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SECRET

MR NORGROVE

Reference No E 0123

cc Mr Unwin
Dr Walker

GAS PRIVATISATION

The main issues outstanding from the earlier E(A) discussions of the privatisation of the BGC are

(i) whether and how price regulation should extend to the industrial market where hitherto contracts have individually negotiated;

(ii) whether BGC's purchases of offshore gas should be regulated in any way;

(iii) the extent of mandatory transparency in the accounting arrangements for offshore operations, gas supply and distribution, and gas appliance retailing, etc respectively;

(iv) whether offshore gas producers could be given improved 'common carrier' access to BGC's distribution system;

(v) future control over imports and exports of gas.

2. I understand that the papers for discussion by E(A) on 14 November will be confined to issues which require to be settled before the legislation is introduced, and that a separate paper will be put forward in a few weeks time on imports and exports of gas. This week's paper will therefore be mainly

about the form and extent of price regulation, the common carrier, and powers concerning the capital structure of the privatised company. The Department of Energy's attitude seems to be that they have brought BGC a long way towards the Government's position on acceptance of an element of debt in capital structure, on improvements in other gas producers' access to BGC's distribution system (which will strengthen their hand in price negotiations with BGC), and on some restraints on BGC's behaviour towards industrial consumers with whom they have individually negotiated contracts. Pressing BGC to go further and accept tighter and more extensive regulation would, in the view of the Department of Energy, risk two serious adverse consequences:

(a) BGC might cease to cooperate, in which case privatisation on the present timetable would become impossible; and

(b) even if BGC continued to cooperate, the proceeds from the sale would be substantially reduced because the business would then be seen as a tightly regulated utility with little scope for business development and profit growth.

3. We understand that Treasury Ministers accept that BGC's gas purchases should not be regulated, but that they are still looking for ways of imposing somewhat stronger control over BGC's behaviour towards industrial customers. They are worried that if the regulatory arrangements are seen to be substantially weaker than those for British Telecom, the reputation of privatisation in terms of its impact on the consumer may be at risk. But they will in the end have to balance this consideration against the importance of BGC's contribution to the £4¾ billion receipts from the special sale of assets projected in each of the Public Expenditure Survey years.

Gas imports and exports

4. It does not appear that there has yet been any very substantial discussion between the Department of Energy and the Treasury on future arrangements for the import and export of gas. We understand that Mr Walker envisages present de facto controls over imports and exports being maintained. The oil companies' acquiescence in this seems to have been secured by the improvements in the common carrier arrangements, and by new arrangements to protect their confidential information about UKCS geology from being exploited by BGC in its future role as an offshore oil and gas producer. BGC meanwhile have more gas available than they can sell, and therefore are not looking for major new imports of gas. It may be that forms of words can be devised for use both during the passage of the legislation through Parliament and subsequently in the Prospectus which effectively shelve this question for a period of years; given the constraints of the Treaty of Rome, it does not appear that overt powers could be taken to control imports and exports, but the existing controls over offshore developments and submarine pipelines give the Government a number of strong cards. Eventually, however, it seems likely that the question will have to be tackled; although the oil industry is not now actively opposing privatisation on the terms proposed by Mr Walker, their attitude would almost certainly change if in the future they were unable to negotiate what they regarded as acceptable prices with BGC and could sell their gas on better terms to continental purchasers. If that situation were to arise, a future Government would find it very difficult to prevent such exports. Similarly if UKCS producers sought to charge BGC a price higher than they would have to pay for imports, the Government would be in difficulty seeking to obstruct future BGC imports. It is clear that Ministers will need to consider carefully how to deal with this question before substantive discussion of the Bill begins; but it does not appear that their future discussions about this point will be substantially prejudiced by the decisions they will be invited to take at this week's E(A) meeting.

JW

A J WIGGINS
Economic Secretariat.
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