SECRET

8 May 1984

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MR TURNBULL

British Gas has four main business areas.

The first is the exploration and production division looking for both oil and gas in the North Sea. This is already a competitive business, and the decision has been taken to sell the oil interests.

British Gas does not want to have to sell its gas interests. It will resist this even more than it resisted the sale of the oil. It will argue:

1. It is its business to sell gas to customers, so it ought to be free to explore for it.

2. It needs some of the fields like Morecombe Bay and Rough as temporary storage sites as well as for their gas reserves. They do need one or two buffer reservoirs into which they can pump gas when demand is low, and from which they can extract gas when demand is high. This does not necessarily mean, however, that they have to own these fields, and it certainly does not mean that they have to own all the others.

The upstream part of the business, therefore, can be segregated quite easily with the distribution business bidding for gas from whoever may find and produce it. This would solve the gas price problem by making it a market price like oil.

The second part of the business is the national transmission system. British Gas has an extensive onshore national transmission system. The gas lines that route gas from the offshore fields to the coast are not all owned by British Gas, and demonstrate that there is no need for them to be so. The economics of constructing oil and gas pipelines and charging tariffs to users are well-established, particularly in the USA

However, it is true that the total transmission system as a whole is a national monopoly, and if it were transferred whole into the private sector, it would need extensive regulation. A sensible compromise in this area would be to keep the national transmission system owned by the residual British Gas Corporation, but to have no hard-and-fast rules about future financing and construction of gas pipelines. More gas pipelines onshore could be put up by private capital as well as offshore, and could be part of the financing and sales contract for new gas being produced.

The third business within the British Gas Corporation is the Area Board activity. They organise the supply, regulate the pressures in regional distribution businesses, own the local pipeline system, and deal with customer problems and billing.

In any given area, the supply of gas to the domestic customer is likely to remain a monopoly. It is also likely to remain a monopoly for all but the largest industrial and commercial users, unless these users are grouped together. For example, on a trading estate customers could be linked, and somebody other than British Gas could bid to supply them direct from a dedicated gas field. The options suggested include splitting up the regional companies and selling all or part of them to the private sector; or selling them whole with the rest of BGC and putting them under a stiff regulatory regime.

I would be suspicious of the alleged advantages from visible competition between different regions through emulation. The only type of competition that ever works is the ability of somebody else to come and supply that customer direct. It is difficult to see how in most cases this could arise under privatised regional companies. Leaving BGC whole poses great monopoly regulation problems.

The <u>fourth</u> section of British Gas's business lies in its retail and service activities. British Gas has a substantial business selling retail appliances to the customers and servicing some of their domestic installations. British Gas is reluctant to see this business pass into the private sector, and in the case of service, uses the safety argument to defend its monopoly. There is no reason why the retail and service business could not be conducted in the private sector, and every reason to suppose that were the retail space sold to new private sector owners, it would be deployed much more successfully. Safety can be dealt with by standards and even by licensing of contractors.

The preferred route in this sector is to sell the whole retail estate, preferably splitting it up, and introduce more private businesses into gas maintenance and servicing. British Gas could rent space from the retail outfits taking over the gas showrooms, or could rent new space in other shops or Post Offices for dealing with customer enquiries and bills. It would need a far smaller estate to do this than it currently employs.

<u>Peter Walker and the Treasury</u>

Peter Walker's model of selling the business whole and regulating it will reopen all the old British Telecom arguments. His preferred method of regulation is clumsier than the BT one, and could lead the Government into endless difficulties. It would be a large sale and would do nothing to further customer interests.

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The Treasury are correct in thinking that the first thing that has to be done is to create a market in gas itself. Once there is an established market price for buying gas from the North Sea, there can then be no logical case for having that gas under public sector control. British Gas becomes a business involved in running a pipeline system, and in distributing gas to the myriad of customers who will always be the customer of a monopoly. They will be subject to competition in this business if some people want to build dedicated pipelines for the supply of gas to particular locations as part of their contract to sell gas to BGC; and if some industrial users, or other users grouped together, might buy gas direct from a private sector producer in the North Sea. Finally, the retail business could be sold off, thereby removing British Gas's stranglehold over gas from wellhead to customer's home.

Would Gas Prices go up?

Under BGC's current corporate plan (1983) domestic gas prices are forecast to rise from 38p a therm (1982-83) to 56.7p by 1987/8 (almost 50 per cent up). They will argue that structural changes in the industry will cause price increases in gas, yet their plans already include the assumption of substantial money increases.

Selling the gas interests and making a market in gas supply will lead to a higher average price of bought-in gas, but so will the natural course of events, as cheap Southern gas runs out and dearer new UK North Sea gas and Sleipner gas are brought in. If early action is taken to make a market in gas, the gas price can be taken out of politics that much earlier.

BGC will doubtless oppose these proposals, and attention has to be given to how to sell them politically.

John Redwood

JOHN REDWOOD

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ANNEX

Businesses

1983 Turnover	£m
Oil	127
Installation and Contracting	212
Other Service Work	50
Appliances	215
	604
Gas	5,326

In 1982-83, BGC bought gas at a cost of £1,916 million and sold this for £5,326 million. It paid £523 million of gas levy to the Government on cheaper gas.

The 1983 Plan forecasts are (rounded in pence per therm):

	82/3	83/4	84/5	85/6	86/7	87/8
Domestic gas price	38	40	43	48	52	57
Average gas price	32	34	37	41	44	49
Cost of gas	12	14	16	17	19	23

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