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CONFIDENTIAL

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1 3AG

Dr 2/2

31 January 1984

Dear Peter,

I wrote to you on 14 December 1983 about the external financing limits of the Scottish Electricity Boards, which seemed likely to result in the Boards having to make price increases at or above the rate of inflation and well out of line with those proposed for England and Wales. You replied on 23 December refusing to increase the EFLs.

You concentrated on changes in the Boards' capital expenditure proposals compared with the baseline for the 1983 IFR. Capital expenditure is only part of the picture, since the EFL is set by reference to the net cash requirements for the business as a whole. In the absence of updated financial forecasts during the IFR process - in which respect I acknowledge that the SSEB in particular has not been helpful - it is often convenient to make the assumption that cuts in the EFL will be reflected in cuts in the capital programme and that is why the figures you were able to quote show such variations. I must stress, however, that I did not agree to any specific levels of capital expenditure during our bilateral discussions. In fact SSEB's own forecasts throughout last year have only increased to a small extent and this is hardly surprising in a capital programme dominated by a single major project such as Torness. The bulk of this increase was due to my own decision following a public inquiry into the route of the transmission lines; while for NSHEB the increase is mainly due to the need identified before our bilateral for extra expenditure on parts of the local distribution system - a need we can scarcely deny following the supply interruptions in the recent adverse weather. It is to operating costs that we must look in the short term at least for savings to meet EFL reductions and, as I explain below, the Scottish Boards' latest figures for next year show that they are making every effort to achieve this.

Secondly, you suggested that any difficulties about larger price increases north of the Border were the Scottish Boards' own faults. It is clear that they are making every effort to produce operating cost savings as well as savings in administrative costs and you should not lose sight of the fact that the recent efficiency audit gave them a comparatively clear bill of health. You went on to mention the possibility of increased trading between the Scottish Boards and CEGB. As you say, this is something which in my recent discussion with John Moore I agreed to consider, and I will shortly be receiving a report from SSEB. But I approach increased trading on the basis that it would be beneficial to Scotland: it would involve greater use of our relatively more efficient coal-burning plant (which would increase the total coalburn, a sensitive point in Scotland) and would improve the SSEB's cash flow and profits. You now appear to be suggesting that the effect of increased trading should be to raise Scottish prices, a proposition which I find quite unacceptable.

Turning to next year's EFLs I now have the Boards' latest forecasts, and my officials will let yours have any further details of these which are required. The figures show that the Boards are making every effort to live with the tight EFLs we have already announced. As I have said, the capital programe is dominated by Torness and I am satisfied that other elements in it have been constrained to the greatest possible extent. The assumptions which have been made on operating costs are extremely optimistic, with nuclear availability at the high end of the possible range and with increased thermal efficiencies. Administrative costs and other overheads have been scrutinised and held down so far as practicable.

When I wrote to you on 14 December we were facing the possibility of a price freeze in England and Wales, and I wanted to ensure that any price increase in Scotland was below the rate of inflation. Since then the position has eased considerably with the Electricity Council proposing small tariff increases. SSEB are now proposing to increase tariffs next year by an average of about 4.5% and the NSHEB tariffs seem likely to increase by a similar though slightly smaller percentage.

In the circumstances, while there may be a presentational difficulty in Scotland, particularly on industrial tariffs, I am content not to press you further for a relaxation of the EFLs. They remain very tight however and I may need to come back to you if they seem likely to threaten progress on Torness.

I am copying this to the recipients of our earlier correspondence.

Yours ever,

George

Nat Ind Gas + Elec
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