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PRIME MINISTER

COAL CONTRACTS

When you saw my earlier minute (immediately below) last night you decided to call a meeting with John Wakeham, the Chancellor, Nick Ridley and Malcolm Rifkind. We have now fitted that in before lunch tomorrow. Greg Bourne (Policy Unit) and Richard Wilson (Cabinet Office) will also be attending. Malcolm Rifkind will not be able to come as he has to get back to Scotland after Cabinet for an important meeting on Ravenscraig; but he will be sending a minute in the morning.

You did not have the chance last night to go through any of the detailed papers. These are:

Flag A - John Wakeham's minute

Flag B - Policy Unit comments

Additional papers prepared today are:

Flag C - Cabinet Office brief

Flag D - minute from the Chancellor

I suggest you use the Cabinet Office brief at Flag C to steer the discussion.

It now appears from the Chancellor's minute that he is prepared to go along with the three-year interim deal proposed, but wishes to reserve his position on the precise public expenditure implications of support to the coal industry. But there are some other important issues on the handling of the coal industry - see paragraphs 6 to 12 of the Cabinet Office brief at Flag C - that you will want to work through.

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Subject to the outcome of the meeting, you will want to consider the timetable and subsequent handling. I assume John Wakeham is still keen to make an announcement on Monday. Given that tomorrow's meeting is after Cabinet, the only way in which it would be possible for Cabinet or E(A) to be consulted before a Monday announcement would be in writing.

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PAUL GRAY

29 November 1989

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PRIME MINISTERCOAL CONTRACTS

One of the remaining issues to be settled in the run-up to electricity privatisation is the future arrangements between British Coal and the generators covering the purchase of coal.

The original aim had been to reach an agreement covering the first five years of privatisation. But, as John Wakeham's minute at Flag A reports, this has not proved possible. However, John Wakeham has been able to bring about an interim outline agreement for the first three years, as detailed in his minute.

The main elements are:

- Sale volumes of 70, 70 and 65 million tonnes.
- A two-tier pricing structure.
- An effective base price which reflects a continuation of the present price freeze. Thereafter an escalator based on RPI minus 6 per cent in the first year, then minus 5.5 per cent, then minus 5 per cent.
- A limited exchange rate reopener.
- Both sides continuing to negotiate with a view to a longer term agreement. But the prospects for early progress seem poor; there is quite a gulf between the parties.

This proposed package raises a number of fundamental issues. For example:

- A further pit closures round of some 10-12 pits will be needed in the next year or so. And thereafter substantial further closures may be necessary. It will not be possible totally to shield the UDM areas from

this process. But the hope is that a miners' strike can be avoided in the near future.

- Substantial further public expenditure support for the coal industry will be needed, although it is not quantified at this stage.
- The financial advisers on electricity privatisation think the package should enable flotation to proceed. But while the position after year three remains open, there are continuing major uncertainties.
- Longer term, it is not clear how this package affects the prospects for coal privatisation.

John Wakeham is anxious to obtain early agreement to the package. He would like to be in a position for it to be announced when the new Coal Bill gets its second reading next Monday. Other Departments have not yet commented, but I gather that the Treasury - who claim not to have been fully consulted in advance - may raise some significant worries. Greg Bourne has commented, in his minute at Flag B; he commends the package as a good interim solution, but stresses the importance of ensuring that negotiations proceed on a proper commercial basis to avoid a potential crisis in three years' time when the initial agreement runs out.

You will want to consider how to handle this. I think the options are:

- (i) Broadly accept the package, on the terms recommended by Greg Bourne, without waiting for comments from other Departments. The main argument for this would be that, faced with another difficult hand, John Wakeham has done the best he can, and the package does provide a viable means for pressing on with electricity privatisation.

(ii) Wait for comments from other Departments, and if need be accept that the package cannot be announced as early as next Monday.

(iii) Given the major ramifications of the package for all aspects of the future of the electricity and the coal industries, call a meeting with John Wakeham, the Chancellor, Nick Ridley and Malcolm Rifkind for later this week. At a pinch we could squeeze this in either before lunch on Thursday or late Friday morning.

Fixed
for 12/5
on Thurs
AP 29/11

Which option do you favour?

ms

mcg.

PAUL GRAY

28 November 1989

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PRIME MINISTER

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COAL CONTRACTS

Minute by Secretary of State for Energy

24 November 1989

DECISIONS

Mr Wakeham seeks agreement to the outline coal supply contract agreed between British Coal and the electricity generators.

2. The Chancellor of the Exchequer may minute you before the meeting. Treasury advice is that the package is acceptable in principle but the financial terms require further work.

3. In discussion you may wish to concentrate on the effect on:

i. the coal industry. The contract will contribute to a substantial rundown over the next 3 years. You will want especially to ask about the effect on the UDM, and on the prospects for industrial action. As to the financial terms, you may be prepared to agree the package in principle but will want the level of support to be further discussed by the Chancellor and Mr Wakeham.

ii. the electricity industry. The key point here is Mr Wakeham's judgement that the package will allow the flotation to go ahead.

4. Finally, you will want to consider the form and timing of public disclosure of the package. There must be a risk of leaks. But you will probably want the financial aspects to be sorted out with the Chancellor before anything is said publicly. You may also want there to be a report to E(A) or Cabinet.



BACKGROUND

5. In June Mr Parkinson proposed, and you agreed, a transitional period of 5 years before British Coal prices were reduced to the world level. Sir Robert Haslam later put proposals to the generators accordingly. Mr Wakeham now reports that British Coal and the generators have been able to agree only a 3-year deal. They still disagree about the likely level of world-related prices after 3 years.

ISSUES

Effect on British Coal production

6. The deal would require the closure of 10-12 pits in the next year or so, with further closures after that which could be justified on grounds of exhaustion. The reduction in manpower over the next 4 years would be about 25,000.

7. In the summer you asked for the UDM's position to be considered "with particular care and sensitivity". Mr Wakeham now says that it will be "almost impossible" to shield them completely from further closures. You may wish to ask about the effect on the UDM, and especially whether any estimate can be provided of the number of closures or job losses affecting them.

8. Mr Wakeham says he will ask both sides to consider the scope for "differentiation in contract prices" to the benefit of the UDM. You may wish to explore this. The CEGB have for many years argued that coal prices should be related more closely to costs at individual pits, and such a change seems likely to benefit the lower-cost UDM pits.

Independent Review Body

9. British Coal have said that the rundown in prospect would require the Independent Review body on colliery closures to be abandoned, although in September Mr Wakeham doubted whether this was necessary. You may wish to ask about the latest thinking on



the Review Body, given the special interest NACODS take in it.

Compulsory redundancies

10. Mr Wakeham also reported Sir Robert Haslam in September as believing that compulsory redundancies might be necessary, although again he doubted it. You may wish to ask for the latest assessment of the need for compulsory redundancies.

The risk of industrial action

11. Mr Wakeham says that although the contraction of the industry will not be easy to manage, he does not at present see any major risk of industrial action, although it can never be completely ruled out. You will wish to probe this assessment. (This year's pay round has gone well in coal. The settlement awarded to the UDM has been imposed on the NUM, whose special delegate Conference rejected industrial action. NACODS have not yet settled, but are expected to do so).

12. Depending on the discussion about the risk of industrial trouble, you may wish to ask Mr Wakeham whether any further preparatory action, such as increasing coal stocks, is necessary.

Effect on British Coal finances

13. Mr Wakeham asks for agreement in principle that British Coal should receive further help to avoid heavy losses over the next few years. It would be authorised under the powers in the Coal Bill which has just been introduced. The Treasury may agree that support is needed in principle, but argue that it should be reduced by cutting investment and tough cost targets. The Chancellor has not yet however taken a final view. Subject to the discussion, you may be prepared to accept in principle that extra support is needed but will want to ask Mr Wakeham to agree the amount with the Chancellor.



Effect on electricity privatisation

14. Mr Wakeham says that the prices agreed are not as low as the generators would have wished, but they should allow flotation to proceed. The judgment that flotation will be possible is crucial and you will wish to check that Mr Wakeham is satisfied that it is right. You could ask how far British Coal's prices now exceed the world level, and how quickly they are likely to come down to it.

EC and UK competition law

15. You might ask about the status of the proposed deal under:

- the UK's competition legislation;
- the Community's rules on competition. Is Commission clearance required?

Scotland

16. The proposed deal applies only to England and Wales. You might ask Mr Rifkind what he has in mind for Scotland.

Next steps

17. You might ask Mr Wakeham when the deal will become public knowledge. It may leak from one of the industries and there may be pressure for some disclosure during the passage of the Coal Bill. But you may prefer nothing to be said until Mr Wakeham and the Chancellor have agreed the financial terms.

18. You may also want to consider whether at some stage there should be a formal reference to E(A) or Cabinet.

R.T.J.

R T J WILSON
Cabinet Office
November 29, 1989