

## SECRET AND PERSONAL

PRIME MINISTER

## ELECTRICITY PRIVATISATION

Following the September meeting at Chequers of the small Ministerial group (the record of the meeting is at Flag A), Mr. Parkinson now wants to report to you his conclusions on electricity privatisation before he carries them further forward. Peter Gregson, with the knowledge of Mr. Parkinson, described to me the broad lines of what he will be briefed to tell you.

Mr. Parkinson sees three conditions which need to be satisfied for a successful privatisation:

- (i) from the outset of privatisation there needs to be a 'second force' providing generating capacity. That is, there should be two generating companies from the outset. It is not enough to privatise the CEGB as a whole and rely on the subsequent growth of private generation to provide competition in generation.
- (ii) All private generators should have equal access to the grid. This is not compatible with CEGB ownership of the grid.
- (iii) Subject to achieving the changes at (i) and (ii), the chosen form of privatisation should minimise the changes in the structure of the industry.

The structure which best satisfies these conditions, in Mr. Parkinson's view is as follows:

- (i) the grid should be owned by the distribution companies which should have the statutory obligation to supply.
- (ii) There should be two generating companies formed

from the CEGB: Big GENCO, owning some 70-80 per cent of the CEGB's generating capacity and Small GENCO owning 20-30 per cent of the generating capacity. Small GENCO capacity would be entirely fossil-fuelled with all the nuclear capacity owned by the Big GENCO.

Why

- (iii) The 12 area boards would be floated as 12 separate distributing companies (though there could be a clever device for achieving this in one flotation). This flotation might raise some £10 billion.
- (iv) The grid would be split from the CEGB and owned by the 12 distribution companies.

Mr. Parkinson believes that there is a good chance of selling the distribution companies in this Parliament. There is a less certain chance of selling Big GENCO - it depends on how long Parliament would last. There was even less possibility of selling SMALL GENCO in this Parliament. The timetable might be as follows:

Sell distribution companies in the Spring, 1991  
 Big GENCO in November 1991  
 And Small GENCO in Spring 1992

Lord Marshall would like some features of this structure, for example:

- (i) keeping all the nuclear generating capacity in one company - the Big GENCO;
- (ii) maintaining the grid as an integral unit.

Lord Marshall will probably not argue that Mr. Parkinson's proposals are 'technically impossible'. But he will insist the costs of such an approach (higher electricity prices and lower security of supply) would outweigh the benefits. He is

almost certain to find the approach unacceptable and refuse to support it.

His preference would be to establish a company, broadly the existing CEGB, responsible for the bulk of generation and owning the grid. This generating company would have the statutory obligation to supply. Lord Marshall would try to introduce competition into the system by the privatised CEGB sub-contracting capacity to private contractors. To that extent he would be willing to sell off some 10 per cent of the CEGB's capacity to private generators, provided that there was some contractual arrangements whereby the private contractors undertook to sell their output back to the CEGB, and not direct to customers. He would want controls over this private generating capacity, taking decisions on new capacity and the degree of competition. He will insist that the CEGB remain owners and controllers of the grid. (Lord Marshall's views are further elaborated in Sir Robert Armstrong's minute at Flag B and my letter at Flag C.)

Mr. Parkinson may refer to what he understands to be the Chancellor's preferred approach. Mr. Lawson would prefer splitting the CEGB into four or five separate generating companies, with the nuclear stations grouped in one company. This would have the advantage of introducing greater competition into generation and so requiring a less stringent regulatory regime. Its difficulties are that it would greatly disrupt the existing structure of the industry (eg. requiring recruitment of new management for each of the five companies). This would delay privatisation (perhaps by as much as five years). It would also reduce proceeds (because of the extra competition - which implies some monopoly pricing under Mr. Parkinson's preferred model - and because investors would believe that this multi-generation structure would introduce more uncertainty into the industry's prospects).

Mr. Parkinson will want to describe this to you in his own words and to discuss with you the handling of the next steps with colleagues and of discussions with Lord Marshall. He may

argue that the Government has, to some extent, lost the public initiative in the debate on electricity privatisation to the CEGB. This needs to be regained.

I suggest that you let Mr. Parkinson describe his thinking. You might then probe him on the following points:

- (i) the sticking point for the CEGB looks to be ownership and control of the grid. Is it essential that the CEGB should lose the grid?
- (ii) What would the CEGB board do if they were told they were to lose the grid? Resign en bloc? Does Mr. Parkinson have an alternative board in mind?
- (iii) What is the timing for discussions with Lord Marshall and with colleagues (small ministerial group, E(A) and then presumably Cabinet)?
- (iv) What are the consequences of the approach on electricity privatisation for the coal industry? (NB. in the short and medium term, savings in electricity prices are more likely to be introduced by prompting the CEGB to buy or threaten to buy coal from abroad, rather than by the most competitive form of privatised generating capacity.)
- (v) What would be the timetable for the steps in the privatisation process described by Mr. Parkinson?
- (vi) How would the privatisation of the Scottish electricity industry fit into Mr. Parkinson's proposals?

John Wybrew has produced the useful note at Flag D.

N.L.W.

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