

PERSONAL



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10 DOWNING STREET

*From the Private Secretary*

20 November 1985

GAS INDUSTRY PRIVATISATION

The Prime Minister was grateful for your Secretary of State's minute of 19 November.

David Norgrove

Geoff Dart, Esq.,  
Department of Energy, .

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PRIME MINISTER

Prime Minister

cc BGC

GAS INDUSTRY PRIVATISATION

Mr Walker clearly feels exceedingly strongly about this. But I see nothing for you to do at this stage: the Ministers concerned must try to agree.

Agree to await the report back, and hope Mr Walker will be able to reach agreement with Treasury and DTI?

You asked, when we considered gas privatisation at E(A) on 14 November, that I should explore further with the Treasury and DTI the scope for changes in the proposals which would strengthen the role of OFGAS and offer more explicit assurance against unfair price discrimination but avoid attracting the determined opposition of the BGC Board. Peter Gregson has now held urgent discussions with officials concerned. He has, I believe, explained more fully what we intend and has identified ways in which the proposals could be further tightened.

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We have re-emphasised to other Departments the differences between this privatisation, Telecom and others due to follow such as water, which bear on where the balance of the regulatory regime is struck. Water is a pipeline monopoly with no ready substitute for the product. Telecom had a statutory monopoly of its network and retailing, both of which we have opened for the first time to competition. It also lacked any established tradition of separate accounting for different parts of the business and work on this had to begin from scratch. Gas, by contrast, competes in the energy market with other fuels, has never been specially protected in its ancillary activities and has a long history of separate accounting, where it has already been subject to regular scrutiny and pressure from the OFT.

Officials have reviewed the points which John Moore made at E(A):-

- (a) non-discrimination in purchasing. The fundamental requirement here is that Government should be able to restrain the company from importing gas on a scale or timetable which damages UKCS exploration and development.





Government also needs flexibility to allow UKCS producers to export gas. I shall be bringing forward proposals. On non-discrimination as such, BGC is already subject to the requirements of competition law and I should be prepared to seek from Denis Rooke an explicit assurance that BGC will not engage in practices which would offend under that law.

- (b) industrial contract market. The company will be obliged to meet any reasonable demand for gas, wherever it is economic to do so, and this duty will be enforceable by OFGAS. The contract market will be open to the consumer body, which will provide a complaints handling service in the first instance. Discriminatory and predatory pricing are matters for investigation by OFT under the Competition Act and can be referred by them to the MMC (on a 6 month time limit, with the possibility of a 3 month extension). In addition, we are negotiating with BGC the terms of assurances covering:-

- (i) publication of prices;
- (ii) fairness as between customers (in line with the requirements of the Competition Act); and
- (iii) level of prices for an initial period of three years, during which circumstances can reasonably be predicted.

These are new features, being applied for the first time to the gas contract market, and are specifically designed for the reassurance of customers. With proper presentation they will be a strong selling point.

- (c) regulatory backstop for contract market. The Bill provides for OFGAS regulation to be extended to the contract market by Ministerial Order following a MMC Inquiry. This is intended as a final safeguard against gross and persistent abuses by





the company, all other channels and remedies having been exhausted. Given the assurances which we are aiming to secure on maximum prices during an initial period, a major concern may be about the possibility of predatory pricing. Should this occur, the anti-competitive practices provisions of the Competition Act would bite and the procedure described at (b) above could lead quickly to an extension of OFGAS regulation to the contract market by Ministerial order.

- (d) ring fence. There are a number of detailed issues to be addressed in establishing the initial cost allocations for the gas supply business. We shall need the advice of Touche Ross and will want a number of other expert contributions. I do not agree with John Moore's suggestion that we should delay starting on this until a Director-General of Gas Supply has been identified. The time factor is a major constraint, as details of this kind need to be settled well before the flotation. I shall however be very glad to involve John Moore in the further work on this.
- (e) separate accounts. There will be published separate accounts for the ring-fenced gas supply business. Establishing the right initial cost allocations, and control over subsequent changes, should deter hidden cross-subsidy from gas supply into, for instance, retailing which John Moore mentioned. Together with publication of contract prices, the ring fence promises a high degree of transparency for the gas supply business. Within that, details covering the tariff market can be called for by the Director-General who will have substantial discretion as to the information he makes public in his Annual Report to Parliament. As requested I have re-considered the possibility of requiring publication of separate accounts for the tariff and industrial contract markets. I am satisfied that the practical problems would severely impair their objective accuracy. My officials have consulted Touche Ross, who fully endorse this view. I am





however prepared to seek an undertaking from BGC that they will maintain their practice of publishing separate accounts for their upstream, retailing and other ancillary activities. I believe that the arrangements we have in mind are, taken together, fully adequate for our purposes.

I hope these further clarifications and strengthenings will help other Departments to support our proposals. We have provided a very full range of safeguards which, together with BGC's voluntary assurances, constitute an attractive package.

The CBI's positive reaction should not be discounted. Their sentiments were supported by discussions I had only yesterday with the Chemical Industries Association, who were particularly involved on the only previous occasion when problems arose in the industrial contract area.

There is no prospect of persuading the Gas Board to accept an active role for OFGAS in the contract market or a regulatory model designed to suit a very different industry. To say to the Gas Board that the benefit of privatisation is that you will have less freedom to compete in the contract market against oil, electricity and coal and your purchasing policy will be crawled over by officials in a manner which never took place under nationalisation is asking them to change from a system of interference from a government department to a system of far greater interference from a government appointed body. In any case they know that the safeguards that they have been prepared reluctantly to accept in terms of a regulatory backstop means that they could never be tempted to exploit their monopoly position for if they did the regulator would then become a permanent feature of the contract market.

For many months I have toughly and patiently negotiated with the Gas Board without any leaks taking place and I have moved them in almost every sphere to a position that most of my experienced





officials thought was impossible. I must warn you that I can move them no further, nor can anybody else. We can now go ahead with privatisation with their support and therefore with success, or we can enter a public battle with them in which case I think success is impossible.

I am sending this minute privately to you because of the timescales involved. Treasury, DTI and my officials having met, I am now aware of the totality of the arguments and the position. I am endeavouring to fix a meeting with a Treasury minister and DTI minister - I hope on Thursday. But I will have to convey to them very firmly what I now convey to you in this minute.

I will report to you the result of the meeting after it takes place.

*Bill Callaghan*

SECRETARY OF STATE FOR ENERGY

19 November 1985