

SECRET

24 February 1984
Policy Unit

②
PRIME MINISTER

GAS INDUSTRY PRIVATISATION

I met Peter Walker today.

I put to him the following points (in a spirit of friendly assistance):

1. Investors will be excited by the thought of owning a share in a business which generated £1,300 million of cash last year: this point should be made to offset his gloomy comments concerning medium-term gas shortage.
2. Investors will adjust the stated profit and loss account, adding back to profits all of the additional depreciation and provisions currently being made by the management to conceal the true profitability of the operation.
3. Competition. The paper should expand on why it is oil companies and others are not taking advantage of the Oil and Gas Enterprise Act provisions. No other company is currently using the gas grid as a common carrier. The paper should also question whether BGC can be brought more fully into the international gas market. If a market in gas can be established, many of the difficult pricing problems disappear. The reason Cabinet at the moment gets involved in acrimonious pricing disputes, and the reason why Peter Walker recommends complex regulation, is that there is no market price of gas to which you can refer; whereas in the case of the oil industry, the market price acts as the answer to most of the criticisms.
4. I queried whether there were so many disadvantages for the regional company option. In particular, it seems unlikely that the additional costs will be as great as he suggests, as there could be offsetting gains in the form of better gas purchasing and some efficiency improvements.
5. The paper should draw attention to the unsatisfactory nature of BGC's current monopoly position. It is unlike BT in that it does

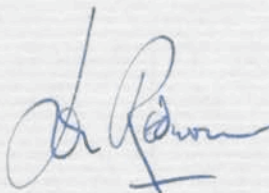
SECRET

not have to provide a service to every industrial consumer, and there are large numbers of private individuals who are debarred by location from having access to gas supply. Worries about future non-availability under a privatised system should be set against the ill will of many companies and people who feel wronged by the current arrangements.

6. I agreed that if he does propose the sale of the complete enterprise, there must be a regulatory framework for price, and there must continue to be a gas tax to remove the difference between the very cheap gas BGC buys under long-term contract from older North Sea fields, and the new contract price of gas which is reflected in the price to the customer.
7. The regulatory framework he proposes is worse than that which has already caused trouble with the BT issue. I explained my reasons for disliking a profit-linked rather than a price-linked formula (particularly because it is more difficult for the customer to understand) and argued that there would have to be much more competition for customers to be at all reassured. He suggested that Mr Davis from his Department comes to see me on Monday to go into detail on these issues, and I agreed.
8. I agreed with his proposition that the retail activities should be segregated (including service?). I expressed a preference for sale of 100 per cent: he said he also favoured this, but thought that 80 per cent was the best that he would be able to do.
9. Gas exploration and production. I suggested that the arguments for segregating this activity in the way in which the oil interests have been segregated, and selling it separately, should be explored, as there would be many people who favoured this route.
10. Employee participation. I expressed enthusiasm for substantial employee participation, but warned that this proposal - along with his main proposal to sell the whole business - would not buy union peace necessarily. The gas unions have in the past opposed the sale of the retail showrooms, and would try to orchestrate a campaign against any denationalisation proposals.

I concluded by saying that Peter Walker's proposals and his paper represented the results of a great deal of hard work, and had shifted the debate a long way. The criticisms would come from two separate angles. Some would see in the solution of selling the whole all the BT arguments writ large, as there is no fledgling competitor, and the regulatory framework is arguably worse. Others would argue that the segregation by function was not sharp enough and had not been taken far enough; they would prefer to see the sale of the retail interests, and sale of the gas exploration and production interests as separate entities, early on in the denationalisation process in order to reduce the monopoly stranglehold on all sectors of the business. I suggested that the paper should at least examine those options more carefully and set them out as realistic choices, whilst strengthening protection for customers.

Peter Walker is going to see John Moore on Monday to hear his views: the Treasury seems to be moving in favour of selling the upstream and downstream businesses, and leaving the central grid as a public monopoly utility.



JOHN REDWOOD

