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Prime Minister

ELECTRICITY PRIVATISATION

minutes with PG

At the last meeting of E(A) on Monday 22 February (E(A)88 3rd meeting), it was agreed that I should report to Cabinet my proposals for privatising the electricity industry in England and Wales.

If colleagues agree, I propose to make a statement and release a White Paper on Thursday 25 February. Copies of the draft statement and White Paper are attached.

I am copying this to members of the Cabinet and to the Paymaster General, the Chief Whip and Sir Robin Butler.

C.P.

Secretary of State for Energy

23rd February 1988

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DRAFT STATEMENT

With permission, Mr Speaker, I will make a statement about the future of the electricity supply industry in England and Wales.

In our manifesto, we promised to bring forward proposals to privatise the industry. Our purpose is to give the customer and the employees a better deal and a direct stake in the industry. I believe the industry will achieve more if it is moved into the private sector, freed from Government interference, and made accountable to its customers and shareholders, including its employees.

In framing my proposals, I have adopted six principles:

- Decisions about the supply of electricity should be driven by the needs of customers.
- Competition is the best guarantee of the customers' interests.
- Regulation should be designed to promote competition, oversee prices and protect the customers' interests in areas where natural monopoly will remain.
- Security and safety of supply must be maintained.
- Customers should be given new rights, not just safeguards.
- All who work in the industry should be offered a direct stake in their future, new career opportunities and the freedom to manage their commercial affairs without interference from Government.

Mr Speaker, there is substantial room for competition in the electricity industry. The distribution and transmission of

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electricity are largely natural monopolies, in which it would not be economic to duplicate resources. But there is no natural monopoly in electricity generation, which accounts for some three-quarters of the cost of electricity. Only if competition is introduced will there be real incentives for generators to build power stations efficiently, to have their stations available and to fuel and run them efficiently.

There are three conditions which must be met if competition in generation is to develop. First, the effective monopoly enjoyed by the Central Electricity Generating Board will have to be ended. It will not be sufficient to leave the CEGB in its dominant position and rely on the growth of competition from Scotland, France and private generators. Second, ownership and control of the National Grid will have to be transferred to the distribution side of the industry. However well regulated, the CEGB would have little incentive to allow competing generators fair access to a grid it owned and controlled. Private generating companies would have little incentive to enter the market and compete. Finally, the CEGB's obligation to provide bulk supplies of electricity will have to be ended, since it obliges the CEGB to take all the key decisions on power supply.

I therefore propose to introduce legislation at the earliest opportunity to provide powers to restructure and privatise the industry. These powers will be used to reorganise the CEGB into three new companies. The first will be a new generating company, owning some 30% of the CEGB's existing capacity, all of it non-nuclear. The second will comprise the remainder of the CEGB's generating capacity, both fossil-fuelled and nuclear. The third will be a national grid company, whose ownership will be transferred to the twelve existing Area Boards. The Area Boards will in turn be converted into twelve distribution companies, preserving their strong regional identity. The Government will consult the industry about the implications of privatisation for the employees and continuing functions of the Electricity Council, but the Council itself will be abolished when the new structure is put in place. Once they have been established, the shares in the twelve

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distribution companies and two generating companies will be sold to the public and employees.

Mr Speaker, in future the distribution companies will be able to look to private generators, Scotland, France, the two large generating companies or their own generation to meet demand. The new structure will introduce competition, which will be the best guarantee of the customer's interests. But the legislation will also provide safeguards and new rights. It will create new opportunities for employees.

First, it will establish regulatory arrangements to promote competition, to provide incentives for efficiency and to oversee electricity prices to the consumer.

Second, a number of measures will be taken to ensure the security of supply. Because there are no alternatives to electricity in many of its uses, security of supply is of great importance. The legislation will therefore place a clear obligation to supply on the twelve distribution companies, which will ensure that they contract for sufficient capacity. But security of supply is not simply a question of having sufficient capacity. Power has to be transmitted through the national grid, and the grid controllers have a central role in planning and directing the use of power stations so as to prevent the failure of the system and to minimise cost. Our proposals will ensure that the national grid company, owned by the distribution companies, retains this central role. The integrity of the grid and the operation of power stations in merit order will be preserved.

The other principal condition for maintaining secure supply is to ensure that electricity is generated from a diversity of fuels. It would be irresponsible to rely on fossil fuels to meet all our electricity generating requirements. The legislation will therefore provide for a clear obligation to be placed on the distribution companies to contract for a specified proportion of non-fossil-fuelled generating capacity.

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The legislation will also incorporate an Electricity Supply Code, consolidating and updating the legislation that currently governs the supply of electricity, dating back to the last century. Above all, we will maintain present standards of safety throughout the industry.

Finally, the legislation will establish new rights for the consumer. Even after privatisation, the local distribution companies will remain natural monopolies. Although their prices will be regulated, I do not believe this will be sufficient. The consumer will therefore be given the right to financial compensation if the distribution companies fail to provide a guaranteed level of service. They will also be required to provide a range of indicators of standards of service, which will be published.

Competition and the other measures I have described will benefit the consumer. But the employee will also benefit, and that is just as important. The new structure of the industry will provide wider career opportunities for employees, and there will be attractive provisions to ensure that they can acquire shares. Existing pension obligations will be safeguarded. The legislation will make no changes to the industry's negotiating and consultation machinery.

Because of the importance of these proposals, I am today publishing them in the form of a White Paper.

Mr Speaker, the electricity industry has much to be proud of, but I believe it can achieve more. My proposals will create a modern competitive industry, owned by the public and responsive to the needs of customers and employees. There are real benefits in prospect.

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Privatising Electricity

The Government's proposals for the
privatisation of the electricity supply industry
in England and Wales

*Presented to Parliament by the Secretary of State for Energy
by Command of Her Majesty
February 1988.*

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Privatising Electricity

"In framing my proposals for privatisation, I have adopted six principles:

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- Regulation should be designed to promote competition, oversee prices and protect the customers' interests in areas where natural monopoly will remain.
- Security and safety of supply must be maintained.
- Customers should be given new rights, not just safeguards.
- All who work in the industry should be offered a direct stake in their future, new career opportunities and the freedom to manage their commercial affairs without interference from Government."

Secretary of State for Energy
House of Commons, February 1988

Introduction

1. This White Paper sets out the Government's proposals for privatising the electricity supply industry in England and Wales. It explains the present structure of the industry, the reasons for privatisation, the reorganisation involved, the benefits, and the next steps to be taken.
2. The story of the electricity supply industry has been one of continuous evolution and change, ever since its beginnings in the late 19th century. In those early days, the industry consisted of many small private companies and municipal undertakings, largely meeting local needs for lighting, industrial motive power and public transport.
3. From the end of the First World War, the industry developed by pursuing the economic benefits of building larger power stations and sharing their capacity to meet demand. This required the construction of high voltage transmission lines to carry the output of power stations round the country. In the 1930s, a largely regional 132kV (kilovolt) transmission system was constructed and connected to form a "national grid". In the 1950s and 1960s, a truly national transmission system was built, operating at 275kV and 400kV; this became known as the "super-grid". As a result, the size and efficiency of power stations rose and their number fell. There are now 78 commissioned power stations, supplying some 230 TWh (Terawatt hour = 1000,000,000 kilowatt hours) of electricity a year through more than 390,000 miles of transmission and distribution lines to some 22 million customers.
4. Electricity is now of great importance to the economy. Last year, it accounted for some three-quarters of the UK coal market and about a third of the country's primary fuel consumption. Revenues from the industry amounted to almost 2% of our national income. The price and security of electricity supply are important to the competitiveness of industry.
5. The electricity industry has a record of technical and professional excellence, acknowledged throughout the world. Its greatest assets are the people who work in it. What hampers the industry is its structure and its position in the public sector.
6. Despite the attempt by the Energy Act 1983 to introduce more competition, the industry remains an effective monopoly in areas where this is unnecessary and harmful to the interests of customers. Because of the legislative framework in which it operates, the industry remains one in which the most important investment decisions are effectively taken by a monopoly supplier, with those who pay the bills having little influence. These decisions will become increasingly important in the years ahead since many of the industry's assets are approaching the end of their useful lives. A substantial new investment programme will be needed to replace old plant and meet growing demand.
7. The Government's proposals will end the effective monopoly in generation and give more influence to the distribution companies and their customers. Every part of the industry will become properly accountable to

its shareholders. The Government is determined to make electricity a better industry, by introducing competition and new customer rights, and by building on its existing strengths. Not just the industry, but the economy too, will benefit.

8. The reorganisation proposed in this White Paper will be carefully managed. The Government will work closely with the industry to ensure that the interests of customers and employees are at all times safeguarded.

The industry as it is now

9. In terms of organisation, the electricity supply industry in England and Wales comprises:

- * The Central Electricity Generating Board (CEGB) which supplies some 95% of power requirements from its power stations and owns and operates the "super-grid" transmission system, including the links with France and Scotland; the CEGB also specifies the performance requirements of new power stations, determines their design and supervises their construction; it has a statutory obligation to provide bulk supplies of electricity for the Area Boards.

- * Twelve statutory independent Area Boards, each responsible for the distribution of electricity from the high voltage grid to the final customer, through their 132kV and lower voltage distribution networks; the Boards have a statutory duty to plan and carry out the distribution of electricity to people who want it.

- * The Electricity Council, which is made up of the Chairman and two other members of the CEGB, the Chairmen of the Area Boards, and a small number of full-time members. The Council exercises a co-ordinating role on matters of industry-wide concern. It also has specific responsibilities for the central management of finance and taxation, industrial relations, R&D, national marketing and advice to Government.

10. Two key features of the present organisation will need to be retained in the privatised industry:

- * The regional nature of the Area Boards, responsible for the distribution of electricity to the final customer.

- * The National Grid and the benefits it provides.

The Area Boards

11. The market for electricity varies from area to area. For instance, 25% of sales by the South Eastern Electricity Board in 1986/87 were to industrial customers, whereas the figure for industrial sales by the Merseyside and North Wales Electricity Board was 53%. The costs of distribution also vary, depending on factors such as geography and the number and type of customers. There is a strong case for retaining independent regional distribution companies, to respond to local needs and prospects. It is important for both customers and employees that the companies responsible for distributing electricity should be concerned with particular areas and should develop a regional identity. There is also scope for competition by comparison.

The National Grid

12. There is also an overwhelming case for retaining the benefits of the National Grid, and the way in which the grid controllers plan and direct the use of power stations.

13. The management of the power supply system is complicated because electricity cannot be stored. The output of power stations and the demand on the system have to be matched at all times, otherwise the quality of supply will deteriorate and, in extreme cases, the system will fail. To ensure that secure supplies are maintained, National Grid Control continuously directs the use of power stations and the power flows in the transmission system. Within this constraint, it also plans and directs the use of those power stations available so as to minimise generation costs. It does this by calling up the cheapest stations first, operating stations in what is known as "merit order".

14. The operation of the power supply system need not be determined by its ownership. Whoever owns the grid in the new structure of the industry, the grid controllers will need to retain their central role in scheduling and directing the use of power stations so that:

- * Power is transmitted reliably to the distribution companies.
- * Demand at any moment is met from those power stations which offer the cheapest energy in much the same way that the present "merit order" operates.

Nothing in the Government's proposals will change this.

15. There are, however, some features of the present structure which are not in the interests of customers or employees. These are largely the result of the legislation that determines the structure, functions and duties of the industry.

16. This legislation:

- * Gives an effective monopoly in electricity generation to the CEGB. Subsequent legislation aimed at promoting competition has not been successful.
- * Gives the CEGB too much influence in power station investment decisions—which play a major part in determining prices—and too little say to the Area Boards whose customers have to meet the costs.
- * Allows the Government of the day to interfere unpredictably in the running of the industry. The industry's managers do not have the freedom to use their initiative enjoyed by managers in the private sector.

Monopoly

17. The CEGB has an effective monopoly of power generation. Its ownership of the National Grid gives it control of access to the market for bulk supplies of electricity. There are, in fact, no power stations built by private sector companies to supply regularly through the "super-grid", even though existing legislation was designed to encourage competition. There is no reason why there should not be competing power stations, supplying the Area Boards through the grid, and the Government believes it is not in the interests of customers to be supplied by a monopoly producer.

The obligation to supply

18. The CEGB has a statutory obligation to provide bulk supplies of electricity to the Area Boards. While this provision was intended to ensure security of supply, it has had some important consequences:

- * Because the CEGB has to be sure of generating enough electricity to meet its statutory obligation, the CEGB has to have the final say on the number and type of power stations needed.
- * Because it has to be sure of delivering electricity to meet its obligation, it has to own and control the grid, even though this discourages potential competition.
- * Because it has to meet its obligation, it naturally has to be able to recover the costs of doing so.

Although demand forecasts and power station investment plans are discussed and agreed in the Electricity Council, the CEGB's statutory obligation means that it has to have the final say and the Area Boards and the customers have to pick up the costs. Because of the industry's structure, power station investment decisions, which play a major part in determining electricity prices, are effectively taken by the producer and are not necessarily driven by the needs of the customer.

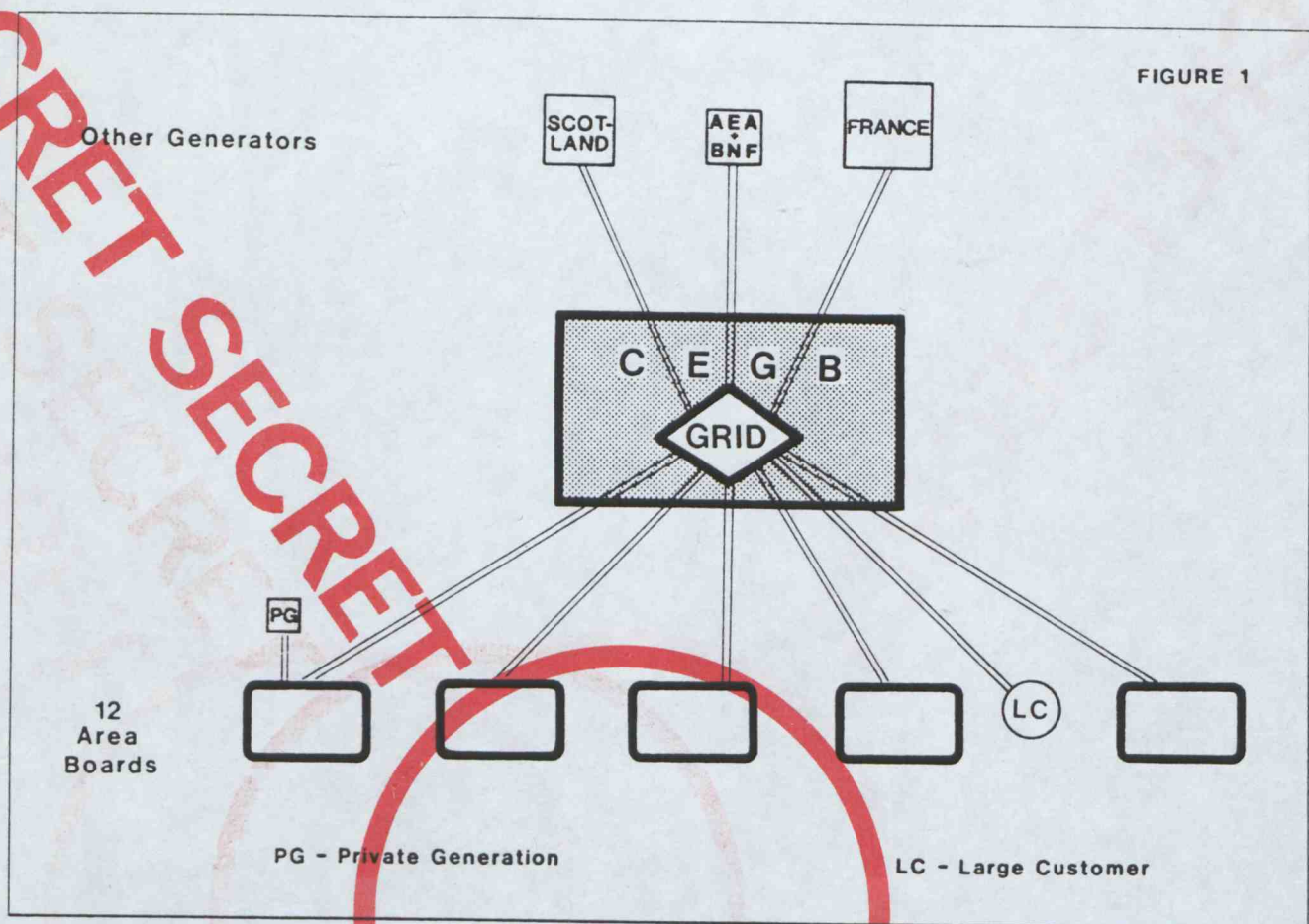
Government intervention

19. The other weakness in the present structure is that the Government of the day has wide ranging powers to interfere in the running of the industry. The Government appoints the members of all the Boards that run the industry. All capital expenditure plans have to be approved by the Government, which also determines the industry's total borrowing limit. While attempts have been made to set a clear framework in which these controls will be exercised, the management of the industry does not have freedom to manage in the same way as in the private sector. In the private sector, the industry will be free of Government intervention in its day to day management, protected from fluctuating political pressures, and released from the constraints on financing which public ownership imposes.

The industry as it will be

20. The Government's aim is to build on the strengths of the present structure and to correct its weaknesses, so that a more efficient industry can develop. To achieve this:

- * The twelve Area Boards will be privatised as twelve distribution companies; each will have the obligation to supply in its area.
- * The National Grid will be maintained and will retain its central role in scheduling and directing the use of power stations.
- * The CEGB's effective monopoly of electricity generation will be ended.
- * The CEGB's obligation to provide bulk supplies of electricity will be ended.
- * An effective system of regulation will be put in place to ensure fair competition, to oversee prices, and to see that the privatised industry meets its obligations.



Ending monopoly 21. Present power supply arrangements are illustrated in Figure 1. Two steps will be taken to end the C E G B's effective monopoly in generation.

22. First, a substantial part of its capacity will be formed into a competing generating company. This new company will own some 30% of the C E G B's existing capacity, including a broad spread of coal, oil and gas turbine plant of various sizes and ages. This will enable the new company to compete with the remainder of the C E G B at all levels of demand and to compete, through competitive tendering, for contracts with distributors to build new capacity. The shares in the new company, and in the remainder of the C E G B, will be offered to the public.

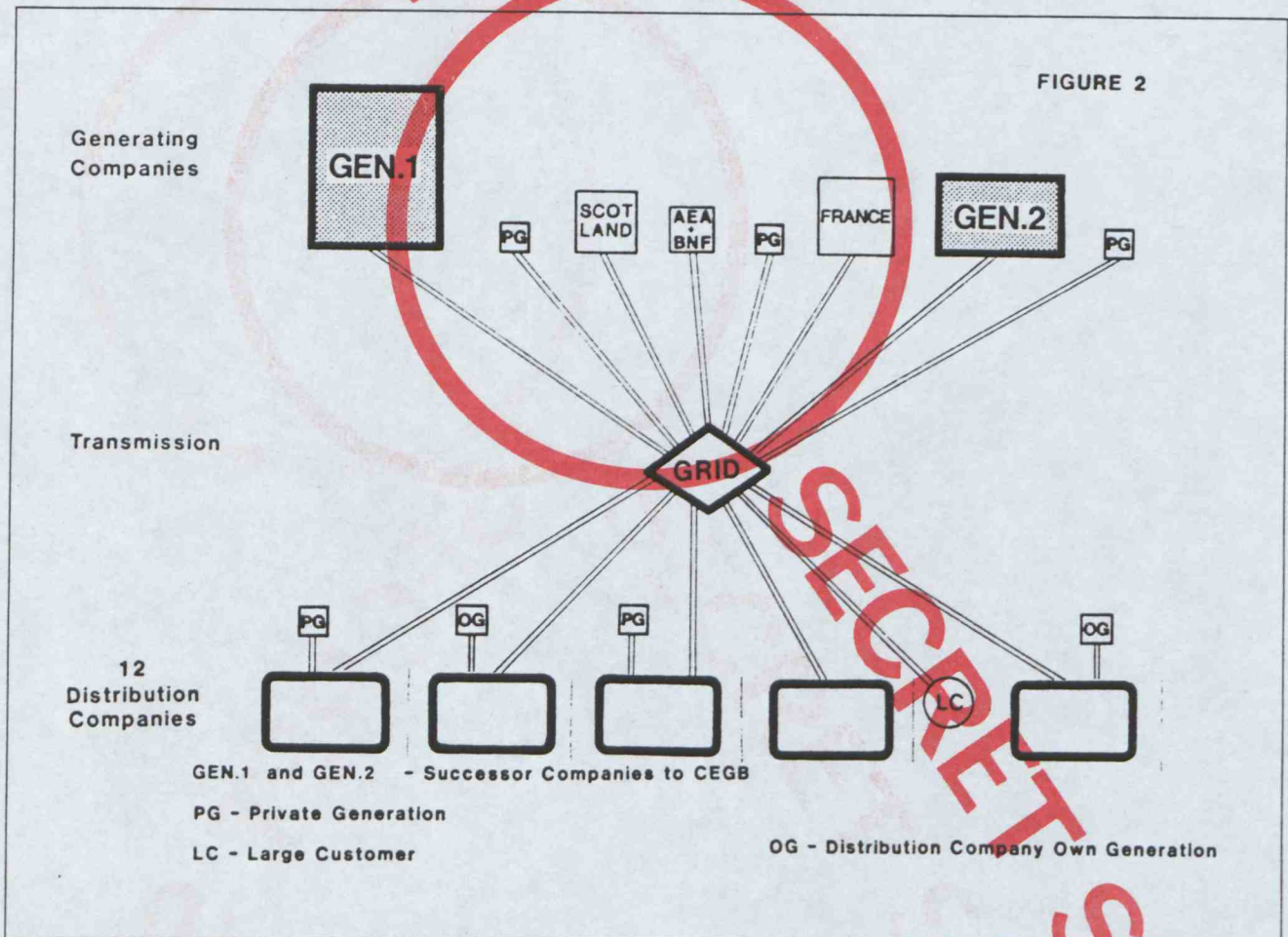
23. Second, control and ownership of the National Grid will be transferred to the distribution companies. This is because the grid has to retain a central role in planning and directing the use of power stations to minimise cost and to ensure that the system does not fail. It follows from this that, if the C E G B or any other generating company owned the grid, it would inevitably have to direct the use of all the major power stations on the system. To a large extent, it would have to determine how much competing generation was allowed access to the system and how its competitors' stations were run. The Government does not believe that it would be fair to put any generating company in such a position after privatisation, where it effectively owns the means of transmission and controls its competitors' power stations. This task will therefore be given to a grid company owned

jointly by all the distribution companies, which will have a direct incentive to seek the cheapest sources of supply and to promote competition among generators.

Future structure

24. The future structure of the industry in England and Wales is illustrated at Figure 2. It will comprise:

- * A substantial new generating company, formed from some 30% of the CEGB's existing capacity, all of it non-nuclear.
- * The remainder of the CEGB, owning the remaining power stations, including the nuclear stations.
- * Other existing and potential private generators, who will generally contract with the distribution companies, the grid company, or large customers.
- * A separate grid company owned by the distribution companies. This will operate and own the 275kV and 400kV "super-grid" transmission system, the CEGB's interests in the interconnectors with Scotland and France and the pumped storage stations at Dinorwig and Ffestiniog.
- * Twelve distribution companies, based on the existing Area Boards, which will also have the right to generate themselves where this does not create local monopolies in the production and supply of electricity.



25. In the new structure, the commercial relationship between the distribution companies and generators will be governed by contracts. There will therefore be no continuing role for the Electricity Council itself, in which the Area Board Chairmen, the full-time members of the Council and the Chairman and two other members of the CEBG discuss industry-wide concerns. The implications of privatisation for the functions and employees of the Electricity Council will be a matter for consultation between the Government and the industry.

Operation of the grid company

26. The grid company, owned by the distributors, will operate in much the same way as the CEBG's National Grid Control and Transmission Division operate at present. It will direct power stations so as to meet demand at lowest cost, ensuring that power flows on the transmission system and the quality of supply remain within technically acceptable limits. So the major advantages of a national integrated system, with a merit order of operation, will be maintained.

27. What will be different is that the grid company will operate on the basis of contractual relationships with generating and distribution companies. This will be a change from the present operational and command relationships between the CEBG's grid controllers and the CEBG's power stations.

28. The contractual arrangements between the generating, distribution and grid companies will be for them to negotiate; and the Government will play its part in helping to put in place the new arrangements before privatisation. There are at least two approaches which would be workable because they largely preserve the way in which the system operates at present:

* **Contracts through the grid company:** In this approach, the distribution companies contract for electricity supply from the grid company. The grid company would, in turn, contract for capacity and for energy supplies. It would call up those power stations which offered the cheapest energy, so as to minimise the cost of meeting any particular level of demand. There would also have to be other provisions in the contracts to allow the grid company to use power stations as necessary to keep the system operating reliably and efficiently.

* **Direct contracts:** In this approach, the distribution companies contract direct with the generating companies for existing and new capacity. They could do so either singly or jointly, though it is likely that overall demand forecasts and requirements for reserve capacity would be agreed on a national basis. As with contracts through the grid, direct contracts would involve capacity and energy charges. The grid company would have to be involved to confirm the technical feasibility of adding capacity to the system in the manner proposed and to agree the associated connection and transmission charges. On a day to day basis, the grid company would still call up those power stations which offered the cheapest energy.

29. These two approaches are not mutually exclusive. Both may develop side by side. While some or all of the distribution companies may choose to

start by contracting with generating companies through the grid company, there will be no statutory provision to prevent them from contracting direct with generators. However, the grid company will need to be involved, to ensure that the interests of the power supply system as a whole are protected. In all cases, the grid company will have to retain its central role in scheduling and directing the operation of generating capacity connected to the grid.

The obligation to supply

30. In the new structure, the statutory obligation to supply will be placed on the twelve distribution companies. It is not possible to give the obligation to a generator in a freely competitive market. To decide otherwise would be to stifle competition at the outset. The generator could not be sure of winning contracts for the capacity it felt was necessary to meet its obligation. So it would have to be given the power to build whatever capacity it considered necessary, whether or not the distribution companies agreed. The generator could perhaps allow some capacity to be built outside its control; but it would still have to have the final say on how much capacity was needed, and the right to recover its costs from potentially unwilling distribution companies. In effect, it would be able to prevent competition developing and that is precisely the weakness of the present system that the Government's proposals seek to overcome.

31. In the new structure, the distribution companies will meet their obligation by contracting for sufficient capacity and energy from the generating companies, or by generating themselves. This will give the distribution companies a much greater say in decisions about how many and what type of power stations should be built. It is these companies who deal direct with the industry's 22 million customers; they are best able to judge their customers' requirements; and it is therefore right that they should have more say in the industry's investment decisions.

Competition

32. The new structure will introduce competition and provide a framework in which more will develop. It will give the distribution companies:

- * The incentive to promote competition in generation.
- * The ability to connect competing generators to the system.
- * A wide choice of generators.

So long as electricity generation remains a monopoly, there will be no way of telling whether costs are as low as they could be and no effective external pressure to reduce them. In the new structure, the distribution companies will contract for power station capacity on the basis of competitive tenders. They will also have stronger incentives to pursue economic schemes for local generation and for managing peak demand, so as to reduce requirements for bulk generating capacity. So generators will

face real pressures to build plant efficiently. This will be crucial in the years ahead as the industry invests substantial sums to meet growing demand and replace old plant. More than 70% of the CEGB's capacity is now 15 years old or more, and the CEGB currently predicts a need for some 13 GW (Gigawatt = 1000 megawatts) of new plant to be commissioned by 2000, equivalent to a quarter of its present declared net capability.

33. Since the grid company will be calling up those power stations which offer the cheapest energy, generators will also have incentives to fuel and run their stations efficiently. They will also face real contractual incentives to ensure that their power stations are available. Last year, fuel costs amounted to almost half of total electricity operating costs and, in future, generating companies will be free to purchase coal and other fuels from the most competitive sources.

34. In these ways, competition will create downward pressure on generating costs, which last year accounted for some three-quarters of total operating costs.

Incentives

35. The new structure will represent a fundamental change from the existing organisation. At present, the CEGB has an effective monopoly of power supply and the Area Boards have little incentive to promote competition. The CEGB has a statutory duty to supply them and they effectively have to meet the CEGB's costs; there is therefore little point in encouraging other sources of supply.

36. Under the new structure, no single generating company will have a statutory duty to meet all requirements for new capacity; every generator will have to compete to meet the distributors' requirements. Because the distributors' prices will be regulated, and their costs not simply passed on to the customer, their profits will depend on how well they control their costs. And because generating electricity accounts for some three-quarters of these costs, the distribution companies will have a very strong incentive to contract with the most efficient generating companies. Real competition in generation will develop.

**Access to the grid
and the market
in power**

37. In the new structure, the distribution companies will own the grid and will be able to connect competing generators to the system. Potential private sector generators will have confidence they will be treated fairly. They will not face the prospect of having their power stations directed by grid controllers working for the CEGB. Few private sector concerns would be willing to take the substantial risk of financing a major power station if access to the system and use of the station were controlled by their principal competitor.

38. If it is owned by the distribution companies, the grid company will be able to operate a market in power. It will operate much as it does now, calling up the cheapest power stations in "merit order" to meet demand, while ensuring that the power supply system as a whole does not fail.

39. However, the present arrangement does not necessarily meet the demand for electricity at minimum cost to the customer. Because the CEGB has no competitor, there is no way of telling whether its capital and operating costs are as low as they could be; and there is no real external pressure on the CEGB to ensure total capacity is minimised, that its most efficient plant is available or that its costs are kept as low as possible.

40. In the new structure, the distribution companies will seek competitive tenders for the construction of new capacity and the grid company will call up the stations of competing companies based on their quoted prices. There will be real financial incentives for generators to build plant efficiently, to have their plant available, and to run them efficiently. So because there will be competition, the grid company will have more chance of meeting demand at minimum cost to the customer.

**Choice in generation
and scope for
competition**

41. The distribution companies will have a wide choice of sources of generation:

- * They will be able to contract with the two new generating companies formed out of the CEGB's existing capacity.
- * They will be able and more willing to contract with existing private generators, and with new ones that enter the market once they see that fair and effective access has been introduced.
- * They will be able to generate themselves, or enter into joint ventures.
- * They will be able to obtain supplies from Scotland, France and elsewhere; existing links could be strengthened or new links built.

42. The distribution companies themselves will also have to bid for part of their business in a competitive environment. Adjacent distribution companies could find themselves competing to supply large users near their common borders. And larger users will also be able to buy electricity direct from generators, by-passing the distribution companies but using their transmission and distribution systems for "common carriage" of the electricity. Common carriage was allowed for in the Energy Act 1983, but the provisions of that Act will be updated to ensure that common carriage tariffs properly reflect the costs involved; to ensure that the tariffs are scrutinised by the regulator; and to give the regulator powers to settle disputes.

43. In addition to the competition that will occur straight away, there will be considerable scope for further competition in the building and operation of new power stations. The substantial requirement for new generating capacity in the next ten years, and the growing requirement thereafter, will create room for new private sector generators to enter the market. This new capacity will be necessary if winter peak demand is to be met. At other times of the year, there will be surplus capacity and room for competition between power stations to meet demand at lowest cost. The prospect is for a more diverse and competitive electricity industry, with new types of power station, better equipped to meet the demands of customers.

Security of supply and the need for nuclear power

44. There are three principal conditions for a secure supply of electricity:

- * Proper control of the generating and transmission systems, to ensure that power can be delivered where it is needed.
- * Sufficient generating capacity to meet demand.
- * Protection against interruptions in fuel supply.

45. The first of these conditions will be met by ensuring that the grid company retains central control of the transmission system and the power stations connected to it. As far as the second is concerned, the distribution companies will have every incentive to contract for sufficient capacity to meet demand. But to ensure that they do so, they will retain a statutory obligation to supply. The reasons for not placing any additional obligation on any of the generating companies have been explained earlier. If one organisation has responsibility for ensuring supply, it can effectively prevent competition developing. The present monopoly in electricity generation does not have to be left intact to ensure secure supply. The Area Boards are at present responsible for maintaining final supply to 22 million customers. In future, the distribution companies will also take responsibility for contracting for sufficient generating capacity. They will continue to demonstrate the same commitment to ensuring that their customers are supplied as they have in the past.

46. Protection against fuel supply interruptions is best achieved by using a number of fuels from which to generate electricity. There are various ways of maintaining diversity in fuel supply, such as facilities for importing coal or electricity itself, the use of oil or gas or dual-firing in power stations, or generation from renewable sources of supply, such as wind or tidal power. Maintaining high stocks of fuel can also provide protection. All of these are likely to play their part. But too much reliance on fossil fuels would increase the electricity industry's exposure to future price shocks of the kind witnessed in the last 15 years. Renewable sources of energy will play their part, but there remains a vital strategic need for the significant non-fossil-fuelled contribution that can only be made by nuclear power.

47. The Government is determined that public confidence in the nuclear programme should be maintained. The industry has an exceptional safety record: standards of safety and environmental protection are vigorously enforced now, and will be no less vigorously enforced in the future. Nuclear safety legislation makes no distinction between public and private ownership; changes of ownership will not compromise the maintenance and enforcement of safety standards. The Government is committed to ensuring that the independent Nuclear Installations Inspectorate has all the resources necessary to perform its duties effectively. Nuclear operators will be under no less a duty to attach the highest priority to the safety of the workforce and the public.

48. By leaving the existing nuclear stations in the hands of a substantial company which will inherit the CEGB's nuclear resources, the new structure will ensure continuity and high standards in the management of the nuclear programme. The Government is satisfied that the Pressurised Water Reactor (PWR) can provide nuclear energy safely. The decision to proceed with the PWR at Sizewell B was taken only after careful independent assessment of the issues by the inquiry inspector. The Nuclear Installations Inspectorate (NII) has completed its assessment of the safety issues for the Sizewell B design and granted a nuclear site licence. The safety of that design has been exhaustively examined and found to be acceptable. The NII will, of course, have to continue to be satisfied in respect of individual projects, examining in particular those safety issues which are site specific. The construction and operation of any future nuclear station will be subject to receiving the necessary safety, planning and other consents.

49. The Government believes that Parliament, the public and the privatised industry should be given a clear statement of its strategic priorities. The legislation to privatise the industry will therefore provide for a statutory obligation on the distribution companies to contract for a specified minimum proportion of non-fossil-fuelled generating capacity. The proportion required will be fixed at a level achievable at the time of privatisation. The Government will have powers to vary the specified level after consultation with the industry. In doing so, it will have to take account of the time it takes to commission new power stations. The distribution companies will be able to meet this obligation by contracting for nuclear capacity, though contracts for renewable sources of energy, such as wind or tidal power, will also make a contribution. The distribution companies will be able to seek capacity from any source, provided the necessary safety, planning and other consents are obtained. The two main generating companies, Scotland, France, the Atomic Energy Authority (AEA), and British Nuclear Fuels plc (BNFL) are all potential sources of supply.

Regulation, customers and employees

Regulation 50. Even after privatisation, the supply activities of the distribution companies and the national grid company will remain, in large part, natural monopolies. An effective regulatory regime will therefore be established by legislation, to promote competition and to safeguard the interests of customers. The market in wholesale supplies of electricity will also be regulated initially, although the burden of regulation should diminish as competition in generation increases.

51. The regulatory system will be designed to provide each company in the industry with incentives to operate more efficiently and to ensure that the benefits are shared with customers. Regulation will be based on a system of price control, which will help to provide the right incentives to the industry's management, and avoid unnecessary bureaucracy. The issues to be addressed in constructing an effective regime are, however, complex. They include the nature of the price to be controlled, the treatment of generating costs in any price control formula, the feasibility of having the same formula for all twelve distribution companies, the scope for

excluding some parts of the market from price control, and the regulatory implications of the obligations placed on the distribution companies. The terms for common carriage on the distribution and transmission systems will also have to be reviewed. All of these issues will be the subject of detailed consultation with the industry.

52. Responsibility for supervising regulation will rest with a Director General of Electricity Supply, who will enforce the provisions of licences issued to the industry. The terms of these licences will regulate the prices which can be charged for electricity and specify certain terms and conditions of supply. In addition, the Director General will be given statutory duties to safeguard the interests of customers and to promote competition in the industry. The costs of the Director General's office will be met through fees charged to the various licensed bodies.

53. The monopoly aspects of the core business of supplying electricity will need to be "ring-fenced" for regulatory purposes from the other activities currently undertaken by the industry. The new companies will be liberated from existing public sector restrictions on diversification and will be free to develop other business activities outside the regulated area of electricity supply. Separate accounts will be required for the core business and for the other activities of each company. The revenues of the regulated activities will not be allowed to cross-subsidise the other businesses; businesses outside the regulated core will be subject to existing competition legislation. The relationship between the Director General of Electricity Supply, the Director General of Fair Trading and the Monopolies and Mergers Commission will be carefully defined.

54. Another important area for regulation will be the terms of access to the transmission and distribution systems. While the new structure will provide real incentives for the distribution companies to allow their own suppliers access, they may be less willing to allow private generators to use their systems to supply large customers direct, or to provide back-up and top-up supplies at reasonable cost. So the terms for common carriage of this kind between private generators and large customers will be closely regulated. The Government will review carefully the provisions of the Energy Act 1983 governing common carriage on both the transmission and distribution systems, including back-up and top-up supplies. The Government is determined to remove barriers to full and effective competition.

**Customer protection
and safety**

55. The Government intends to create and maintain strong and effective safeguards for the customer not only on prices, but also on the standard and safety of service provided by the distribution companies. This will be achieved by co-ordinated action in a number of areas.

56. The Electricity Supply Regulations, which lay down the procedures and standards that public electricity suppliers have to observe on safety and quality of supply, are being thoroughly revised and brought up to date. The new Regulations will provide a sound basis for the safe operation of the privatised electricity supply industry.

57. An Electricity Supply Code will set out the basic statutory right of customers to receive a supply of electricity and the duties of public electricity suppliers in providing that supply. The code will be included in the privatisation legislation and the licenses issued to the industry. It will codify and update the law governing electricity supply.

Standards of service

58. Arrangements for maintaining an effective voice for customers' interests will be made to ensure that none of the benefits of the existing customer representation by Electricity Consultative and Electricity Consumers' Councils are lost.

59. The Government believes that it is right not only to regulate the price of electricity, but also to provide for high standards of service. The legislation will therefore create a new system of guaranteed standards of service, to be overseen by the Director General of Electricity Supply. Defined levels of service will be set by the Director General after discussion with the distribution companies. Where companies fail to meet these levels of service, customers will receive a pre-determined level of financial compensation. The Director General will also collect and publish a range of standards of service indicators. These will enable comparisons to be drawn between distribution companies, and encourage them to improve their efficiency and standards of performance. The details of these two schemes will be completed after thorough discussion with the industry and customer representatives.

Industrial relations and employee rights

60. The electricity supply industry has a long tradition of good industrial relations which is rightly prized by management and the rest of the workforce. The present industrial relations machinery covers both the negotiation of terms and conditions of employment and consultation on matters of common interest, such as education, training, and health and safety. It was originally set up before nationalisation, when there were several hundred employers. So it is not geared specifically to the present structure of the industry. The Government has therefore accepted that there is no need to make any changes to the negotiating machinery in the privatisation legislation. After privatisation, it will be for the successor companies and the industry's unions to negotiate any changes which either consider to be desirable.

61. The trade unions in the industry will be consulted about matters affecting their members' employment. Employees' rights and terms and conditions of employment will be safeguarded. Privatisation will not affect the benefits payable to the members and pensioners of the industry's pension schemes. The industry will continue to have an obligation to finance pension liabilities.

62. The new structure of the industry will provide wider career opportunities for employees, and there will be attractive provisions to ensure that they can acquire shares. Privatisation will give employees the right to a direct stake in their industry.

Next steps

63. The Government intends to introduce legislation at the earliest opportunity to:

- * Provide powers to restructure and privatise the industry.
- * Establish a regulatory system.
- * Modernise the law on electricity supply.
- * Establish a new system for maintaining and improving standards of service.

64. The Government's intention is that these powers should be used to create the proposed new structure of the industry. The CEGB will be reorganised into two generating companies and a national grid company. The Area Boards will be converted into twelve new distribution companies, to which ownership of the grid company will be transferred. The industry will be consulted about the future handling of the Electricity Council's functions, and the Council will be abolished when new arrangements have been agreed. The shares in the distribution companies and the two generating companies will be offered for sale to the public, including the industry's employees.

65. The drawing up of this legislation and the subsequent reorganisation will be carried out in detailed consultation with the electricity supply industry.

The benefits of privatisation

66. The proposals set out in this White Paper will secure a more efficient and economic supply of electricity, by building on what is best in the industry and ending what is wrong with the present structure.

- * Decisions about investment in power stations will be driven by the distribution companies and so will reflect the needs of customers.
- * Greater competition will create downward pressures on costs and prices, and ensure that the customer, not the producer or distributor, comes first.
- * Customers will be given new rights, not just safeguards.
- * Management will have more freedom to use their initiative within a clear regulatory framework.
- * The security and safety of electricity supply will be maintained.
- * Investment plans will be subject to commercial tests, and the industry will have access to private sector finance.
- * Employees will have the right to own shares in their industry, and customers will also have the opportunity.

A modern competitive industry will be created, widely owned by the public, and more responsive to the needs of customers and employees. The industry will have a better chance of meeting electricity demand at minimum cost. There are real benefits in prospect for the customer, employee and the economy.