

E(81)80

COPY NO

58

22 July 1981

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BRITISH GAS CORPORATION'S MONOPOLY

Memorandum by the Secretary of State for Energy

Introduction

1. The purpose of this memorandum is to seek approval for the drafting of legislation to change the monopoly position of the British Gas Corporation (BGC). Cabinet is to decide on 30 July whether space should be found in the 1981/82 legislative programme for such a Bill. In earlier discussion on 11 June (CC(81)22nd, Minute 4), the Cabinet had asked for the Bill to be ready for introduction considerably earlier than February 1982, and I have accordingly arranged for it to be ready immediately after Christmas.

Present Position

2. At present BGC have virtually complete control over the market for gas in this country. With minor exceptions mainly related to the petrochemical industry (i.e non-fuel use) BGC are effectively:-

- the only buyer of gas from on and offshore sources;
- the only agency allowed to transmit gas through pipelines onshore;
- the only seller of gas to final consumers.

The Case for Change

3. We are all agreed that a major disadvantage of public sector monopolies is that they lack the competition needed to ensure internal efficiency and the proper allocation of resources. BGC faces some market competition from other fuels but these are generally higher cost and through its purchasing monopoly the Corporation has a large degree of control over the price it pays for gas. There are therefore considerable political attractions in changing the present position so far as BGC is concerned. Such a move would be highly popular amongst our supporters.

4. Onshore, the monopoly has had a major effect on the gas price structure. Decisions by BGC and by Government in the past have resulted in a significant price benefit going to small (especially domestic) consumers. This has resulted in buoyant domestic gas demand which, because of BGC's statutory obligations, has had to be met whilst many industrial companies have over the past few years been denied supplies. This diversion of supplies has been a serious mis-allocation of our gas resources. Allowing the effects of competition to bring about a fundamental restructuring of prices to consumers accords with the Government's economic philosophy.

1.

5. The influence of BGC's monopoly also extends back upstream to offshore gas exploration and production, normally regarded as class risk-taking, entrepreneurial activities. BGC's purchasing monopoly so dominant however that exploration has been discouraged and licenses have, in some cases, been unwilling to proceed with development of discoveries. The same argument applies to gas manufacturing (for the production of synthetic natural gas) and to importing liquefied natural gas. These activities could be carried out by private firms as well as BGC, but this is unlikely to happen whilst BGC is a monopoly purchaser.

6. I therefore propose that we should introduce legislation to remove BGC's gas purchasing monopoly and to break their monopoly over sales to industrial consumers. The broad intention would be to free manufacturing industry (defined in terms of the Standard Industrial Classification) to purchase gas, without BGC acting as intermediary. The monopoly of supply to non-industrial (including domestic) users would however be preserved because in this case the existence of a monopoly supplier confers genuine advantages (security of supply, safety, lower cost economies of scale and avoidance of duplicate facilities). Legislation will give us the following advantages:-

- (a) improved efficiency of BGC, through increased competition;
- (b) an increase in gas exploration and production;
- (c) a better allocation of gas resources in the economy.

OTHER IMPLICATIONS

7. (a) Landing Requirement

The requirement that gas from our Continental Shelf must be landed in the UK is already vulnerable to attack on grounds that it is incompatible with the Treaty of Rome. Removal of the BGC monopoly is not directly connected with the landing requirement since the monopoly only applies to gas coming onshore in the UK. But this could possibly encourage some licensees to seek approval to export gas. We would have to consider the desirability of this when the time came and, if we decided against it, I have available powers to prevent gas from being exported. Nevertheless a succession of cases in which I used these powers might lead to our being challenged under the Treaty.

(b) Economic and Financial

In consultation with the Treasury and Inland Revenue, my officials have studied the likely economic consequences of removing BGC's monopoly. Their analysis shows that the new regime could increase total gas production. The powers for any depletion controls which we wished to exercise in consequence already exist. The economic analysis also shows that the resource gains from breaking the monopoly should outweigh any losses and that the FSRB should benefit over time. No insurmountable technical problems are foreseen in introducing taxation changes to recoup part of the high profits likely to be earned on new Southern Basin gas developments under the new regime, if that is desired.

(c) BGC Pipeline System

An important problem in achieving the objectives of the Bill stems from the difficulty which private sector suppliers may have in transmitting gas to the point of consumption. I intend that the private sector should have greater freedom under the new regime to build its own onshore pipelines, but in practice it may only be economic to do so in the case of large bulk supplies or supplies to customers whose premises are near the landing point of the gas. To encourage private sector deals on any scale it will be essential for access to be given to the national transmission system operated by BGC. The first step will be to impose a duty on BGC not unreasonably to refuse to carry private sector gas. But that will not be enough in itself. Difficulties are still likely to be encountered if BGC act, or are alleged to act, unreasonably (for example by charging unfairly for transmitting gas or claiming to have insufficient capacity).

A form of regulation will be needed to overcome these problems. One solution would be to set up an independent regulatory agency. The difficulty here is that it will be impossible at the outset to forecast the volume of regulatory work likely to be generated by the new policy. It would be useful to gain some experience of this role before attempting to establish an agency and deciding on its size and structure. An alternative would be to vest the regulatory powers in me but that could not be done without providing additional staff for my Department. I believe that a regulatory agency is the better solution in the longer term, provided the volume of work justifies it. I propose therefore that the regulatory powers should be vested in me initially but that this should be regarded only as a first step towards setting up an agency when the volume of business is sufficient to support an independent body.

FINANCIAL AND STAFFING CONSEQUENCES

8. On the basis of my proposal in paragraph 7(c), additional staff will be required during the period in which regulatory powers are vested in me. I shall need an additional 8 to 10 staff, including professional grades, to deal with the relatively small number of cases which might arise in the early stages. Some of these staff will be required before the legislation is passed to prepare the groundwork. I might also need to employ one or two consultants to help with this in the first year. If the policy succeeds in due course in generating a great deal of direct business between private sector producers and consumers, the staff requirements could rise to perhaps 40 to 50; but at that stage we would transfer the work to a separate agency. This additional task, even though an interim one, could not be contained within current staff ceilings. Significant financial consequences apart from those arising from staffing and the employment of consultants as outlined above, are not anticipated.

COVERAGE OF BILL

9. The rights and duties of BGC which support their present monopoly are described in Annex I. This goes on to list the changes which are intended to make in the proposed Bill. The most important of these relate directly to the breaking of the monopoly and to the requirement that BGC should transmit third party gas. I am assuming, on the basis of legal advice, that there will be no case for compensating private landowners whose third party gas is transmitted through existing pipelines under their land. If we do encounter problems on this, I will consult my colleagues further.

RECOMMENDATION

10. I recommend that approval be given for the drafting of a Bill as outlined in para 9 and incorporating the changes referred to in Annex I.

Department of Energy

22 July 1981

DARH

ANNEX IPRESENT RIGHTS AND DUTIES OF BGC AND PROPOSED CHANGESPresent Position

1. The legal powers which have created BGC's monopoly position have derived over the years from the concept that a single public utility should operate the British Gas supply system. The powers which create the monopoly position are paralleled by duties imposed on the Corporation. Section 52 of the Gas Act 1948 effectively gave Area Boards the sole right of supply of gas through pipes. Section 9 of the Continental Shelf Act 1964 disapplied that provision to offshore natural gas but required ministerial consent to the supply of such gas through pipes. Such consent could not be given for non-industrial purposes nor for industrial fuel purposes unless the relevant Area Board (subsequently BGC) had been given an opportunity of purchasing the gas at a reasonable price. Such consent had to be given for supplies for industrial non-fuel purposes. Sections 8 to 11 of the Energy Act 1976 repealed section 9 of the 1964 Act replacing it with similar (but more elaborate) provisions. There have so far been no formal approaches by producers to the Secretary of State to seek his decision on whether, for the purposes of these provisions, they have offered gas at a reasonable price.

2. These privileges may be seen as the converse of BGC's duty under the 1972 Act

" to develop and maintain an efficient, co-ordinated and economical system of gas supply for Great Britain, and to satisfy, so far as it is economical to do so, all reasonable demands for gas in Great Britain".

Alongside this general duty, BGC are obliged to supply gas on request to any premises within 25 yards of an existing main, subject to the limitation that they need not supply any premises with more than 25,000 therms a year (a small amount by industrial standards). This last limitation was introduced by section 13 of the Energy Act 1976 and strengthened by the Gas Act 1980.

CONFIDENTIALANNEX I CONT'DProposed Changesa. Gas purchase/supply3. i. Repeal of sections 8(3) and 9(3) of the Energy Act 1976

This will remove the need for BGC to have first option on the purchase of UKCS gas at a reasonable price before any person can supply it, or a purchaser from a producer can use it for industrial fuel purposes. This will put supplies or use of such gas on the same footing as supplies of gas for non-fuel industrial purposes over which BGC enjoys no special rights of first refusal but for which the Secretary of State's consent is required. It is not proposed that the need to obtain the Secretary of State's consent should be repealed as the Government will need to satisfy itself that this finite national resource is not used wastefully.

ii. Amendment of section 29 of the Gas Act 1972

This section will need to be amended to put the supply of manufactured and imported gas on the same basis as UKCS gas as in i above.

iii. Amendment of sections 26 and 31 of the Gas Act 1972

These sections deal with standards of quality, pressure of gas supplied, and gas safety, but only apply to BGC at present. These provisions will need to be extended to all potential suppliers.

iv. Amendment of section 4 of the Petroleum (Production) Act 1932

This gives BGC first offer rights at a "reasonable price" on gas found onshore in Britain. BGC's right of first refusal will be abolished but not the need for the Secretary of State's consent for the reasons given in i above.

ANNEX I CONT'D

v. Amendments may also be needed consequential to i - ii above to prevent anomalies in relation to the Gas Act 1980. This will be studied further.

b. Gas transmission/distribution

Powers will be vested in the Secretary of State for Energy to regulate common carrier questions. An additional duty will be imposed on BGC not unreasonably to refuse to carry private sector gas. Sections 26 and 29 to 31 of the Gas Act 1972 will need to be modified to take account of the impact of the changes on the Secretary of State's responsibility for safety and quality standards. Where BGC transmit gas under sole rights granted by landowners, in respect of pipelines under their land, such rights will require modification.