



Treasury Chambers, Parliament Street, SW1P 3AG  
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29 November 1989

Rt Hon John Wakeham MP  
Secretary of State for Energy  
Department of Energy  
1 Palace Street  
Victoria  
LONDON  
SW1E 5HE

*Dear Secretary of State,*

**COAL CONTRACTS**

Thank you for copying to me your minute of 24 November to the Prime Minister.

I understand that you need to reach agreement on these contracts quickly in order to keep to the timetable for electricity privatisation; and that you have tried as far as possible to persuade the two sides to reach their own settlement, so that it can be shown to be a freely negotiated agreement. On this basis, I am content to agree to the package of prices and volumes which you set out. But I have several reservations about its effects on British coal (BC) which I should make clear.

The agreement lasts for only three years. If past behaviour is any guide, some BC managers will be tempted to imagine a much rosier future for the Corporation after 1992-93 in which prices or demand or both will rise. I am sure you will agree that the Corporation's investment plans should be based on realistic assumptions and that BC has much to do to justify the present, provisional investment totals agreed in the Survey. In reviewing these plans, I would also be grateful if you could consider and set out for colleagues below how the generators' efforts to reduce emissions of sulphur dioxide might affect BC in the mid to late 1990s as imports of low sulphur coal or oil and gas burn may be cheaper alternatives to meeting targets for emissions than fitting flue gas desulphurisation equipment.



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Secondly, I hope that the Corporation places as high a priority as you do on controlling costs. As some, presumably high cost capacity will be shut over the next three years in addition to that forecast in the Investment and Financing Review, it would be reasonable to expect more demanding unit cost targets than BC was prepared to offer in the IFR. We will need to go over the Corporation's plans in some detail in order to offset the costs of further restructuring and I welcome your commitment to set demanding targets.

Third, BC will indeed require further financial assistance: we have agreed in principle to the power to make deficiency grants and the extension to restructuring grant which are included in the Coal Bill. But I am yet to be convinced that we should take action either on the scale you imply or through the number of mechanisms that you propose. Assistance that is too extensive will damage the pressures on BC to cut costs and close capacity as it will be tempted to look instead to yet more help from the Government. We will not simply adjust these mechanisms to give BC's management the fillip of a short term profit. Instead they must make real progress in reducing costs and reassessing their investment. I am sure you will make this clear to Sir Robert Haslam. I understand that you were unable to make any estimate of the likely cost of the settlement. But this will have substantial consequences for public expenditure and must be sorted out soon.

Finally, the expression of the contracts in global terms is unwelcome. I hope that you will make further progress towards the transparent pricing of output from individual pits or coal fields, which will be essential both to ensure that BC manages its assets effectively and to preserve our options on its break-up before privatisation.

I am copying this letter to the Prime Minister, Nicholas Ridley, Malcolm Rifkind, Brian Griffith and Sir Robin Butler.

*Tonnes Tarkenton*

pp JOHN MAJOR

*[Approved by the Chancellor  
and signed on his behalf]*