



AD
JL

①

Prime Minister

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

Do you wish

CPRS to take this
on (it would,

presumably, set back
their existing programme?)

PLS 15/2

PRIME MINISTER

The CPRS has
enough to do at present.
Other departments have fact
more people.
Energy/industry
can do it.
not

REVIEW OF ELECTRICITY PRICES

Your Private Secretary's letter of 8 February to mine recorded your wish to be kept in touch with the conclusions of my meeting on 10 February on electricity pricing policy and its industrial implications. I attach the minutes of the discussion.

2. It was clear from the NEDC Working Party Report on energy prices that certain heavy users of industrial electricity do get more favourable prices in continental countries and North America than they do here. This is not just a temporary situation, and its continuance would seriously weaken the competitive position of hitherto important parts of British industry. There are many reasons for this: natural endowment abroad, cost inefficiencies here, different pricing policies and perhaps foreign subsidies. Our present system of prices is aimed at neutrality between industrial and domestic users; whereas in many other countries there is a bias in favour of industry and especially certain heavy users.

3. I concluded, therefore, that we ought now to take a deeper and longer-term look at policy on electricity prices in all its aspects. There are of course conflicting policy considerations here - energy pricing policy, industrial policy and public expenditure policy and the review would need to be a fundamental one.

4. As you will see from the minutes, at the meeting on 10 February, all were agreed that a review of the kind I have suggested should



go ahead urgently. The issues involved are already to a large extent under active consideration within the Department of Energy and Nigel Lawson would be content for his Department to lead the study, which would of course be an interdepartmental one involving the CPRS.

5. My own strong preference, which you will see received support at the meeting, would be for the study to be led by the CPRS. This is partly because the issues involved go beyond energy policy to include important and long-term questions of industrial policy; and partly because I feel a more independent and fresh approach to the problem is needed than the Department of Energy is likely to offer. Those who live and breathe problems are not always best placed to take a long hard look at them, however expert they may be.

6. I also feel that because it does straddle the interests of several Departments, and because of its fundamental nature, this review would be well suited to CPRS treatment. The CPRS would of course be involved even if the review were to be led by the Department of Energy, but Robin Ibbs has said that while he would welcome the task, he could not take on the leading role in the study given his other commitments for 1982. If he were to take on this review as well it would require some adjustment to the priorities in the programme.

7. I feel the case for the CPRS taking the lead in the review of electricity prices is sufficiently important to justify such an adjustment to the programme. The aim would be to complete the study by early to mid autumn.

Peter Jenkins

for G.H. (Approved by the Chancellor of the Exchequer and signed in his absence).

12 February 1982



NOTE OF A MEETING HELD AT 11, DOWNING STREET ON WEDNESDAY, 10 FEBRUARY

Present:

Chancellor of the Exchequer	Secretary of State for Industry
Chief Secretary	Mr. Owen - Dept. of Industry
Mr. Rylie	Secretary of State for Energy
Mr. Wicks	Mr. D. le B. Jones) Dept. of
Mr. Chivers	Mr. Morphet) Industry
Mr. Ridley	
	Secretary of State for Scotland
Mr. Ibbs - CPRS	Mr. Harrison - Scottish Office

The meeting had before it a letter dated 14 January and 8 February from the Secretary of State for Industry to the Chancellor about the possible widening of the application of the coal-fired boiler scheme and the Chancellor's reply of 5 February; a letter dated 25 January from the Chancellor to the Secretary of State for Energy about electricity prices, and Mr. Lawson's reply dated 29 January; and a letter dated 1 February from the Secretary of State for Energy to the Chancellor dated 1 February, and the Chancellor's reply dated 5 February; and a letter dated 1 February from the Secretary of State for Energy to the Chancellor on energy conservation and possible assistance for large electricity users.

1. Coal fired boiler scheme

2. The Secretary of State for Industry said that having seen the Chancellor's response to his proposal for an extension of the scheme to include conversions from gas to coal, he had asked for this question to be included on the agenda as he still regarded the extension as important for the success of the scheme. So far the take-up had been disappointing; and it seemed likely that on the present basis there would be a significant shortfall from the £50 million allocation, perhaps by as much as one-third. His main proposal was to extend the scheme to cover gas to coal as well as oil to coal conversion, for which there was considerable pressure. Gas should logically be regarded as an expensive premium fuel when used for boilers, rather than in cases where instant heat was needed.



Extension would help with the problem of the NCB's coal stocks, and it was neutral from the point of view of the PSBR.

3. The Chancellor, summing up a short discussion on this point, said it was agreed that the extensions proposed by Mr. Jenkin should go ahead, subject of course to the scheme remaining within the £50 million total allocation for it. A suitable sentence might be included dealing with this point in the Budget speech.

2. Review of electricity prices

3. The Chancellor, referring to his letter of 25 January, said that he had come to the conclusion that there should be a fundamental look at electricity pricing policy. His letter suggested some of the questions which might be studied. He understood that the CPRS would wish to be involved in and help with the study as far as they were able, but that their work programme had recently been settled by the Prime Minister for the year ahead, and they would not therefore have the resources to lead the study.

4. The Secretary of State for Energy said that his Department already had the issues raised by the Chancellor very much on board, but he had no objection to having an interdepartmental study if that was felt desirable. It could be led either by his Department, which in some ways seemed most appropriate, or by the CPRS. He considered the main thrust of the study should be to consider how the generation of electricity in the United Kingdom could be made more competitive.

5. In discussion there was general agreement that a fundamental study of electricity prices as proposed by the Chancellor should go ahead. It would need to consider not only how to make the industry more competitive, but the industrial and economic consequences of different pricing policies. For example an important question to consider was how far the extra cost of lower electricity prices for industry would be offset by the possibility of saving part of the industrial base. The review would also need to consider the relationship between industrial and domestic prices, and what the reaction should be to lower energy prices in other countries. It was agreed that the precise terms of reference for the review should



be agreed by officials of the Departments concerned.

6. On timing, it was suggested that there was strong arguments for seeking to complete the review by the early autumn. But thoroughness should not be sacrificed for speed.

7. The Chancellor, summing up this part of the discussion, said it had been agreed that the fundamental review of electricity prices proposed in his letter of 25 February should now go ahead on the basis of terms of reference agreed between the Departments concerned. It had also been agreed that outside consultants should be involved in the study. On the question of who should lead the review, his preference, which had received some support, would be for it to be carried out by the CPRS, and he proposed to consult the Prime Minister to see whether she would be prepared to agree to a change in the priorities in their work programme to make this possible.

3. Electricity prices: energy package for the Budget

8. Referring to his letter of 29 January, the Secretary of State for Energy said that following discussions with the electricity supply industry, he had concluded in favour of proposals for significantly increased assistance to high load factor consumers at a maximum EFL cost in 1982-83 of £87 million. This broke down between £71 million for the introduction of new load management terms, and £16 million for the retention of the flexible arrangements introduced last year.

9. The Secretary of State for Industry said he agreed very much with these proposals, which looked of considerable value to some of the more vociferous complainants, in particular the steel-makers. There were bound to be some who fell the wrong side of any side which was drawn, and until there had been consultation with all the industrial users it was difficult to predict with certainty which sectors would be helped by the scheme, and which would be left unsatisfied.



10. In discussion there was general agreement with the Secretary of State for Energy's proposals. The Secretary of State for Scotland suggested that the problem of those at the margin who might not benefit from the concessions should be paid special attention, as they were bound to feel aggrieved. To some extent there would be distortion of competition in some sectors, and any means of alleviating the position of those who were the wrong side of the borderline should be considered. The £87 EFL cost, did not include any figure for Scotland; the pro-rata increase for Scotland would be £10 million, and he was therefore seeking this.

11. The Chancellor, summing up this part of the discussion, said there was general agreement with the Secretary of State for Energy's proposal for increased assistance to high load factor consumers at a maximum EFL cost in 1982-83 of £87 million for England and Wales, and £10 million for Scotland. The concession would be announced in the Budget speech; and given the poor publicity which last year's measures had received, everything possible should be done to give the proposals the maximum effective publicity.

4. Energy conservation: assistance for large electricity users

12. Referring to his letter of 1 February, the Secretary of State for Energy said that he was proposing a scheme to promote investment in projects which would save large amounts of energy at a cost of £50 million committed over 1982-83 and the three succeeding years. The scheme would be concentrated on the same type of consumers as were being assisted through the electricity price measures, and the projects concerned would be those which saved at least 4,000 tons equivalent a year. He felt it was important to tackle the problem of heavy electricity users through the route of energy efficiency as well as price, because of the constraints which UK law and Community law placed in the way of what could be achieved through the price route alone. The scheme would cost only £3 million in 1982-83, and £14½ million in 1983-84.



13. The Secretary of State for Industry said he strongly supported the proposal. When he had seen the paper and board EDC their real complaint had been that energy conservation was desperately needed, but could not be afforded by the industry because of its cash flow problems. Our competitors abroad were developing schemes of this kind, and those who were not going to benefit from the load management concessions, would press very hard if nothing else was done.

14. In discussion, it was pointed out that the scheme would give rise to difficult borderline problems, as was the case with all forms of selective assistance. The scheme was different in kind from one which sought to adjust tariffs, because it was intended to encourage particular investment. Arguably if a firm was able to show a properly audited report to its bank to the effect that real savings could be gained through investment in energy conservation, it was difficult to see why the money could not be borrowed.

15. Against this, it was pointed out that many of the firms concerned would in present circumstances regard it as imprudent to move to the edge of their overdraft limit even for an attractive project; and others would not be able to pay the interest on more debt.

16. The Chancellor, summing up, said the Treasury did not feel able to agree to the Secretary of State for Energy's proposal for support for new investment in manufacturing industry on large scale energy conservation projects. The proposal should be examined further between the Secretary of State and the Chief Secretary before a final decision was taken. An important question would be how far it would prove possible to draw a satisfactory ring-fence round the scheme so as not to give rise to other claims.

5. Electricity prices and the review of the BST

17. Referring to his letter of 29 January on this subject, the Secretary of State for Energy said that he had noted the objections set out in the Chancellor's letter of 5 February to his proposal to appoint consultants to assist the Department in its consideration of



the BST review. He himself did not regard the review as a satisfactory document, and was convinced it needed probing in depth. But he felt it was far better to use outside consultants with precise terms of reference, rather than risk an examination by a revamped NEDC taskforce, as Mr. Utiger had suggested at the last Council. The question was bound to be raised at the March Council.

18. In discussion it was suggested that the main difficulty with the proposal to appoint consultants to assist the Department in considering the review was not so much the principle involved, as the fact that it would be made public. This would make it difficult to maintain the confidentiality of the consultants' report, and if this was adverse or embarrassing to the Government it could strengthen the demands of the energy lobby for more expensive price concessions. It should be possible at the March Council to head off any suggestion for a re-constituted taskforce to look at the review, by stressing that the issues involved were difficult and complicated issues of policy not of fact. But comments and reactions to the BST review should be welcomed.

19. The Chancellor, summing up this part of the discussion, said that it was agreed that while there was no objection to the appointment of consultants to assist the Department of Energy in its consideration of the BST review, this should be on a private basis, and not given an publicity.

20. It was noted that an interdepartmental report would be made shortly on the question of heavy fuel oil duty and its relationship to the Frigg contract.

Circulation:

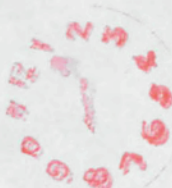
Those present
Financial Secretary
Minister of State (C)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr. Quinlan
Mr. Battishill
Mr. Burgner
Mr. Wood
Mr. Ridley
Mr. French
Mr. Harris

P.S.
P.S. JENKINS

10 February 1982

CONFIDENTIAL

12 FEB 1982



Not final
Gas/Electricity

FILE

dl



Not final
be August

10 DOWNING STREET

From the Private Secretary

16 February 1982

Review of Electricity Prices

The Prime Minister read with interest the Chancellor's minute of 12 February, with which were enclosed minutes of the Chancellor's meeting on 10 February.

The Prime Minister believes that the CPRS has enough to do at present, and wishes to avoid a re-arrangement of their programme of work. She accordingly would prefer this proposed study on electricity prices to be led by the Department of Energy or by the Department of Industry.

M. C. SCHOLAR

Peter Jenkins, Esq.,
HM Treasury.

B

CONFIDENTIAL



①

10 DOWNING STREET

Prime Minister

You said you thought Tsy/
Energy and not CPRS should
do this study; but I'm not
sure that you had as long as
you wanted to glance through.

MCS 15/2

Nat Ind
Geoff Howe

CONFIDENTIAL

Prime Minister (2)

cc. AD

JU17

pus 9/2

JV.



DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

8 February 1982

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Thames House South
Millbank
London SW1

Dear Nigel,

ELECTRICITY PRICES AND THE REVIEW OF THE BST

Thank you for copying to me your letters of 29 January and 1 February to Geoffrey Howe.

2 Your proposals for improved load management terms to large industrial electricity consumers look encouraging and I very much hope that room can be found in the Budget to accommodate them. In view of the findings of the Task Force report and the expectations centred on the BST review, industry would be very disappointed to receive anything less generous than what is proposed.

3 I would have preferred it if these terms had been developed in fuller consultation with potential users. Discussions between the area Boards and their major customers are still in progress and the firms which stand to benefit will still be assessing the costs of meeting the requirements of the contracted load terms. However, the terms seem to me to be considerably more attractive than those of Category C, particularly in respect of prior notification, the limitations on the total hours involved and the provision of a minimum supply during load managed period.

4 One feature which may cause difficulties is the requirements on firms to commit themselves to load restrictions for as long as three years. I would urge that you press the Electricity Council to consider either annual contracts or provisions for annual revisions; companies which anticipate variations in their levels of activity or substantial reorganisation of their operations may feel inhibited from taking advantage of the new arrangements. I would also suggest that in view of the rather compressed consultations, the contracted load terms should be refined further for adoption in 1983/84 and that this should also form part of the Consultants' study.

CONFIDENTIAL



top
be. liquid

10 DOWNING STREET

From the Private Secretary

8 February 1982

ELECTRICITY PRICES AND THE REVIEW
OF THE BULK SUPPLY TARIFF

The Prime Minister has seen a copy of the Chancellor's letter of 5 February to the Secretary of State for Energy, commenting on two recent letters from Mr. Lawson.

The Prime Minister has asked to be kept in touch with the conclusions of the meeting which the Chancellor proposes to hold on electricity pricing policy and its industrial implications.

I am sending copies of this letter to Jonathan Spencer (Department of Industry), Muir Russell (Scottish Office), John Craig (Welsh Office), David Wright (Cabinet Office) and Gerry Spence (CPRS).

M. C. SCHOLAR

John Kerr, Esq.,
HM Treasury.

6

CONFIDENTIAL

ce JV
LAD



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

5 February 1982 Prime Minister

The Rt. Hon. Nigel Lawson, M.P.,
Secretary of State for Energy

Shall I ask

that you be kept in
touch with the

outcome of the Chancellors
meeting at X?

Yes please

not

Dear Secretary of State,

ELECTRICITY PRICES AND THE REVIEW OF THE BULK SUPPLY TARIFF

MUS 5/2

Thank you for your letters of 29 January, in which you propose a new load management scheme, and 1 February in which you suggest that consultants should be appointed to assist the Department in its assessment of the BST Review.

The load management scheme described in your letter certainly seems to have some attractions. From what you say, it appears to avoid the problems which bedevilled the scheme considered in the follow up to the MISC 56 work and the benefits seem to be directed to the high load factor consumers which the NEDC Task Force identified as disadvantaged compared to some of their Continental competitors. But the scheme has a significant cost - put in your letter at a maximum of £87m - and I would need to consider how this should be financed. Before taking final decisions here, I wonder if we first should see the outcome of the Prime Minister's meeting next Monday at which I understand that we may have to consider proposals with considerable public expenditure consequences. We could then meet quickly both to discuss the load management proposals and the longer term study which I suggested in my letter of 25 January. My office will be in touch with yours to arrange a meeting.

It will be no surprise to you if I say that if the new load management scheme is to proceed, I would want to refer to it in the Budget Statement, perhaps with your Department or the Electricity Council giving the details later that day. I hope that the timetable described in the last but one paragraph of your letter would not prevent this. I suggest that if we do accept the load management proposals, you could tell the CEGB that while they can pass the generality of their BST proposals to the Area Boards, the Government do not want to give a final decision on the new load management scheme until nearer the Budget so that if it is agreed, it can be announced on Budget Day. Meanwhile the Generating Board could enter into contingent discussions with the Area Boards with a view to announcement then. We could emphasise to the Electricity Council and the CEGB that we attach great importance to full publicity for the new proposals on Budget Day, if they are agreed, so that maximum

/presentational



presentational advantage is gained from them. You will recall that the £43m relaxation in the industry's EFL, announced in the 1981 Budget, did not secure as much early credit as it might have done because of inadequate publicity on Budget Day. It would be helpful if you could confirm that the load management proposals could be handled in this way when we meet to discuss this scheme and the longer term study.

It would also be helpful if George Younger could let me know whether the Scottish Boards would wish to make similar arrangements for their customers, and if so, at what cost.

Your proposal to appoint consultants to assist the Department in its consideration of the BST Review causes me some difficulty. My understanding is that the purpose would be to largely demonstrate to industry that the Department is examining all the options and not meekly accepting the electricity supply industry's views in what is hardly a convincing report. There are two obvious risks in this course:

(i) Your approach apparently assumes that the consultants' report would confirm the BST Review's conclusions, subject perhaps to marginal glosses. But the suggested terms of reference are wide and the report could conclude that the philosophy/accountancy/economics underlying the BST are wrong and recommend fundamental change. The industry's £7bn turnover means that even marginal changes in tariff policy could have large public expenditure consequences.

Of course, in those circumstances we could try to maintain the confidentiality of the consultant's report. But this would be virtually impossible if, as you propose, you had given it advance publicity in Parliament. We could also reject its findings. But the report's conclusions, if embarrassing to us, would have made certain sections of British industry even more pressing in their demands for expensive price concessions, which are not allowed for in the public expenditure plans.

(ii) The relationship between the consultants' work and the new load management scheme would look odd. If it is agreed, the £87m scheme would be announced on Budget Day before we, let alone industry generally, could have studied the consultants' report, even if it was ready before then. Industry would therefore tend to discount the £87m scheme when it is announced in the expectation that there might be something more to come when the consultants had produced their report and Ministers given their views on the BST Review in the light of the consultants' advice.

/Of course,



Of course, I recognise the pressure which your Department is under on energy prices generally. But I wonder whether it is essential to go as far as you suggest during Energy Questions on 8 February. You could simply repeat that the Government has received the report, is paying particular attention to the new load management scheme suggested in it (but without saying that it is going to be accepted) and would welcome representations from industry on the Review. This approach would not tie us to appointing consultants, which we might consider again after the Budget if industry's reception of the £87m scheme is disappointing and in the light of representations received from industry. It is relevant here, I think, that the CBI in their Budget representations were seeking only £70m relief on energy prices so that there is a good chance that the £87m scheme, if it is agreed, would meet most of the legitimate criticism without tying ourselves to the hostage of a consultants' report.

X | For these reasons I could not agree to your announcing the appointment of consultants at next Energy Questions; but I should like an opportunity to discuss the whole question of electricity pricing policy and its industrial implications with you and Patrick Jenkin and George Younger, including the suggestions I made in my letter of 25 January. I shall arrange a meeting shortly.

I am sending a copy of this letter to the Prime Minister, Patrick Jenkin, George Younger and Nicholas Edwards as well as to Sir Robert Armstrong and Robin Ibbs.

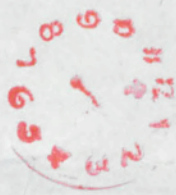
Yours sincerely,

Jim Rubin

PPGEOFFREY HOWE

Seen and approved by the
Chancellor and signed in
his absence

- 5 FEB 1942



100



With the Compliments of

ROBIN IBBS

CENTRAL POLICY REVIEW
STAFF

Cabinet Office
Whitehall London
SW1A 2AS

Telephone 01- **233** 7765



CABINET OFFICE
Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

✓ EC AD
JV
Prime Minister

(2)

MS 5/2

Qa 05818

From: J. R. Ibbs

CONFIDENTIAL

5 February 1982

Dear Secretary of State,

Electricity Prices and the Review of the BST

Thank you for sending me copies of your letters to the Chancellor dated 29 January on Electricity Prices, and 1 February on the Review of the Bulk Supply Tariff. I have also seen the Chancellor's letter to you of 25 January on Electricity Prices.

The new load management terms proposed by the electricity industry do seem to offer a genuine way through the many constraints involved in providing assistance to high load factor consumers and will result in some alleviation of the price disparities they suffer. I would therefore support you in the view that the only practical course is to accept the industry's proposals.

From your letter of 1 February I assume that the purpose of engaging consultants would be to obtain an outside opinion on the view put forward by the industry in their review of the Bulk Supply Tariff. However, if consultants were to recommend some radically different pricing mechanism such as one based on short-run marginal costs as some consumers advocate, this could be embarrassing even though you would be free to reject the advice. I therefore would like to underline the importance of giving guidance to the consultants, as stated in your letter, on the financial constraints within which the industry needs to work.

Like the Chancellor I am concerned that the problem of electricity prices to large users is a fundamental one. I have some doubts whether it can be resolved completely within the existing confines of the BST which to a degree are imposed by legislation - e.g. the need to avoid

The Rt Hon Nigel Lawson MP
Department of Energy
THAMES HOUSE SOUTH
S W 1

CONFIDENTIAL

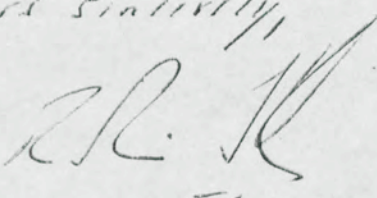
discrimination. The underlying questions seem to me to be two-fold and go considerably wider than a review of the tariff structure could be expected to cover:

(i) What are the implications of the present price structure for energy-intensive industries in the UK? Are there any such industries that it would be a mistake to lose from the economy?

(ii) What are the long-term prospects for energy prices in the UK and what must be done to ensure that Britain's future electricity prices are competitive with those in other countries? What in the short-term is the electricity price structure necessary to keep any industries identified in (i) in business in Britain? How do we bridge the gap, meeting the short-term needs while moving towards the longer term goal?

These are fundamental questions of policy on which it would not be appropriate to ask consultants to advise. I would therefore support the Chancellor's suggestion that there should be a study within Whitehall of this area.

I am sending a copy of this letter to the Prime Minister, the Chancellor of the Exchequer, the Secretaries of State for Industry, Scotland and Wales, and to Sir Robert Armstrong.

yours sincerely,


J R Ibbs

See Mr. Elton

✓ AD
JV
Prime Minister (2)

UNITED KINGDOM OF GREAT BRITAIN
BY AIR MAIL
POST OFFICE

Ms 2/2

01 211 6402

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
London
SW1

MA

| February 1982

Dear Chancellor

REVIEW OF THE BST

In my letter of 29 January I set out proposals to assist large industrial users of electricity through development of load management arrangements, as put forward by the CEGB. These proposals were in fact first set out in outline in the Electricity Council's review of the BST which I received early this month.

Copies of the review are now being made available on request by the Electricity Council and I have already been asked questions about my response. This subject is certain to arise during Energy Questions on February 8, and it will be essential for me to be able to give a clear indication of how the Government intends to handle the review.

In my letter of 8 January to you I suggested that the best way to emphasise that the Government were considering this report both comprehensively and objectively would be to appoint consultants to advise us. I do not think it either possible or desirable for us to exclude consideration of outside representations in coming to conclusions about the review; I believe that a consultants' study would make this easier to handle. I would propose to tell the CBI that the Department and the consultants would welcome any representations they wish to make. We would of course be free at the end of the study to reject the advice of the consultants and indeed I envisage the study as assisting my Department in its assessment of the review rather than having a completely free-standing status. This is made clear in the draft terms of reference, of which I attach a copy, and which I would propose to make public. My Department would also, of course, give more detailed guidance to the consultants, and in particular draw their attention to the statutory and financial constraints within which the industry works.

I would be grateful for your agreement to this in time for me to announce how we intend to handle the BST review on 8 February.

I am sending a copy of this letter to the Prime Minister, Patrick Jenkin,
George Younger, Nicholas Edwards, Sir Robert Armstrong and Robin Ibbs.

Yours sincerely

David Humley

PP NIGEL LAWSON
(Approved by the Secretary of State
and signed in his absence)

BST REVIEW CONSULTANCY

TERMS OF REFERENCE

1. To assist the Department in its assessment of the BST Review and in particular to advise on whether the conclusions of the Review are derived from a satisfactory analysis of the industry's costs and operations, and of alternative pricing structures.

2. Consultants will be free to seek information from the Electricity Council. They should also have regard to representations made by outside bodies to the Electricity Council and to the Department in connection with this study.

E1 FEB 1982



CONFIDENTIAL

Prime Minister

2

cd AD
JV

MUS 29/1

01 211 6402

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

29 January 1982

Dear Chancellor

M

ELECTRICITY PRICES

In my letter of earlier today I said that I considered development of our assistance to large industrial consumers of electricity to be the most significant energy item which might figure in this year's Budget. Following discussions with the electricity supply industry, this letter sets out proposals, at a maximum EFL cost in 1982/83 of £87m, for significantly increased assistance to high load factor consumers.

These measures are also intended to meet the remit of last August from the MISC 56 group to bring forward firm proposals for the introduction of a general scheme of assistance to certain users of industrial electricity. The proposals for 1982/83 are of course without prejudice to the longer term review you refer to in your letter of 25 January, on which we will be meeting in due course. I will also be writing to you very shortly on the handling of the Review of the Bulk Supply Tariff, on which we need urgently to establish our public position.

You will recall that last year a relaxation in the 1981/82 EFL was granted to the industry for the introduction of a new load management Category 'C' and flexibility measures to benefit a relatively small number of large electricity users. Although customers who were able to take advantage of these facilities gained benefits on average of a 5% reduction in prices, and in some cases as much as 10%, the scheme met with some criticism on grounds that some heavy users were not able to meet the conditions, and for others the cost of meeting the conditions almost eliminated the benefits.

In the BST review, submitted to me at the beginning of this month by the Electricity Council, a development of the load management approach was proposed which it was hoped would prove more attractive. The CEGB have incorporated this new load management proposal - known as contracted load - in their 1982/83 proposals.

The Electricity Council and the Area Electricity Boards have assessed, with the help of discussions with some customers who might be able to take advantage of these proposals, what the take-up and likely benefit of the contracted load terms would be. They estimate that over 100 customers would benefit as compared with 50 under this year's Category 'C'. About half of these would be customers switching from Category 'C' to contracted load. The other half would comprise customers who are not currently taking advantage of Category 'C' terms. For the first group, the average benefit in terms of overall price reduction might be about 5% - 10% in addition to the 5% average reduction which Category 'C' has given them this year; for the second group the reductions might be in the range of 10 to 16%. In some cases, this could mean an actual reduction of as much as 5% in prices as compared with present levels. These price benefits should be set against the expected rise in the general level of electricity prices in April in line with or slightly below inflation. The bulk supply tariff proposals contain other minor changes to the structure of tariffs, some of which should have the effect of reducing prices to high load factor consumers by about 1%.

Of the total benefits arising from contracted load terms, about a third would accrue to firms in the chemical industry and a third to firms in the iron and steel industry. In both these groups, the benefits could amount on average to nearly £1m per customer over the year. The majority of firms who we would expect to benefit would be in those categories which the NEDO Report last year indicated as suffering energy price disadvantages as compared with foreign, and particularly European competitors.

The industry also wish to retain the new flexibility introduced last year in the application of tariffs to important industrial customers, mostly in the high load factor category. To withdraw these arrangements in 1982/83 would produce additional price increases which could significantly reduce the value of the new proposals as a whole by leaving some customers worse off.

The general level of prices in the BST has been set at a level which would be consistent with the industry achieving their financial target. If however, the EFL is relaxed in order to pay for the new load management category, the actual rate of return earned will be slightly reduced. The Board have in fact repeated their request, which we refused last year, for a reduction in their financial target on the grounds that they are very close indeed to exceeding long run marginal cost price levels. I do not propose to grant a reduction in the financial target, but if we can agree to the relaxation in next year's EFL, the consequential reduction in the return actually earned will go some way to meeting

the industry's request and should help to defuse any criticism that we are forcing prices above economically justifiable levels.

The industry have estimated that the introduction of the new load management terms would require a relaxation in 1982/83's EFL of £71m. The retention of the flexible arrangements introduced last year would cost £16m amounting to a total relaxation in the EFL of £87m. In making these estimates, the industry have drawn on their experience of the actual take-up and cost of the Category 'C' terms this year and discussions with customers on the new contracted load terms. I believe that the estimates are the best that can be made at this stage and constitute a reasonable basis for decision. This year we have introduced new load management Category 'C', and the "flexibility" arrangements. Clearly we must continue with both, and we have agreed that the possibility of doing more should be examined. Given the legal constraints, highlighted by the Attorney General's advice on 3rd December on the earlier possibility we considered, we have only limited room for manoeuvre. I believe the only practical possibility is to accept the industry's proposals for development of the load management scheme.

As a separate matter, I am urgently considering whether we can supplement our assistance to industry in this area by a scheme to promote investment in projects which would save large amounts of energy and would in practice be largely concentrated on the same types of consumers as we are assisting through the BST measures. In this connection I note that in Patrick Jenkin's letter of 26 January he has also identified energy conservation projects as deserving of further support. I will be writing to you on this in the next few days.

In order for electricity price increases to be introduced on 1 April, the CEGB will need to pass its BST proposals to the Area Boards very soon. At this stage, I am therefore seeking your agreement, and that of our colleagues, to a relaxation of £87m in the industry's 1982/83 EFL, and to a small consequential reduction in the rate of return which the industry may expect to achieve, to allow the introduction of the new contracted load terms and the continuation of this year's load management and flexibility arrangements.

I am copying this letter to the Prime Minister and to Patrick Jenkin, George Younger and Nicholas Edwards as well as Sir Robert Armstrong and Robin Ibbs.

Yours sincerely
David Lunley

11 NIGEL LAWSON

(Approved by the Secretary of State
and signed in his absence)

12 9 JAN 1982



✓cc AD
JV
Nairland

(2)

Prime Minister

MUS 8/1

01 211 6402

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

ms

8 January 1982

Dear Chancellor

INDUSTRIAL ENERGY PRICES: REVIEW OF THE BULK SUPPLY TARIFF

I have just received from the Electricity Council the final version of the review of the Bulk Supply Tariff which David Howell asked the Industry to undertake in July 1980. As expected, the review broadly endorses the Industry's pricing policies and offers only very modest further help to large users through structural changes to the BST itself. It does mention the question of assistance to some large industrial users of electricity through a new load management scheme for 1982-83 about which I hope shortly to be able to write, substantively, to you and our MISC 56 colleagues. Meanwhile, however, there is certain to be considerable interest in the review, and I intend to ask the Electricity Council to publish it or make it available on request. The review will not satisfy the major critics among the industry's larger customers, but it will be for the Council in the first instance to defend the review's conclusions. Pressure will of course come on the Government to declare its response. Not least in view of the proposals made by Mr Utiger at the November NEDC meeting, I believe it will be vital to emphasise the independence and impartiality of our response and I therefore propose to seek an outside view by appointing consultants to assist my Department in its assessment. Their study will take in representations made to the industry and to my Department by key industrial customers. It would be my intention that the consultants' assignment would be completed in a matter of weeks, subject to discussion with them. Your officials would of course be kept closely in touch.

I am copying this to the Prime Minister, Members of MISC 56, the Secretary of State for Northern Ireland and Sir Robert Armstrong.

Yours sincerely
David Hulley

NIGEL LAWSON
(approved by the Secretary of State and signed in his absence.)

8 JAN 1959

