

You may have seen that the first electricity sale
by a private company to an industrial concern
has now been agreed. CONFIDENTIAL
It's small but would be useful presentationally.

PRIME MINISTER

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DFN
20/12

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GAS PRIVATISATION

Peter Walker's gas privatisation package has had a critical reception, particularly from serious commentators. The fact that the most hostile criticism emanates from our own supporters is not helpful. Moreover, the evident unease in Whitehall has given journalists the opportunity to portray the Government as divided. Now the City is picking up the bad vibrations and becoming concerned about the climate of public opinion surrounding the world's largest equity flotation. If things go on in this vein, there is a danger that we will end up making the worst of a potentially-good job.

Put starkly, the charge is that the Government has subordinated its belief in freeing up markets and promoting competition to the short-term goal of maximising the proceeds from gas privatisation. Given more time for a comprehensive, balanced presentation of the gas privatisation package, this charge can be refuted:

- The system devised to protect 16.5 million small, domestic and commercial customers receiving gas under tightly-controlled tariffs can be defended as appropriate and more protective than that for BT.
- Regulation is much lighter for large industrial consumers on individually-negotiated contracts, but in that market,

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we and they want to rely primarily on competition - both
between fuels and between alternative gas suppliers.

Being
considered
for the
following the
E(A) discussion.

Our Achilles heel is liberalisation of gas imports and exports. The lack of a pro-competitive line on this issue is a shortcoming, not because free-flowing imports and exports would transform the market - the scope is limited - but because it has come to assume symbolic importance; the touchstone of the Government's commitment to competition.

Within Whitehall, we are not as far apart on this issue as might appear. It is recognised that the Secretary of State for Energy already has well-established powers for regulating the development of UK oil and gas resources - and the system is working well. We all want to prevent BGC putting a damper on UK gas exploration and development by discriminating in favour of large, expensive gas imports.

What, in practice, is at issue is the Government's attitude to small-scale gas exports. Future gas discoveries of a size which might entail large exports are most unlikely in the heavily-explored southern North Sea. The potential probably lies outside the North Sea in areas such as the waters west of the Orkneys and Shetlands. Any gas found in this area will be expensive to develop and, logistically, the natural market would be the UK.

Peter Walker would prefer to block exports unless there are manifest benefits. The Treasury and ourselves would

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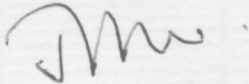
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prefer freedom to export, except where there is a manifest
conflict with the national interest. In an EC context, we
must appear to be even-handed as between exports and imports.

The gap should be bridgeable, perhaps building on Nigel
Lawson's suggestion of giving BGC the right of first refusal
on potential exports.

If you have any opportunity to urge an early resolution
of this issue in a way which gives a positive signal to the
pro-competitive lobby, it would be worth taking. Then the
Government and its supporters can unite in advocating the
virtues of gas privatisation.



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