7 June 1984

MR TURNBULL

I attach a draft options paper on Gas.

Do we need something like this to bring Thursday's meeting to a decision?

JOHN REDWOOD

Discussed with JR & DP

AT 8/6

File

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GAS INDUSTRY

There are three options for handling gas privatisation:

Peter Walker's idea of selling BGC as a whole and regulating the monopoly.

This has the advantages of:

(a) speed

(b) management likely to favour this route;

(c) substantial proceeds

(d) favoured by the Department of Energy.

The disadvantages are:

(a) entails denationalising a monopoly, posing enormous regulatory problems, and rekindling the argument that privatisation is not about improving the service to the customer but about flogging the family silver;

(b) it does nothing to make a better market in gas, to lower prices to the customers, or to deal with the problem of the exploitation of British North Sea gas.

The Treasury Model

The Treasury are suggesting that privatising BGC as a whole is too difficult, and that parts of it are a natural monopoly. They therefore suggest splitting BGC into functions:

i. retailing and servicing: sale to private sector;

ii. ownership and exploitation of gas reserves: sale to private sector;

iii. the pipeline system: remain in public sector;

iv. the regional distribution companies: remain in public sector.

The major advantages of their scheme is that:

1. It deals with the problem of monopoly. It only privatises those sections of the business which are not monopolies, and avoids the need for the very complex regulation as would be required for a privatised business.

2. It makes the sale of assets more manageable, as discrete parts would each raise less money, but in aggregate would produce more than selling the business as a whole at a bigger discount.

3. The legislation would be less complex, and the Opposition more muted from outside the industry.

The major disadvantages of the Treasury scheme are:

1. It would upset the Board of BGC, probably require the resignation of Denis Rooke, and may in the process encourage strong employee opposition, probably fermented by the Board itself.

2. It does not meet with Department of Energy agreement, and therefore the policy if adopted would be implemented reluctantly and with difficulty.

3. The pipeline and regional distribution company part of the package would take a long time to set up satisfactorily, and delays could get built into the system. It would need regulation, even though remaining in the public sector.

A Possible Compromise Solution

The creation of regional distribution companies brings no competition benefit within each region, and would be time-consuming, administratively complex and quite costly. We could therefore agree with Department of Energy and BGC that this should be ruled out.

We could build on the agreement between the Department of Energy and Treasury that the retail business should be sold as a separate entity. Added to it could be the installation and maintenance business, subject to satisfactory statutory safeguards concerning safety. (Maintenance of everything on

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the customer side of the meter could be privatised as a fallback position.) Collective decision could determine what, if any, percentage of the equity of the retail business should be left with BGC to buy their acquiescence: we strongly recommend none, but some might be necessary as a gesture.

We should then support the idea that the upstream gas business - the ownership, exploration of production of gas reserves - is a competitive business and could be sold to the private sector using the same logical arguments that were used to justify the sale of the oil businesses. This in itself would raise over £2.0 billion.

The central pipeline network and regional distribution system should remain as a single entity. The first part of the strategy should be to encourage the use of the common carrier provisions already embedded in legislation, and to encourage the establishment of alternative feeder networks from the main grid system when new developments are undertaken using private capital. Once the market pricing of gas has been sorted out through the Sleipner decision, the encouragement of common carrier, and the severing of gas-ownership from gas supply through the privatisation measures, we could sell this company to the private market. Then we could decide whether any price regulation were needed, bearing in mind that most of the problems would have been dealt with by the establishment of a market in gas.

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This could all be achieved within the life of this Parliament if commenced immediately.

Conclusion

The meeting on Thursday should come to a conclusion about which of these three possible ways of proceeding should form the basis for seeking the approval of E(A). System 3 seems to have most to recommend it, in view of the understandable wish of Department of Energy to make some concessions towards the BGC interests, but in view of the overriding political need highlighted by the Treasury, to avoid privatising a monopoly which could then fleece the customer and/or launch an extremely complex regulatory system.

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