Prime Minister and to the Secretaries of State for Industry and Scotland.

Howell

D A R HOWELL

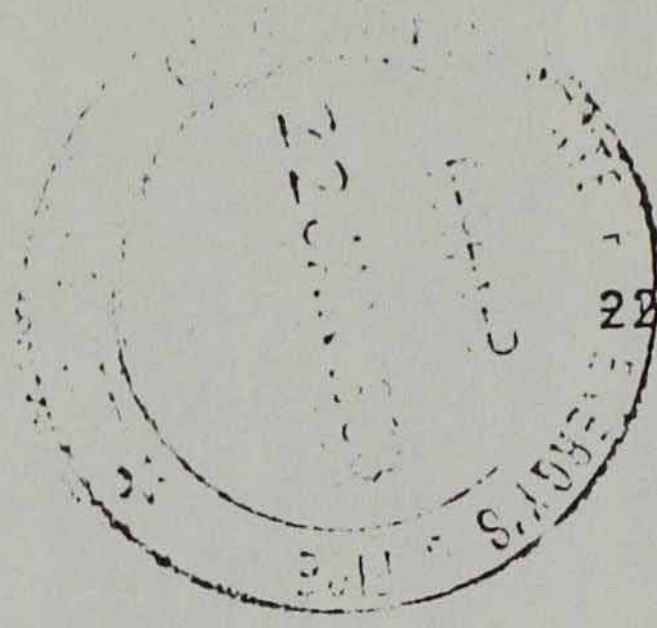
David
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THE ELECTRICITY COUNCIL

SIR FRANCIS TOMBS
Chairman

CONFIDENTIAL

30 MILLBANK
LONDON, SW1P 4RD
TELEPHONE: 01-834 2333



22nd January 1980.

The Rt. Hon. David Howell MP,
Secretary of State for Energy,
Thames House South,
Millbank,
LONDON SW1P 4QJ.

Dear David,

This is to confirm the information we gave you and the Chief Secretary at our meeting yesterday.

We accept that we should have given you an indication of the deteriorating EFL position in 1979/80 a few weeks earlier than my letter of 11th January. Until the NUM accepted the NCB's wage offer in early December, however, it was not sensible to depart materially from earlier assumptions about the fuel stocks position. The absence of industrial action in the coal industry coupled with deliveries of coal in excess of those programmed (arising in part from coking coal made available as a result of reduced demand by the steel industry), and a fall back in the rate of growth in electricity demand have led to a marked improvement in coal stocks as compared with those previously envisaged. Equally the measures taken by CEGB to improve oil stocks proved successful. As you know, higher than expected fuel stocks are the biggest single reason for the EFL deterioration as compared with the figures we notified your Department in November.

We are taking steps to ensure that in future we give you progress reports on the EFL position as early as possible.

It is implicit in the figures that the industry's profitability will be well down this year. Consistent with the EFL, we expected that profit after interest would be £191M. The latest estimate, before allowing for the effects of the BSC strike, is that profit will be about £50M on present accounting practices. This has been allowed for in the deterioration in the EFL position.

Even at this time of the year there remains considerable uncertainty regarding the EFL outturn. Coal deliveries are still running at a high level and estimates made since my letter of 11th January suggest that power station coal stocks at the end of the year could be 1.5M tonnes or more higher than I then indicated. This would add about £50M to our external financing requirements and in addition the direct effects of the BSC strike are worsening our cash flow by about £4M a week. It would be prudent, therefore, to assume that, before allowing for the remedial action I outline below, our external financing requirements by the end of the year could be about £300M worse than the EFL, plus the effects of the steel strike.

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The possibilities of remedial action we outlined to you are as follows:-

	<u>Approximate benefit</u>
Defer payments to the NCB	£50M
Defer payments to oil companies	£25M
Defer payments to CEGB plant and other suppliers	£25M
Area Board action to defer payments and increase income	£20M
Reduction in "cash in transit" through the banks	£30M
	<hr/>
	£150M
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I have to emphasise that the first three items and part of the fourth will defer payments from 1979/80 to 1980/81 and will thus worsen the EFL position next year. In addition, all the figures are at this stage broad indications of the possible benefits and may need to be varied when we have completed the detailed examination of what is involved.

Although the question of running down oil stocks was raised, this would give rise to problems especially as some stations are fuelled directly by pipeline and one could not precipitately upset refinery balances.

You emphasised that you did not wish us to take any action on these possibilities, except as regards cash in transit, until you and your colleagues have had an opportunity to consider the implications. I hope that the following comments will help you in this.

CEGB Actions

We consider that it is essential that we discuss the possibility of deferring payments with the suppliers concerned. This will be almost entirely a task for the CEGB, who will have the following points very much in mind:

- (i) The scope for deferring payments to the NCB demands very much on their EFL position. We know that they understand our problem and will do their best to help.
- (ii) Any actions with the oil companies must not disturb the good relations the CEGB has with them. In the EFL context, we are talking about payments for supplies up to the end of February as the March supplies will not be paid for until April. The oil companies may be prepared to have payments for February supplies deferred until next year, but there will no doubt be a price to be paid. This may be in terms of an interest charge or they may require February supplies to be paid for at the oil prices ruling when the payments are made. There are a number of oil companies involved but the most important one is ESSO. It is therefore particularly important in an international context that any arrangements made are with their full agreement.

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- (iii) Plant and other suppliers. Steps would need to be taken to discuss the position with certain contractors and other suppliers with a view to deferring payments until 1980/81, having regard to contractual terms and conditions. Again some cost could be involved.

Area Board Actions

The Area Boards could take actions on the following lines:-

- (i) Defer payments to their suppliers of distribution plant and equipment. It will be important that these deferrals are also negotiated with their suppliers.
- (ii) Attempt to negotiate with large electricity consumers earlier than normal payment of February and, possibly, March bills. This might be done on the basis that in return the consumers will be able to pay late some bills arising early next financial year, in which case this would only affect the timing of the cash flow, but it is possible that these consumers might require a financial incentive to pay earlier their bills for the remaining months of this financial year.
- (iii) Try to speed up payment of bills by consumers in general. This is a particular problem in the London Board where for some years the ratio of outstanding debt has been very much higher than for other Area Boards. The London Board has been trying hard this year to improve the position by generally tightening up on debt collection procedures. These efforts have not so far been particularly successful, partly no doubt because of the difficult economic climate. The Board intend to press this issue hard in the coming months. The reason for mentioning this particular problem is that the Board's actions will be directed, inter alia, at central and local government debtors and could also result in more complaints by MP's who find that their constituents are being pressed harder to pay.
- (iv) Look again at Boards' charges for miscellaneous services although the cash benefits this year would be small.
- (v) Run down stocks of distribution equipment and domestic appliances and, where appropriate, to arrange "cash only" sales of appliances during March. These actions may lead to short time working by manufacturers.

The possibility of a reduction in "cash in transit" through the banking system arises because at the end of last year there was a total of £63M in cheques passing through the system which could not be included in our cash balances at 31st March. We are investigating the special arrangements that could be made to get earlier clearance of a proportion of these cheques and the figure of a £30M reduction in the EFL in this respect is very much a first estimate of what we might be able to achieve.

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Other Matters

Mr. Biffen raised the question of the desirability of reintroducing fuel cost adjustment in quarterly tariffs as a way of covering the uncertainties of fuel cost estimates. We have considered this, but it should be appreciated that while this helps the profit and loss account it does not overcome the EFL position in this respect because of unbilled revenue at the end of the year. Nor would it cover departures from assumptions in other key respects and we feel that it is preferable to review the whole financial situation and increase tariffs as necessary in the light of the EFL position. There is a further public relations aspect. As you know, we withdrew quarterly f.c.a. at the urging of consumer bodies, the Price Commission, the Select Committee, etc., and we feel that it would be difficult to reintroduce it.

Arising from our meeting, there are three further topics which we will arrange to discuss with you as soon as possible:

- (i) What is meant by an external financing limit. We have hitherto provided you with best mid-point estimates of the outturn, emphasising that there are substantial uncertainties for a large trading organisation. If you consider that "limit" means a figure which we must keep within unless really exceptional circumstances arise, then clearly we will need to build in contingencies in our planning and this will require that electricity tariffs be higher to reflect these contingencies.
- (ii) Fuel stocking policy for 1980/81. Glyn England mentioned that he is urgently reviewing this and you emphasised that you wished to be fully consulted.
- (iii) Financial prospects for 1980/81. We indicated that our latest estimates of fuel and other costs for next year suggested that it would be desirable to keep open in our minds the level and timing of the Autumn tariff increases; increases of only 5 per cent in October might not generate sufficient cash to enable us to keep within the EFL.

Your sincerely,
Frank.

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24 JAN 1980

