PREM 19/1328

PART NINE

SECRET

CONFIDENTIAL FILING

Gas and Electricity Pricing Policy

Gas and Electricity Industries EFL's

Industrial Energy Policy

NATIONALISED INDUSTRIES

Pt 1: SEPTEMBER 1979

Pt 9: JANUARY 1984

PREM 19/1328

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
23.1.84		8.5.84					
25.1.84		9.5.84					
8.1.84		7.6.84					
9.2.84		11.6.84					
13.2.84		20.6.84					
14.2.84		2.7.84					
22.2.84		3.7.84					
24.2.84		6.7.84					
27.2.84		31.7.84					
2.3.84		2.8.84					
7/3/84		7.8.84					
8/3/84		15.8.84					
12.3.84		5.9.84					
20.3.84		13.9.84					
22.3.84		17.9.84					
4.3.84		21.9.84					
		15.8.84					
		ENDS.					

PART Pt 9. ends:-

s/s Energy to Ch/Ex 15/8.

PART Pt 10 begins:-

s/s DTI to Ch/Ex 5/9.

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
ES(84) 2nd Meeting, only item	20/06/1984

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed J. Gray Date 17/7/2013

PREM Records Team

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

House of Commons – Eighth Report from the Energy Committee – Session 1983-84 – The British Gas Corporation's proposed purchase of Gas from The Sleipner Field, published by HMSO 21May 1984. ISBN 0 10 243884 6

Signed J. Gray Date 17/7/2013

PREM Records Team

CEN 9
2

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

Prime Minister

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Whitehall
LONDON SW1

15/8

15 August 1984

My Nigel

ELECTRICITY: NEXT FINANCIAL TARGET

Thank you for your letter of 2 August.

As you say, it is a little early to start a debate on the ESI's financial target before we have had, and been able to examine, formal proposals from them explaining the basis of the new financial target which they appear to favour.

I note your argument in favour of a much higher rate of return, 5%: that the industry has been long required to earn a 5% rate of return on new investment, and that therefore this ought by now to be achievable on all its net assets. The 5% Required Rate of Return - on new investment programmes as a whole - was however enshrined as a Government objective only in the 1978 White Paper (Cmd 7131). The bulk of ESI investment now productive was undertaken in the 1950s and 1960s; and it would be quite unrealistic to expect that, within 7 years of the publication of the White Paper, the industry's overall investment programme should be earning a return of 5% real - particularly in view of the substantial over-capacity which resulted from the ambitious growth expectations and investment programmes in the period up to about 1973. In that connection, I ought to say that I do not think that the view of your officials that ESI assets "are properly valued to within about 10%" is one which the ESI would accept, certainly as a basis for a 5% CCA return.

Moreover, the 1979 White Paper said that the opportunity cost of capital was only one of the factors in determining financial targets: sectoral and social as well as counter inflation policy considerations needed to be taken into account.

We should, at all events, be cautious about deriving financial targets (and therefore pricing levels) direct from asset values in the balance sheet - as distinct from expressing it in terms of a return on assets. In the first place, it is doubtful whether asset valuations take proper account of all the market and economic considerations which must influence our decisions on financial targets and pricing levels.

My officials continue to debate these matters with yours and with the ESI. Secondly, assets in the ESI's accounts are valued on a CCA basis. Though the target rates of return of 1.4% or 2% may seem modest enough, they represent rates of return on an historic cost basis in the range 12% to 15% - by no means a poor performance compared with a good deal of the private sector, recognising that the industry is recovering from over-investment in the '50s and '60s and substantial over-capacity as a result.

All that said, I entirely agree with the main point in your letter: namely, that we should look hard at every opportunity to contain the ESI's costs, so as to achieve a satisfactory financial target without pushing up real prices; especially as it is no more than market and economic sense that a capital intensive industry with substantial over-capacity should improve its <u>relative</u> pricing, ie raise prices at less than the rate of inflation. My officials are already examining all the areas for cost saving you mention in your letter; and will be glad to discuss their conclusions with your officials in the normal way. I must make it clear however that cost savings of the order required to achieve a 5% return on net assets without any real price increase, cannot be achieved within the next few years. Such savings would be roughly equivalent to a reduction of 33% in the ESI's controllable costs. I intend to press the industry hard on the level of the next performance aim but cost reductions of £1 billion a year are impossible.

I am copying this letter to the Prime Minister and to Norman Tebbit.

Pete

PETER WALKER

Gas & Elec NAT. IND. Pt 9.

15

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

Adam Butler Esq
Department of Economic Development
Netherleigh
Massey Avenue
BELFAST
BT4 2JP

15 August 1984

Dear Adam

Thank you for your letter of 7 August about electricity tariffs in Northern Ireland and the effects of the miners' strike.

There is no plan to raise electricity tariffs in Great Britain during the strike. This conclusion was reached after careful consideration of the impact of any such move on the handling of the strike itself and of the scale and nature of the extra costs arising from it. The position will be reviewed when the strike ends.

Meanwhile I am grateful to Jim Prior and to yourself for bringing your situation to my attention.

I am copying this letter to the Prime Minister, to the Chancellor of the Exchequer, and to Sir Robert Armstrong.

Peter

PETER WALKER

Gas & Electricity. NAT. IND. Pt 9.

FROM: MINISTER OF STATE

SECRET

1 of 14

K4

010

DEPARTMENT OF ECONOMIC DEVELOPMENT

NETHERLEIGH
MASSEY AVENUE
BELFAST
BT4 2JP

Telephone 63244

2

Peter Walker Esq MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

Prime Minister

7/8

7 August 1984

Dear Peter.

Jim Prior has asked me to write to you on his behalf to draw your attention, and that of colleagues, to an awkward problem that we face in relation to electricity tariffs in Northern Ireland as a result of the current miners' dispute.

Supplies of coal to the Northern Ireland Electricity Service (NIES) have dried up completely and the Service, which had previously been maximising its coal burn, has had to switch to oil-fired generation, with a consequent increase in costs currently running at about £800,000 per month. Since NIES runs an operating deficit which is funded by Government, these extra costs will represent an additional demand on public expenditure unless we take steps to avoid this. The natural course of action would be to increase electricity tariffs - by 3% if it is assumed that coal supplies will be resumed on 1 October, or by 4% if the date of resumed supply is assumed to be 1 November. To make such a move in Northern Ireland ahead of action in Great Britain would, however, run directly against our firmly stated policy of keeping Northern Ireland electricity tariffs in line with the highest in England and Wales, and would therefore provoke a political furore in Northern Ireland - but we may have no option but to grasp that nettle.

More crucial, however, is the need to reconcile any such increase in tariffs in Northern Ireland with our overall attitude to the miners' dispute and its effects. Any reasons which we might advance for so recouping additional costs in Northern Ireland could be held to apply equally to the rest of the United Kingdom. It would clearly be much more acceptable politically if any tariff increase in Northern Ireland followed a similar rise in Great Britain, and maintained the relationship which currently exists. If there is likely to be any decision in the early Autumn to raise tariffs in Great Britain (as Norman Tebbit appeared to be hinting last week) then this would create the necessary room for manoeuvre in Northern Ireland; but if any decision on raising tariffs in Great Britain is likely to be postponed much beyond early September, our difficulties in Northern Ireland will multiply. The required 4% increase at 1 November rises to 9½% if applied from 1 January / and that of course would not take account of the additional cost of

SECRET

Peter Walker Esq MP

of our normal oil burn arising from higher sterling oil prices7. The later the decision, the greater the size of the tariff increase, or, alternatively, the shorter the time available to find funds to meet the extra public expenditure provision which would be in a cash limited area and quite impossible to cover. It is that impossibility which is at the heart of our problem.

I appreciate, of course, that there are many sensitive considerations to take into account. But I thought I should alert you now to the additional difficulties we face in Northern Ireland, so that they may be taken into account in your thinking. If considerations of national policy mean that no decision to raise tariffs in Great Britain is to be taken by early September, then I will need to consult you and our colleagues again with a view to deciding whether tariffs should be increased uniquely in Northern Ireland.

I am copying this letter to the Prime Minister, to the Chancellor of the Exchequer, and to Sir Robert Armstrong.

Yours ever

Adam.

ADAM BUTLER

Electricity Prices

8.16 cc NO

CONFIDENTIAL

Prime Minister (2)

The opening shots in what will be a tough battle.

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

2 August 1984

The Rt Hon Peter Walker MP
Secretary of State for Energy

Dear Secretary of State,

ELECTRICITY: NEXT FINANCIAL TARGET

I was a little surprised, as no doubt you were, to see figures starting to appear in the press last week about the Electricity Industry's position on the level of their next financial target. It seems early to start this debate.

As the debate does appear to have started, however, I thought I should let you know now that we shall be looking to move to a level of about 5 per cent, rather higher than figures attributed as the industry's view. This is based on the straightforward proposition that an industry which has long been required to earn a 5 per cent return on new investment (and is still expected to do so) should produce a 5 per cent return on its assets valued in current cost terms. Studies involving my officials and the industry suggest that the ESI's assets are properly valued to within about 10 per cent.

I doubt this given, coal strike apart, the enormous surplus capacity. AT

The immediate purpose of this letter is not, however, to open a debate on these broader policy issues. My concern is that this question should not be addressed solely in terms of target levels and prices. That would obscure the other key factor - the industry's own costs.

All the indications are of unparalleled scope for savings over the next three to five years. Some areas are:

(a) the continuing real reduction in power station coal prices under the new NCB/CEGB Joint Understanding.

(b) the availability of cheap French and Scottish electricity over the interconnectors.

(c) the coming fully on stream of the three delayed AGR stations with Heysham II to follow, and the extended life of Magnox.

(d) the new terms of trading between CEGB and BNFL aimed at cost reduction on nuclear fuel services (though yet to be formally approved between us), which should more than offset other nuclear cost increases.

(e) the recent MMC report of Area Boards which have shown performance in containing costs which was (for example in South Wales) not "particularly impressive". The new performance indicators to be published shortly will give clear pointers to further areas for savings.

(f) the reduction in the number of CEGB's power stations, and the ending of a large building era, which should give new opportunities for major savings in the Board's overheads and manning.

(g) the fact that the industry have acknowledged that certain staff are overpaid. Total salary costs per unit increased by 9 per cent in real terms between 1979 and 1983, despite a manpower run-down, with employees moving steadily up the earnings' league table.

No doubt many other possibilities are evident to your Department.

I suggest, therefore, that we should tackle costs before beginning any discussion on prices, and that officials could begin by examining what reductions would be needed to achieve a 5 per cent target without real price increases. That is consistent with the approach recommended by E(A) on 3 July. Peter Rees, of course, will be in touch later about the implications for the 1984 Investment and Financing Review.

A copy of this letter goes to the Prime Minister and to Norman Tebbit.

Yours sincerely,
Judith Simpson

NIGEL LAWSON

approved by the Chancellor and signed on his behalf.

14

SECRET

(2)

PRIME MINISTER

Electricity Prices

The Chancellor is proposing bringing forward to September the 6 per cent increase which he considers is necessary anyway from next April. He would like to discuss this with you for 15 minutes before Cabinet.

The Chancellor makes no suggestions on how the agreement of colleagues should be sought. The next stage is surely for him to talk to Mr. Walker (and Mr. Younger has responsibility for electricity prices in Scotland) together with Mr. Tebbit. When we know their positions, it will probably be necessary, given the political sensitivity of the issue, to seek the endorsement of a wider group of colleagues. This could be MISC 101 or E(A).

AFT

I would do it in 2 stages

M

ANDREW TURNBULL

3 July, 1984

SECRET

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

Following my minute of 26 June, I said I would minute further on electricity prices.

2. This year's public expenditure situation has deteriorated in recent weeks. You will recall that the previous forecast was for an overshoot of £½ billion on total public spending. It is becoming increasingly clear that local authority capital overspending will, unless we take swift action to contain it, increase this figure by anything between £¾-1¼ billion. Further, the earlier forecast assumed that the miners' strike would be over by the end of July. That assumption is looking increasingly improbable. The strike has cost the public sector about £300 million to date and these costs are mounting at the rate of £30 million a week.

3. We are considering urgently how to deal with the huge overspend on local authority capital. On the costs of the miners' strike, we have so far deferred any action on electricity prices. Given the seriousness of the overall public expenditure I believe that we must now take action.

4. As a direct result of oilburn, the CEGB's costs are now running some 10 per cent higher than was foreseen at the start of the year. To the end of June the miners' strike had cost them some £250 million. While this would fully justify a corresponding 10 per cent increase in electricity prices, it may be argued that at least part of the cost should fall on the Reserve. But I believe we should at least agree to an increase of 6 per cent to all consumers.

5. This is the increase which I believe would be in any case needed next April to validate the decisions on nationalised industries taken at E(A) this morning. Bringing forward the increase in this way would mean that, if the strike lasted another month or so, we would not need another electricity price increase for at least 12 months. Of course if the strike lasted longer we might have to reconsider the position earlier than that.

6. We need to take decisions now to enable the price increase to come into effect at the beginning of September. Bringing forward the increase in this way would of course also bring forward an addition of something rather less than 0.2 percentage points to the RPI. It would generate some £250 million in 1984-85 and so make a valuable contribution to our public expenditure problem; and it should avoid the need for further discussions about electricity price increases in April 1985 in the Public Expenditure Survey.

7. Needless to say, it would be desirable to ensure a reasonable gap between any action we decided to take on local authority capital spending and the announcement of an increase in electricity prices. In any event the latter should be announced by the electricty industry itself and presented as action by the CEGB in respect of the additional cost it is incurring to ensure electricity supplies to its customers.

NL.

N.L.

3 July 1984

TOP COPY FILED ON:
PRIME MINISTER: Mtg with Mr Garvin of EXXON - June 82

CONFIDENTIAL

PRIME MINISTER'S MEETING WITH EXXON - 3 JULY 1984

SLEIPNER

LINE TO TAKE

- Last week we told the Norwegian Government of our requirements for approval of the Sleipner deal.

- We believe that these requirements are compatible with the essence of the draft commercial contract and we hope you will use your good offices to give our proposals a fair wind.

BACKGROUND

1. The Minister of State for Energy met Norwegian Ministers in strict confidence last Wednesday. Mr Buchanan-Smith tabled the terms on which HMG would approve the draft Sleipner contract between BGC and Sleipner partners (Statoil, Esso, Norsk Hydro). These concern (i) offtake rates, (ii) destination of liquids, (iii) control over pipeline capacity and (iv) UK content in the project.

2. The Norwegians maintained that these were not issues for Governments to negotiate upon. The UK rejected this and the meeting closed. Subsequent contacts indicate that this was merely an opening Norwegian line and we expect serious Government-to Government negotiations to take place soon.

3. Esso (with a 26% share in Sleipner) appear very keen that the Sleipner project goes ahead. Their position seems more flexible than Statoil's and Mr Garvin's influence could be helpful in getting the Norwegian Government to adopt a realistic stance when negotiations resume.

N.B. 4. WE HAVE LEARNED THIS AFTERNOON THAT MR GARVIN HAS UNDOUBTEDLY BEEN BRIEFED BY ESSO NORWAY ON THE LATEST MOVES.

Gas 4 (D/Energy)

2 July 1984

PRIME MINISTER

KINSALE GAS

Mr Prior's minute of 22 June reported the deterioration in the economics of the Kinsale Gas project. He set out three options - cancellation, perserverance and renegotiation. The Foreign Secretary recommends renegotiation though acknowledges that it might be necessary ultimately to cancel the project. To cancel the project without attempting further negotiation would have serious political disadvantages. The Chief Secretary believes that there is no genuine prospect that the economics of the project can be restored by further negotiations and recommends cancellation now.

Mr Prior's paper implies that renegotiation and cancellation are alternatives. In practice, these could be two stages in the same process. It would be important to enter further negotiations with a minimum objective which, if not achieved, would lead to cancellation. To enter negotiations knowing that the project would be retained come what may would be very dangerous particularly if this were ever known by the Opposition.

(i) Agree that the negotiations be attempted but in the knowledge that there is a price beyond which we cannot go?

(ii) Agree that after renegotiation the terms be put to colleagues for approval?

2 July 1984

SL HAAY

SECRET

File 12B

RECORD OF MEETING BETWEEN THE PRIME MINISTER AND SIR PETER WALTERS (BP) ON TUESDAY 19 JUNE AT 1630

Sleipner Gas

Sir Peter Walters came into see the Prime Minister to give her his views on whether the UK should purchase gas from the Sleipner field. He was concerned at the advice which it appeared Ministers were receiving. When BGC's monopsony was broken, BGC began to offer significantly improved prices for UKCS gas - around 18p for associated gas and around 22p for gas only fields compared with previous offers of around 10p (Sir Peter expected the Sleipner offer to be around 27p). This had released a new spate of activity. BP had found four small fields off Yorkshire which together had reserves of 2½tcf and on a neighbouring block CONOCO had discovered reserves of a similar size. Undoubtedly other developments would follow.

Sir Peter said that BGC were anxious about security of supply for the UK in the 1990s when there appeared to be a shortfall between demand and known reserves of about 9tcf. Purchase of Sleipner, accounting for around 7tcf, would substantially meet that gap, leaving only a small amount of additional gas to be found on the UKCS. The Sleipner contract would cost £20 billlion in foreign exchange over 15 years. Compared with seeking this gas from the UKCS, there would be a loss of revenue to the Exchequer, a loss of jobs and a loss of opportunities for the offshore industry. Supplies for UKCS developments had a British content of 70-75% while British firms would probably secure only 15% of supplies for the development of the Sleipner field.

Sir Peter was confident that the 9tcf shortfall in the 1990s could be met from domestic resources as he estimated that UKCS gas reserves were 20-25tcf. The only doubt was

SECRET

whether all the necessary gas could be developed in time to meet demand in the early or mid 1990s. He felt this risk was acceptable as even if it couldn't it would still not be too late to secure imported supplies.

Sir Peter said Ministers were being offered a "siren solution" of accepting the Sleipner contract while allowing exports of UKCS gas. While this appeared to satisfy all parties he did not believe it provided a good incentive for the development of domestic resources. The outlook for gas supplies in Europe had changed radically in recent months. In particular the Netherlands had upgraded the reserves on the Groningen field by 25% from 54 to 67tcf. This represented no less than one third of the 35tcf which the Continent would need by the end of the century. UK producers would thus find themselves excluded from a large part of the UK market by Sleipner while being forced to export into a plentiful market.

The Prime Minister thanked Sir Peter for his views which she would keep in mind during the forthcoming discussions on Sleipner.

20 June 1984

SECRET

12A

PRIME MINISTER

You will need to look at Mr Walker's 2e card paper though it is largely a series of debating points.

Although the E(S) meeting is on Wednesday, you might like to look at this folder tonight. First, you have more time tomorrow; second, you will want to try out some of the propositions in the papers when you see Sir Peter Walters at 1630.

(i) Do BP really go as far as to claim that the UK could dispense with imported supplies after 1990?

(ii) If some imports are required, how do we ensure maximum development of UKCS resources?

(iii) How do BP assess profitability of UK gas prospects at the prices BGC is offering domestically, e.g., 24p per therm?

(iv) How should the export regime be specified so as to give maximum confidence to producers while safeguarding future supplies to the UK?

While Sir Peter is in you could ask him about

(i) his assessment of the Gulf

(ii) what he would do about BNOC.

AT

18 June, 1984.

SECRET

ANNEX A

TREASURY DRAFT

I have authorised BGC to enter into contract with Statoil and its partners for the purchase of gas from the Sleipner Field.

This contract will greatly reduce the risk of a major shortfall in supplies of natural gas to BGC to meet the requirements of both industry and the domestic consumer so far as we can now foresee them. BGC will also require substantial further quantities of gas from fields on the UK Continental Shelf.

The Government considers it important to ensure that the purchase of Sleipner gas should not have an adverse impact on future exploration and development acitivity on the UKCS. The Government has therefore decided to waive the landing requirement for gas on new UKCS developments for as long as proven gas reserves exceed 5 years consumption of gas at existing levels. This will provide proper incentives to companies active on the UKCS while at the same time protecting the UK's own security of supply.

CONFIDENTIAL

P.01314

PRIME MINISTER

Sleipner Gas

The meeting of ES arranged for Thursday 14 June was broken off before it began when the Secretary of State for Energy circulated his lengthy minute of 14 June round the table. Despite its length it is concerned almost wholly with rebutting statements or implications in the Chancellor of the Exchequer's minute of 12 June which are not central to the issue facing the Committee. That is, what should be the nature of the new export regime which, as seems to be common ground between the Chancellor of the Exchequer and the Secretary of State for Energy, will be needed on the assumption that the proposed purchase of gas from Sleipner will go ahead? The only significant new point is that Mr Walker has now put forward the draft text of a Government announcement. This should enable the Committee to judge better whether, as Mr Walker claims, a regime on which the onus of proof would lie on those wishing to export gas would give a clear enough assurance to ensure continued exploration, development and exploitation of gas reserves on the UKCS. Otherwise, the brief I previously submitted stands.

PG

P L GREGSON
Cabinet Office

18 June, 1984

CONFIDENTIAL

Sherpa file

Private Office
No 10 Downing St

With the compliments of

ENERGY, SCIENCE AND SPACE DEPARTMENT

18/6/84

John Nichols
x3533

FOREIGN AND COMMONWEALTH OFFICE
SW1A 2AH

GRS 100
UNCLASSIFIED
COMMERCIAL IN CONFIDENCE
DESKBY 180900Z
FM OSLO 180800Z JUN 84
TO IMMEDIATE FCO
TELEGRAM NUMBER 123 OF 18 JUNE
AND TO DEPT OF ENERGY

YOUR TEL 83: SLEIPNER
IN A RADIO INTERVIEW SUBSEQUENTLY REPEATED ON TELEVISION ON 16 JUNE, PRIME MINISTER WILLOCH SAID THAT THE BRITISH AUTHORITIES HAD A CLEAR CHOICE OF SAYING YES OR NO TO THE ENTIRE SLEIPNER AGREEMENT. IN THE LATTER CASE, THE NORWEGIAN GOVERNMENT WOULD HAVE TO CONSIDER WHETHER TO DEVELOP OTHER OIL FIELDS BEFORE SLEIPNER OR TO SEEK ALTERNATIVE CUSTOMERS. WILLOCH ALSO SAID THAT STATOIL AND THE MINISTER OF PETROLEUM AND ENERGY SHOULD ACT IN UNITY AND SUPPORT EACH OTHER'S POSITION TOWARDS THEIR OVERSEAS COUNTERPARTS. SEE MIFT.

BENTLEY

LIMITED
ESSD
WED
TRED
PS
PS / MR WHITNEY
PS / PUS
SIR C TICKELL
MR JENKINS
MR ADAMS
PS / LADY YOUNG

COPIES TO
MR P HARDING
GAS DIV DEPT OF ENERGY

MR BRINDED GAS DIV
DEPT OF ENERGY

CONFIDENTIAL

GRS 5600
CONFIDENTIAL
DESKBY 180930Z
FM OSLO 180810Z JUN 84
TO IMMEDIATE FCO
TELEGRAM NUMBER 124 OF 18 JUNE
AND TO DEPT OF ENERGY

MIPT: SLEIPNER

1. THIS PUBLIC CONFIRMATION OF WHAT KRISTIANSEN TOLD MINISTER OF STATE FOR ENERGY BY TELEPHONE ON 15 JUNE IS A NEW AND AWKWARD DEVELOPMENT. IT HAS COME WITH VIRTUALLY NO WARNING, THOUGH I RECEIVED VEILED HINTS OF SOMETHING OF THIS SORT FROM OFFICIALS MET BY CHANCE ON THE EVENING OF 14 JUNE.

2. IT UNDOUBTEDLY OWES MUCH TO GROWING DISQUIET, PERHAPS IRRITATION, AT THE LONG DELAY IN GIVING THE NORWEGIANS HMG'S VIEWS ON THE AGREEMENT REACHED BETWEEN BGC AND STATOIL AND TO THE EXTENSIVE PRESS SPECULATION ABOUT THE LIKELY CONDITIONS HMG MIGHT ATTACH TO RATIFICATION. BUT IT SEEMS TO HAVE BEEN PRECIPITATED BY THE ACUTE DIFFICULTIES WHICH CAME TO A HEAD LAST WEEK BETWEEN THE GOVERNMENT AND ARVE JOHNSEN, STATOIL'S MANAGING DIRECTOR.

3. THESE UNEASY RELATIONS HAVE ALWAYS BEEN A POTENTIAL BLOCK TO PROGRESS (MY TELNO 112): AND WHEN JOHNSEN ALLOWED TO LEAK HIS OPINION THAT KRISTIANSEN HAD ENDANGERED A DEAL OF CRUCIAL IMPORTANCE TO NORWAY BY QUESTIONING PUBLICLY THE ASSUMPTIONS UNDERLYING IT, THE CABINET MUST HAVE DECIDED AT ITS MEETING ON 15 JUNE THAT IT HAD BETTER DISTANCE ITSELF FROM STATOIL AND, BY EXTENSION, FROM THE SLEIPNER NEGOTIATIONS THEMSELVES. IN THE RUN-UP TO NEXT YEAR'S GENERAL ELECTION, WILLOCH MUST HAVE BEEN INFLUENCED BY THE FACT THAT KRISTIANSEN IS A FORMER LEADER OF ONE OF THE MINIORITY PARTIES ON WHICH HIS COALITION DEPENDS.

4. I AM NOT SURE WE NEED TO TAKE WILLOCH' STATEMENT WHOLLY AT FACE VALUE FOR THE PRESENT. IT MAY, HOWEVER, BE SIGNIFICANT THAT SO FAR IT HAS ATTRACTED LITTLE PRESS COMMENT, AND THAT DIRECTED MOSTLY AT JOHNSEN AND STATOIL. BUT AT BEST THIS DEVELOPMENT SEEMS LIKELY TO MEAN THE END OF HOPES THAT A RENEGOTIATION BETWEEN THE TWO COMPANIES CAN BE AVOIDED. I THINK WILLOCH WILL WISH TO LEAVE JOHNSEN NO SCOPE FOR CLAIMING THAT AN UNFAVOURABLE DEAL HAS BEEN FORCED ON HIM BY THE GOVERNMENT. AND AT WORSE, OF COURSE, IT MAY MEAN THAT THE NORWEGIANS ARE READY TO ABANDON PLANS TO DEVELOP SLEIPNER FOR THE TIME BEING. WE SHALL TRY TO FIND OUT MORE IN THE COURSE OF THE DAY AND AT THIS EVENING'S QUEEN'S BIRTHDAY PARTY. WE CAN ALSO, IF YOU WISH, GO AND ASK FOR AN OFFICIAL EXPLANATION, PERHAPS BEST FROM STATE SECRETARY BERG AT THE FOREIGN MINISTRY WHO HAS BEEN MUCH INVOLVED AND WAS, I AM TOLD, DEPUTED TO HAUL JOHNSEN OVER THE COALS LAST WEEK. IF I AM TO DO THIS, IT WOULD BE EASIEST EITHER TOMORROW OR TODAY WEEK, AS I AM ENGAGED IN THE NORTH FOR 5 DAYS FROM 20 JUNE, FIRST WITH THE MINISTER OF STATE FOR THE ARMY AND SUBSEQUENTLY ON A FIRST VISIT TO TRONDHEIM. ONE OF THE COUNSELLORS COULD, OF COURSE, TALK TO BERG IN MY ABSENCE.

CONFIDENTIAL

15.

5. IT MAY, HOWEVER, BE BETTER TO CONCLUDE THE EXAMINATION OF THE AGREEMENT NOW UNDER WAY AND THEN PRESENT OUR CONCLUSIONS TO THE NORWEGIAN GOVERNMENT AS EARLIER ENVISAGED. UNTIL THE NORWEGIAN POSITION IS TESTED BY AUTHORITATIVE PROPOSALS, WE SHALL NOT KNOW THE EXTENT TO WHICH THEY MAY BE BLUFFING IN ORDER TO ACHIEVE CONDITIONS MORE ACCEPTABLE THAN THOSE WHICH HAVE BEEN THE SUBJECT OF PRESS SPECULATION. IF THIS CAN BE DONE BEFORE YOUR VISIT NEXT WEEK, SO MUCH THE BETTER: IN THE CIRCUMSTANCES SLEIPNER IS NOW BOUND TO PLAY A LARGE PART IN YOUR CONVERSATIONS WITH NORWEGIAN MINISTERS.

6. I HAVE UNDERTAKEN TO ATTEND THE OPENING OF THE EUROPEAN OFFSHORE IN 1984 CONFERENCE THIS MORNING. IT WOULD, I THINK, BE A MISTAKE TO STAY AWAY BUT I SHALL REFUSE TO COMMENT, IF PRESSED, ON THIS DEVELOPMENT ON THE GROUND THAT THERE HAS BEEN NO TIME YET TO STUDY IT.

BENTLEY

LIMITED
ESSD
WED
TRED
PS
PS/MR WHITNEY
PS/LADY YOUNG
PS/PUS
SIR C TICKELL
MR JENKINS
MR ADAMS

COPIES TO:-
MR P HARDING GAS DIV } D/ENERGY
MR BRINDED GAS DIV }

SUBJECT

cc Master.

12

file
bc D.Pascall
Mr Gregson

10 DOWNING STREET

From the Private Secretary

15 June 1984

Gas Industry Privatisation

The Prime Minister held a meeting yesterday with your Secretary of State and the Chancellor of the Exchequer to discuss gas industry privatisation. Mr. Redwood was also present.

The Prime Minister said she had serious reservations about privatising BGC as one entity. This would lead to criticism that the Government was creating a private sector monopoly and it was doubtful whether this would achieve the necessary improvements in efficiency. She asked how much could be achieved by selling or injecting private capital into up-stream and down-stream parts of the industry, leaving the distribution network in the public sector for the time being.

Your Secretary of State said that if this exercise were to be carried out successfully it would be necessary to carry management and unions within BGC and also the consuming public. On appliances, BGC already had a programme for disposing of loss making outlets and for improving the performance of the rest. It would be possible to increase the speed of disposals but he doubted whether outright sale of all the showrooms would be acceptable to public opinion. The chief attraction to a buyer of the showrooms would be in the underlying property and this could lead to a large number of outlets being closed without being replaced. In the paper attached to his minute of 11 June, he had set out a number of other options. In his view, the most promising was for BGC to go into joint ventures with High Street retailers whose premises could provide a service for payment of bills, appliance sales and installation. He did not think it was necessary to look for a single comprehensive solution; BGC could go for different partners in different parts of the country and the nature of the joint venture could also vary.

/On

MF JABI

On servicing, he said it was vital to satisfy the public that there would be national emergency cover and adequate safety standards. Without this there would be strong opposition to the Government's plans. He doubted whether, if BGC withdrew from servicing, the private sector would be keen to fill the vacuum. With around 30,000 BGC employees in this sector, the cost in redundancy payments could also be very high.

The Chancellor was more optimistic that the private sector would come in. Private contractors had a large part of the market in the installation and servicing of central heating and provided adequate servicing for other appliances and utilities. In discussion, it was agreed that BGC should be asked to look into ways in which servicing could be included in the package provided in partnership with the private sector.

The discussion then turned to BGC's gas exploration and production interests. Your Secretary of State said that the Deloitte, Haskins and Sells Report had concluded that it was advantageous for BGC to have an interest in gas exploration and production as this provided it with insight into the state of gas reserves and the problems of gas production. It was argued that while BGC would resist fiercely total divestment of its gas interests, as had been done with its oil interests, it was not necessary for BGC to retain the current size of stake in order to maintain a foothold in the up-stream sector. Your Secretary of State said it would be necessary to counter the argument that gas consumers had helped to finance BGC's gas interests and that if these were sold consumers would then be paying to acquire gas from the resources which they had helped finance. The Chancellor doubted whether the price to consumers would be affected as there would be offsetting adjustments to BGC's financial targets.

Summing up the discussion, the Prime Minister invited your Secretary of State to speak to Sir Denis Rooke and to develop proposals under which BGC would establish joint ventures with the private sector to provide a service for the payment of bills, and for the sale, installation and servicing of appliances. Arrangements would have to be developed to provide adequate safety standards and emergency cover. Your Secretary of State should also ask BGC to prepare plans for the disposal of its gas interests, with BGC retaining a minority stake. Your Secretary of State should also examine to what extent existing legislative powers were sufficient to put into effect these proposals and to what extend new legislation would be needed. He should also consider the implications for the rest of the Government' legislative programme. The Prime Minister asked your Secretary of State to report back to the same group in

/about

about a month.

I am sending a copy of this letter to David Peretz (HM Treasury).

Andrew Turnbull

Michael Reidy Esq
Department of Energy

cc DP

PRIME MINISTER

SLEIPNER

The Chancellor's minute to you of 12 June requires a reasoned reply before we discuss this.

My understanding of colleagues' views was that in general they were not ready to take the risk with gas supplies involved in a total veto on the BGC deal with the Norwegians. The argument has been about the character of the export assurance to producers on the UKCS.

We could debate at length the merits of the Frigg field which is not at all as simple a matter as Nigel suggests. He does not mention that 40% of the Frigg field is British and he assumes rather readily that the 25% of our supplies from Norwegian Frigg have dominated the UK market. What is certain is that increased availability of gas to both domestic and industrial consumers in the last decade, 40% from the Frigg field, has greatly improved our oil balance and, recently, our ability to resist industrial action in the coal industry.

On Sleipner, the facts in Nigel's paragraphs 5 and 6 are simply wrong. BGC's existing contracts plus Sleipner cover only 55 to 60% of forecast demand in the mid 1990s. As I said in my minute of the 8 June, BGC needs to contract the equivalent of two Sleipners from the UKCS in order to close the gap. And a large slice of the gas in existing discoveries not yet contracted to BGC is in condensate fields where best reservoir practice may dictate oil extraction first, with delay in any gas extraction until the late 1990s or the next century.

The views expressed by oil companies naturally differ according to their interests, but the majority of them have not been prepared in informal exchanges to advise us to rule out imports, or specifically to reject Sleipner. Even BP, which is most optimistic about UKCS resources, does not go this far.

I take Nigel's point that it would be better for the balance of payments if we could do without imports of gas in the 1990s, but as his minute makes clear, what we are talking about is the continuance of an existing cost, not the imposition of a new one. Essentially, Sleipner is a substitute for Frigg when Frigg runs out and the balance of payment cost of Norwegian Frigg is, as he says, now about £1½ billion a year.

On Dutch gas, Nigel says he would feel more confident if he believed that BGC had thoroughly explored this alternative. I can assure him that, whatever BGC has or has not done, I have myself pressed the Dutch hard. They have not been willing to put on the table an offer which comes near to competing with Sleipner on price.

I agree with Nigel when he says in his paragraph 9 that it is not right that the development of our natural gas resources should be determined by BGC's use of its dominant buying power. The proposals I have made would prevent that by providing a right of appeal against BGC wherever an oil company considered that BGC was using that buying power in a way which hindered development. But I think it is a mistake to think that by simply opening up our natural gas resources to unrestricted exports we can produce a market like that which operates with oil. Unlike oil, natural gas is contracted many years ahead often in very large units and for the life of the field. Over most of the world the only economic means of transport is by pipeline, and pipeline construction is linked to individual sale transactions. At the consumer end, gas supplied now always flows from contracts made several years ago. All this means that for technical reasons the gas market is in any area a market of few sellers and very few purchasers.

Paragraph 10 of Nigel's minute warns us against confusing prices paid to oil companies for new gas with prices charged to consumers. There was no such confusion in my minute of 8 June. What I said was that if we allowed uncontrolled exports, there would be a sharper and immediate effect on prices even for those Southern North Sea developments which are already expected to be so profitable that the Inland Revenue recently proposed an extra tax on them.

Charges to consumers would rise more gradually so long as the gas levy and financial targets set to BGC permitted them to continue averaging the cost of their gas supplies as at present. Even so, I estimate that if prices for all new UKCS gas contracted rose to European levels, there would be an extra 5% increase in real terms for both industrial and domestic consumers over the next decade, in addition to the 16% increase in real terms over the same period which BGC are at present envisaging. If gas were priced immediately at the level of the most expensive gas contract, as suggested at the end of paragraph 10 of Nigel's minute, there would indeed be no effect from exports. We would simply get the whole real terms price increase to industry and domestic consumers at once in this Parliament.

These consumer price increases assume that prices paid by BGC to the oil companies do not move above European levels. However, as I said in my minute of 8 June we would under the Chancellor's proposal risk moving in one step from a virtual British Gas monopsony to a situation where the oil companies would have a potential monopoly. If they contracted considerable amounts of gas to exports and a shortfall in gas for the UK began to appear at a time when more imports were not available, they would be in a position to move prices above European levels and we cannot ignore the fact that the extent of their relations with affiliates could tempt them to organise the market. If indeed BGC has used monopsony power in the past, at least that has worked to the advantage of the UK consumer.

Paragraph 12 of Nigel's minute says that an unrestricted export regime would mean that UKCS gas was playing its full part in reducing Western European dependency on Soviet gas. I do not think that anybody outside the UK - and very few in the UK - would put much weight on that. Any UK surplus of gas would be trivial compared with European needs or Soviet reserves. On the other hand, the Americans see the purchase of Sleipner as central to their wish to limit Western European dependency on Soviet gas. Norwegian gas is the one major Western European gas deposit which the local population does not need. UK purchase of Sleipner would not only open up that particular source but would pave the way for the development of the very large but difficult Troll field further north. If we were to reject Sleipner, we would have to expect some pressure and complaint from the Americans because if we did that, it is very likely that major Norwegian gas development would be set back for a number of years.

It seems to be common ground between the Chancellor and myself that announcement of unrestricted exports could produce an interruption in development. I want to avoid such interruption, which I believe would be more serious than he thinks. I also think he exaggerates the impact of the Sleipner purchase on the gas development of the UKCS because the companies have already largely discounted it and are well aware we still have very large gas needs. Nigel talks about "current inhibitions on activity". In fact, activity is going forward at a record pace and the Southern North Sea is a highly attractive and well established area for exploration and development. So attractive is it that Nigel has agreed with me that in the Ninth Round of licensing we should use allocations of blocks in the Southern North Sea as a bait to induce companies to undertake hazardous exploration in deep waters.

The Chancellor recognises that I am in agreement with him in wishing to allow exports if this is necessaary to keep up development. I attach the outline of a Parliamentary statement which I have been discussing with the Treasury. The approach I propose does not require the Government to commit itself to particular forecasts of demand or supply or to some arbitrary "floor" of proven reserves. The Chancellor says he wants an export regime based on "clear objective criteria", but there is no objective basis on which such criteria could be defended. My proposal is unlikely to be seriously controversial and would, I believe, go fully as far as the oil industry would expect. For them, the statement, supplemented by appropriate briefing, would give an assurance of our determination to maintain development, and a right of appeal against BGC which is new and important. For industry and domestic consumers, there would be an assurance of security of supply in the 1990s and beyond, while avoiding a threat of a sharp price rise. For BGC there would be agreement to a modified Sleipner, and the opportunity to secure the UKCS supplies they need, provided they offered the right terms.

Immediate uncontrolled exports, or any move which amounted to that, would be a high risk, even aggressive step. BGC would be likely to make the most of the situation by saying they could now only be sure of carrying out their statutory obligation to supply by paying substantially higher prices and passing them on to consumers. Industry and domestic consumers would be likely to object, as Nigel foresaw when he considered such an export announcement at the time of the Oil and Gas Enterprise Act at the beginning of 1982. The move would be played up by the press as a "tit-for-tat" reaction to BGC and, because of its uncertain effect, would be seen as undermining the whole rationale of the Sleipner purchase which is to meet a large gas deficiency in the 1990s. It would not look like an independent decision to free the market, but simply a reaction to a particular import deal by BGC - as indeed it is.

I think Nigel saw all these reasons for caution when he considered this same question of exports in January 1982. His letter of 11 January 1982 to Geoffrey Howe then said the following:

> "If exploration does yield sizeable new reserves we would of course still need to ensure that exports could be managed without disrupting the supply of gas to Britain. To avoid supply difficulties in the late 1980s/early 1990s large volumes of as yet uncontracted gas will have to be landed here. (By the beginning of the 1990s barely half of projected British demand will be covered by existing contracts). New contracts to fill this gap must be signed in the next few years if the gas is to be on stream in time, and because individual gas contracts are so large it would only require a small number of export deals during the critical period to knock supply in Britain badly off balance. With no control of exports, market forces alone might not automatically lead to the right answer. Political pressures might be applied by other countries and some key North Sea companies have gas-hungry continental affiliates. So even if exploration leads to substantial new discoveries in the next few years, it will probably remain desirable to retain some control over the level of exports".

All this remains valid even with the purchase of Sleipner, except that what is relevant now is that only 55/60% of the gas needed in the mid-1990s is now contracted, including Sleipner. Remaining proven reserves are actually lower now than at the time Nigel wrote his letter. And, of course, in recognition of Sleipner, I am proposing to make a more forthcoming statement about exports and to create an effective right of appeal against BGC.

I hope therefore that it can be agreed that we should open negotiations with the Norwegians to reduce the Sleipner volume and, when those negotiations have been brought to a successful conclusion, that I should make a statement on the lines of the draft I have attached.

I am copying this minute to other ES colleagues, to George Younger and to Sir Robert Armstrong.

Secretary of State for Energy
14 June 1984

OUTLINE GOVERNMENT ANNOUNCEMENT

I have authorised BGC to enter into a contract with Statoil and its partners for the purchase of gas from the Sleipner Field. This agreement is however subject to approval by the Norwegian Parliament.

[Descriptions of the quantities and time periods of the deal, making it clear (if we are successful in negotiating it with the Norwegians) that offtake volumes above a stated minimum will be subject to HMG approval].

This contract will greatly reduce the risk of a major shortfall in supplies of natural gas to BGC to meet our requirements, both for industry and for the domestic consumer, so far as we can now foresee them. However, very large volumes of new gas from the UK Continental Shelf will still be required, over and above present contracted supplies, to meet that demand. The Government are satisfied that companies developing the gas resources of the UK Continental Shelf can proceed with exploration and development with confidence, in the knowledge that BGC is in the market for very large volumes.

However, if it should become clear that exploration and development on the UK Continental Shelf is being inhibited by lack of gas demand in Britain, the Government will be willing to waive the landing requirement for gas on new UKCS developments, provided that security of supply to the British market would not thereby be undermined. Developers in the UK Continental Shelf can move forward in full confidence in the light of these assurances.

CONFIDENTIAL

P.01310

PRIME MINISTER

Sleipner Gas

BACKGROUND

The latest projections by the British Gas Corporation (BGC) and Department of Energy of GB demand for gas against supplies already contracted to BGC indicate that a gap will open up in the 1990s, its size depending on price developments for gas and other fuels, economic growth etc. That gap must be filled by imports of gas; from the development of known, but not yet contracted, reserves; and from undiscovered reserves in the United Kingdom Continental Shelf (UKCS).

2. Negotiations have been under way for some time to import gas from the Norwegian Sleipner field. A draft contract was signed in February for gas to be supplied over a 12-15 year period from the early 1990s. The amount has still to be settled; but the Department of Energy aim to meet about half the above projected gap from Sleipner. The remainder will be met by production from the UKCS. But production may by the 1990s well exceed the amount required to fill the remaining gap, if Sleipner gas is bought, leaving a surplus available for export. At present, however, gas exports from the UKCS are not permitted: all gas from the UKCS must be landed in the UK, and re-exporting gas landed here is not economic.

Proposals

FLAG A

3. In his minute to you of 8 June, the Secretary of State for Energy proposes that the Government should announce its intention to proceed with the Sleipner purchase, and should negotiate further with the Norwegian Government on the precise volume. At the same time the Government should announce that if the purchase appeared to

CONFIDENTIAL

be inhibiting exploration or development of the UKCS, the landing requirement might be waived (thus permitting gas exports) either generally or for a particular development, providing security of supply to the UK was not undermined. BGC would be required not to damage development through its policies.

FLAG B

4. In his minute to you of 12 June, the Chancellor of the Exchequer, drawing a parallel with the Frigg gas field in the mid-1970s, expresses concern about the impact of the Sleipner purchase on the development of the UKCS. He argues that the addition of Sleipner to BGS contracts (existing and expected) will lead to an excess of supply over demand. This will discourage the exploitation of the UKCS with detrimental effects on UK employment, profits, tax revenue and the balance of payments. He argues that to encourage more UKCS activity the Sleipner purchase should only go ahead if restrictions on gas exports are removed. He favours an unrestricted export regime. But in recognition of the concern about security of supply, he is also prepared to agree to Sleipner with a restricted export regime providing it allows immediate exports and is based on clear and objective criteria.

FLAG C

5. The Secretary of State for Trade and Industry in a letter of 15 May, had broadly endorsed the Chancellor's approach with the proviso that reserve powers to prevent export contracts should be taken. The Foreign and Commonwealth Secretary in a minute of 8 May to the Secretary of State for Energy supports the purchase of Sleipner gas.

FLAG D

MAIN ISSUES

6. There is no dispute that the Sleipner gas is available on relatively favourable price terms. Though there are other options (eg Dutch gas), the purchase of Sleipner should not be an issue: the Chancellor's minute makes it clear he will agree to the purchase providing satisfactory conditions for derestricting gas exports can be agreed. Nor does Mr Walker dispute, at least in principle, that

gas exports should be allowed, if that is necessary to maintain exploitation activity on the UKCS. The main issue therefore is:

- what kind of export regime should be applied to gas exports assuming that the Sleipner gas purchase will go ahead?

7. In essence the difference between the two alternative proposed export regimes is as follows:

- that proposed by the Secretary of State for Energy is discretionary, with the implication that exports will be the exception rather than the norm and with the burden of proof resting on those who wish to export;

- that proposed by the Chancellor is based on objective criteria (albeit not yet finally settled), with an assumption that exports will normally be allowed and with the burden of proof resting on those who wish to restrict exports.

The Committee will need to consider the respective impacts of these two approaches on: gas prices; exploration and development of the UKCS; security of supply; and they will then wish to asses the overall balance of advantage in the light of these factors.

Gas prices

8. The first effect of the strategy proposed by Mr Walker is to strengthen BGC's negotiating position against other suppliers. BGC would have access to a large and secure supply from Sleipner while retaining to a high degree its monopsony over UKCS supplies. Both theory and experience suggest that the BGC would use this position to depress the price of new supplies from the UKCS. No doubt part of the gains to BGC would be passed on to gas consumers through lower prices. It is however likely that there would be higher profits for the BGC reflecting its monopsony powers rather than economic efficiency. This might be defensible if the BGC was to stay in the public sector (though it would still be less satisfactory than securing the revenue for the benefit of the taxpayer). It would be much harder to defend if the BGC is privatised.

9. The Chancellor's approach would mean BGC losing its monopoly powers, having to compete for supplies and having to pay something closer or equal to the international market price. That would be reflected in higher purchase prices for new gas supplies. But the impact of that on consumer prices would be fairly small: only the price of the last tranche of gas supplies in the 1990s would be affected. The Chancellor suggests prices to consumers might be about 4 per cent higher in the 1990s under his proposals.

Pace of exploration and development

10. Mr Walker's proposals on the exploitation of the UKCS would leave the responsibility for keeping up the momentum of exploration and development largely on BGC and Government rather than the market. But the discretionary approach proposed would mean the companies could not be sure whether their gas would go to the UK or be exported; the price, and hence the return on their investment, would be uncertain. Nor could the effectiveness or fairness of BGC in stimulating activity be relied upon. Both factors would tend to dampen the level of exploration and development activity.

11. It seems more likely that the kind of free export regime proposed by the Chancellor would stimulate greater exploitation of the UKCS. Under a market regime, companies would expect higher prices with more certainty of, and a larger volume of, sales.

Security of supply

12. There is likely to be agreement that the UK should have adequate security of supply. Mr Walker will argue that his proposed export regime gives better assurance in that respect because it leaves the Government in the position effectively to ensure that the UK has first call on gas supplies from the UKCS. The Chancellor suggests that the problem can be dealt with by allowing exports only as long as the level of proven reserves not already contracted to export remains above a prescribed benchmark, or by allowing exports for a limited period. There is a genuine problem because gas purchases are so much more inflexible than oil purchases.

When gas has been contracted for many years ahead to a foreign purchaser and the appropriate pipelines and facilities constructed, the position is irrevocable. On the other hand, the three main companies involved - BP, Esso and Shell - are unlikely to discriminate in favour of export markets, providing BGC are prepared to pay the going rate. The existence of pipelines to the UK in the southern basin and the geographical proximity to the UK in the north make the UK the obvious market. Moreover, security of supply is in the last resort dependent on exploration and development.

Overall assessment

13. Under Mr Walker's proposals gas prices to the consumer would be a little lower than under the Chancellor's, but the pace of exploration and development activity would be slower. Hence tax revenue, profits, employment and export earnings would be lower, perhaps substantially less, than under the Chancellor's proposals. Mr Walker's strategy would favour gas consumers in general and certain energy intensive industries in particular; it would also probably increase BGC's profits and the return to BGC's shareholders in the event of privatisation. Mr Lawson's proposals would lead to lower taxes (and a higher exchange rate), spreading the benefits more widely through the economy. Mr Walker's export regime might give more reassurance about security of supply, but much will depend on exactly what objective criteria are provided under the Chancellor's approach. Moreover the lower benefits to the economy as a whole may be too high a premium to pay for this added insurance.

Detailed export regime

14. If the Committee concludes that the balance of economic advantage lies with the Chancellor's more export-biased approach, it will be necessary for officials to do more work on the details of the export regime. The Chancellor has left open the precise nature

of the objective criteria to be applied. It may be sufficient for the Committee to agree that objective criteria should be drawn up to ensure that if serious concern were to arise over security of supply exports could be restricted. The details might be worked out by officials and cleared in correspondence. Similarly, if Mr Walker's proposals are favoured, it would probably be useful for officials to do further work on the details.

HANDLING

15. You will wish to invite the Secretary of State for Energy to put forward his proposals on the Sleipner purchase and associated export regime and the Chancellor of the Exchequer to reply. The Secretary of State for Trade and Industry will wish to comment on the industrial aspects and the Foreign and Commonwealth Secretary on the international aspects. The Secretary of State for Employment may have views on the employment implications of the proposals.

CONCLUSIONS

16. You will wish the Committee to reach conclusions on the following:

i. whether to proceed with negotiations for the purchase of an appropriate volume of gas from the Sleipner field;

ii. whether the export regime for gas from the UKCS should be on the basis proposed by the Secretary of State for Energy or that proposed by the Chancellor of the Exchequer;

iii. what, if any, guidance should be given to officials about the details of the preferred export regime.

PLG

P L GREGSON

13 June 1984

SECRET

PRIME MINISTER

13 June 1984

GAS INDUSTRY PRIVATISATION

Peter Walker's latest paper sets out a range of options in addition to his preferred course of denationalising BGC lock, stock and barrel.

The meeting on Thursday should decide whether you wish to proceed with Peter Walker's preferred scheme of denationalising a monopoly, or whether you should proceed with splitting up the different functions of BGC and privatising them, starting with gas production, retail and servicing where competition is already strong.

Having seen the arguments between the Treasury and the Department of Energy, we still recommend the latter course.

Peter Walker's four points

We would not be opening up a "second front" with BGC for some time. A decision now would require several weeks of preliminary work on splitting the Corporation and obtaining the agreement of E(A). The miners' strike will not go on indefinitely. We should also remember that the unions may well oppose the Peter Walker scheme of complete denationalisation, even though the existing management would be happier.

There should be gas servicing and safety cover available to customers. However, a decision to denationalise retailing and customer servicing does not mean that this cover would be withdrawn or unavailable. Private providers, as in the water industry for maintaining the domestic water system, would emerge and compete with the denationalised business. BGC could retain responsibility for safety of mains and trunks.

We should not worry about the alleged difficulty of finding takers for the peripheral parts of the business. Several major energy companies and a large number of individual and corporate investors would be interested in taking a stake in offshore gas assets. The only specialised feature which limits their current appeal is the price-rigging which goes on in the marketplace. As one of the main aims of the gas-pricing policy is to establish a market price in gas, this particular problem will disappear. Gas servicing as well could be attractive. Companies like Dynorod and Hat Group (plastering and other building trades) have solved the problems of running labour-intensive service businesses, and make good money out of them.

LAUABJ

SECRET

SECRET

There is a risk that unions, management, and even customer interests could combine to resist change, and mobilise opinion against it. However, we should - with the piecemeal denationalisation approach - be able to win over the customer interests. If customer retailing and servicing is tackled first, there will be a better and more wide-ranging service at a lower price, with more choice. Consumer groups won't oppose this; I have even heard representatives from the National Consumer Council argue in favour of such changes. The unions will resist it, but they will probably resist any type of denationalisation. The management may well be unhappy about this suggested route, but that would argue for making selected changes to the Board so that it contains people who are enthusiastic about the policy.

Conclusion

It is recommended that the meeting agree to:

(a) privatisation by splitting the functions off;

(b) a tight timetable for bringing the first proposals to E(A) which should include sale of the retail business and the gas production interests.

(c) The pipeline system and regional distribution companies could be considered later, once a market in gas has been established, and other companies are using the pipeline as a common carrier.

John Redwood

JOHN REDWOOD

LAUABJ

SECRET

ANNEX

1. The detailed businesses reviewed in Peter Walker's paper

Appliance retailing. Peter Walker suggests that any buyer will be an asset-stripper. He is worried about the comprehensive nature of the service being jeopardised by the change of ownership; yet his paper indicates that BGC Board policy is to close down a large number of marginal outlets, and to concentrate on the larger outlets, where the prime activity is appliance retailing.

A private sector takeover and new senior management in BGC's retail business could transform it. The showroom chain could be dramatically improved, with the goods being better displayed. It could be made profitable whilst the price of goods could be reduced, for BGC retail at the moment manages to combine quite high prices with low profitability. BGC service could retain counters and facilities in the former BGC retail outlets, but it would also be free to negotiate similar arrangements with other retailers. For example, leading department stores and the Post Office are looking for more franchisees, and might be very interested in a BGC customer service point. Similarly, the Post Office is interested in expanding its counter business.

We recommend requiring BGC to end retailing and to sell its existing assets to the private sector. Of the other options, the least objectionable is the requirement to form retailing into separate companies and sell a majority interest to the private sector. Even with this scheme, there is the potential for cross-subsidy between the businesses in BGC and for some abuse of monopoly power. The idea that BGC should only sell a minority interest in retailing would achieve practically nothing, and leaving it for BGC to sort out their business under option (d) begs the question about why they haven't improved it years ago, both to give their customers a better deal, and to make some profit.

2. Installation and contracting. The private sector can handle installation, servicing and contracting work. It does so in many other areas - eg electrical installation and contracting, and in the water industry.

It is desirable to transfer this work to a greater extent to the private sector, where the work force is likely to be better motivated and better organised, and where the quality of customer service is likely to rise. Customers find it annoying that when they wish to have their facilities maintained or repaired, they can't even be told roughly what time of day the fitter is likely to call; and often when the fitter arrives, he is only able to do one part of the work - needing to call on a private sector plumber, for example, when fixing a central heating system.

LAUABJ

Concern about safety could be dealt with by:

(a) leaving it to BGC to tackle the safety of anything on the street side of the customer's meter; and

(b) considering registration of qualified fitters who would be capable of doing the work in the private sector.

The strategic options set out are not exciting. There are two that are worth pursuing. One is option (a), to include it with appliance retailing. **Another option - which we recommend - would be the creation of a separate company or companies to handle servicing, and the sale of these companies to the private sector**.

3. Petroleum exploration and production. In the context of a policy to have a market in gas, the sale of the gas assets would be both easy and desirable. It helps competition by breaking BGC's stranglehold over gas from the North Sea to the customer. It helps the general policy of disengagement by the Department of Energy and BGC and it would raise substantial money for the Treasury. It might also assist in encouraging separate routing of gas by mechanisms other than the BGC pipelines, to develop more competition in the gas supply business which, to date, has failed to appear.

Option (a), a requirement to dispose of all its licence interests, would arouse antagonism from the existing management. BGC could get a realistic price for the gas. There is a lively market in gas and oil interests, and a fair market price could be arrived at through an offer for sale or an auction. The best price of all would probably be realised by selling the assets to more than one party.

There is little attraction in putting the assets into a company in which a majority of shares was retained by BGC. There would still be the same close linkage between the policy on exploitation of gas and the sale to customers, and there would still be the same cross-subsidisation. It would still be difficult to get accurate figures about the cost-effectiveness and value for money provided by the different elements of BGC's business, which is the core of the current problem.

Merging the assets with an existing oil company or oil companies is a variant of sale, and this should be left open if the general route to selling the oil assets is agreed, to be decided at a later stage when the bidding becomes clearer, and approaches can be made to potentially interested parties.

LAUABJ

The asset valuation of £1.1 billion seems to be a distinct under-estimate of their worth. The true answer could well be nearer to £2 billion. However, it is no bad thing to start off with a low estimate valuation, as the BGC style of resisting these changes is always to hold out the prospect of a very large figure and then claim, when a smaller figure is realised, that the public has been cheated.

JOHN REDWOOD

LAUABJ

10 DOWNING STREET

Prime Minister

Getting a liberal export regime for gas is more important than any of this. Hopefully you will come to the meeting having made progress on this in the morning.

I see no prospect of the meeting agreeing on privatisation by splitting up. You will, however, want to make clear that you see serious objections to Mr Walker's all-in-one approach. The way forward might be to ask Mr Walker to put to E(A) a series of options for introducing private capital into the upstream and downstream parts of BGC's business, to see if colleagues are prepared to be bolder than Mr Walker is.

AT
13/6

MR TURNBULL   12 June 1984

SLEIPNER

The Government has been placed in a ridiculous position over the Sleipner deal. We are expected to second guess estimates of future gas supply, demand and price which runs completely counter to our market based policy for energy.

We must now ensure that the Government are never again put in this position. The establishment of a market price for gas is the best way of regulating future supply and demand. Allowing exports is the best way of ensuring a market price.

The Sleipner Deal

The volume of gas proposed by the Norwegians is too large. Even if no further discoveries of UK gas are made, the Department predict an excess of supply over demand in the mid-1990s if Sleipner is purchased. Several of the oil companies predict such a surplus even without Sleipner. In these circumstances it is unclear even whether we need Sleipner and the purchase of the proposed volumes will undoubtedly discourage UK companies from exploring for gas.

There has also not been any serious attempt to renegotiate the terms of the initial Dutch approach and to play the Norwegians off against the Dutch in a normal commercial negotiation. We have the strong impression that the Dutch price could be improved, and that if this is the case, we may well be better off with the lower Dutch volumes.

In these circumstances, Peter Walker should, as he proposes, re-enter negotiations immediately with the Norwegians in order to secure a smaller volume of gas. He should also re-open commercial negotiations with the Dutch.

Establishing a Gas Market

Allowing exports would be the quickest method of creating a gas market. Once market prices dominate the UK, more domestic production would be stimulated whatever British Gas may wish to do on price.

Without the discipline of exports, we cannot expect BGC to operate in a commercial manner. The risks of under-supply dominate their thinking and they are much less concerned with the risk to national income, the PSBR and the balance of payments of deferring UKCS production.

DATABH

BGC have consistently refused to pay international prices for gas from the UKCS. In consequence, all gas drilling stopped during the 1970s and we are now faced with the ludicrous position that a country full of energy sources may well have to rely on imported gas to meet its needs in the early 1990s.

ie to repeat the Frigg error

The attitude of BGC today has not significantly changed. They are not prepared to offer UKCS producers the same price which they are contemplating for Sleipner. Although the removal of BGC's monopoly over purchasing gas and the potential supply gap has forced them to offer higher prices in recent years, these prices are still some 20% below market prices. Indeed, John Allcock, BGC's lead negotiator on Sleipner, has argued in public that the gap between prices offered to UKCS producers and international prices has narrowed too much.

The Export Regime

Any export regime must give clear signals to the companies in order that the future development of gas can proceed on market principles.

Although self-sufficiency is a curious argument to deploy in an international trading environment, we accept that long lead times and rigidity in the gas market do require some conditions on the free export of gas.

We suggest that exports should be allowed with immediate effect for as long as established reserves not contracted to export are at least a factor of ten greater than current annual supplies. Today's figure is fourteen. We also suggest that BGC are given an opportunity to match any negotiated export deal and that these conditions are publicly announced. These concessions should meet Peter Walker's and BGC's concerns about security of supply.

We do not agree with Peter Walker that it should be left to the Government's* discretion to look after security of supply and the rate of development in the North Sea. Neither do we agree that allowing exports would precipitate a sharp rise in prices to the consumer. As the Chancellor points out, we would only be ensuring that international prices apply to new supplies. BGC are anyway proposing to pay international prices for Sleipner and a greater incentive to UKCS producers would not significantly affect future prices. Arguments about economic pricing are not relevant to the export decision and need not be discussed in E(S).

* advised inevitably by BGC

DATABH

Conclusions

We recommend

- That any decisions on gas imports should depend upon a renegotiation of Sleipner volumes and Dutch prices.

- That permission to export is essential to ensure that market forces dictate the development of gas reserves in the North Sea to the maximum benefit for our economy.

- That the gas export regime is based on objective and published criteria allowing unrestricted exports as long as established reserves not contracted to export exceed 10 x current annual supplies and provided that BGC are given an opportunity to match the terms of any export deal.

DLP

DAVID PASCALL

DATABH

4.42 CONFIDENTIAL B CC NO

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

PRIME MINISTER

SLEIPNER

With AT?

I have seen Peter Walker's minute to you of 8 June.

2. I think there is a risk of confusion over Peter's statement that colleagues have agreed we should proceed with Sleipner. As you will recall, both Norman Tebbit and I have made clear in correspondence that the introduction of an export regime should be an essential element in any agreement to the Sleipner contract.

3. In 1974 BGC contracted with the Norwegians to import gas from the Frigg field in similar volume to that envisaged for the purchase of Sleipner. There can be no doubt that the Frigg deal has had a very harmful impact on the development of the UK's own gas resources. BGC's need for gas from UK fields was dramatically reduced and as a result, the Corporation offered potential developers of UK gas fields prices far below international levels. This stopped the development of our own fields and brought exploration for new gas discoveries to a standstill for several years.

4. The delay placed a heavy burden on our economy. The balance of payments cost of Frigg is running at about £1½ billion a year. The failure to develop our own gas resources has reduced our wealth as a nation, has hit jobs and profits in the UK offshore construction industry and has meant fewer tax receipts for the Exchequer (but correspondingly higher tax revenue for the Norwegian Government).

5. If we agree to the Sleipner purchase we risk repeating these unfortunate effects. Peter Walker's minute makes clear that, even if no further discoveries of UK gas are made, his department's best estimate is that BGC's existing contracts plus Sleipner will lead to an excess of supply over demand in the mid 1990s. This is true even at the bottom end of the range of supply from Sleipner.

6. This is not a prospect which will encourage companies to explore for UK gas. Indeed the companies themselves will view the situation even more gloomily. As Peter makes clear, the majority of the oil companies expect a significantly (up to 50 per cent) higher supply of gas from fields already contracted to BGC than does Peter's department. If (as is likely) they are right, this would lead to an even greater excess of supply.

7. The costs involved if the Sleipner deal were allowed to crowd out the development of our own gas are quite clear. In balance of payments terms Sleipner would cost £1½-1¾ billion a year in the mid 1990s, rising to around £2 billion at the turn of the century (in 1983 prices). The loss of tax revenue would be some £400 million a year in the mid 1990s (in 1983 prices) and the loss of national wealth would be of a similar size. On top of this, orders, jobs and profits in UK industry would again be forgone. I cannot believe this is an acceptable price to pay for any extra security of supply Sleipner provides in the mid 1990s.

particularly when we are facing too too much rather than too little gas.

8. There are two main options for reducing these costs:

(a) to reject Sleipner and rely on other gas sources, principally our own;

(b) to agree to Sleipner on the basis proposed by Peter Walker but to couple this with freedom to export gas from the UKCS.

Of the two, I prefer the latter, although I should feel more confident if I believed BGC had thoroughly explored an alternative offer from the Dutch to supply us with gas.

9. The attraction of an export regime is that it would allow the development of our natural gas resources to be determined by the market place. This is the policy we have followed very successfully with oil to the enormous benefit of the economy. The problem for companies wanting to develop gas fields and explore for gas in the 1970s and early 1980s was that they had nobody to whom to sell if BGC did not want their gas. An export regime would allow them to turn elsewhere. It is not right that the development of our natural resources should be determined by BGC's use of its dominant buying power.

10. I believe Peter Walker's concerns about an export regime are misplaced. He predicts a sharp impact on prices. It is true that prices paid for new gas supplies on the UKCS should rise to international levels in order to encourage exploration and development. But the price of new supply levels should not be confused with the prices charged to gas consumers. At most prices might be about 4 per cent higher by the mid 1990s, with the bulk of the increase coming after 1990. This assumes that gas charges to consumers are based on the average cost of gas to BGC. It reflects the fact that for many years to come BGC's new supplies will represent only a small part of total BGC gas supplies; most will come from gas already contracted. If gas were properly priced on the cost of marginal supplies, exports would have even less effect; the Sleipner contract would itself be likely to represent the marginal cost for years to come.

11. Peter also foresees exports leading to an interruption in development. Of course, whenever exports are allowed, oil companies will reassess their position in the changed circumstances. But Peter is not opposing exports in principle for this reason; only the timing of their introduction. In my view, we should introduce exports now. If we do not, the signing of the Sleipner purchase will deal a severe blow to confidence on the UKCS and produce a major and lasting fall in activity. By comparison, any temporary interruption for reassessment will be small and short lived.

12. Against this background, I consider the best approach would be to permit an unrestricted export regime for gas in order to ensure the proper economic development of UK gas and the earlier discovery of major new reserves. Not only would this be a major benefit to our own economy. It would also mean UK gas was playing its full and proper part in reducing West European dependency on Soviet gas.

13. By contrast, the discretionary regime proposed by Peter would be seen by oil companies as arbitrary and uncertain. Given BGC's long record of obstruction to UK gas development, they would have doubts about the way in which discretionary powers would be exercised. A discretionary regime would add further uncertainty to the inevitable business risks associated with gas exploration and development. Confidence would not be sustained and investment would not go ahead.

14. If our colleagues nevertheless feel that some reserve powers of control are desirable in order to maintain security of supply, we should need to ensure that two conditions were satisfied.

15. First, any regime should allow immediate exports in order to overcome current inhibitions on activity. Even now BGC are only prepared to buy UK gas if they can acquire it at a 15-20 per cent discount below international prices. (But they are prepared to pay the international price for Sleipner). In at least one case they have told a company they do not wish to discuss the development of the gas field for two years.

16. Second, the regime should be based on clear objective criteria. Otherwise companies will not have the confidence to press ahead with the massive expenditures involved in exploration and development. There are a number of possible criteria. One approach would be to link exports to the level of proven reserves which were not already contracted to export. If the level were to fall below a particular benchmark figure, no further exports would be permitted until the level of proven reserves had risen sufficiently. This would encourage the oil companies to continue the search for new gas fields. Another approach would allow exports at least until a particular date. The latter is the approach successfully used in the past in providing the same companies with assurances about oil depletion policy.

17. In summary I believe we should only agree to the Sleipner deal if we can agree to the immediate export of gas from the UKCS. In my view this export regime should be unrestricted but, if there are to be restrictions, these must be based on clear objective criteria. If this is not acceptable, I see no satisfactory alternative but the rejection of Sleipner.

18. Copies of this minute go to the other members of ES, George Younger and to Sir Robert Armstrong.

(N.L.)

12 June 1984

CONFIDENTIAL

cc DP.

No of Copies: 6
Copy No: 1

PRIME MINISTER

GAS INDUSTRY PRIVATISATION

Following our discussion on 10 May, I have examined further options for partial privatisation in two specific areas - appliance retailing and servicing and offshore gas production. Papers dealing with these are attached.

2. There are constraints on our freedom of action:-

(a) the undesirability of opening up a second front with the nationalised industries in present circumstances;

(b) the need to guarantee, whatever decisions we take, that there will be gas servicing and safety cover available to consumers throughout the country;

(c) the limited prospects - as the papers bring out - of finding takers for the peripheral parts of the business. Gas servicing, in particular, is not an attractive business for investors and the major offshore assets have highly specialised features which limit their appeal; and

(d) the risks - enhanced by the back history of 1981 described in the third paper attached - that unions, management and consumer interests would combine to resist change and mobilise public opinion against it.

3. The options realistically available for partial privatisation in these areas are, I believe, extremely limited. The major

choice remains between a radical change of ownership for the gas business, as discussed in the previous paper, and continuing the existing nationalised industry set-up.

4. If we chose the nationalised industry option, I would propose to concentrate action on appliance retailing which offers genuine prospects for pursuing our competition objectives and promoting a more diverse market. I believe the way forward is through a further reduction in BGC's involvement in this sector and that this can be achieved in partnership with the private sector. This would include making best use of existing gas industry property sites in joint ventures with High Street retailers and, probably, BGC continuing to give ground in some areas to others. BGC's installation and customer service operation would remain in being and be made generally available to all retailers.

5. I am copying this to the Chancellor of the Exchequer.

SECRETARY OF STATE FOR ENERGY
11 JUNE 1984

CONFIDENTIAL

APPLIANCE RETAILING AND INSTALLATION AND SERVICING

Appliance Retailing

BGC has a chain of about 600 showrooms which sell gas appliances, provide facilities for the payment of bills and the arrangement of appliance servicing, and give advice on the use of gas generally. Net assets employed in appliance retailing had a book value (current replacement cost) of £86m at 31 March 1983 within this, the major saleable asset is the property, much of which is leasehold and which is probably valued in the books at approaching £75m. The operation employs about 5,000 staff.

2. BGC's overall market share for appliances is declining but remains about 50% by volume. It is concentrated in the lower value appliances - cookers, wall heaters and fires (see Annex A for more detailed figures). The major growth market of the 1970s in central heating was taken by the private sector and BGC's share of this has remained low (currently about 15%).

3. The activity is barely profitable. In 1982/83, after revision of the accounts following the MMC report, it made a loss of £1.7m on a turnover of £226m and this year is expected to show a small profit. The showrooms range from high volume, high turnover High Street sites, through those in deprived inner urban areas, where much of the activity centres on accepting payment of bills, to small town general contact and sales points. The longer term tendencies are towards more customer inquiry and similar business being handled by the Post Offices etc and a concentration of appliance display and over-the-counter sale in the larger town centres. In the past year BGC have closed 70 unprofitable showrooms and expect to close another 70 over the next 1½-2 years. The limited information available to the Department suggests that, with sales restricted to gas appliances, few of the retained sites will be very profitable:

most probably just about break even, with the best making a few per cent on turnover.

4. The sale value of the existing operation is concentrated in the value of the sites and there would be unlikely to be much goodwill value attached. A purchaser would rightly look to turning the premises to a wider range of more profitable uses and these opportunities would be a main factor in determining value.

Installation and Contracting

5. In addition BGC currently employ about 30,000 staff on customer service which covers installation and servicing of appliances as well as the provision of an emergency service. Emergency service is a necessary part of the provision of gas supply and would remain the responsibility of BGC. The assets of the installation and servicing activities are valued at current cost in BGC's books at about £70m. The activity had a turnover of £212m and made a loss of £5m in 1982/83. This year it is expected to show a small profit.

6. BGC does not have a monopoly in appliance installation and servicing. But it does undertake over half the work in this area. Unlike appliance retailing which has drawn some new entrants (eg Comet and others), installation and servicing holds few attractions for investors and the existing competition comes mainly from small contractors who are not able to offer a comprehensive service.

Options for Privatisation

7. Whatever decisions are taken, it will be necessary to ensure that gas customers throughout the country continue to have available an emergency service, adequate general servicing facilities and access to appliances. Failure to meet this would

inevitably generate rapid and widespread criticism of any proposals for change that Government brought forward and might well necessitate abandoning the exercise.

8. The main options for appliance retailing are:

(a) to require BGC to end retailing and sell its existing assets to the private sector. This would achieve privatisation. But it would mean substantial gaps in the market, because no doubt whoever purchased the retailing chain would do so with a view to a property break-up. The reality is that many of the premises concerned would be used for other purposes. In many parts of the country there would be permanent loss of the facilities at present provided by BGC showrooms. In the absence of arrangements between BGC and successor retailers, its existing customer service operation would cease to be viable and would be run down, leading to a further, more serious loss of facilities probably with consequences for safety. This course would be strenuously resisted as it was in 1981. It does not represent a practicable way forward.

(b) to require BGC to form its retailing assets into separate companies, a majority interest in which would be sold to the private sector. This would introduce private capital and could be a means of harnessing new private sector managerial talent and making profitable and diversified use of the existing retailing sites. The minority BGC share could underpin an agency arrangement between BGC and the new companies under which they would perform, for payment, services related to the main gas supply business - eg accepting payment of bills, providing advice, while they in turn made use of installation services, warehousing etc provided by BGC. The existing restrictions on diversification in the Gas Act need no longer apply if the operation were outside the public sector and it is likely that a much wider range of goods would be on offer in the shops. More profit-oriented managements would probably accelerate the programme, initiated by BGC of closures of showrooms which are uneconomic or only marginally economic or apply the sites to wholly new purposes. The process of setting up the new companies would inevitably be a complex and lengthy business.

(c) to require BGC to form its retailing assets into separate companies, a minority interest in which would be sold to the private sector. This would be broadly similar to (b) but would mean the operation remaining in the public sector. The advantages of diversification would not be achieved unless the present Gas Act restrictions were lifted. Overall BGC control would also probably limit the interest shown by private sector investors and further depress the price achievable.

(d) promoting competition within the nationalised industry framework. BGC could be pressed to accelerate its programme of showroom closures (eg the remaining 70 to be closed within 1 rather than 2 years) and to pursue in a radical way options for joint ventures with the private sector. These would include in particular arrangements for making best use of the major city centre sites in partnership with High Street retailers and could extend also into franchising and gas use of others' floorspace in appropriate cases. The approach would also involve a new emphasis on BGC linking up their installation and servicing facilities with appliance sales made by other retailers. This combination of elements should lead, within a reasonable space of time and without undue disruption, to a more diversified market and improved choice for consumers.

9. The options for privatising installation and customer service are very much more limited. The labour intensive nature of the business and its poor profitability record make it most unlikely that alternative owners and managements would be found, able and willing to take the existing comprehensive operation on and run it in something approaching its present form.

10. Gas installation and servicing work is the area that touches most closely on safety and the training of fitters and maintenance of standards has rested substantially with BGC. HSE, who are responsible for safety, propose to limit installation in future to qualified fitters and are considering introduction of compulsory registration. Any changes that are introduced will need to ensure at least a maintenance of existing standards and safeguards for the consumer.

11. The main options in this area are:

(a) to include customer service with appliance retailing under options (b) or (c) at para 8. This would considerably diminish the attractiveness of the companies being floated. There would be no clear assurance of the long term continuation of the successors in gas servicing. Unless the emergency service were transferred to them, the costs of its continued operation by BGC would increase significantly. Privatising this part of the business would encounter the fiercest union opposition and there would be heavy costs in redundancy payments.

(b) to require the Corporation to put more work out to contract. Some such work is already sub-contracted. This could be stepped up, though beyond a point it could run into similar difficulties to those at (a).

(c) <u>to leave installation and servicing with BGC requiring them to make the facilities generally available to retailers</u>. This would ensure continuity of existing cover to consumers, which is the basic underpinning required for making real progress towards increased competition in appliance retailing (options (b)-(d) at para 8 above).

ANNEX A

BRITISH GAS APPLIANCE RETAILING

% SHARE OF MARKET BY VOLUME

	1977/78	1979/80	1983/84 (estimated)
Freestanding Cookers	93	88	86
Built in Cookers	79	64	47
Wall Heaters	86	80	73
Fires	78	67	60
Water Heaters	62	58	53
Total excluding central heating	80	70	65
Central Heating	25	15	15
Total including central heating	65	51	50

% SHARE BY VALUE

All Appliances excluding central heating	80	72	70 (for 81/2)
All Appliances	48	29	26

PETROLEUM EXPLORATION AND PRODUCTION

BGC's petroleum interests are listed at Annex A. They range from minority interests (held with US oil companies) in gas fields in production to interests in unexplored territory both onshore and offshore. Most of BGC's oil assets have already been removed (either to Enterprise Oil or in the case of Wytch Farm by sale), but a limited amount of oil prospective territory remains.

2. Discounted cash flows for the interests are given in Annex A. The largest item is the Morecambe gas field currently being developed by BGC as a seasonal peak lopping gas supply. The operation of the field, like that of the gas storage facility being developed at the depleted offshore gas field, Rough, will be closely bound up with the day-to-day running of the onshore transmission system. Decisions would be needed on whether to include only Morecambe or both Morecambe and Rough in any disposal.

3. A degree of involvement in gas production is the international norm among gas transmission and distribution companies. In the USA some 7% of gas is bought by the major transmission companies from their own affiliates. Similar connections exist in Australia, New Zealand and most of Western Europe. In the case of the Netherlands, the partners who run gas distribution (including Shell and Esso) are virtually identical with the main gas producers. BGC obtain some 7% of gas from their subsidiaries.

4. The options for privatisation are:

(a) to require BGC to dispose of all of its petroleum licence interests. This would achieve full privatisation of these interests. It could be done either by creating a new company and selling its shares on the market, or by selling the interests piecemeal to the highest bidder, taking account of BGC's existing licence partners' pre-emptive purchase rights. Advice would be needed on the likely proceeds under each route. A company concentrated on gas, and at least initially a captive supplier to BGC, would be a less attractive prospect for investors than an equivalent oil venture. The BGC staff (perhaps a few hundred) could either be transferred to the new company or made redundant. Either route would be complex and involve lengthy negotiations to establish gas purchase terms and then sell the assets. The main practical problems would arise over Morecambe Bay which BGC has developed to meet its special seasonal requirement and for which no gas purchase contract exists. A purchaser is likely to offer a fairly low price for the asset - discounts of up to 50% are regular for oil companies - and require a high price for the gas, particularly given uncertainty about seasonal year to year offtake. It may be difficult to defend the deal as a good bargain for the public sector. The gas industry management would object strongly arguing that involvement in gas exploration and production is an integral part of its main function - the distribution and supply of gas in Great Britain - both directly in providing gas and indirectly in enabling it to be a well informed purchaser of gas from others. In the absence of compensation - perhaps the book value of the assets would be appropriate - BGC would be able to argue, particularly in the case of Morecambe, that it was paying for the gas twice - once in development expenditure which had not been recovered and secondly to the new vendor. The course would be politically contentious and would be strongly criticised by consumer interest: the cost of arm's length purchase of present BGC gas, if passed on fully to consumers, would require a tariff increase of the order of 3%. It could not be defended on competition grounds (BGC is only one offshore producer among many) and would have to be justified to the public on the privatisation and PSBR merits.

(b) to require BGC to put its exploration and production assets into a company in which a majority of shares could be sold to the public. This would take the assets into the private sector, but would allow BGC to retain a minority interest. A new management would be needed and an arm's length trading relationship would have to be set up. Some of the disadvantages of (a) would remain - eg probable difficulty of justifying the terms of the bargain. With only a minority share BGC would not retain access to inside operational information and would still be likely to oppose the change. The attractiveness of the package of assets to the private sector might be low and hence the price achieved depressed.

(c) to require BGC to put its exploration and production assets into a company in which it retained a majority interest. This would avoid BGC losing access to information about offshore exploration and production, but at the cost of leaving the operation in the public sector. Control by BGC might reduce opposition to the proposal but could also reduce the attractiveness of the shares to investors. An arm's length trading relationship would still be needed.

(d) to merge BGC's remaining assets with an existing oil company. This would achieve full privatisation of the assets without the need for creating a new management structure. The merged company would be more broadly based from the outset, would have larger resources and should be less affected than a company at (a) by problems of being a captive gas supplier to BGC. Other disadvantages discussed at (a) would, however, probably still hold. Purchase by one of the larger oil companies would be the shortest route, though a merger could probably be arranged with a smaller company eg Enterprise Oil, on the basis of some combination of new equity sale and loan finance. The chief difficulty would be that of showing HMG had got a good price.

(e) to require BGC to farm out all licence interests above 5%. This would allow BGC to retain access to operational information but would otherwise be substantially the same as (a).

(f) to accelerate existing policy of requiring BGC to divest itself of its residual oil assets. BGC holds some remaining territory, onshore and offshore, where prospects are more for the discovery of oil than gas. These were not included in Enterprise Oil's territory either because they were not attractive enough or because they were too difficult to detatch eg because BGC was the operator. It would be possible to require BGC to dispose of this territory within a certain time. One route, which BGC has been examining for a small onshore oil discovery near to development under the operatorship of BP, would be to arrange an exchange of oil interests for gas interests held by private sector companies.

ANNEX A

BGC's Petroleum Interests

	BGC Interest %	Operator	NPV of BGC's Interest (at 15%) (£m)
1. **Producing Gas Fields**			
Leman bank	14	Shell	50
Indefatigable	19	Amoco	30
2. **Gas Fields Under Development**			
Morecambe Bay	100	BGC	850
3. **Other Gas Discoveries Offshore**			
South Morecambe	100	BGC	50
Lomond (Condensate)	50	Amoco	10
47/9b	73	BGC	35
49/29a	40	Mobil	10
4. **Other Interests**			65
			1100

These are:

(i) 43 Offshore blocks, 17 operated by BGC
BGC Interest;
In 10 blocks BGC has a stake between 20% and 35%
In 17 blocks BGC has a stake between 40% and 50%
In 4 blocks BGC has a stake between 69% and 73%
In 12 blocks BGC has a 100% stake

(ii) 20 Onshore licences, 5 operated by BGC
BGC Interest:
In 11 licences BGC has a 25% stake
In 2 licences BGC has a 33% stake
In 4 licences BGC has a 50% stake
In 3 licences BGC has a 100% stake

(iii) The Rough depleted offshore gas field which is being redeveloped as a seasonal storage facility. (As this will be operated as an integral part of the onshore transmission system it has not been included in the valuation).

THE UNIONS AND PRIVATISATION: THE 1981 CAMPAIGN

The principal gas unions are GMBATU (manuals) and NALGO (staff); others with smaller memberships in the industry include the T&GWU and the AUEW.

2. Following the 1980 MMC report on gas appliance retailing the gas industry unions formed their own organisation to fight the hiving off of showrooms, GUARD or "Gas Unions against the Report for Dismantling BGC". GUARD has no formal contact with BGC but its membership is similar to the Union Side of the Planning Liaison Committee in which the Unions negotiate with BGC. Its secretary is the National Officer of NALGO (D Stirzaker).

3. The gas unions rejected the MMC's "radical option" (an end to BGC retailing) on the grounds of heavy job losses (estimated at around 31,000), adverse effects on standards of installation work and general safety cover to consumers, loss of availability of spare parts for older appliances and, they argued, likely higher prices to consumers. They also argued, less vigorously, against the MMC's "less radical option" (accounting changes and adoption of improved commercial practice). The gas unions had the backing, in this, of the TUC.

4. The announcement of 8 July 1981 that the Corporation would be required to withdraw from retailing over a five year period was followed on 18 July by a one day strike in the industry. This was supported by 95% of the workforce. The majority of those who stayed at work were management, who maintained gas supply and were, generally, able to ensure safety cover. (One consequence of the strike was the formation of the Gas Higher Management Association to provide for separate representation of senior grades in the future). Union action and campaigning ran in parallel with that of consumer interests led by the Gas Consumer

Councils and with BGC's own campaign against the decision. The latter included advertising ("Wonderfuel Gas"), and PR handouts to employees which were widely distributed, all designed to win public support for the status quo and heighten concern about the effects of change, particularly on safety: the handout made some play of comparisons between BGC's safety record and that of others in the UK and abroad. This was followed in late 1981 by Government agreement to defer action.

5. The interests that campaigned in the summer of 1981 believe that their efforts on that occasions paid off and, if brought together again, could be expected to show at least equal determination in opposing changes.

NAT IND
GAS PT9

CCB 1

10 DOWNING STREET

Prime Minister (2)

This will be discussed on Thursday. The Chancellor will be circulating his own paper early next week. Policy Unit will also comment.

AT 8/6

M

A

CCNO
CCB1

PRIME MINISTER

SLEIPNER

I wrote to Nigel Lawson on 2 May enclosing a paper about the proposed purchase of Sleipner gas. There has been subsequent correspondence from colleagues, including Nigel's letter of 15 May.

– when? Letters from Chancellor and SS/TI

Colleagues agreed that we should proceed with the Sleipner purchase provided the Norwegians were prepared to agree to reduce the volume which they would require us to take under the contract. The Chancellor however sought a further condition, which was the immediate announcement of unconditional permission for gas exports from the UK Continental Shelf.

Since then, my officials and those of the Treasury have discussed and corresponded about a form of assurance on exports which might be given to developers on the Continental Shelf, and I have myself now discussed the matter with the Chancellor. I am as anxious as he is to maintain the momentum of development on the UKCS and had hoped that it would be possible to reach agreement. This has not proved possible, and in view of the urgency of the matter I would be grateful if you could arrange for it to be discussed at a very early date. I understand that you consider ES to be the appropriate forum.

In the announcement which will have to be made about Sleipner I believe we should say: first, that the British Gas Corporation will require very large volumes of new gas (the equivalent of two Sleipners) from the UK Continental Shelf, over and above supplies already contracted; and secondly, that if it becomes clear that exploration or development is being inhibited, either in a particular case or more generally, the Government will waive the landing requirement for gas either on the particular development or on new UKCS developments generally, provided security of supply to the 15 million British industrial and domestic consumers is not undermined. I would tell British Gas that if they acted, either through reluctance to contract or through price, so as to inhibit UK exploration and development, or indeed if general evidence of a failure of development through insufficient UK demand began to emerge, then

Calculation?

I would allow exports. I would make it clear to the companies that the Government meant business about avoiding inhibition of development. I believe that these steps would in fact ensure that BGC would be careful not to damage development through its policies. That is perhaps the most important step we can take.

Over a period, this would raise BGC prices to producers, but not in one fell swoop. It would in effect create a right of appeal against BGC and leave to the Government the discretion needed to look after security of supply as well as development.

However, the Chancellor wishes to announce immediate unrestricted exports, perhaps with a rider about the level of our gas reserves which would however have no impact on the foreseeable future. I fear that this sharp change of policy would produce an interruption in development, in which the oil companies held off contracting new supplies to BGC while they reassessed the position and looked at export opportunities. We would have moved in one step from a virtual British Gas monopsony to a situation where the oil companies would have a potential monopoly, which would tempt them to form a cartel and to hold off from contracting with British Gas. There would be a sharper and more immediate effect on price, even for those Southern North Sea developments which are already very profitable. This would put at risk the security of supply for British industry, precipitate a gratuitous price increase for consumers, industrial and domestic; and undermine the rationale of the Sleipner purchase, which is after all security of supply to UK consumers in the 1990s, at a time when we still needed two Sleipners from the UK Continental Shelf.

The gas market is totally different from the oil market. Purchases are very large and lumpy, and are usually for delivery at dates far in the future. The market is greatly limited by geography and by the fact that the pipeline is the only economic transport system. Security of supply means looking a decade or more ahead, and forecasting either supply or demand is inevitably speculative. In this situation the flexible approach to exports which I suggest is, I am sure, right.

I am much concerned that our negotiating position with the Norwegians on reducing the quantities in the Sleipner contract is being weakened by delay. They have a viable alternative in oil developments to which they may turn to secure continuity of services, if delay on Sleipner continues. The Foreign Office recently stressed again the desirability of early contact with them on Sleipner given other matters of difference affecting our relations with them. It is likely already to be necessary for them to recall the Storting to discuss Sleipner. There is of course a wider strategic advantage in securing the progressive development of Norwegian gas which, with an eye to the Soviets, the Americans have pressed upon us from time to time. I very much hope that I can be enabled to open negotiations with them on the reductions as speedily as possible.

I am copying this minute to Members of ES, George Younger and to Sir Robert Armstrong.

John Neilson

p.p. SECRETARY OF STATE FOR ENERGY
8 June 1984

(Approved by the Secretary of State and signed in his absence)

NAT IND: Gro

08 JUN 1984

7 June 1984

MR TURNBULL

I attach a draft options paper on Gas.

Do we need something like this to bring Thursday's meeting to a decision?

JOHN REDWOOD

Discussed with JR & DP

AT 8/6

File

CONFIDENTIAL

7 June 1984

GAS INDUSTRY

There are three options for handling gas privatisation:

Peter Walker's idea of selling BGC as a whole and regulating the monopoly.

This has the advantages of:

(a) speed

(b) management likely to favour this route;

(c) substantial proceeds

(d) favoured by the Department of Energy.

The disadvantages are:

(a) entails denationalising a monopoly, posing enormous regulatory problems, and rekindling the argument that privatisation is not about improving the service to the customer but about flogging the family silver;

(b) it does nothing to make a better market in gas, to lower prices to the customers, or to deal with the problem of the exploitation of British North Sea gas.

The Treasury Model

The Treasury are suggesting that privatising BGC as a whole is too difficult, and that parts of it are a natural

CONFIDENTIAL

CONFIDENTIAL

monopoly. They therefore suggest splitting BGC into functions:

i. retailing and servicing: sale to private sector;

ii. ownership and exploitation of gas reserves: sale to private sector;

iii. the pipeline system: remain in public sector;

iv. the regional distribution companies: remain in public sector.

The major advantages of their scheme is that:

1. It deals with the problem of monopoly. It only privatises those sections of the business which are not monopolies, and avoids the need for the very complex regulation as would be required for a privatised business.

2. It makes the sale of assets more manageable, as discrete parts would each raise less money, but in aggregate would produce more than selling the business as a whole at a bigger discount.

3. The legislation would be less complex, and the Opposition more muted from outside the industry.

The major disadvantages of the Treasury scheme are:

CONFIDENTIAL

CONFIDENTIAL

1. It would upset the Board of BGC, probably require the resignation of Denis Rooke, and may in the process encourage strong employee opposition, probably fermented by the Board itself.

2. It does not meet with Department of Energy agreement, and therefore the policy if adopted would be implemented reluctantly and with difficulty.

3. The pipeline and regional distribution company part of the package would take a long time to set up satisfactorily, and delays could get built into the system. It would need regulation, even though remaining in the public sector.

A Possible Compromise Solution

The creation of regional distribution companies brings no competition benefit within each region, and would be time-consuming, administratively complex and quite costly. We could therefore agree with Department of Energy and BGC that this should be ruled out.

We could build on the agreement between the Department of Energy and Treasury that the retail business should be sold as a separate entity. Added to it could be the installation and maintenance business, subject to satisfactory statutory safeguards concerning safety. (Maintenance of everything on

CONFIDENTIAL

CONFIDENTIAL

the customer side of the meter could be privatised as a fallback position.) Collective decision could determine what, if any, percentage of the equity of the retail business should be left with BGC to buy their acquiescence: we strongly recommend none, but some might be necessary as a gesture.

We should then support the idea that the upstream gas business - the ownership, exploration of production of gas reserves - is a competitive business and could be sold to the private sector using the same logical arguments that were used to justify the sale of the oil businesses. This in itself would raise over £2.0 billion.

The central pipeline network and regional distribution system should remain as a single entity. The first part of the strategy should be to encourage the use of the common carrier provisions already embedded in legislation, and to encourage the establishment of alternative feeder networks from the main grid system when new developments are undertaken using private capital. Once the market pricing ? of gas has been sorted out through the Sleipner decision, the encouragement of common carrier, and the severing of gas-ownership from gas supply through the privatisation measures, we could sell this company to the private market. Then we could decide whether any price regulation were needed, bearing in mind that most of the problems would have been dealt with by the establishment of a market in gas.

CONFIDENTIAL

This could all be achieved within the life of this Parliament if commenced immediately.

Conclusion

The meeting on Thursday should come to a conclusion about which of these three possible ways of proceeding should form the basis for seeking the approval of E(A). System 3 seems to have most to recommend it, in view of the understandable wish of Department of Energy to make some concessions towards the BGC interests, but in view of the overriding political need highlighted by the Treasury, to avoid privatising a monopoly which could then fleece the customer and/or launch an extremely complex regulatory system.

JOHN REDWOOD

C

a tw

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215) ....
(Switchboard) 215 7877

JF6514
Secretary of State for Trade and Industry

15 May 1984

CONFIDENTIAL

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

D Nigel,

SLEIPNER

Peter Walker sent me a copy of his letter 2 May. I am reluctant to support his proposals as they stand, because they would tend to slow down development of the UK Continental Shelf.

2 At present UKCS gas can only be supplied to the UK market, and Sleipner would enable BGC to continue holding down the price they pay to UKCS developers below international levels. The market, not BGC alone, should determine the rate at which the UKCS is developed and it would be particularly undesirable to postpone worthwhile gas developments during a period when the contribution of North Sea oil to the economy may begin to fall.

3 One option would therefore be to turn down the Sleipner deal and hope that our needs can be met by a combination of high UKCS production, encouraged by more realistic prices from BGC, and a low level of imports from other sources. That would, however, be a high risk strategy. There is a considerable measure of uncertainty about how much UKCS or imported gas will be available and in a few years' time we could face an uncomfortable choice between increasing Europe's dependence upon Soviet supplies or pushing up prices further to secure a cut in consumption. Such a cut would probably be borne largely by industry.

/4 There ...

4 There is a second and less risky option, which is to allow the Sleipner deal to go ahead (with the improvements recommended in paragraph 7 of Peter's memorandum) on condition that a more liberal regime is introduced for gas exports. UKCS developers woudl be confident of finding a market, either at home or abroad, and BGC would enjoy the security of the Sleipner supplies. The supply and demand projections indicate that with Sleipner we would probably have to allow exports anyway, to cope with a surplus of gas, and announcing this now would have a stimulating effect on UKCS development.

5 I am not advocating a complete dismantling of the controls on exports. The inflexibilities and imperfections in the European gas market suggest that the Government should retain some reserve power to prevent an export contract in circumstances where the contract was likely to jeopardise UK gas supplies in the short term.

6 I am copying this letter to the Prime Minister, Geoffrey Howe, Peter Walker, George Younger and to Sir Robert Armstrong.

Yours,
Norman

NORMAN TEBBIT

NAT IND GRD Pt 9

CONFIDENTIAL

Prime Minister ②

You may want to discuss handling of this decision at bilateral with Chancellor

AT 15/5

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

15 May 1984

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy

Dear Peter

SLEIPNER

I was interested to receive your letter of 2 May and its detailed enclosures.

However, a careful reading of all the documents leaves me far from convinced it is necessary for BGC to enter into this massive commitment at this stage. As your own analysis makes clear, there is inevitably a good deal of uncertainty surrounding the underlying projection of supply and demand. For this reason, if we are to proceed as you propose, I think it is essential that we should simultaneously announce the introduction of a regime of unrestricted gas exports.

Until recently, and in sharp contrast to the North Sea oil scene, the level of gas exploration and development activity on the UKCS has been very disappointing. It has increased dramatically in the past couple of years, partly as a result of the 1982 Oil and Gas (Enterprise) Act and partly as BGC's increasing awareness of their need to sign up new supplies has led them to offer prices nearer to international levels, (although I note that the price BGC are currently offering on the UKCS remains well below the level they are prepared to offer the Norwegians for Sleipner). My concern is that the purchase of Sleipner gas could easily stifle this resurgence, dealing a severe blow to companies seeking gas on the UKCS, in addition to its implications for the balance of payments.

These problems are, of course, well recognised in your paper, where you acknowledge that an export regime would provide a solution. Freedom to export would enable companies wishing to explore and develop UKCS gas to flourish, could remove the balance of payments implications of Sleipner and could produce valuable tax revenue at a time when receipts from oil were falling.

For these reasons, I consider it essential to permit unrestricted exports. We would need to announce the new regime publicly at the same time as we told BGC of our decision on Sleipner in order to avoid damaging the confidence of companies operating on the UKCS. If you can agree to this, I should be content to proceed on the basis set out in your paper.

Finally, you mentioned in your paper the price at which BGC sells gas to its customers. We will need to return separately to this in due course.

I am copying this letter to the Prime Minister, Geoffrey Howe, George Younger, Norman Tebbit and to Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

NAT CND: Gas Pt 9

15 MAY 1984

CC/50
NBPM
AT
11/5

DEPARTMENT OF HEALTH & SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

The Rt Hon George Younger MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
LONDON
SW1A 2AL

11th May 1984

Dear George

ELECTRICITY STANDING CHARGE REBATES SCHEME

will request if required

Thank you for sending me a copy of your letter of 24 February to Peter Walker.

Briefly, I agree with Peter Walker and Peter Rees that the standing charge rebates scheme was never intended as a way of helping the needy, and that we would therefore be wary of schemes such as that suggested by the SSEB. I agree with Peter Walker that the best time to take stock on the present arrangements will be when we have the views of British Gas and the Electricity Council on the operation of the present scheme.

There are possible practical implications for my Department which I should register at this stage. Although there might not be any operational problems for us in limiting the rebates to those on supplementary benefit if the rebate could be obtained by producing a current supplementary benefit order book or giro, if our local social security offices were asked to confirm whether or not customers were receiving benefit, there would be additional work, for which they do not have the staff. The constraint that this imposes will need to be borne in mind in any proposals the industries produce for amending the current arrangements.

I am sending copies of this letter to the Prime Minister, the Chancellor of Exchequer, the Secretaries of State for Energy, Trade and Industry, Environment, Northern Ireland and Wales and to Sir Robert Armstrong.

Yours Norman

NORMAN FOWLER

Nat Ind : Gas & Electricity Prices Pt 9

lc VC

11

bc John Redwood

SECRET

10 DOWNING STREET

From the Private Secretary

10 May 1984

GAS PRIVATISATION

The Prime Minister held a meeting today to discuss gas privatisation. Present were your Secretary of State, the Chancellor of the Exchequer, the Economic Secretary and Mr. Redwood.

BF

In the course of the discussion, the pros and cons of different approaches to privatisation were considered. The Prime Minister invited your Secretary of State to prepare a paper comparing these different approaches. It should compare the option of selling the existing business largely as one, under a regulatory regime, with dividing the business up and either selling or seeking private sector participation in the constituent parts other than the distribution network When this was available the same group would meet again to discuss it.

I am copying this letter to David Peretz (HM Treasury) and Andrew Hudson (Economic Secretary's Office).

(Andrew Turnbull)

Michael Reidy, Esq.,
Department of Energy.

SECRET

VSCAAH

NR

SECRET

SUBJECT

SECRET

cc Master.

Lee VC(AA1)

bc John Redwood.

10

RECORD OF A MEETING HELD ON 10 MAY 1984 AT 1830 HOURS TO DISCUSS GAS PRIVATISATION.

Present:

Prime Minister
Secretary of State for Energy
Chancellor of the Exchequer
Economic Secretary
Mr. Redwood

The Secretary of State for Energy said he had undertaken a substantial study of how the gas industry might be privatised, involving an extensive comparison with the structure of the gas industry in other countries. He had concluded that there was little scope for increasing competition in the supply of gas to consumers. In any area there could only be one network. Even if the gas industry were broken up, it would still constitute a local monopoly. The creation of a common carrier network would not allow greatly increased competition. An attempt to break up the gas industry into parts would be very complex and would be totally dependent upon the cooperation of BGC's management and staff, which was unlikely to be forthcoming. Even if this could be achieved it was doubtful whether the separate gas business would be attractive to investors.

He had therefore come to the conclusion that the best approach was to privatise the whole of the existing business as one entity, with the exception of appliance retailing which could be run as a joint venture with the private sector. This entity would be subject to appropriate regulation. This would stand the best chance of securing the support of management and unions and customers.

SECRET

The Chancellor and the Economic Secretary had strong reservations about these proposals which they felt would do little to increase competition. The Government had been severely criticised in the case of BT for doing no more than creating a private sector monopoly. They argued that several different parts of the gas industry could be identified - gas exploration and expenditure, gas storage, the distribution network, customer servicing, and appliance retailing. For all except the distribution network there were good prospects for privatisation and increasing competition. Dividing up the industry would eliminate the scope for cross subsidisation. Such an approach could be completed under existing legislation plus a limited addition to the Nationalised Industries Bill.

The Secretary of State for Energy questioned whether removing large parts of the up-stream and down-stream business could be achieved without antagonising management and unions. Selling off the up-stream business would not add to competition - there was already substantial competition in the field of exploration and production. He doubted whether the public would welcome being required to turn to the private sector for servicing. Concern for safety was very strong. The Government had retreated from earlier proposals of this kind and would probably do so again in the face of opposition. The appliance showrooms were losing money and were largely attractive because of the underlying property values. In many areas of the country the private sector investors would not be interested in operating the showrooms. The only way an approach of this kind could be made to work would be to sell up-stream and down-stream assets to the private sector while allowing BGC to retain a minority stake.

Summing up, the Prime Minister invited the Secretary of State for Energy to prepare a paper comparing different approaches. It should compare the option of selling the existing business largely as one under a regulatory regime, with dividing up the business and either selling or seeking private sector participation in the constituent parts other than the distribution network. The same group should meet again when this paper was available.

BT

10 May 1984

9 May 1984
Policy Unit

PRIME MINISTER

GAS INDUSTRY

The points I would have made this morning in the meeting concerning the future of the gas industry are:

1. British Gas's gas-ownership and production business is a very valuable asset. It is consistently under-played in all the BGC reports and accounts, corporate plans, and in Peter Walker's paper. According to the Deloitte efficiency study of British Gas, it owns 6.1 trillion cubic feet of gas, or 30 per cent of the net United Kingdom Continental Shelf reserves revealed in their study. (According to the Brown Book, this total is an underestimate, and the figures above overstate BGC's percentage.) 6.1 trillion cubic feet of gas converts roughly to 60 billion therms, or 4 years' total gas sales by British Gas. This is an extremely valuable and saleable asset.

   This underlines the point that denationalisation of parts of British Gas's business would in itself be a major move and not messing about at the edges, as Peter Walker's paper implies.

   British Gas argue that it is impossible to retain control over their supply without ownership of gas, and argue that Morecambe and Rough - operating as gas stores - have to be owned by themselves to work properly. However, they have already signed a contract with the private owners of Indefatigable to fulfil a similar function to that fulfilled by Morecambe. It can be done in the private sector.

2. Peter Walker is right that the Treasury proposals for splitting BGC and selling off different parts of the business would require a change in management. Dennis Rooke is likely to fight these proposals every inch of the way, and if the debate is left too late in the life of this Parliament, it could be damaging to the Government's whole standing.

3. Making the market work in gas could put real gas prices as well as money gas prices up. To this extent, in the first year or two of the policy the critics will be right that it means dearer gas. Either this argument has to be faced out in the interests of matching supply and demand accurately; or some price control has to be placed on the market over a transitional period. This would be much less satisfactory, but it would be better to go the route of moving towards a market solution with some price

regulation than the present system of political price control coupled with price control exercised by BGC as part of its propaganda war against the Government.

JOHN REDWOOD

LASAAM

cc NO

D

NBPM at this stage
AT 8/5

FCS/84/129

SECRETARY OF STATE FOR ENERGY

Sleipner Gas

with AT.?

1. Thank you for your letter of 26 April and for the paper on Sleipner. I find it cogent and convincing. I support your recommendation that we should buy Sleipner gas subject to the changes you would propose to negotiate.

2. So far as specific international aspects are concerned, I endorse paragraphs 2(t) and 2 (u) of the paper about the consequences of not buying Sleipner for our relations with Norway, and concerning the issue of Western European energy security. Such a purchase would avoid UK dependence for the foreseeable future on unreliable or politically unacceptable supplies of gas (I note that you believe the purchase of Soviet gas may be unattractive for commercial as well as political reasons). The course you advocate would also help preserve our good relations with the Norwegians, with whom we have extensive and vital links over North Sea exploration and development and who are important NATO partners. And it would demonstrate to the US and others our readiness to play our part in developing indigenous energy resources and, I hope, put to rest the pipeline issue so far as the UK is concerned.

3. I hope we can now move ahead quickly. As you know, the Norwegians wanted to have our answer on the Sleipner purchase in time for an agreement between BGC and Statoil to be considered by the Storting in its Spring session. This, they have told us, would entail our final endorsement of an agreement by mid-May, which is clearly impossible. There are

/indications

indications that they may be willing to put an agreement to the Autumn session of the Storting, but clearly the sooner we can get back to them, even with the conditional answer you suggest, the better. They are anxious to know where they stand, and the longer we delay the greater the risk that, as they have hinted, they may decide to withdraw the Sleipner offer and concentrate on developing their oil reserves first.

4. I am copying this minute to the other recipients of your letter.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
8 May 1984

8 May 1984

9

MR TURNBULL

British Gas has four main business areas.

The first is the exploration and production division looking for both oil and gas in the North Sea. This is already a competitive business, and the decision has been taken to sell the oil interests.

British Gas does not want to have to sell its gas interests. It will resist this even more than it resisted the sale of the oil. It will argue:

1. It is its business to sell gas to customers, so it ought to be free to explore for it.

2. It needs some of the fields like Morecombe Bay and Rough as temporary storage sites as well as for their gas reserves. They do need one or two buffer reservoirs into which they can pump gas when demand is low, and from which they can extract gas when demand is high. This does not necessarily mean, however, that they have to own these fields, and it certainly does not mean that they have to own all the others.

The upstream part of the business, therefore, can be segregated quite easily with the distribution business bidding for gas from whoever may find and produce it. This would solve the gas price problem by making it a market price like oil.

The second part of the business is the national transmission system. British Gas has an extensive onshore national transmission system. The gas lines that route gas from the offshore fields to the coast are not all owned by British Gas, and demonstrate that there is no need for them to be so. The economics of constructing oil and gas pipelines and charging tariffs to users are well-established, particularly in the USA

However, it is true that the total transmission system as a whole is a national monopoly, and if it were transferred whole into the private sector, it would need extensive regulation. A sensible compromise in this area would be to keep the national transmission system owned by the residual British Gas Corporation, but to have no hard-and-fast rules about future financing and construction of gas pipelines. More gas pipelines onshore could be put up by private capital as well as offshore, and could be part of the financing and sales contract for new gas being produced.

The third business within the British Gas Corporation is the Area Board activity. They organise the supply, regulate the pressures in regional distribution businesses, own the local pipeline system, and deal with customer problems and billing.

In any given area, the supply of gas to the domestic customer is likely to remain a monopoly. It is also likely to remain a monopoly for all but the largest industrial and commercial users, unless these users are grouped together. For example, on a trading estate customers could be linked, and somebody other than British Gas could bid to supply them direct from a dedicated gas field. The options suggested include splitting up the regional companies and selling all or part of them to the private sector; or selling them whole with the rest of BGC and putting them under a stiff regulatory regime.

I would be suspicious of the alleged advantages from visible competition between different regions through emulation. The only type of competition that ever works is the ability of somebody else to come and supply that customer direct. It is difficult to see how in most cases this could arise under privatised regional companies. Leaving BGC whole poses great monopoly regulation problems.

The fourth section of British Gas's business lies in its retail and service activities. British Gas has a substantial business selling retail appliances to the customers and servicing some of their domestic installations. British Gas is reluctant to see this business pass into the private sector, and in the case of service, uses the safety argument to defend its monopoly. There is no reason why the retail and service business could not be conducted in the private sector, and every reason to suppose that were the retail space sold to new private sector owners, it would be deployed much more successfully. Safety can be dealt with by standards and even by licensing of contractors.

The preferred route in this sector is to sell the whole retail estate, preferably splitting it up, and introduce more private businesses into gas maintenance and servicing. British Gas could rent space from the retail outfits taking over the gas showrooms, or could rent new space in other shops or Post Offices for dealing with customer enquiries and bills. It would need a far smaller estate to do this than it currently employs.

Peter Walker and the Treasury

Peter Walker's model of selling the business whole and regulating it will reopen all the old British Telecom arguments. His preferred method of regulation is clumsier than the BT one, and could lead the Government into endless difficulties. It would be a large sale and would do nothing to further customer interests.

The Treasury are correct in thinking that the first thing that has to be done is to create a market in gas itself. Once there is an established market price for buying gas from the North Sea, there can then be no logical case for having that gas under public sector control. British Gas becomes a business involved in running a pipeline system, and in distributing gas to the myriad of customers who will always be the customer of a monopoly. They will be subject to competition in this business if some people want to build dedicated pipelines for the supply of gas to particular locations as part of their contract to sell gas to BGC; and if some industrial users, or other users grouped together, might buy gas direct from a private sector producer in the North Sea. Finally, the retail business could be sold off, thereby removing British Gas's stranglehold over gas from wellhead to customer's home.

Would Gas Prices go up?

Under BGC's current corporate plan (1983) domestic gas prices are forecast to rise from 38p a therm (1982-83) to 56.7p by 1987/8 (almost 50 per cent up). They will argue that structural changes in the industry will cause price increases in gas, yet their plans already include the assumption of substantial money increases.

Selling the gas interests and making a market in gas supply will lead to a higher average price of bought-in gas, but so will the natural course of events, as cheap Southern gas runs out and dearer new UK North Sea gas and Sleipner gas are brought in. If early action is taken to make a market in gas, the gas price can be taken out of politics that much earlier.

BGC will doubtless oppose these proposals, and attention has to be given to how to sell them politically.

John Redwood

JOHN REDWOOD

LASAAJ

SECRET

ANNEX

Businesses

1983 Turnover	£m
Oil	127
Installation and Contracting	212
Other Service Work	50
Appliances	215
	604
Gas	5,326

In 1982-83, BGC bought gas at a cost of £1,916 million and sold this for £5,326 million. It paid £523 million of gas levy to the Government on cheaper gas.

The 1983 Plan forecasts are (rounded in pence per therm):

	82/3	83/4	84/5	85/6	86/7	87/8
Domestic gas price	38	40	43	48	52	57
Average gas price	32	34	37	41	44	49
Cost of gas	12	14	16	17	19	23

LASAAK

SECRET

Prime Minister
To note. Agree I write along lines recommended
AT 4/5

CONFIDENTIAL

No - we will talk about it first
MT

POLICY UNIT
4 May 1984

PRIME MINISTER

SLEIPNER GAS

From the late 1960s until the 1980s, the British Gas Corporation refused to pay the going rate to buy gas from the United Kingdom continental shelf. In consequence, all drilling stopped for specific gas targets. When gas was found with oil, companies preferred to reinject the gas where possible during the early life of a well, to avoid the trouble of selling it.

Owing to past follies over gas prices, we are faced with the ridiculous position that a country full of energy resources may well have to rely on imported gas to meet its needs in the early 1990s. The same folly that has left us short of native production of gas has also served to stimulate demand - when prices were too low, many more customers signed up, thereby exacerbating the potential shortage.

The attitude of BGC today has not significantly changed. The Department and BGC see the purchase of Sleipner as a way (p6) of enabling "BGC to continue to purchase new UKCS gas at several p/therm below international prices (probably with favourable escalation formulae which increase the difference with time)".

The removal of BGC's monopoly over purchasing gas and a potential supply gap has led BGC to offer higher prices to UKCS producers. These prices are still some 20% below market prices but they have encouraged a wave of exploration and development activity. More gas would become available if BGC paid international market prices to the UK but it seems to want to penalise domestic gas producers whilst paying a good price to foreigners!

BGC has placed the Government in a silly position, expecting Ministers to decide on future gas prices and supply. BGC have been more concerned with fulfilling their statutory duty to supply than with assessing proper commercial risks and rewards. Their risk averse proposal may turn out to be a very expensive solution for all concerned. The Department of Energy like it because it brings a kind of depletion policy in by the back door.

It was decided in 1982 that the rate of gas depletion in the North Sea is best left to market forces and that there is no case for Government intervention. The decision on whether to conserve UKCS reserves for future use by allowing earlier imports should be decided on commercial criteria.

BGC has in the past sold imported gas at a loss. The Deloitte study showed that this was happening to Frigg gas in 1982/83 when the profit from the early Southern Basin fields was being used to subsidise new sources of supply.

CONFIDENTIAL

LARABN

In order to avoid this situation occurring again, we need to redouble our efforts to create a working market in gas as soon as possible. The only known way of balancing supply and demand with any reliability is to allow the price to take the strain. The best way of ensuring a market price would be to allow exports. Prices paid for new UKCS supplies would then have to rise to international levels which would in turn ensure that gas competed on an economic basis with other fuels. BGC seem incapable of paying the going rate to the UK gas producers without external stimulus. It is precisely this approach which has given such a strong impetus to the oil sector.

The consequences would be:

1. our balance of payments would not be heavily damaged by the need to import energy;

2. we can ensure more activity in the UK, as UK suppliers typically deliver around 70-80% of the hardware required for getting gas out of the North Sea and putting pipelines down;

3. as competitive forces come to bear, the Government would no longer have to take a view on what future gas supply and demand might be.

In the meantime, it is true that there might be a shortfall of gas in the early 1990s because of past errors. It is also true that if world energy demand picks up before the early 1990s, the current security of supply and the price formula which can be agreed now would be preferable to any deal in the early 1990s. In such a condition, it would be no embarrassment to have found a lot more gas in the United Kingdom continental shelf, because we could export it. If Peter Walker is right in second-guessing price movements in the early 1990s, we would then be making a trading profit by buying Sleipner gas at a lower price than we could be selling our own indigenously produced gas for export.

However, Peter Walker may be wrong. This illustrates exactly why Government should not be involved in taking these sorts of decisions. We could get to the position where we have liberalised the gas market sufficiently to bid up the price BGC and others are offering United Kingdom continental shelf producers for new gas. This would undoubtedly stimulate United Kingdom gas production. If at the same time world energy markets moved into greater surplus of supply over demand, prices would then weaken internationally and the Sleipner deal could look like an expensive white elephant.

LARABN

Conclusion

Perhaps the best way of handling this is to extract a substantial price from both BGC and the Department of Energy for continuing negotiations on Sleipner. This price should be:

There is a meeting with PW and NL on Thursday on this AT.

i. Pressing ahead with the denationalisation of British Gas itself. This would then mean that the commercial risks and rewards on the contract for buying Sleipner Gas would pass to the private sector rather than resting as an ultimate charge on the consolidated revenues of the UK.

ii. Agreement with Peter Walker that in the negotiations there should be an attempt to limit the volumes that are being purchased, whilst keeping the price down, given the uncertainties about the supply/demand balance in the early 1990s and the sloppiness of the market for all types of energy at the moment.

iii. Agreement to the more rapid creation of a gas market, including export from the UK. Once market prices dominate the UK, more domestic production would be stimulated whatever British Gas may be doing on price. It would reduce the risk of the UK being left with too much gas through errors by BGC in over-ordering both domestic and foreign gas: it could be exported instead.

Peter Walker is bound to argue, against the background of the current coal strike, that it would be silly to throw away the opportunity of buying other forms of energy at realistic prices. We think you could concede this much, but only against the background of ramming home the message that we are in a mess because we have systematically refused to allow market prices to decide in the past. The price of accepting this negotiation must be that from here on the aim is to remove Government from these difficult and embarrassing dilemmas.

We recommend that you should welcome Peter Walker's intention to hold an early meeting with Nigel Lawson and that you should indicate your interest in the following questions:

- how to establish a true market in gas in the UK
- wouldn't it be worth one more try to improve the terms for buying Dutch?
- could the risk be reduced by a firm contract for a smaller volume without undermining the economics of the scheme?

LARABN

- can BGC offer better prices to UK producers to stimulate activity further?

- whether Sleipner supplies would be subsidised by existing low price UKCS contracts?

JOHN REDWOOD

LARABN

CC NO (without enc's)

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

2 May 1984

Dear Nigel,

SLEIPNER

I enclose a paper on the proposed purchase of Sleipner gas. You will see that within this paper I have dealt with all the points you raised in your letter to me of 14 February.

I am afraid I am also having to circulate a detailed appendix, as this is a most complicated subject.

You will see from my paper that I have taken a great deal of trouble to look at all of the options. Indeed, I intervened personally to obtain a realistic assessment of what is available from the Dutch.

The Norwegians have been very understanding in recognising the importance of our examining this proposal thoroughly. They do however have a genuine Parliamentary problem. If the proposal in my paper to seek some amendments to their proposals is agreed, I will need to negotiate these very speedily in order to enable them to obtain the appropriate approvals in the Norwegian Parliament. I would therefore appreciate a meeting being held on this as quickly as possible. I would also be only too pleased to provide at such a meeting a visual presentation of the factual background to the analysis we have carried out.

I am copying this letter to the Prime Minister, Geoffrey Howe, George Younger, Norman Tebbit and to Sir Robert Armstrong.

Peter

PETER WALKER

CONFIDENTIAL

BGC'S PROPOSED PURCHASE OF SLEIPNER GAS

(Memorandum by the Secretary of State for Energy)

THE PROBLEM

1. The gas industry is faced with making major new investments in gas supplies in order to maintain its important role in meeting a high proportion of premium energy requirements of British industrial and other consumers in the 1990s and beyond.

2. The purchase of gas from the Norwegian Sleipner field, for which BGC is seeking HMG approval, arises in this context. The background to this, together with an analysis of the effects of allowing or not allowing the purchase to proceed, is set out in detail in the paper at Appendix I. The position may be summarised as follows (where references appear at the end of the following sub-paragraphs they refer to paragraphs in Appendix I where more information may be found):-

(a) Between 35% and 45% of new requirements for gas in the mid-1990s can be satisfied by contracting to buy Sleipner gas. The Corporation has made a provisional deal with the Norwegians which is good in terms of the international market and they have advanced strong arguments for accepting it. The deal is less clearly advantageous in national terms because it will cause us to rely on imports to a greater extent than may really be necessary in the 1990s, thereby delaying developments on the UKCS unless gas exports are permitted. The Dutch have also offered gas (and being a smaller volume this drawback would be avoided) but the terms offered are substantially inferior to those agreed for Sleipner. (Paragraphs 1, 2.4, 3 and 8).

(b) Sleipner reserves are of the same order of magnitude as those in the Frigg field (60% Norwegian, 40% UK) which has been supplying us with gas since 1977. The balance of payments cost of buying Sleipner would be £1.4 to £1.8 billion/annum (1983 prices) in the mid-1990s rising with increasing oil prices to perhaps £1.9 to £2.4 billion/annum by 2000. This compares with the current balance of payments cost of Norwegian gas of about £1.2 billion/annum. There is however a high probability that, if Sleipner were not purchased, imports would still be needed in the 1990s and much more would certainly be needed later; so the cost of gas imports to the balance of payments would not eliminated even in the 1990s. (Paragraphs 2.1 and 10).

(c) Sleipner gas would come on stream in 1990 (just as Frigg runs out), reach plateau in 1996 and remain there for up to 10 years. Plateau offtake (430 to 550 bcf/year, meeting 23% to 30% of our total demand) compares with 180 bcf/year (10% of demand) offered by the Dutch. On the basis of their present offer, Dutch gas would be 20% more expensive than Sleipner by 1995; and this assessment ignores the fact that Sleipner terms include delivery to Britain, whereas Dutch gas would have to be transported from Holland at BGC's expense. The Sleipner deal would also make available to BGC spare capacity in the pipeline for transporting non-Sleipner gas without payment other than a contribution to operating costs. This could be of considerable value in allowing UKCS gas which at present has no means of delivery to shore, to be gathered. (Paragraphs 2.2 to 2.6).

(d) (i) Forecasts of gas demand 10-15 years ahead are inevitably uncertain. BGC's forecast for the mid-1990s (1840 bcf/year) is 10% below the peak expected in the next five years, and assumes that by 1995 prices to consumers will have risen by 15% or so in real terms (with a further 25% rise predicted by 2000).

(ii) These increases assume a continuation of current pricing policies, but reflect a declining base of cheaper gas under old contracts available to be averaged in with newer more expensive gas. My Department's forecast based on these same selling prices is actually 100 bcf/year more than BGC's. Against this, however, prices could be higher still, and demand in the 1990s lower, if prices are moved up to full long run marginal cost levels, depending on how such marginal cost prices are defined, and when they are achieved.

(iii) I would be loath to rest too much faith on any lrmc calculation, or to assume, in considering gas demand forecasts, that gas selling prices will necessarily follow a path dictated by such lrmc estimates.

(iv) On BGC's latest lrmc estimates, their current selling prices are virtually at full marginal cost levels already, and their proposed prices in the 1990s fall only slightly behind full lrmc levels based on the forecast cost of Sleipner then. BGC's lrmc estimates are at the top end of the plausible range for marginal costs in the 1990s, when demand will be falling, and even assuming selling prices were increased to such full marginal cost levels then, the impact on the Department's forecast of gas demand would merely be to bring it back to the same level which BGC anyway project. I am therefore confident that BGC's demand forecast for the 1990s is realistic in terms of the pricing policies we are likely to want to be pursued, and that it is consequently an appropriate basis for judging the need for Sleipner. I am also satisfied that BGC will be able to on-sell Sleipner gas profitably, in the sense that their finances will be better if they buy replacement gas at these prices than if they do not do so. (Paragraphs 4.1.1 to 4.1.18).

(e) BGC believe that, in view of the favourable Sleipner price, they could in addition retain profitable sales of 230 bcf/year in the interruptible and petrochemical feedstock markets which they were previously planning to shed. This seems over-optimistic particularly with regard to retention of sales in the petrochemical feedstock market where it is known that ICI have recently turned down a private sector deal for future supplies of gas at a price less than BGC will be able to supply to them profitably in the 1990s. For this and other reasons which are explained in Annex C, my Department thinks it would be more reasonable to assume retention of 100 to 150 bcf/year of additional sales in these markets if sufficient gas were available. Without such sales, there would be additional opportunities for competing fuels, which in this context would be mainly coal, although not necessarily British coal. (100 bcf/year of gas is approximately equivalent in terms of thermal value to 4 million tonnes/year of coal). (Paragraphs 4.1.19 and 4.1.20).

(f) Although the recent upsurge of activity on the UKCS has increased our confidence, my Department's forecasts of supply availability from the UKCS still cover a wide range (from 1200 to 1900 bcf/year). Our central forecast of 1500 bcf/year in the mid-1990s assumes some 25 or so new North Sea gas developments could be brought on stream by then if Sleipner-type prices were offered for new UKCS gas within the next year or two. This figure might be increased by gas from at present undiscovered fields (by perhaps 50-200 bcf/year). (Paragraph 4.2)

(g) Comparison of the demand and supply forecasts in (d) and (f) suggests that, in a central case, supplies would fall short of demand by 340 bcf/year if we attempted to rely solely on present UKCS discoveries, whilst supply would exceed demand by 210 bcf/year if we bought Sleipner and it achieved the top end of its supply range (see para 4.3.1 of Appendix I). Only on optimistic estimates of gas from both existing and future UKCS discoveries could demand in the mid-1990s be met. In contrast if UKCS supplies are at the low end of our forecast range, they could still fall short of requirements, even if Sleipner is bought. This assessment is based on 1996, when the chance of a surplus is at its greatest (as shown in Figure 3 to Annex A); on average in the 1990s the need for Sleipner is some 50 bcf/year greater than in 1996 taken alone, and beyond 2000 (when Sleipner will still be at plateau) there would on central estimates be no surplus resulting from buying Sleipner, even at maximum output. (Paragraph 4.3).

(h) Various measures might be taken in the event of a prospective shortfall in supplies. Increasing prices offered for UKCS gas by some 10-15% above the Sleipner level could perhaps bring forward another 150 bcf/year of UKCS gas, but such higher prices could not be limited to this extra gas, the marginal cost of which to BGC and to gas consumers would therefore be high. The availability of imports other than from the Soviet Union is uncertain. The alternative course would be to reduce demand by increasing prices or restricting supplies; the latter would mainly hit industrial customers (e.g. by the accelerated withdrawal from the interruptible market). Gas demand is not particularly responsive to price increases; to eliminate 150 bcf/year of demand, BGC would have to increase their proposed selling prices by a further 10% in the mid-1990s, (in addition to the 15% real increase already projected), and withdraw completely from the interruptible market. (Paragraph 5).

(i) Clearly, we would not want to contract for a possibly excessive quantity of Sleipner gas now if we were confident that sufficient imports would be available in future at no greater price. Such confidence is not sustainable.

(j) There are at present four major gas suppliers to Europe. If we turn down Sleipner, Norway seems likely to accelerate oil developments and defer both Sleipner and its successor, the giant Troll gasfield, until competition for the gas is stronger (probably the late 1990s or beyond 2000).

(k) The Netherlands has limited new reserves to contract for export now (in total, about two-thirds of Sleipner) but could commit all of this simply by extending existing export contracts, which run out in 1995, by five years. These contracts are due to be renegotiated by October of this year; after that it seems likely that the Netherlands will again close the door to new exports.

(l) Algeria has in the past been a price hawk and an unreliable supplier. Judged on these three sources of supply alone, prices in the European market (relative to crude oil) would appear to have reached a low point which would not recur.

(m) Two factors which complicate the picture are Soviet gas and LNG. The USSR has massive gas reserves and spare capacity in the pipelines to Western Europe presently under construction. Soviet gas (or gas displaced by Soviet gas) would therefore probably be available if we need it in the 1990s, but there are obvious political drawbacks. There is no reason why the price of Soviet gas should be less than just sufficient to under-cut the marginal supply of gas to Europe, which by then will probably be LNG from the Middle East or West Africa.

(n) At present major LNG schemes from these sources are ruled out by their high cost; and though many projects could in theory become viable, as real gas prices rise (e.g. because oil prices rise), it is not clear that the exporting countries (such as Nigeria, Cameroon, Qatar and Trinidad) will radically revise their expectations of net-back prices in relation to crude oil. Given this, and the major act of faith by both investors and customers that promotion of an LNG scheme requires, I do not believe it likely that we could turn Sleipner down now and buy either Soviet gas or LNG later at a similar price in the event of a shortfall.

(o) The effect of a prospective surplus of supplies might be initially to accelerate the appraisal and offering of new UKCS fields as licensees made efforts to get the gas contracted by BGC before their needs were met. Later, however, licensees would start delaying exploration and appraisal for gas. Some developments would be delayed (on central estimates, about a quarter of the new gas projects otherwise expected by the mid-1990s) but would come forward some years later, which would have advantages as well as disadvantages. (Paragraphs 6.1 to 6.3).

(p) In the absence of competition, BGC would be enabled to continue to offer, as at present, prices several pence per therm below international levels, with consequent loss of offshore tax revenues. This could be remedied by introducing an export regime. Another possibility to reduce tax loss would be to require BGC to pay prices which took more account of international deals; this could be done directly or via the tax system. (Paragraph 6.4 to 6.7).

(q) A decision to buy Sleipner or other imports would enable some UKCS reserves to be conserved for later use. On current estimates, reliance solely on UKCS gas throughout the 1990s would, if it were possible, result in only some 7-14 years reserves remaining by 2000. From being self-sufficient in 2000, we would have to become 50% dependent on imports by 2010, and would therefore be in a weak bargaining position when negotiating such new contracts. In contrast maintaining imports at current levels throughout the 1990s would result in a more gradual descent into heavier import dependence (from 30% in 2000 to 50% only after 2015) giving us much more scope to contract new imports only when the terms were right. (Paragraph 7).

(r) The choice to be made is not simply between Sleipner or an equivalent volume of UKCS gas. The key question is rather whether some combination of more UKCS gas, limited imports and reduced demand might not be better than importing such a large tranche as Sleipner. My Department has addressed this issue extensively, comparing the risks and consequences, in resource cost terms, of either buying Sleipner, buying the volume now offered by the Dutch, or seeking to rely on UKCS gas unless and until imports become unavoidable. This analysis has shown that although the resource costs of production (net of taxes and profits retained in the UK) of UKCS gas will probably be significantly lower than the cost of Sleipner gas in the 1990s, this saving will be wholly or partly offset by the cost of increased import dependence 10 or 15 years later, by the costs of cutting back gas demand and by any premium paid on other imports. The analysis has addressed a 'worst case' focussing on 1996 (the year of largest potential surplus) and assuming that Sleipner output would then be at the top of its range (550 bcf/year). Even so it appears to be worth turning down Sleipner only if Dutch gas or other imports can be bought at virtually the Sleipner price, or if we expected that any exports of surplus UKCS gas (in the event of buying Sleipner) would be at a significant loss. As the earlier discussion of the European gas market suggests, I would consider neither such eventuality likely. (Paragraph 9).

(s) The effect of buying Sleipner on the PSBR has also been considered although the conclusions are not clear-cut. The initial impact would be to moderate the surge of new UKCS gas developments otherwise required, on which tax-relievable capital expenditure would have taken place in the late 1980s and early 1990s. Later in the 1990s the effect would reverse as taxes on any such extra UKCS fields would then have become payable. Finally having some extra UKCS gas to offset imports beyond 2000 would benefit the PSBR then. Allowing UKCS gas exports would reduce or eliminate the PSBR impact of the Sleipner purchase. (Paragraph 11).

(t) The Sleipner deal is significant from the UK's viewpoint as buyer. It has far greater importance for Norway as the seller both because of its size relative to the Norwegian economy and its place in determining their future oil and gas development strategy. Vetoing of the deal by HMG would inevitably sour Anglo/Norwegian relations, though this should certainly not deter us if the case against Sleipner were clear-cut. We should also recognise the longer-term implications on commercial dealings with Norway if we turned Sleipner down. First, we might lose out in terms of British oil company licence interests on the Norwegian Continental Shelf and British suppliers missing Norwegian orders. Secondly, the Norwegians are likely to be exporting gas long after our supplies run dry - and we will be back negotiating with them for such longer term imports, within a decade, even if we buy Sleipner, and sooner if we do not.

(u) The Sleipner purchase is also of wider international significance. Looking beyond our bilateral relations with the Norwegians, the security of European gas supplies is important to East/West relations, particularly following the Siberian gas pipeline dispute with the US. There is clear evidence that US interest in, and concern over, European gas security has not abated. Major studies undertaken by both the International Energy Agency and the European Community as a result of the dispute, the conclusions of which have been endorsed by UK Ministers, have stressed the importance of fully developing indigenous Western European resources to limit the level of dependence on Soviet gas supplies. The early development of the massive but complex Norwegian Troll field has been singled out, particularly by the US, as a necessary alternative to still higher dependence on Soviet imports from the mid-1990s onwards. US concern on this point was emphasised to me during my recent visit to Washington. Two further studies this year by the IEA and EEC also urge the opening of immediate negotiations over the delivery of Troll gas. A deferral of the Sleipner development now would postpone the development of Troll perhaps into the next century. Such a delay would increase international concern over European gas security and leave the Government open to criticism that it has stifled an important European gas development to the long term advantage of the Soviets.

CONFIDENTIAL

OPTIONS

3. (a) On the basis of our analysis, the main options for HMG appear to be:-

(i) to refuse the Sleipner offer and request BGC not to negotiate any further imports until it is clear to us that UKCS gas will be inadequate;

(ii) to accept a Dutch offer;

(iii) to authorise BGC to sign a contract for Sleipner on the terms offered;

(iv) to seek changes in the proposed Sleipner deal.

(b) Under option (i), the denial for the time being of further imports to BGC would force them to pay much higher prices to UKCS producers. The paucity of new UKCS supplies in relation to forecast demand would probably result in their having to raise their offer prices to Sleipner levels within a short period. Although this would generate higher tax receipts and avoid short-term loss to the balance of payments it is likely that, within a few years, it would become apparent that UKCS supplies alone could not meet requirements in the 1990s. We would then be faced with the alternatives of even higher prices for UKCS gas with consequent sharp increases in prices to consumers or with having to authorise an alternative import. Although we would by then have a better idea of the volume required, such an import would probably not be available on terms as attractive as Sleipner is on offer now and might not be available at all other than from the USSR.

(c) On (ii), the first question is whether it is possible to negotiate the Dutch offer down to, or near to, the Sleipner price. The second question is whether the 180 bcf/year on offer from the Dutch would be sufficient for our needs. On the former, further negotiations with the Dutch would of course take time (the Sleipner negotiations took nearly 18 months to complete). The Dutch can probably sell all the gas they want to their existing customers in the late 1990s without going down to the Sleipner price (adjusted for pipeline costs). If further negotiations were pursued, we would expect pressure from the Norwegians in the meantime to make up our minds on their offer. Although our bargaining position might seem strong, the Norwegians could well decide to withdraw their offer on Sleipner and switch their attention to oil development as the means of securing construction activity in their yards in the late 1980s and in the expectation of a better market for their gas after an interval of several years. On the second question, the Dutch will not be prepared to increase the volume of gas made available to us. It represents half the total volume they have decided, after much deliberation, to release for new export contracts generally; the remaining half is not much to spread between existing customers, with whom they will wish to retain a relationship. The Dutch appear to realise that the Norwegians are offering a favourable deal. In fact, the Dutch Ambassador told me recently that the

Dutch could not believe that the Norwegians had quoted such a low price and if he were us he would certainly takes advantage of the Norwegians' "crazy" offer.

(d) One of the main problems with Sleipner is its size and the consequential risk that UKCS developments which would otherwise come on stream in the early to middle 1990s would be deferred and prices to producers depressed in the meantime, with consequential effects on tax take. Under the proposed contract terms, the actual rate of delivery in the range 430 to 550 bcf/year is to be determined at the seller's option. At the lower level, the risk of significant deferral of UKCS developments would be greatly reduced. I therefore propose that if we buy Sleipner gas we should seek inclusion in the contract of a provision that any increases above 430 bcf/year should be subject to the approval of HMG. The objective would be to ensure that any decision in favour of such an increase took full account of the consequences for developments on the UKCS. Our analysis has shown that the cost of this concession to the Norwegian licensees is probably not great although it would not be surprising if they asked for a compensating price increase. If they did so, we should have to consider the position further.

(e) I propose that we should also inform the Norwegian Government that we would like the Sleipner liquids to come to Britain on substantially the terms (including tariffs) included in the Heads of Agreement currently under discussion between the Occidental Group and the Sleipner Group for conveying the liquids to Flotta or on comparable terms if the liquids are taken to Cruden Bay. (See paragraph 2.6 of Appendix I).

(f) The spare capacity in the Sleipner pipeline which BGC have negotiated for their own use in transporting additional quantities of gas (without payment other than an operating cost contribution) represents about 25% of the total capacity in the line. BGC's present intention is to use it solely for transporting gas from UKCS fields in the vicinity of the pipeline. However, I would wish to safeguard our position in case, at some future date, it is proposed that this spare capacity should be used to convey additional quantities of Norwegian gas. We might of course be quite prepared for this to happen but not, I imagine, if UKCS gas was thereby to be excluded. I will therefore wish to propose that in the Treaty between HMG and the Norwegian Government governing the operation of the pipeline, use of the spare capacity referred to above will be subject to British Government (but not Norwegian Government) approval. I will also wish to propose that the use of any additional space which is available or which develops in the remaining 75% capacity in the line shall be subject, under the Treaty, to joint British and Norwegian Government approval.

(g) I propose to seek a commitment from the Norwegians to give British suppliers genuine full and fair opportunity to bid for the equipment to be used in the Sleipner development.

(h) If we authorise the purchase of Sleipner, we would still have to be prepared to take measures to mitigate the consequences of deferred development and lower prices to producers. To allow exports would be one course but we should bear in mind that something like 16 new UKCS gas developments will be required on stream to supply the British market as soon as Frigg runs out in 1991. Though some of these will be phased in over the next few years BGC will not be able to absorb them all quite as soon as the companies offer them. To allow exports immediately without any form of control would therefore be risky, as licensees could well choose to export such fields to gain a more immediate return, leaving us short of supplies in early 1990s.

(i) An attempt to control the rate of export would need careful handling because of the risks of infringing the Treaty of Rome. The Law Officers have now advised that there would be reasonable prospects of successfully defending a partial restriction on gas exports on the grounds of public policy, security and safety. However, the outcome of the Whitegate case now before the European Court of Justice, which is not expected until later in the year, could change this view (see Appendix D).

(j) We could agree now to be ready to allow a controlled export regime, if the judgement in the Whitegate case does not erode confidence in our ability to fend off any challenge to such a regime. If the Whitegate outcome undermines that confidence we could still consider whether the benefits of an uncontrolled regime outweigh any disadvantages; and we could also consider possible alternative measures as outlined in paragraph 6.7 of Appendix I.

CONCLUSIONS AND RECOMMENDATIONS

4. This decision is of great importance, both for the future of the gas industry and for the national economy. It has to be seen against the background of our plans for the future of the industry and of our views on the proper division of responsibilities between Government and the industry's management.

5. BGC have the statutory function of buying gas to meet the needs of their consumers. When considering whether to accept or reject a supply contract firmly offered to them, they are unwilling to rely on necessarily highly uncertain estimates of future gas availability from other fields for which no firm plans exist, and still more unwilling to rely on gas which has not yet even been discovered.

6. If we were to turn down the deal, we should be assuming a major degree of responsibility for the adequacy of future supplies to consumers, on the basis of faith in the more optimistic estimates of future UKCS supplies and faith in the future availability of reasonably priced alternative imports if needed. I should particularly regret the fact that rejecting a Sleipner purchase on favourable terms now may

foreclose the opportunity to retain natural gas as a major source of bulk heat to industry in the 1990s, an opportunity of great value to industry itself and potentially to the environmental policies we may adopt in future.

7. I recommend that we should proceed on the basis of option (iv) in paragraph 3(a) and that we should approach the Norwegians with the prime objective of seeking their agreement that any increase in supply above 430 bcf/year should be subject to HMG approval (paragraph 3(d)). We should at the same time, in so far as we see opportunity to do so without prejudicing this principal objective,

(i) endeavour to secure their agreement to the Sleipner liquids coming to Britain on acceptable terms (paragraph 3(e));

(ii) seek their agreement that suitable provisions should be included in the Treaty governing the operation of the pipeline, on the use of spare capacity (see paragraph 3(f));

(iii) seek a commitment from them that British suppliers will be given genuine full and fair opportunity to bid for orders on the Sleipner project (paragraph 3(g)).

Secretary of State for Energy

1 May 1984

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE

SLEIPNER

APPENDIX I

AND

ANNEXES

This document will be processed by the Department for Business, Innovation & Skills who are responsible for Department of Energy records

G. Gray

18/7/2013

APRIL 1984

D. ENERGY

CONTENTS

APPENDIX I - BACKGROUND AND DETAILED ANALYSIS

SECRET

Prime Minister ①
Agree to arrange a discussion with Treasury and Energy?
AT 18/4

Yes - but I shall need a preliminary "tutorial" on the main issues MT

17 April 1984

MR TURNBULL

GAS PRIVATISATION

The debate between John Moore and Peter Walker has taken an inordinately long time, and seems to have achieved very little. The arguments are no further advanced than when we discussed the matter with Peter and his officials on 24th and 27th February.

John Moore's Five Points

Allowing the export of gas from the United Kingdom would be one part of a programme to develop a genuine market in gas between the producers at the wellhead, the distributors of gas and the final customers. It might even be a question Peter Walker and John Moore could agree on. Peter Walker is wrong to suggest that the issue can be entirely divorced from the question of introducing competition into a large monopoly. You need an international market to fix a market price for gas.

Peter Walker is right that privatising BGC's gas exploration, production and storage does not increase the number of participants nor strengthen competition. However, sale of the gas production and exploration activities as a separate business would reduce some of the BGC's monopoly power which comes from having a stranglehold on some gas from North Sea to final customer, and would be the next stepping stone in the policy so far followed of selling the oil interests.

But this is a pretty trivial question by comparison with main business

John Moore and Peter Walker almost agree on the desirability of denationalising appliance retailing. The only disagreement between them is whether you can sell 100 per cent or a significant majority. We favour selling 100 per cent, and do not believe the difficulties are that great.

Peter Walker is right in saying that if the gas retail monopoly was sold separately, it would need a regulatory regime; and that there would be some merit in lumping it together with the pipeline network and selling the two in one go. Regulation, of course, is needed whether it is publicly or privately owned.

Conclusion

Yet to be arranged

1. There has been too much delay and prevarication. The issues between the Treasury and Department of Energy now have to be put to your meeting. Peter Walker should be asked to bring forward his options paper, and the Treasury to bring forward any commentary upon it. We gave Department of Energy extensive comment on

MINABE

SECRET

their paper within 2 days of receiving it in February.

2. The Treasury and Department of Energy positions are not as far apart as they first appear. There is a certain animus in the debate which goes deeper than the apparent issues. It needs cooling down.

3. The exchange of letters makes no comment on regulation. The first step of creating a proper market in gas to fix a market price for the basic raw material goes a long way to limiting monopoly. There then needs to be a regulatory check on the costs of distribution. We have written at some length before on why we favour a simple customer price-based system rather than the complex profit system in Peter Walker's original paper. We should ask that the options paper should include both regulatory models set out in a comprehensible way.

It is important to make decisions soon, otherwise the slot in the legislative programme will be wasted.

JOHN REDWOOD

MINABE

cc JR

~~2~~ 7

PRIME MINISTER

GAS PRIVATISATION

I enclose a letter which I have now received from John Moore, 4.4.84 in response to the draft paper I gave him on 28 February. John lists five main elements to his approach. The first three just do not affect the main task of tackling a nationalised monopoly. Allowing gas exports is a question we can look at on its merits, irrespective of what happens to BGC. The proposal to privatise BGC North Sea and Irish Sea gas activities is in no way central to the issue and does nothing for competition - indeed would perforce reduce it. John's third point - privatising appliances retailing - is already proposed in my paper but is of limited significance, representing but a minute percentage of the value of the corporation. John's fourth element is the proposal to privatise the gas retailing monopoly. This is the part of the industry which would most require a regulatory regime. His fifth element suggests that the pipeline network should be accepted as a natural monopoly and run as a common carrier - apparently remaining in the public sector. Under this we would get a private monopoly requiring regulatory machinery and a residual nationalised industry. If you put the two together in the private sector you are essentially back to my proposal.

The political and adminstrative effort and the industrial problems in John Moore's approach would be much greater. We would have to let the coal industry return to normal before notifying anything resembling his proposals to those working in the gas industry. The consultations would be extensive and the legislation complex and lengthy. Certainly no vesting day would be reached in the lifetime of this Parliament.

Perhaps when you have had time to reflect we could have a discussion with Nigel Lawson.

Peter Walker

SECRETARY OF STATE FOR ENERGY
13 April 1984

SECRET AND PERSONAL X6.

NUMBER 3 OF FOUR COPIES

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Thames House South
Millbank
LONDON SW1P 4QJ

4 April 1984

Dear Peter.

COMPETITION AND PRIVATISATION: ENERGY INDUSTRIES

We have now had two discussions about your proposals for the privatisation of BGC. We agreed it would be useful if I set down my broad reactions.

I have considered your proposal very carefully and have, of course, discussed it with Nigel. Let me start by saying that I thought your paper was very well presented. My concern about the substance can be best expressed by saying that your proposal is, in essence, a British Telecom approach to BGC privatisation, without Mercury. As such it rests very uneasily with our commitment to increasing competition as part of our policy of privatisation and I have grave doubts about it on both economic and political grounds.

On the economic side, we were able to argue with Telecom that the company was in high technology and in an expanding sector of the economy As a result there was scope for competition to emerge. BGC, on the other hand, is a mature company supplying a commodity with an uncertain future. These points are, of course, brought out in paragraph 6 of your paper. It is hard to expect competition emerging for BGC.

My concern on the political side is linked to this. We have just about got away with Telecom. It has been far from easy. Another privatisation on the same lines - with even flimsier economic justification - will attract even greater criticism and could well alienate public sympathy for the entire privatisation programme.

I do acknowledge that your proposal has its attractions. Proper regulation would probably be better than interference by civil servants. BGC would be moved into the private sector. But I do not think these gains are enough to justify creating a private sector monopoly.

Against this background, I start from the view that we must bring competition into BGC at all levels. This can only be done by breaking up BGC on a functional basis. I appreciate that this will take longer but it is the only approach which is consistent with our policy of promoting competition as well as privatisation. In broad terms I would see the main elements of this approach as:

a. allowing the export of gas from the UKCS;

b. privatising BGC's gas exploration and production and storage;

c. privatising BGC's appliance retailing and servicing business. This follows E Committee's decisions before the Election - E(83)1st and E(81)21st;

d. privatising BGC's gas retailing business;

e. accepting the pipeline network as a remaining natural monopoly, but run as a common carrier.

In the end our approaches reflect different political as well as economic judgements. I think the best way forward would be to discuss the matter at a small meeting of the sort you have suggested with the Prime Minister and Nigel Lawson.

Yours ever
John

JOHN MOORE

CC NO

NBPM
AT 6/4

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

4 April 1984

Dear Peter

STANDING CHARGES REBATE SCHEME

Thank you for your letter of 16 March commenting on George Younger's letter to me of 27 February. I note from your points and in particular agree that the rebate scheme was not designed as a measure of social assistance.

My own letter of 16 March, to George Younger, mentioned that BGC and the Electricity Council are reviewing their schemes and promised a further response when I have the industries' views. I shall of course take account of your points at that time.

I am copying this letter to the recipients of yours.

Yours

PETER WALKER

Nat. Ind: Gas & Electricity Pricing Policy Pt 9.

- 4 APR 1984

file
cc D/Energy

10 DOWNING STREET

THE PRIME MINISTER

22 March 1984

Dear Sir Alistair,

Thank you for your letter of 7 March amplifying the points you made in your earlier paper. I am grateful to you and Allen Sykes for the interest you have shown and I am sure Peter Walker will bear your arguments in mind when considering the Government's policy on gas.

Yours sincerely

Margaret Thatcher

Sir Alistair Frame

ECL

AT

CONFIDENTIAL

Ref. No: SS(84)11
Date: 20.3.84

on file

Members of Parliament may find the enclosed useful for Wednesday's debate on the Opposition Motion,

"Fuel Costs & Poverty"

Wednesday 21st March 1984

House of Commons

Part I Energy Prices.
Part II Help with Heating Costs.

Conservative Research Department,
32 Smith Square,
London SW1
Tel. 222 9000

Enquiries on this brief to:
Part I Nigel Hawkins Esq
Part II Mrs Dykes &
Mrs Walpole

FUEL PRICES PART I

1. INTRODUCTION

During the last few months there has been widespread comment about gas and electricity prices. In recent weeks both the British Gas Corporation and the Electricity Council have announced modest price increases. Domestic gas prices rose by 4.3 per cent in January 1984, whilst domestic electricity prices will rise by just 2 per cent in April. Both these price increases are below the current rate of inflation. To help the less well-off, the Government is continuing to increase the level of heating additions, which are now at record levels. Currently around 2½ million people - including 1½ million pensioners - benefit from these payments.

In short the Government's energy policies since 1979 show a high degree of commitment to maintaining a successful energy industry, whilst simultaneously promoting a compassionate approach to the less well-off. Oil production, investment in the the coalmining industry and heating additions are all at unprecedented levels. Further the number of electricity and gas disconnections has dropped substantially since 1980.

The recent discussion on gas and electricity prices led to an enquiry by the House of Commons Select Committee on Energy. The two major conclusions in the Committee's First Report were -

- The Committee has been presented with no evidence to suggest that the recently announced gas price increases conflict with the commercial judgement of the industry (page ix).

- Neither in terms of the need for the industry to meet its financial target, nor on the basis of the Government's policy of economic pricing for electricity are we persuaded by the case for a 2 per cent price increase in 1st April 1984 (page ix).

2. GAS PRICES

In December 1983 the British Gas Corporation announced that domestic gas prices would rise by 4.3 per cent following the first reading of the customer's meter on or after January 1st. Standing charges are, however, unaltered and will continue to be limited to a maximum of 50 per cent of a customer's bill. No changes are also being made to the rebate scheme.

This price increase is the first for 15 months and is below the current rate of inflation. Whilst domestic gas prices have exceeded the level of inflation since 1979, this has principally occurred because of the last Labour Government's deliberate policy of subsidising domestic consumers at the expense of industrial customers. Between Q1 1974 and Q2 1979, industrial gas prices rose by a staggering 288 per cent. During the first few years of the Conservative Government, this anomaly was removed. Domestic gas consumers were not encouraged to waste gas by blatant subsidies, whilst heating additions were raised substantially to help the less well-off.

The British Gas Corporation requested the recent price increases, principally because of rising extraction costs. The Select Committee Report on Energy confirmed that:

> 'in the four years to March 1983, the average cost of gas to the Corporation more than doubled from 5.8p/therm to 14.8p/therm (including 3.2p/therm gas levy). This trend is likely to continue as cheap gas from the early North Sea contracts is replaced by more costly new supplies which British Gas has recently been

buying at prices above 20p/therm' (page 25).

Despite these rising costs the price of domestic gas is little different in real terms from its price in 1970 - some years before the quadrupling of oil prices by OPEC members. Further the British Gas Corporation needs a reasonable level of profit for future investment in projects such as the Morecambe Bay gasfield.

Despite this need for a price increase, there are no plans for a 40 per cent price rise over the next 4 years, as suggested recently by a leading national newspaper. It appears this calculation was based on a four year estimate of inflation added to a figure of 20 per cent. This latter percentage was contained in a report drawn up by Deloitte, Haskins and Sells - a leading firm of accountants - and it represents their estimate of the level of gas underpricing. The British Gas Corporation has formally rejected this report.

3. ELECTRICITY PRICES

The Electricity Council has announced that domestic electricity prices will increase by 2 per cent as from April 1984. There will however neither be an increase in standing charges nor in tariffs to large industrial users.

This 2 per cent increase is the first since April 1982 and is by any standards, a modest one - well below the current annual inflation rate of around 5 per cent. In fact if an allowance is made for the maintenance of the standing charge level, the net increase from April will be just 1.6 per cent.

Under the last Labour Government, electricity prices rose alarmingly. Between February 1974 and May 1979 - when the British economy was imperilled with inflation - domestic electricity prices rose by 170 per cent. This represents a real increase of 27 per cent.

Labour's poor record on electricity prices was explained by the Secretary of State for Energy, Mr Peter Walker:

> 'The Energy Select Committee has been looking at energy prices. If a Select Committee has been looking at every electricity price increase of 1.6 per cent under a Labour Government, we would have had a Select Committee every five weeks' (London, 29th February 1984).

The following table shows the standard domestic tariffs for England and Wales since April 1978.

Standard Domestic Tariffs - England and Wales

	Average price per unit (excluding standing charges) p/KWh	Average quarterly standing charge £
1 April 1978	2.826	3.01
1 June 1979	3.070	3.31
1 September 1979	3.111	3.71
1 April 1980	3.844	4.72
1 August 1980	4.244	5.15
1 April 1981	*4.707	5.94
1 April 1982	5.095	6.82
1 April 1983	5.098	6.82
Percentage increase from 31 May 1979 to 1 April 1983	80	127

* Excludes 0.34 pKWh rebate on bills rendered, January to March 1982

(Hansard, 25th January 1984 W/A, Col. 576).

Notwithstanding this price increase, the electricity industry's return on capital employed will be relatively modest. In 1982-3 electricity profits after tax and interest were £332 million representing a return of just 1.0 per cent.

NH/CR
16.3.84

PART II

ASSISTANCE WITH HEATING COSTS

Assistance with fuel bills comes from 3 Government Departments:

i) The DHSS offer help, chiefly through heating additions, to the low paid and supplementary benefit recipients.
ii) The Department of Environment offers help with conservation measures eg., the home insulation scheme.
iii) The Department of Energy provides additional help for home insulation projects through voluntary organisations. In addition the gas and electricity industries operate a number of schemes to assist consumers who have special difficulties meeting their bills.

A. The Department of Health & Social Security

The aim of the Government's fuel assistance policy is to concentrate worthwhile help where it is most needed, both through income support and conservation measures. In particular the Government recognises the difficulties that poor families with children, and the old, experience in meeting fuel bills. Help has therefore been concentrated on these two groups.

Since coming to office in 1979 the Government has:

i) simplified the system by removing the complicated Electricity Discount Scheme which provided no help for people dependent on fuels other than electricity;
ii) substantially increased heating additions so that total help with heating costs exceeded that offered both under the Electricity Discount Scheme and heating additions, under Labour (see below);
iii) directed help to where it is most needed. For example since November 1980 the basic heating additions has been paid automatically to supplementary benefit recipients with a child under 5 or where the householder is a pensioner aged 70 or over.

The Supplementary Benefit Commission commented in its Annual Report (Cmnd 8033 September 1980) that the Government's,

"Measures go a long way towards protecting the poorest from the impact of the rising cost of fuel. The help given by the present Government is of much greater value to the people receiving it than that provided by the previous Government's Electricity Discount Scheme."

Higher Heating Additions

The heating additions paid to people on supplementary benefit have been substantially increased since 1978 with the two higher rates being consolidated into one.

	Nov 1978	Nov 1979	Nov 1980	Nov 1983
Basic Rate	0.85	0.95	1.40	2.05
Higher Rate	1.70 or 2.55	1.90 or 2.85	3.40	5.05

The increase in heating additions has been about 140 per cent since November 1978 compared with an increase of about 100 per cent in fuel prices. (Hansard 28th February 1984 WA Col 162).

Moreover heating additions are being paid to more people. In November 1978 53 per cent of all claimants received heating additions. This figure has now risen to 60 per cent. The proportion of pensioners and other persons on supplementary benefit receiving heating addition has risen from 70 per cent in 1978 to the present level of 90 per cent. (Lords Hansard 13th December 1983 col 101 & Hansard 28th February 1984 col 164). Altogether more than 1 million more people benefit from heating addition in 1982 compared with 1978.

Expenditure

Expenditure on help with heating costs under Labour and under the Conservatives is shown below. This includes supplementary benefit heating additions; extra help towards heating costs through Family Income Supplement; and expenditure up until 1979 through the Electricity Discount Scheme.

Expenditure on Heating Costs

	£m
1978-9 (Labour)	125
1982-3	325

The latest estimate is that expenditure on supplementary heating additions is expected to be £380m 1983-84. (Hansard 31st January 1984 col 134).

In a recent Parliamentary answer Dr Rhodes Boyson, Minister of State for Social Security announced heating additions will be increased again in November 1984 by reference to the increase in the fuel and light element of the retail price index in the year ending May 1984. (Hansard 12th March 1984 col 67).

The abolition of standing charges for all consumers would cost the electricity and gas industries some £500m a year in lost revenue. To abolish standing charges to pensioners alone would cost some £300m.

Ways help with fuel bills is extended:

1) weekly heating additions to supplementary benefit can be claimed;

i) if the householder is aged 70 or over (basic) 1½m pensioner householders qualify for heating additions;
ii) to a householder where there is a child under 5 (basic)
iii) to a claimant if he or his dependents has a long lasting illness which could be helped by extra heating (eg., arthritis, rheumatism) or difficulty in walking (basic);
iv) help at the higher level is available for various other reasons; for instance those suffering from a serious or worsening illness (eg., ulcerative colitis, muscular dystrophy, kidney failure) or to those who are house bound or bed bound.

v) help is available for householders whose houses are difficult to heat (at basic level) or exceptionally difficult to heat (higher level);

vi) special help is given to those who live on a housing estate that is recognised as having a very expensive central heating system by way of estate rate heating addition (ERHA). These are two rates of ERHA depending on the number of rooms, not counting the bathroom, wc., or hall. These are as follows:-

1-4 rooms	£4.10
over 5 rooms	£8.20

vii) householders with central heating are entitled to an addition based on the number of rooms that have central heating (excluding bathroom, wc., and hall.

1-4 rooms	£2.05
over 5 rooms	£4.10

viii) tenants on supplementary benefit who pay a fixed charge to their landlords which includes all their heating costs are entitled to a rebate from their local authority of any excess over £6.05.

2)i) Help can also be extended to a supplementary benefit claimant or a person eligible for SB by a way of a lump sum (subject to £500 capital disregard limit). Lump sum single payments can be used for providing extra blankets, hot-water bottles, heaters; to save heat by means of draught proofing or lagging; or if there are unexpected difficulties paying bills, a change in heating system.

ii) Under Regulation 26 of Supplementary Benefits (Single Payments) Regulations additional help for fuel bills is available for exceptionally severe weather. During the winter of 1981/82, nearly 300,000 payments were made, at a cost of about £4m. The average payment was around £13. In 1982 new guidelines were introduced by the Chief Supplementary Benefit Office to provide a more objective scientific basis for interpreting the regulation. At the same time arrangements to let people know of this addition were improved.

B. The Department of Environment

Home Insulation Scheme

Under the Home Insulation Scheme (started in 1978) owner occupiers, tenants and landlords can apply to their local authority for a grant to insulate their lofts and water tanks. Those on supplementary benefit and housing benefit receive 90 per cent of the cost (up to a maximum of £95) and every one else 66 per cent (up to a maximum of £69) towards the cost of insulating roof spaces and the associated lagging of tanks and pipes in dwellings with no insulation.

Mr Ian Gow, Minister for Housing & Construction, has recently announced (November 1983) the Government is intending to extend H.I.S. to people with no more than 25mm or less of existing loft insulation.

Since 1978 £95m has been paid out in H.I.S. grants and a total of 1.75m lofts have been insulated.

YEAR	LOFT INSULATED
1978-79	239,000
1979-80	410,000
1980-81	304,000
1981-82	377,000
1982-83	431,000

Help for those on low incomes

Social Security expenditure is 25 per cent higher in real terms now than in 1978/79.

The Social Security programme for 1984/5 has been increased by £163 million more than was planned in last year's Public Expenditure White Paper. Social Security expenditure accounts for about £37 billion a year, nearly 30 per cent of all government spending.

The chief priority of the Conservative Government's social security policy remains the concentration of help on those most in need.

The Elderly

* Between November 1978 and November 1983 retirement pensions for a single person and a married couple increased by 74 per cent while prices rose over the same period by 69 per cent.

Retirement and Widow's pension	Nov 1978	Nov 1982	Nov 1983
Single	19.50	32.85	34.05
Married couple	31.20	52.55	54.50

The Government is not only increasing pensions but is paying pensions to more people - the number of retirement pensioners has increased by 600,000 since 1978. The Manifesto gave a clear commitment to protect retirement pensions against rising prices.

* The Government remains committed to abolishing the earnings rule as soon as it is able. As a first step, between November 1978 and November 1982 the earnings rule limit was raised from £45 per week to £57 per week. In November 1983 the limit was raised by 14 per cent to £65 a week.

  The £10 Christmas bonus has been paid each year under the Conservative Government. Legislation was enacted in 1979 to make the Christmas Bonus permanent; it was not paid under Labour in 1975 and 1976. The bonus benefits 9.1 million pensioners and 1.8 million other people at an annual cost of £109 million.

* Since November 1980 the basic heating addition has been paid automatically to householders aged 70 or over who receive supplementary benefit. In November 1983 the basic heating addition was increased from £1.90 to £2.05 and the higher rate was increased from £4.65 to £5.05 a week. The Government is spending over £350 million on special schemes to help with heating costs.

* All men over 60 on supplementary benefit can, from June 1983, qualify immediately for the long-term rate of benefit; this will benefit 80,000 claimants.

Pensions

* The 1983 Election Manifesto stated that the Government would consider how the pension rights of early leavers in occupational pension schemes could be better protected, and how fuller information could be given to members of such schemes. A consultative document setting out the Government's proposals on early leavers was published in November 1983. Additional measures will follow.

* Mr Fowler has also announced the setting up of a special pension inquiry which he will chair himself. The inquiry will study the future development, adequacy and costs of state, occupational and private provisions for retirement (including the 'portability' of pension rights and the age of retirement). The inquiry will aim to reach conclusions by Spring 1984 and will be conducted, as Mr Fowler said, 'as openly as possible'.

Low Incomes

* Supplementary benefits which are paid to about seven million people including dependants are often referred to as "a safety net" because they provide a minimum level of income to such as the unemployed, one parent families and pensioners.

  Although the Government is legally obliged under current legislation to raise many benefits, eg retirement pensions, each year in line with the rise in prices, there is no such obligation in respect of supplementary benefits or child benefit. Nevertheless, in November 1983 all supplementary benefit rates were raised by 4.3 per cent. The long term supplementary scale rate will therefore be increased from £32.70 to £34.10 for a single householder and from £52.30 to £54.55 for a married couple.

* From November 1983, the two main supplementary benefit disregards have been improved. The main limit has been increased from £2,500 to £3,000 and for single payments from £300 to £500. A new disregard limit of £1,500 was also introduced in respect of the surrender value of life assurance policies.

* Between 1978 and November 1983 the "prescribed amounts" of Family Income supplement have been substantially increased ahead of prices; for example, a family with one child has had the prescribed amount raised from £46 a week to £85.50 a week from November 1983.

The Family

* Child benefit has been raised by stages from £4 per week in April 1979 to £6.50 in November 1983 - its highest ever level in real terms.

* One parent benefit has been more than doubled from £2 per week in April 1979 to £4.05 in November 1983 - its highest ever level. Moreover single parents are now eligible for the long term rate of supplementary benefit after one year instead of two; changes in the supplementary benefit rules allow single parents to earn more without losing so much supplementary benefit.

The Disabled

* Total social security spending on the disabled and long term sick has gone up over the period 1978/79 - 1982/83 from £1,730 million to £3,370 million. This represents an increase of 21 per cent over and above the rate of inflation. This increase is accounted for not only by substantial increases in some benefits but also by the increase in the number of recipients. For example, between 1978/79 and 1982/83 there was a 47 per cent increase in the number of people receiving attendance allowance and an 180 per cent increase in the number of people receiving mobility allowance.

* The attendance allowance has been increased by 74.3 per cent between November 1978 and November 1983.

* The mobility allowance has been increased from £10 per week in November 1978 to £19 per week in November 1983. Furthermore, in 1982, mobility allowance was exempted from tax.

* In the 1981 Budget the Chancellor doubled the tax allowance for the blind from £180 to £360; zero rated VAT car adaptions for disabled drivers; and relaxed the conditions under which trusts for the disabled can obtain capital gains tax exemptions.

* The Invalid Care Allowance was extended in 1981 to non-relatives - some 2,000 should benefit.

* The "invalidity trap" has been abolished so that people on invalidity benefit can, from November 1983, qualify for the long-term rate of supplementary benefit. This will help 30,000 people under 60 at a cost of £3 million in 1983/84 and £10 million in 1984/85. 37,000 sick and disabled people over 60 will gain from a separate measure to give them the long-term rate automatically (see before).

Conservative Research Department
32 Smith Square, SW1

CAD/KEC

DEPARTMENT OF ENERGY
Thames House South
Millbank
London SW1P 4QJ

Tel: Direct Line: 01-211
Switchboard: 01-211 3000

John Neilson

With the Compliments of

the Private Secretary to

the Secretary of State

NBPM
AT 20/3
~~DW~~

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

Sir Alistair Frame
6 St James's Square
LONDON
SW1Y 4LD

20 March 1984

Dear Sir Alistair

Thank you for your letter of 7 March together with the enclosure. I read this with interest. It is, of course, a highly complicated area with a range of considerations but it was nice to have your comments. I will presumably see you next Monday when I lunch with RTZ. Perhaps we could have a word about it then.

Yours

PETER WALKER

NAI IND: Gas

Pt 9

NBPM

cc NO

AT 19/3

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

16 March 1984

Dear Peter

with AT?

George Younger sent me a copy of his letter to you of 27 February about the scheme for limiting standing charges for electricity.

He gave some revealing statistics on the use of the premises which benefit from this scheme. With under one-half of the benefit going to dwellings which are not permanently occupied (eg holiday homes, lock-up garages, etc) it must be questionable whether the scheme is worth continuing at all in Scotland.

While I sympathise with the position in which George Younger finds himself, I have serious reservations about the idea of limiting rebates to those receiving supplementary benefits or pensions. As proposed in the autumn of 1982, the scheme was not justified as a measure to help the poor consumer, but instead to remove a source of grievance for a wider range of small consumers (rich and poor). It would therefore be somewhat illogical to recast the scheme for the benefit of the worse-off. To do so would also run across our long-standing policy that we should not use nationalised industry pricing as a means of helping the poor with fuel bills. The right way to do that is through the supplementary benefit heating addition.

Nonetheless, I think that there are at least two other options that could usefully be examined. These are:

a) to limit the rebate to those properties which were permanently occupied - this would remove the anomalies over holiday homes, lock-up garages etc, but might be administratively complex;

b) to allow individual Boards within the industry to make their own decisions on whether to have the scheme and the form it should take. Onc can well imagine that the balance of advantage may vary in different parts of the country. Clearly the Scottish Boards are firmly against the scheme; I understand that at least one Area Board in England and Wales has already introduced a modified version giving less benefit.

I should be interested to see comparable statistics for England and Wales to those helpfully provided by George Younger. It would be unwise to mix up this scheme with the social security system in any way. Subject to the views of colleagues, I would be content for other options to be examined by officials.

Whatever outcome emerges, we should work on the assumption set down in my predecessor's letter of 6 October 1982 that any loss of revenue on rebating standing charges will be made good by offsetting increases in tariffs elsewhere so that there is no net effect on the external financing requirements of the industries.

I am copying this letter to the Prime Minister, the Chancellor, the Secretaries of State for Scotland, Northern Ireland, Wales, Trade and Industry, Environment and Social Services, and to Sir Robert Armstrong.

Yours ever
Peter

PETER REES

Nat Ind: Gas & Electricity A9

cc NO

01 211 6402

The Rt Hon George Younger MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
LONDON SW1A 2AU

16 March 1984

ELECTRICITY STANDING CHARGE REBATE SCHEME

Thank you for your letter of 24 February. with att

While I understand your concern, and the concern of the Scottish Boards, about the rebate scheme, I think that we need to bear in mind that it was never designed as a measure of help to the needy. Since the Labour Government published "ENERGY TARIFFS AND THE POOR" in 1976 all Governments including ourselves have accepted that assistant to the less well-off with their fuel costs would not be provided effectively by tariff measures but was the province of social security benefits. While the rebate scheme has the incidental effect of giving limited help to those amongst the less well-off who are small consumers, its purpose was to relieve the very considerable pressure for the total abolition of standing charges to some or all consumers, which would distort tariffs far more than the present scheme.

However, that does not mean that we should close our minds to the possibility of changing the Scheme to lessen some of its deficiencies. Unfortunately Mr Miller's suggestion strikes me as posing potential problems in risking both undue preference between consumers, which would be contrary to statute, and greater adminstrative complexity and costs. We do not want a repeat of the last Government's electricity discount scheme which incurred approaching half its costs to administration. Moreover, limiting the scheme as suggested would make it overtly a measure of social assistance and could, by highlighting its obvious inadequacies in this respect, fuel furhter pressure for total abolition of standing charges for the particular groups of consumers in question.

I do not therefore believe that the SSEB suggestion promises a viable alternative. Nor does it seem at all probable that a review by officials would produce such an alternative: the subject has already been thoroughly examined.

But it is difficult to envisage ending the present scheme with nothing to put in its place - politically this would fan the present smouldering discontent. However, I am aware that both British Gas and the Electricity Council are reviewing the operation of the present schemes, and before we take any final decisions on how to proceed I should like to wait to see whether they come up woth any helpful suggestions. When we see their ideas we can better take stock together and make a considered judgement taking account also of Norman Fowlers view on the social implications of the best way forward. I shall write to you again when I have the industries' views.

I am copying this letter to the recipients of yours.

PETER WALKER

File with VAT

cc NO

NBPM
AG
16/3

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

15 March 1984

George Younger sent me a copy of his letter to you of 27 February about the scheme for limiting standing charges for electricity.

He gave some revealing statistics on the use of the premises which benefit from this scheme. With over one-half of the benefit going to dwellings which are not permanently occupied (eg holiday homes, lock-up garages, etc) it must be questionable whether the scheme is worth continuing at all in Scotland.

While I sympathise with the position in which George Younger finds himself, I have serious reservations about the idea of limiting rebates to those receiving supplementary benefits or pensions. As proposed in the autumn in 1982, the scheme was not justified as a measure to help the poor consumer, but instead to remove a source of grievance for a wider range of small consumers (rich and poor). It would therefore be somewhat illogical to recast the scheme for the benefit of the worse-off. To do so would also run across our long-standing policy that we should not use nationalised industry pricing as a means of helping the poor with fuel bills. The right way to do that is through the supplementary benefit heating addition.

Nonetheless, I think that there are at least two other options that could usefully be examined. These are:

a) to limit the rebate to those properties which are permanently occupied - this would remove the anomalies over holiday homes, lock-up garages etc, but might be administratively complex;

b) to allow individual Boards within the industry to make their own decisions on whether to have the scheme and the form it should take. One can well imagine that the balance of advantage may vary in different parts of the country. Clearly the Scottish Boards are firmly against the scheme; I understand that at least one Area Board in England and Wales has already introduced a modified version giving less benefit.

I should be interested to see comparable statistics for England and Wales to those helpfully provided by George Younger. It would be unwise to mix up this scheme with the social security system in any way. Subject to the views of colleagues, I would be content for other options to be examined by officials.

Whatever outcome emerges, we should work on the assumption set down in my predecessor's letter of 6 October 1982 that any loss of revenue on rebating standing charges will be made good by offsetting increases in tariffs elsewhere so that there is no net effect on the external financing requirements of the industries.

I am copying this letter to the Prime Minister, the Chancellor, the Secretaries of State for Scotland, Northern Ireland, Trade and Industry, Environment and Social Services, and to Sir Robert Armstrong.

PETER REES

Electricity

020

CCNO

Secretary of State

Northern Ireland Office
Stormont Castle
Belfast BT4 3ST

NBPM

AF 14/3

The Rt Hon George Younger MP
Secretary of State for Scotland
Scottish Office
Whitehall
LONDON
SW1A 2AU

12 March 1984

Dear George

ELECTRICITY STANDING CHARGE REBATE SCHEME

Will request if required.

Thank you for copying to me your letter of 21 February to Peter Walker.

The Northern Ireland Electricity Service introduced the rebate scheme in February 1983 in line with the Electricity Boards in Great Britain. We do not seem to have experienced to anywhere near the same extent the problem experienced in Scotland. During the first year of operation results have shown that 60 per cent of the benefit has gone to recipients in need, including old age pensioners. Only 8 per cent has related to second home owners. Nevertheless, I do endorse your view that the assistance should be channelled to those in greatest need, provided this can be achieved without adding unduly to the scheme's complexity and cost. I therefore support your proposal to see if the scheme can be modified to concentrate help most fully on those in need. My own officials will of course be prepared to contribute to any such examination.

I am copying this letter to recipients of yours.

Yours
Jim

SP

CONFIDENTIAL

CC NO

NBPM

HT 8/3

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

8 March 1984

M F Reidy Esq
Private Secretary to the
Secretary of State for Energy

Dear Michael,

GAS MANUALS PAY NEGOTIATIONS

with AT.

Thank you for your letter of 2 March, keeping us in touch with developments in these negotiations.

The Chancellor hopes that the British Gas Corporation will stand firm, particularly because of the effect any increase in the offer could have on negotiations elsewhere in the energy sector.

I am copying this letter to those who received yours.

Yours sincerely,

Margaret O'Mara

MISS M O'MARA
Private Secretary

Nat. Ind : Gas & Electricity Pt 9.

BF 13/3 cc NO D/Energy

6, St. James's Square
London, SW1Y 4LD
Telephone: 01-930 2399

7th March, 1984

Dear Prime Minister,

North Sea Gas

Thank you for your letter of the 22nd February replying to our earlier letter and paper. I must apologise for the delay in answering, but both Allen Sykes and I have been travelling abroad. We appreciated receiving your well reasoned reply to the main points in our paper and will, as you have suggested, copy our paper and this correspondence to Peter Walker.

In reply to your letter, we would make only three significant points.

1. Any inter-connection between Britain and the European gas grids must be for the mutual benefit of all the countries concerned and improve the security of the Western Alliance. Accordingly, it is worth pursuing vigorously, despite Norwegian commercial reluctance. Western security is too important to be sacrificed to such a narrow interest. In any event, in the last resort, Britain can link itself to Europe without Norwegian involvement, although such involvement is highly desirable. We believe, however, that Norwegian gas policy is capable of being changed for the better by the combination of a much more liberal economic policy by Britain and an imaginative diplomatic effort at the highest level. These measures could overcome the restrictions, shortsightedness and lack of co-operation of the last decade, although we fully realise that it will take time and careful persuasion. We believe the detailed arguments we developed in our paper should assist in this process. The likely military, political and economic gains are so important that they merit making a major attempt.

2. Britain currently may not need any further gas import deals after Sleipner, if the British Gas Corporation monopoly is abandoned and exports allowed. The going British price for North Sea gas is some 20%below the price that could be earned in Continental Europe and the very best way to ensure the maximum supply of British gas for the British long terms needs is to eliminate completely monopoly buying by the BGC.

/2....

The only realistic way to introduce significant competition into British gas supplies is to allow them to find their true market level, which means allowing exports. The increase in gas exploration and gas finds of the last two years is almost entirely due to the very much higher prices the BGC have been paying for British gas. It would be wise to take this process to its ultimate conclusion, which involves eliminating any difference between British and European prices. This means higher gas prices, but higher economic activity to go with it, and incidentally, no likelihood of a shortage of British gas. The elimination of state monopoly pricing is, after all, the economic policy generally favoured by the Government in nearly all other cases, including oil. It can be expected to bring the same general benefits when applied to gas.

3. While it is true that there is a landing requirement on oil as well as gas, in practice this requirement has often been waived. More importantly, oil is cheaper and much more flexible to transport, whereas gas can only be transported by expensive pipeline. The requirement to land gas in Britain before it can be exported is, therefore, tantamount to denying export in practice. The case for this requirement deserves re-examination.

We hope these points are of some help to you and your advisers when facing the important and difficult decisions over North Sea gas.

Yours sincerely

Antoine Frane

The Right Hon. Margaret Thatcher, M.P.,
10 Downing Street,
London, S.W.1.

NAT IND: Gas Pt 9

ec NO

NPM

AF 5/3

01 211 7214

CONFIDENTIAL

Miss Margaret O'Mara
Private Secretary to the
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

2 March 1984

Dear Margaret

GAS MANUALS PAY NEGOTIATIONS

My letter of 6 February reported the BGC offer averaging 4.3% on earnings which the trade union negotiators had agreed to recommend to their members.

The main union, the General Municipal Boiler Makers and Allied Trades Union, which covers some 80% of union membership among BGC's manual workers, has this week rejected the offer and on the strength of that rejection the union side of the National Joint Industrial Council wrote to the Corporation seeking an improved offer.

The Corporation have replied to the NJIC saying they have nothing else to offer. It now rests with the unions to decide what, if any, action to take. Official industrial action would require a two-thirds support by the membership and a ballot would take at least a week to organise following the GMBATU'S next meeting on 12 March if that route is chosen. The Corporation are not unduly worried at this stage especially since the delegate conference which votes by Regions, rejected the offer by 9 to 3 and was not unanimous. Meanwhile they are prepared for some pockets of unofficial action once the Corporation's rejection of the NJIC approach becomes known.

I am copying this letter to the private secretaries of the Prime Minister, Members of E(PSP) and Sir Robert Armstrong.

Yours
Michael

M F REIDY
Private Secretary

Nat Ind Gas & Elec
Pt 9

CONFIDENTIAL

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON SW1

2 March 1984

Dear Andrew

GAS INDUSTRY PAPER

When my Secretary of State saw the Prime Minister on 23 February he handed her a draft paper. I would be obliged if you could please arrange to have this marked copy number three of thirteen.

Done 5/3/84

Yours

Michael

M F REIDY
Private Secretary

SECRET

27 February 1984
Policy Unit

5

PRIME MINISTER

NBPM AT 27/2

GAS PRIVATISATION

I met Mr Davis from the Department of Energy today.

I suggested to him that the paper be strengthened in three respects:

1. Competition. The paper should ask the question why no-one is using the common carrier provisions for the grid; should assess the chances of bringing competitors into the gas supply market; and should discuss the role of the oil companies and heavy industrial users. It should also ask the question: in what conditions would a new supply company set up, perhaps for a new industrial estate or a new town or an expanding village?

2. Rejection of Price-Linked Regulation, I suggested that the rejection of this scheme had been too hasty.

Customers need to be reassured. They understand prices and are worried by complex profits formulae.

Price control could be related to market prices for oil substitutes. The price of interruptible gas for industry is related to residual fuel oil. Commercial gas also has its oil equivalents.

Price regulation could be arranged on a RPI-X formula for onshore costs, and a market price for gas bought from the North Sea if a market has been established.

Price control could be based on a total RPI+X formula so that the customer had a guaranteed maximum real price on which to plan.

Mr Davis agreed that the case for regulation by price should be strengthened, so that it was a serious option for E(A) debate.

3. Profit base regulation. This is a scheme favoured by the Department of Energy. Under this scheme, there is a grave danger that:

i. The new gas company would be able to gold-plate its investment, as part of the scheme depends on regulation by a profit control expressed as a percentage of net assets.

ii. DEn argue that it would be less complicated than price regulation: however, they would need to regulate not only profits, but also relative prices between types of customer,

SECRET

otherwise any individual group of customers could be made to pay at the expense of the rest.

iii. They wish to include some kind of performance incentive in their formula. I suggested this should be a large element of the allowed profit, in order to have the desired effect of controlling costs.

iv. I suggested that they should deal with the question of transfer prices. It would be possible for the new corporation to avoid the impact of the regulation by transferring the real profits they were earning outside that element of their business that was subject to profit control.

In conclusion, Mr Davis said he found these comments helpful, and would endeavour to sharpen up the choices in the report in the light of these criticisms.

JR

JOHN REDWOOD

CONFIDENTIAL

File

MISS WALLACE

24 January 1984

ELECTRICITY PRICES

You asked me about the Financial Times editorial of 23 January and similar press comment. The following comments may be helpful for general background.

Economic Prices

The Government's commitment to economic pricing is based on both economic and energy policy objectives. There is no conflict between the two:

- economic prices are not a tax upon energy users. Rather prices below economic levels represent a subsidy to energy users;

- such a subsidy would increase pressure on the PSBR and help to push up interest and inflation rates;

- subsidised energy prices would give the wrong economic signals for investment decisions, stimulate energy demand and lead to a waste of natural resources. Efficiency and conservation pressures would be reduced;

- this would be followed by a future painful readjustment when prices would inevitably have to rise to cover future costs of supply;

- economic energy prices will not raise the rate of inflation. Recent prices rises did not exceed the rate of inflation;

- the Government's whole attempt to introduce commercial reality into the nationalised industries would be defeated if prices were influenced by political rather than economic considerations.

It should also be stressed that the purpose of economic pricing is to simulate prices which would exist in a competitive market if, as in the case of gas and electricity, such a market does not operate. It is not an economists' abstraction unrelated to commercial reality. In a market place without differential pricing, long term survival would only be assured if prices covered the marginal cost of supply.

Electricity Prices

It was in recognition of the fact that economic prices need not take into account the cost of building new power stations at a time of overcapacity, that electricity prices were frozen in 1983/84 and will be increased by significantly less than the rate of inflation in 1984/85.

This pricing pattern was agreed at the time the financial target for these years was set in early 1983.

Since the target was agreed, Government pressure has achieved further efficiency savings and coal prices in the CEGB have moved closer to economic levels. Consequently the financial target will be exceeded, irrespective of any decisions on pricing. It is for this reason that the Government has been able to raise the EFL in 1984/85 to £740 million.

This decision is not in conflict with economic pricing nor with the Government's wish to set a clear financial framework in which the industry can operate. Economic pricing principles are taken fully into account when the target is set.

Economic pricing does not lead to excessive profits. The rate of return for the electricity industry on average total assets for 1983/84 and 1984/85 will be less than 2%.

Financial Times Editorial - 23 January 1984

The FT editorial misrepresents the Government's approach:

- Nigel Lawson, when Energy Secretary, did not use a different definition of economic pricing in setting the financial target in March 1983 compared with the Treasury's recent arguments. The target assumed a price rise of 1½% below the rate of inflation in 1984/85;

- the Government accepted and still accepts the general conclusions of the confidential Cooper and Lybrand report. The most significant recommendation was that long run marginal costs at a time of overcapacity should not include a capacity charge for building new plant but for retaining existing capacity on the system;

- the reason why the financial target will now be exceeded does not relate to the level of economic prices for electricity but to the efficiency savings which the industry has achieved and to changes in the coal price;

- the Cabinet does not set electricity prices and the Government has no statutory power to impose prices. Nevertheless the Government is committed to economic pricing throughout the public sector and to improving the efficiency of nationalised industries through demanding financial targets. Within these criteria, the industry is encouraged to operate in as commercial a manner as possible;

- there is no case for an additional regulatory body. If the electricity industry were to be transferred to the private sector, the need for a regulatory agency would depend upon the extent to which competition could be introduced.

The Role of Cabinet

The recent Cabinet discussion was not about economic pricing but about the credibility of the additional efficiency savings which the industry were promising as an alternative to the price increase which had already been agreed.

The problem was that the Electricity Council had offered further savings after the public expenditure discussions had supposedly identified the full scope for savings. As the Council were unable to indicate the source of these new savings, the Cabinet preferred a small price rise. The Electricity Council subsequently agreed with this view.

DLP.

DAVID PASCALL

SECRET

(2)

24 February 1984
Policy Unit

4

PRIME MINISTER

GAS INDUSTRY PRIVATISATION

I met Peter Walker today.

I put to him the following points (in a spirit of friendly assistance):

1. Investors will be excited by the thought of owning a share in a business which generated £1,300 million of cash last year: this point should be made to offset his gloomy comments concerning medium-term gas shortage.

2. Investors will adjust the stated profit and loss account, adding back to profits all of the additional depreciation and provisions currently being made by the management to conceal the true profitability of the operation.

3. Competition. The paper should expand on why it is oil companies and others are not taking advantage of the Oil and Gas Enterprise Act provisions. No other company is currently using the gas grid as a common carrier. The paper should also question whether BGC can be brought more fully into the international gas market. If a market in gas can be established, many of the difficult pricing problems disappear. The reason Cabinet at the moment gets involved in acrimonious pricing disputes, and the reason why Peter Walker recommends complex regulation, is that there is no market price of gas to which you can refer; whereas in the case of the oil industry, the market price acts as the answer to most of the criticisms.

4. I queried whether there were so many disadvantages for the regional company option. In particular, it seems unlikely that the additional costs will be as great as he suggests, as there could be offsetting gains in the form of better gas purchasing and some efficiency improvements.

5. The paper should draw attention to the unsatisfactory nature of BGC's current monopoly position. It is unlike BT in that it does

SECRET

not have to provide a service to every industrial consumer, and there are large numbers of private individuals who are debarred by location from having access to gas supply. Worries about future non-availability under a privatised system should be set against the ill will of many companies and people who feel wronged by the current arrangements.

6. I agreed that if he does propose the sale of the complete enterprise, there must be a regulatory framework for price, and there must continue to be a gas tax to remove the difference between the very cheap gas BGC buys under long-term contract from older North Sea fields, and the new contract price of gas which is reflected in the price to the customer.

7. The regulatory framework he proposes is worse than that which has already caused trouble with the BT issue. I explained my reasons for disliking a profit-linked rather than a price-linked formula (particularly because it is more difficult for the customer to understand) and argued that there would have to be much more competition for customers to be at all reassured. He suggested that Mr Davis from his Department comes to see me on Monday to go into detail on these issues, and I agreed.

8. I agreed with his proposition that the retail activities should be segregated (including service?). I expressed a preference for sale of 100 per cent: he said he also favoured this, but thought that 80 per cent was the best that he would be able to do.

9. Gas exploration and production. I suggested that the arguments for segregating this activity in the way in which the oil interests have been segregated, and selling it separately, should be explored, as there would be many people who favoured this route.

10. Employee participation. I expressed enthusiasm for substantial employee participation, but warned that this proposal - along with his main proposal to sell the whole business - would not buy union peace necessarily. The gas unions have in the past opposed the sale of the retail showrooms, and would try to orchestrate a campaign against any denationalisation proposals.

I concluded by saying that Peter Walker's proposals and his paper represented the results of a great deal of hard work, and had shifted the debate a long way. The criticisms would come from two separate angles. Some would see in the solution of selling the whole all the BT arguments writ large, as there is no fledgling competitor, and the regulatory framework is arguably worse. Others would argue that the segregation by function was not sharp enough and had not been taken far enough; they would prefer to see the sale of the retail interests, and sale of the gas exploration and production interests as separate entities, early on in the denationalisation process in order to reduce the monopoly stranglehold on all sectors of the business. I suggested that the paper should at least examine those options more carefully and set them out as realistic choices, whilst strengthening protection for customers.

Peter Walker is going to see John Moore on Monday to hear his views: the Treasury seems to be moving in favour of selling the upstream and downstream businesses, and leaving the central grid as a public monopoly utility.

JOHN REDWOOD

6, St. James's Square
London, SW1Y 4LD
Telephone: 01-930 2399

NBPM AT
27/2

24th February, 1984

Dear Prime Minister,

In Sir Alistair Frame's absence overseas, may I acknowledge and thank you for your letter to him of the 22nd February. This will be placed before him when he returns to London on the 5th March.

Yours sincerely,

Elisabeth Hughes.

Elisabeth Hughes (Miss)
Secretary to Sir Alistair Frame

The Right Hon. Margaret Thatcher, M.P.,
10 Downing Street,
London, S.W.1.

Nat Ind: Gas + Elec pt. 9.

SUBJECT

c. Master Set

3

SECRET

NOTE FOR THE RECORD

c.c. John Redwood

PRIVATISATION OF BGC

Mr. Walker came to see the Prime Minister yesterday to discuss his ideas on the privatisation of BGC and the way in which this work should be handled. Working with a very limited group of officials, he and his Ministers had produced a major study on the possibilities for privatising the gas industry. They had looked at a number of alternative structures and at the regulatory systems in a number of other countries. He had concluded that the scope for increasing competition in the gas industry was limited. Nevertheless, to put BGC into the private sector under a regulatory system would represent a major improvement on the present structure.

He had given a copy of the study to John Redwood and would be giving another to John Moore. He was inviting both to talk to him about it. He said he was totally committed to the policy of denationalisation and pointed out that he had more experience in the control of nationalised industries than any other of his Ministerial colleagues. In his view, the solutions being considered by the Treasury and the Policy Unit were too purist and did not take sufficient account of economic and political realities. He pointed out that at present there were 750,000 customers, mainly in the South West and North West, who were being supplied at a common price and at a loss. There would be a danger that their supplies would be discontinued in a freely competitive regime.

Mr. Walker said the exercise needed to be handled with great care. Denationalising gas would be a major prize for the Government but represented a major hazard if it went wrong. He was determined that divisions in the Cabinet should not be allowed to surface in public. He wished, therefore, to reach an agreed solution which could be put to colleagues generally. He left the Prime Minister a copy of the study

/ and emphasised

and emphasised the need to restrict access to it.

He observed that in the long run gas was likely to be a declining industry. The era of cheap gas supplies was coming to an end. Gas had been cheaper than electricity but the gap was closing, and if nuclear generation were successful the differential could move the other way.

The Prime Minister endorsed Mr. Walker's wish to achieve an agreed solution with colleagues most closely concerned. She offered to hold a meeting of a small group of Ministers if this would prove helpful.

AT

24 February 1984

MW

10 DOWNING STREET

From the Private Secretary

Prime Minister

Mr Walker is coming in to take your mind on privatisation of gas. He and his officials have a draft paper ready. You are not expected to read it, as John Redwood has prepared a summary, but to be aware of its existence.

You will want to be cautious since, as John's note indicates, there are serious drawbacks to privatising the core business largely unreconstructed.

AT

22/2

CONFIDENTIAL

22 February 1984
Policy Unit

PRIME MINISTER

GAS INDUSTRY PRIVATISATION

Peter Walker's paper argues that British Gas provides a unique opportunity "to engage capital market disciplines and real individual ownership in place of political and bureaucratic control". He portrays a business which is now mature: there will be problems in the medium term in finding replacement sources of gas for the North Sea gas it is currently using, coupled with the possible need for major new investment in coal conversion.

The paper examines the possibility of splitting the Gas Corporation into different operating regions. It concludes that this would result in diseconomies and higher prices for customers, whilst offering little genuine competition, as there would still be local monopolies.

It examines the case of gas retailing, setting out three options:

i. ending retailing by the gas supply industry and selling it off;

ii. allowing a privatised British Gas Corporation to continue to operate retailing and servicing, subject to tight OFT controls; and

iii. selling a majority shareholding in a separate retail business to the private sector, but leaving BGC with a minority stake. The paper recommends this latter course.

The paper examines BGC's interest in gas exploration and production, and concludes that the privatised Corporation should maintain its presence. They currently control 7 per cent of United Kingdom Continental Shelf production, and one-sixth of proven UKCS gas reserves.

The paper favours a substantial management-employee involvement to the extent of around 10-15 per cent of the equity in a denationalised Corporation.

Selling segregated regional companies would delay the sale until the next Parliament. For this and other reasons, the paper concludes in favour of selling the main core of the existing business during the

CONFIDENTIAL

life of the present Parliament. This would require substantial regulation and greater transparency of accounting and information, so that different classes of customer could be assured of non-discrimination. There would be regulation of profits through a complex formula, and a gas tax. Proceeds might be around £6 billion, possibly split 50:50 between debt and equity.

Comment

Peter Walker is right to stress the need for more competition, for employee involvement in shareholdings, and for the urgency of some action in tackling a large public sector monopoly business.

He is right to reject the route of forming separate regional companies. The way proposed in his paper would delay privatisation, and would produce few competitive benefits, as local monopolies are every bit as unpleasant as national monopolies to their customers. You could congratulate him on the range and depth of his draft paper, which covers the regulatory experience in 7 overseas countries, and the history of the UK industry.

The draft paper has its less good points:

1. British Gas is not as unattractive an investment as he makes out. Yes, the gas reserves of the North Sea are finite, and yes, there will need to be investment or new purchasing to replace them. This is exactly the same for any North Sea oil company. In the case of BP, the main profits are earned by two large capital projects - the Forties Field in the North Sea, and the North Slope in Alaska. Forties is already past peak production, and within 15 years both these major investments will have to be replaced at enormous cost. However, investors are still keen to own BP shares.

2. Greater customer benefits could come from pursuing the retail question further. Full denationalisation would provide a much greater spur to improving the service and the range and price competitiveness of products. It would also free BGC to contemplate using other retailers for their gas billing and service activities. Gas servicing and installation should also be sold with the shops.

3. Exploration and development of North Sea Gas is a competitive activity, and the same logic that led to divestment of the oil

interests could sustain a case for separate divestment of the gas interests. British Gas should be a company involved in distributing gas, buying it from the best source but not owning it.

4. It is difficult to see that the regulatory system designed for the main core business presents a material improvement over the BT one; in many respects it is worse.

5. A more important issue in encouraging gas privatisation is how a good gas market can be established both at the well head end of the business and at the customer supply point. The Oil and Gas Enterprise Act took the necessary powers to make BGC's pipeline into a common carrier. Nothing so far has happened to give any meaning to this relaxation. BGC should only be sold if other companies are routing gas through the common carrier pipeline system. In that way, there would then be a market price for gas and BGC would be on risk if they set their prices at the wrong levels. Under the scheme in Peter Walker's paper, the pressures on the regulators to set the price of gas will be just as unpleasant as the pressures at the moment on the Cabinet. Markets work best. It was only the deregulation moves of the last Parliament which forced BGC to offer a better price for new North Sea gas and led to a sharp acceleration of exploration and discovery.

6. The paper does not refer to the chronic shortages of gas which have occurred owing to the managed BGC price regime of recent years. Many potential customers have been prevented using gas as there has been a shortfall in supply. BGC's reluctance to pay a realistic price to producers (until recently) has caused this hardship. There is a growing international market in gas which could help in establishing a fair price.

Conclusion

Peter Walker's preferred route for the core business pays too much attention to reassuring the employees and too little to the questions of competition and customer service. I fear his view of the politics has prejudiced the judgement of the draft paper. People keenest to denationalise could turn out to be the most hostile critics of his scheme! The regulatory system proposed is as complex as it is worrying.

It would be better to be a BGC manager than a customer of the new business proposed.

I have been invited round to talk to him at length concerning the detail of his paper. I would like to concentrate at that meeting on the questions of whether and how an active market in gas supply can be developed, and whether splitting BGC by functions could be carried further to make it a serious option to be studied by E(A) when his paper comes through in final form.

JR

JOHN REDWOOD

COPY NO. 3 of 13

CONFIDENTIAL

GAS INDUSTRY PRIVATISATION

CONTENTS

this document will be processed by the Department for Business, Innovation & Skills who are responsible for Department of Energy records.

G. Gray 18/7/2013

D/EN letter is
Commercial in Confidence

CF - Yours?

JCE SR

c D/N
D. Pascall

10 DOWNING STREET

THE PRIME MINISTER

22 February, 1984

Dear Sir Alistair,

Thank you for your letter of 1 February, enclosing a copy of the paper you have written in collaboration with Allen Sykes on maximising Britain's benefits from offshore gas. I have read this with interest.

The main conclusion of your paper is that as a first priority we should consider in collaboration with Norway the development of a strategic gas supply capacity, available to Continental Europe in the event of a disruption to imported gas or oil supplies. The security of gas supplies to Europe has been the subject of detailed study both in the European Community and in the International Energy Agency. Two reports, the most recent in May last year, concluded that major European gas importing countries could in general cope with a loss of up to 30% of imports over 6 months including a winter period. This confirmed the ability of Europe to withstand even quite severe gas supply interruptions.

The position on imported gas supplies is being kept under close review in the European Community and in the IEA. Further studies on the adequacy of gas transportation and storage facilities within the Community and on the level of future imports are expected shortly. Discussion of these will provide the opportunity for international consideration of further security measures such as those proposed in your paper. The willingness of gas importing countries to pay

/ the

VC

the security 'insurance premium' and the attitude of the Norwegians are important in assessing those proposals. I should mention that the Norwegians have so far shown no interest in those more limited suggestions for co-operative measures to which you also refer, for example for the UK to act as a 'landbridge' for the delivery of Norwegian gas to the Continent.

Your second conclusion is for the Government to pursue increased competition in the supply of gas to the British market by relaxing the landing requirement for gas. We have, as you may know, made clear that the Government is willing to reconsider the question of gas exports if large new volumes of gas should be discovered on the UKCS. The issue rightly identified in your paper is whether current policies are providing sufficient incentive to the oil companies to explore for and develop our offshore reserves. Here, I feel you have under-estimated the impact which our policies are already having. In the late 1970's offshore exploration activity indeed fell appreciably. Over the last two years (which have seen the passage of the Oil and Gas (Enterprise) Act and the Eighth Round of Licensing) some 65 wells have been drilled in the Southern Basin gas province alone and ten new gas developments are either under way or in prospect. This upsurge in activity is resulting in a much better understanding of available gas reserves, which will be reflected in this year's Brown Book, due out in April.

Lastly, the landing requirement, which incidentally applies equally to oil and gas, does afford Britain significant security of supply benefits over our petroleum resources. While these benefits may not be as far reaching as those you suggest on a European scale, they could nevertheless be of great importance to the nation in times of emergency.

/ As

As your paper ranges over a large number of interesting issues relating to gas policy you may like to send a copy to Peter Walker, who would I am sure be glad to discuss it with you.

Yours sincerely

Margaret Thatcher

Sir Alistair Frame

CONFIDENTIAL

CC NO

N BPM

AT 20/2

01 211 6402

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

20 February 1984

R. Pree

BGC CORPORATE PLAN

Thank you for your letter of 2 February.

Your letter expresses some surprise at the two factors bearing on gas pricing mentioned in my letter of 19 January which have emerged since last September. Of course I accept that the BGC financial targets agreed between us were also agreed to be subject to review in the light of the pricing policy review. But it is going too far to say that the targets have no bearing on the work or the decision. The fact is that these targets are now public and they will influence public and Parliamentary reaction to any attempt we make to secure price changes which BGC resist.

On privatisation, I think it rather clear what the nature of the constraint is likely to be. It would not be politically attractive to associate privatisation with any large or exceptional price increases.

On exports I too hope that the Law Officers will shortly be able to help us so that the work can be brought to a conclusion.

I am copying this letter to those who received yours.

Yours ever

PETER WALKER

CONFIDENTIAL

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

GR
For PM's sig pr.
D
20/2

David Barclay Esq
Private Secretary to the Prime Minister
10 Downing Street
London SW1

17 February 1984

Dear David

will come Monday

Thank you for your letter of 2 February requesting a draft reply to Sir Alistair Frame's letter of 1 February and attached paper on 'Maximising Britain's Benefit From Offshore Gas' (returned as requested). Sir Alistair takes a regular interest in gas industry affairs, including a recent unsuccessful bid by RTZ for BGC's share of Wytch Farm and proposals for acquiring directly the assets now vested in Enterprise Oil.

The paper argues that, as a first priority, the UK should consider joint action with the Norwegians for the strategic development of standby gas fields. These, with gas links to the Continent, would provide an insurance policy for NATO against Soviet interruption to gas supplies or OPEC interruption to oil supplies. (Sir Alistair assumes that in such circumstances gas would substitute for oil; he does not recommend that standby oilfields should be similarly prepared for use in a supply emergency). The paper also puts the case for UK gas exports. It argues that the requirement for gas to be landed in the UK, together with BGC's position in the market, have depressed the level of offshore gas activity and consequently estimates of gas reserves, as well as prices to producers (such as RTZ) and consumers. The full potential of UKCS gas resources has not therefore been realised.

The level of European dependence on Soviet gas supplies (notably to France, FRG and Italy) has been studied at length in the International Energy Agency (IEA), following the Siberian gas pipeline dispute with the US, and by the European Community. Both studies, which were carried out in consultation with member States (including the UK), concluded that security of gas supplies would not be jeopardised by dependence on a single source of imports, such as the USSR, at levels below about 30% of supplies. With imports up to this level, countries could cope with even a prolonged interruption to supplies. This conclusion was endorsed by IEA Ministers prior to the Williamsburg summit. In these circumstances, It is unlikely that European countries importing Soviet gas would be prepared to consider paying a considerable 'insurance premium' for developing significant North Sea gas reserves for use only as an emergency standby. It should also be noted that the Norwegians have been actively hostile to ideas for co-operative measures for bringing Norwegian gas through Britain to the Continent, as suggested by Sir Alistair.

You will be aware from my Secretary of State's letter of 9 February to the Chancellor that a decision is called for on the British Gas Corporation's proposal to purchase Norwegian Sleipner gas, once details of the outcome to the commercial negotiations have been established with the Corporation. The relationship between gas imports, levels of UKCS gas production and any future gas exports is relevant to the Sleipner purchase and one of the issues which Ministers will wish to consider carefully. The question of gas exports is further complicated by the legal issues concerning whether a controlled export regime can be established which is defensible against possible challenge under the Treaty of Rome. This aspect is before the Law Officers, whose advice is expected in the very near future. Again, Minister's will wish to consider this advice in the Sleipner context.

In arguing its case, the paper makes a number of exaggerated claims and there are some statements which could reasonably be questioned. These points have not been addressed in the draft reply to Sir Alistair, although a detailed commentary on the paper can be provided if this is thought necessary.

Yours ever

John

J S NEILSON
Private Secretary

DRAFT LETTER FOR THE PRIME MINISTER'S SIGNATURE

Sir Alistair Frame
6 St James's Square
London SW1Y 4LD

Thank you for your letter of 1 February, enclosing a copy of the paper you have written in collaboration with Allen Sykes on maximising Britain's benefits from offshore gas. I have read this with interest.

The main conclusion of your paper is that as a first priority we should consider in collaboration with Norway the development of a strategic gas supply capacity, available to Continental Europe in the event of a disruption to imported gas or oil supplies. The security of gas supplies to Europe has been the subject of detailed study both in the European Community and in the International Energy Agency. Two reports, the most recent in May last year, concluded that major European gas importing countries could in general cope with a loss of up to 30% of imports over 6 months including a winter period. This confirmed the ability of Europe to withstand even quite severe gas supply interruptions.

The position on imported gas supplies is being kept under close review in the European Community and in the IEA. Further studies on the adequacy of gas transportation and storage facilities within the Community and on the level of future imports are expected shortly. Discussion of these will provide the opportunity for international consideration of further security measures such as those proposed in your paper. The willingness of gas importing countries to pay the security 'insurance premium' and the attitude of the Norwegians are important in assessing those proposals. I should mention that the Norwegians have so far shown no interest in those more limited suggestions for co-operative measures to which you also refer, for example for the UK to act as a 'landbridge' for the delivery of Norwegian gas to the Continent.

Your second conclusion is for the Government to pursue increased competition in the supply of gas to the British market by relaxing the landing requirement for gas. We have, as you may know, made clear that the Government is willing to reconsider the question of gas exports if large new volumes of gas should be discovered on the UKCS. The issue rightly identified in your paper is whether current policies are providing sufficient incentive to the oil companies to explore for and develop our offshore reserves. Here, I feel you have under-estimated the impact which our policies are already having. In the late 1970's offshore exploration activity indeed fell appreciably. Over the last two years (which have seen the passage of the Oil and Gas (Enterprise) Act and the Eighth Round of Licensing) some 65 wells have been drilled in the Southern Basin gas province alone and ten new gas developments are either underway or in prospect. This upsurge in activity is resulting in a much better understanding of available gas reserves, which will be reflected in this year's Brown Book, due out in April.

Lastly, the landing requirement, which incidentally applies equally to oil and gas, does afford Britain significant security of supply benefits over our petroleum resources. While these benefits may not be as far reaching as those you suggest on a European scale, they could nevertheless be of great importance to the nation in times of emergency.

As your paper ranges over a large number of interesting issues relating to gas policy you may like to send a copy to ~~might wish to discuss it with~~ Peter Walker, ~~to whom I have sent a copy.~~ ~~[illegible]~~ who would I am sure be glad to discuss it with you.

Sir Alastair FRAME

10 DOWNING STREET

Energy draft reply to "Frame," requested by AB on 2/2, will come tomorrow (deadline was today)

CST 16/2.

GR.

PP. Ring D/Energy - they've returned Sir Alastair Frame's papers but NO DRAFT REPLY.

Coming 20/2

CONFIDENTIAL

CC NO

Prime Minister
Chancellor is also on to point about exports.
AT 15/2

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

14 February 1984

The Rt. Hon. Peter Walker MBE MP
Secretary of State for Energy

Dear Peter

BGC's NEGOTIATIONS FOR SLEIPNER GAS

You wrote to me on 9 February about the negotiations between BGC and Statoil over Sleipner. I agree with the line you propose to take in public for the time being.

The purchase of Sleipner would represent a potentially massive commitment. But the issues involved would be a great deal simpler if exports of gas from the UKCS were allowed. The question of exports has, as you know, been under examination for a considerable time and, I think it would be helpful if we could look at that before we discuss Sleipner. Peter Rees mentioned the point in his letters to you of 29 December and 2 February. If exports are not allowed, there is a substantial risk that, as with its imported Frigg supplies in the past, BGC will use its access to imported gas from Sleipner to hold down prices to producers on the UKCS at great cost to the Exchequer and to the nation. With Frigg BGC has pursued this policy to the point where, as Deloittes made clear, it actually sells Frigg gas at a loss.

I am also conscious that the prospective relationship between UK demand for gas and supplies from the UKCS is changing and is a matter of considerable uncertainty. The recent relaxation in BGC's restrictive approach to development on the UKCS has led to an upsurge in activity and a virtual quadrupling of estimated gas reserves in the Southern Basin. When the Sleipner issue comes before us, it will be important to have the forecasts of supply which take this fully into account.

Clearly one possible alternative to Sleipner is the UK's own gas supplies on the UKCS. Before taking any decision we shall also need to be fully informed about the imported alternatives. I believe the Dutch have recently relaxed their opposition to exports, so it would be helpful to know what they, for one, would offer.

Apart from straightforward contracts to purchase gas, we might also look at less conventional possibilities. Given the particular uncertainties about the size of future supplies from the UKCS, it may make sense to take an option on a source of imports. This would give us assurance of availability while enabling a final decision to be delayed until the position on the UKCS supplies became clearer.

In looking at all the alternatives, we will need to know their differing implications in resource and PSBR terms. I suggest that our officials should produce a full and clear note for us on this.

CONFIDENTIAL

I am copying to the Prime Minister, Geoffrey Howe, Norman Tebbit and Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

CONFIDENTIAL

ci NO

NBPM

AT 13/2

FCS/84/46

SECRETARY OF STATE FOR ENERGY

Purchase of Sleipner Gas

1. Thank you for sending me a copy of your letter of 9 February to Nigel Lawson.

with AT

2. I welcome the news that BGC and Statoil have identified a commercially acceptable deal and look forward to seeing further details of the terms.

3. I am copying this letter to the Prime Minister, Norman Tebbit and Sir Robert Armstrong.

GEOFFREY HOWE

Foreign and Commonwealth Office

13 February, 1984

cc DP
To note PM's reaction.
AT
10/2

10 DOWNING STREET

Prime Minister (2)

To note that a Sleipner deal is nearing completion and will be put to HMG shortly.

If, as is expected, the price is higher than is being offered in the North Sea, this raises two questions

(i) does it make sense to pay foreigners more than we offer in the UKCS?

No

(ii) should not exports be allowed?

AT
9/2

MT

cc DP

01 211 6402

The Rt Hon Nigel Lawson MP
The Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London
SW1

9 February 1984

Dear Nigel

BGC'S NEGOTIATIONS FOR SLEIPNER GAS

The negotiations between BGC and Statoil for the purchase of Sleipner gas on the ad referendum basis we agreed last year, have proved to be more protracted than I expected when I last wrote to you on 25 October. However Sir Denis Rooke has now told me that his negotiators have identified a deal with Statoil which both parties find commercially acceptable. Statoil will now put this to their partners and then to the Norwegian Government.

In pt 8.

I have put a number of detailed questions to Sir Denis in order to elucidate the deal and he has assured me that he will do his best to reply to these rapidly. My officials are also examining the proposed deal as a matter of urgency and I hope to write further to you and other colleagues shortly with a recommendation on whether what is proposed can be regarded as in the national interest.

News of the proposed deal has not yet broken, but it seems almost certain to do so within a few days, once Statoil's partners have been acquainted with the details. I am proposing that we should as far as possible avoid comment until we have decided whether or not the deal should go ahead. In the meantime, our line will simply be that the proposal is under examination.

I am copying this letter to the Prime Minister, Geoffrey Howe, Norman Tebbit and Sir Robert Armstrong.

Peter

PETER WALKER

Nat Ind: Gas + Elec pt. 9.

CONFIDENTIAL

NBPM AT 10/2

cc ~~NO~~

Treasury Chambers. Parliament Street. SW1P 3AG
01-233 3000

9 February 1984

M F Reidy Esq
Private Secretary to the
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1P 4QJ

Dear Michael,

GAS INDUSTRY MANUALS' PAY NEGOTIATIONS

You reported the outcome of BGC's negotiations with its unions in your letter of 6 February. The Chancellor was pleased to see that Mr Walker's meeting with Sir Denis Rooke had such a satisfactory result.

We understand that the increase in average earnings from the settlement now in prospect would be 4.3 per cent (or a shade under), nearly 1 per cent lower than the settlement for this group last year. The Chancellor regards this as a satisfactory outcome both for the gas industry, and also for negotiations elsewhere in the public sector, not least in the energy field. He particularly welcomes the fact that BGC has avoided making any costly concessions on hours of work or retirement age.

Copies of this letter go to the Private Secretaries to the Prime Minister, the other members of E(PSP) and Sir Robert Armstrong.

Yours sincerely,

Margaret O'Mara

MISS M O'MARA
Private Secretary

~~NAT IND. Cons Pt 9~~
Econ Pol. Public Sec. Pay
Pt 11

CONFIDENTIAL

NBPM AT 6/2

01 211 6402

Miss Margaret O' Mara
Private Secretary to the Chancellor
of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

6 February 1984

Dear Margaret

John Neilson's letter of 2 February spelled out the direction in which BGC's pay negotiations with its manuals were proceeding. We have now learned the outcome of the formal meeting on Friday 3 February.

After protracted discussions the union side accepted a package which it will now put to its members. This consisted of an increase in basic rates ranging from 4.15% for the lowest paid to 4.9% for the highest paid and averaging 4.6%. There were a number of minor benefits offered, with some compensating benefits on the Corporation side, and in total the package, if accepted, is estimated to cost the Corporation in the region of 4.3%, or a fraction less, on the pay bill.

Thus the negotiation moved more speedily to a conclusion than we had expected, but the outcome was consistent with the objective which my Secretary of State urged on Sir Denis Rooke. It is also below the latest year on year inflation rate, notwithstanding the recent profit record of the industry.

I am copying this letter to the private secretaries of the Prime Minister, Members of E(PSP) and Sir Robert Armstrong.

Yours sincerely
Michael Reidy

M F REIDY
Private Secretary

CONFIDENTIAL

~~NAT IND. Gas~~ Public Sector

PT 91 Pay

6 FEB 1984

11 12 1 2 3 4 5 6 7 8 9 10

Sir Alistair FRAME

FILE

16/2 Rev

Ack 2/2

10 DOWNING STREET

From the Private Secretary

2 February, 1984

I enclose a copy of a letter and enclosure the Prime Minister has received from Sir Alistair Frame.

I should be grateful if you could let me have a draft reply for the Prime Minister's signature by Thursday, 16 February. Could you also return the enclosure with your draft reply.

(David Barclay)

J. Neilson, Esq.,
Department of Energy

CONFIDENTIAL

CC NO 2

Prime Minister

To note

3/2

Miss Margaret O'Mara
Private Secretary to the
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

2 February 1984

Dear Margaret

GAS INDUSTRY PAY NEGOTIATIONS

There is to be a formal meeting between the two sides on 3 February when it is likely, but not certain, that an offer will be placed on the table.

There are two important factors about the current pay round in the gas industry. First, the gas unions are likely to make a major issue of the fact that last year their settlement was at the bottom of the public sector league. Second, there has been a major change in the unions' negotiating team. The new negotiator will obviously endeavour to show that he is doing better than his predecessor.

My Secretary of State has been in close contact with Sir Denis Rooke, and has impressed on him the importance of obtaining the lowest possible settlement in this pay round. The Gas Corporation are endeavouring to see that agreement is reached in the region of 4.3%.

The package in the claim made by the unions is complex, and involves an unquantified increase in basic rates, reduced working hours, and consolidation of special payments. So far BGC have concentrated on technical discussion of matters other than the basic rate. On the basis that an understanding is reached in these informal discussions, they anticipate making an offer along the lines described above. This will not be a simple across the board increase; it is likely to include consolidation of certain existing payments and an element of differentiation between the various grades.

We will keep you posted on developments.

I am copying this letter to the private secretaries of the Prime Minister, Members of E(ESP), and Sir Robert Armstrong.

Yours

John

J S NEILSON
Private Secretary

Public sector Pay Pt 11

(with AT)

CONFIDENTIAL

CC NO

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

3/2

2 February 1984

Dear Secretary of State,

BGC CORPORATE PLAN

CST SS/Energy?

Thank you for your letter of 29 December.

I note what you say about looking at pricing principles rather than the application of economic pricing. It is, of course, the latter that the Prime Minister has asked for (in the letter of 19th October from her Private Secretary to yours).

I also was surprised by your suggestion that two factors have emerged since the Prime Minister's meeting on 13 September 1983 which bear on the work on pricing. BGC's financial target is accepted by both our departments to be subject to review "in the light of the pricing policy review" (Fitzpatrick's letter to Kerr of 16 November). In these circumstances the existence of the target has no bearing on the work, and decision, on pricing. As far as privatisation is concerned, it is not clear to me that this constrains us on pricing.

Turning to gas exports and the purchase of foreign gas, my view remains as set out in my letter of 19 January. I understand the law officers now have the legal opinion they sought from an outside expert. I trust this will enable the work on exports to be brought to an early conclusion.

I am copying this to the Prime Minister, other members of E(NI) and to Sir Robert Armstrong.

yours sincerely

JBL

PETER REES

(approved by the chief Secretary and signed in his absence).

CONFIDENTIAL

Nationalised Industries : Policy Pt 8.

6. ST. JAMES'S SQUARE
LONDON, SW1Y 4LD
TELEPHONE: 01-930 2399

1st February, 1984

Dear Prime Minister,

Some two years ago, an ex-colleague of mine on the RTZ Board and I wrote a paper on maximising Britain's potential benefits from offshore gas. This was shortly after the RTZ led study into a multi-user gas pipeline in the North Sea had collapsed.

We have recently updated the document, and I thought you might be interested to see a copy.

Yours sincerely
Alistair Frame.

The Right Hon. Margaret Thatcher, M.P.,
10 Downing Street,
London, S.W.1.

Enclosure: Two Copies of 'Maximising Britain's Benefits from Offshore Gas'

STRICTLY PRIVATE & CONFIDENTIAL

MAXIMISING BRITAIN'S BENEFITS FROM OFFSHORE GAS

The case for strategic co-operation with the EEC and NATO, and for giving offshore gas the same competitive regime that has been so successful for oil, including the right to export.

By Sir Alistair Frame and Allen Sykes

January 1984

CONTENTS

1. <u>The Welcome Government Determination to Introduce Competition</u>

Since the 1982 Oil Enterprise Act which restricted the British Gas Corporation's monopoly buying rights, and allowed oil companies access to the UK industrial gas market via the BGC's pipeline system, and since the very much higher prices being paid for British gas, the economic environment for UK offshore gas has certainly improved considerably. All these steps faced both BGC and political opposition, but the government commendably accepted the case for introducing some competition in the supply and marketing of gas.

The question arises whether these new policies of introducing competition go far enough to achieve the intended results of a much healthier and expanding offshore gas industry. To informed opinion within the oil industry, and outside it, the answer to this question is no. Unless the government takes the vital further step of permitting gas exports, hitherto banned regardless of the generally higher available export prices, then there is little likelihood of a major increase in offshore gas activity which is so much in the nation's interest. In the more bracing competitive economic climate of the last two years, the one major argument left against allowing exports is the fear that Britain's offshore gas reserves are sufficient only for British needs. This concern is not generally shared by the oil industry for the good and sufficient reason that there would be no shortage of proven gas reserves once gas could be exploited as freely as oil. The combined BGC buying monopoly and the ban on exports gave the oil industry no incentive to look for gas in British waters between the late 1960s and the early 1980s. Now the much higher gas prices on offer from the BGC are changing the position To judge the availability of gas reserves after a dozen or more years of having no incentive either to look for or to exploit gas inevitably means taking a misleadingly conservative view of what could be there. If the oil industry could be given all the right incentives there should be more than enough gas for Britain's own needs into the foreseeable future as well as providing for the possibility of major exports to the Continent. Further, and most importantly, the freedom to export gas, particularly if allied to wise and energetic co-operation with Norway, the EEC, and NATO, could result in a major increase in offshore gas activity far in excess of that which has resulted from the BGC's more realistic pricing policies and the government's policy changes necessary, welcome though they have been.

In connection with the effect of allowing exports on exploration activity and reserves it should be borne in mind that until Australia allowed exports of iron ore in the early 1960s, and Alberta allowed gas exports to Eastern Canada at a similar time both products were locally held to be in scarce supply. They are now huge prosperous industries with reserves dwarfing initial expectations.

2. <u>Background Factors</u>

a) <u>Too Limited an Incentive for Gas Exploration</u>

Oil companies actively explore for oil but far less so for gas in UK waters. The reasons are that oil effectively sells at the world price and some exports, while controlled, are permitted. Gas, in contrast, must be landed in Britain and can <u>effectively</u> be sold only to the BGC. (The right to sell direct to industrial consumers is more theoretical than real.) Gas exports are effectively prohibited. Many long term gas contracts were signed between the oil companies and the BGC in the late 1960s to take the output from the Southern Basin gas fields off East Anglia. These were in essence on fixed price terms with minimal escalation clauses such that their prices only two years ago were typically only between 15% and 25% of the going free market European gas purchase price. This permitted the Soviet Union to pre-empt much of the large European market with its own huge gas line. The oil companies have been so discouraged by these early contracts that virtually no further new gas contracts from British waters have been signed with the BGC in the last dozen or so years. The exceptions are such cases as the Brent gas where the gas concerned is a by-product (called 'associated gas') of oil production. The oil production is usually so valuable that it pays to develop it even if the profit on the gas is very low or even negative. But no gas fields - i.e. fields whose revenues derive solely or mainly from gas - have been developed in the British North Sea this past decade. (The Frigg gas field which straddles the boundary line - roughly one third in UK waters - is the partial exception.) Now, thanks to very much higher BGC prices under combined political and oil industry pressure some smaller UK gas fields are being developed.

b) No Justification for treating Gas differently from Oil

There is no good reason for making a distinction between the treatment of oil and gas on economic grounds. Oil (hydro-carbons in liquid form) have always been sold at the world free market price and oil exploration and production has flourished. By contrast, gas (hydro-carbons in vapour form) has hitherto had only one market outlet, the nationalised BGC, which can and does set its own restrictive price terms. For the past decade the oil industry has not explored for or developed gas fields in British waters and has been reluctant to enter new contracts even for any associated gas, the automatic by-product of most oil production. Yet this distinction of treatment between the two forms of hydro-carbons is a physical not an economic distinction. The oil policy has succeeded in developing our oil: the gas policy has largely failed to develop our gas reserves to their full potential, and in particular gas or gas condensate fields.

3. The Correct Context for Judging Policy Changes

a) The Need for a Wide Perspective

For most of the last decade the gas prices charged to British consumers have been low in comparison with alternative energy sources. The price paid to the oil industry for supplying gas from British waters has been particularly low because of the effective monopoly bargaining position of the BGC. The oil industry have made it clear that they cannot develop new sources of gas at anything like the existing gas supply contract prices but must have realistic and preferably energy-related prices, the basis on which Western Europe mainly buys gas. The government hope that by allowing the oil industry to use the BGC's distribution network that competition between oil companies and the BGC will result in much more gas exploration and development and a better deal for industrial consumers. This is possible but unlikely, and in any event could take a long time to come to pass. The truth, which should be squarely faced, is that much further British gas over and above existing supplies has a higher value sold to Western Europe than to British industry. This being so the sense or otherwise of changed economic policies cannot be judged solely or mainly in the context of what is best for existing UK industrial customers. Within so narrow a context it is unlikely that the nation's best interests will be apparent.

In addition to the oil industry, the BGC, the industrial consumers, there should also be considered the interests of the rest of UK industry, the balance of payments, and the Treasury tax and royalty take. It would be sensible also to consider the interests of both Norway and our EEC and NATO partners. In the context of this widened constituency there is no doubt that the best interests of Britain would be served by allowing gas exports.

b) <u>Validly Judging Britain's Gas Reserves</u>

Since the late 1960s there has been a marked reluctance in the oil industry to look for gas in British waters. Such gas that has been found has arisen mainly from the search for oil. Even when found it has not paid the industry to go in for extensive proving, still less for development because there was little likelihood of a profitable sale to the BGC. To judge the total possible UK gas reserves after a dozen or so years of these conditions is to say the least difficult and indeed unreasonable. It will be possible to judge the likely UK gas reserves realistically only when economic conditions have for some years freely encouraged the same unrestrained search for gas as has always existed for oil.[1] If the government want gas to be the same success as oil has been then the course of action is clear: they must give exactly the same economic conditions which means free exports. Can anyone suppose that we would have had a flourishing offshore oil industry if for the last 15 years a BNOC has been allowed to buy all British produced oil without competition or exports, and entirely on its own price terms? The answer is obvious.

4. <u>The Case for Unified Development with Norway of North Sea Gas Reserves</u>

a) <u>The Wasteful Restrictions of the Boundary Lines</u>

An examination of known gas reserves in the North Sea, and particularly in British and Norwegian waters, reveals that the majority of gas and gas condensate fields, plus oil fields with significant quantities of associates gas, cluster around the boundary line between the British and Norwegian sectors. Every serious observer of the North Sea scene over the last ten years has lamented the effect of this artificial dividing line and the accompanying policies of both governments. These have caused, and continue to cause separate and thus non-optimal development. There can be little doubt that if the two nations could co-operate they would both gain substantial advantages, but this can only happen if <u>both</u> countries have a free economic regime (Norway needs one too) and are determined to act in a way that maximises their joint gains. This means that the North Sea

1. Consider the experience of Alberta gas and Australian iron ore mentioned in Section 1.

should be developed in a much more unified fashion than existing short sighted policies have allowed. The cheapest way to transport gas for long distances is to use landlines wherever possible as these costs are typically considerably lower than for offshore lines. If the oil industry is given a free hand in British and Norwegian waters then it is very likely that there would be joint schemes for bringing British and Norwegian gas to Western Europe, certainly by offshore lines but possibly by at least some landlines.

The September 1981 cancellation of the government supported gas gathering line has predictably resulted in the oil companies taking several separate initiatives to bring gas (mainly associated gas) ashore to Britain. If the export ban is lifted then similar initiatives would be very likely to happen with <u>international</u> gas pipeline systems involving not just associated gas, but mainly gas in gas and gas condensate fields. It is wasteful for the Norwegians that they have had to transport their gas and gas liquids by their own offshore pipeline system now being built across the deep Norwegian Trench merely to land liquids in Western Norway to promote industrial development, and then to take the dry gas back again across the same Trench on the route south to Germany and Holland. It is equally wasteful that any Norwegian pipeline should be denied any British gas which can more easily and economically flow into it. Similarly, it is undesirable that Norwegian gas which could more sensibly flow to Britain should be compelled to use the Norwegian system. Patently present restrictions are unnecessarily disadvantageous to both nations. It should also be noted that an international pipeline network would both provide flexibility and permit advantageous 'swap' agreements, thus minimising gas transport costs.

b) <u>The Reasonable Requirements of Norway for Unified Development</u>

Before considering the very considerable advantages to Britain from unified development it is necessary to consider the needs of Norway which must be met as a precondition to such development. Until the Norwegians had to commit to developing a further separate gas pipeline to the Continent (there is only one such at the moment - Ekofisk) they have been compelled either to sell their gas to the BGC or to await other export opportunities. The Norwegian government was, of course, well aware of the economies to be had from marketing its gas in Western Europe via British offshore and land pipelines. But they were understandably reluctant to agree to such lines because of the control this would give to the BGC (the only possible owner of at least the land part of such lines under present British law) over any future Norwegian gas supplies which should be huge. If Norway's understandable and indeed reasonable reluctance is to be overcome there must be a radically new and more open approach to them. It will be obvious that the only way to get their involvement in a pipeline system in British territory is if they own a substantial part of it, perhaps half, and if it in no way restricts market opportunities for their gas. In these conditions they should welcome lines in British territory <u>because they would greatly enhance their marketing possibilities</u>. Not only would they be given cheaper access to the massive Continental market but, thanks to the government's recent policy changes, they should also have additional possibilities of selling their gas to British industry as well as to the BGC. Thus, with the appropriate safeguards, it should be possible to meet every reasonable Norwegian objection and simultaneously give them greater opportunities for marketing their gas on profitable terms.

c) <u>The Gains to Britain</u>

The gains to Britain from unified development would be equally impressive. But freeing British gas for direct export to the Continent (which would require waiving the requirement of first landing it in Britain) even without further Norwegian co-operation would bring very substantial gains. The first gain is that the oil industry would now have a much greater and appropriate incentive to look for gas because the marketing restraints of the last dozen years would be entirely removed. Second, this in its turn could eventually cause a major offshore gas exploration effort. More existing gas indications would be investigated and proved up, and eventually new gas reserves would be actively sought. This would happen throughout British waters and certainly in all promising areas of the British North Sea. It would cause an early and major expansion in offshore activity and thus in the industries supplying goods and services to them. Third, as and when new gas reserves were ready for development there would be major opportunities for platform building (few British yards have significant orders at present), offshore pipelines and, of course, land pipelines, nearly all of which could be done by British firms and presumably supplied by British Steel.

d) <u>The Greatest Gain of All - Enhanced Western Security</u>

The most important casualty of British and Norwegian economic policies for gas over the last decade or so, however, are not lost economic opportunities, important as they are, <u>but the avoidable weakening of EEC/NATO security</u>. The two countries' economic policies had the unintended result of permitting the Soviet Gas line project which has made Western Europe too dependent on the Soviet Union in times of political strain or a major OPEC inspired energy crisis. And who can safely predict these events will not happen? Due to the short sighted pursuit of export orders in a recession, Western Europe is now going to pay a heavy economic, political and security price for supporting the Soviet gas pipeline and signing long term contracts with high floor prices. (See in particular the attached article from 13 December 1983 issue of the Wall Street Journal.) It is too late to stop the Soviet project, but it is <u>not</u> too late to take steps to mitigate the Soviet Union's ability to put pressure on Western Europe in time of crisis. What is needed is the development of both British and Norwegian gas reserves on a standby basis, plus putting in place an interlinked pipeline system to Europe. For a start this could include tying in a new offshore British pipeline to the Norwegian Statpipe line presently under construction. Later, perhaps an additional pipeline or two should be constructed sufficient to ensure that Western Europe could get enough gas in an energy crisis not to be beholden to the Soviet Union in any significant way.

Such a project, at least initially, would be a pure insurance policy to improve NATO security, although it might soon be the channel for commercial exports as gas demand expands in Europe, particularly the demand for politically secure energy (Europe is overdependent on both OPEC oil and Soviet gas). Because it is initially an insurance project all, or certainly most of the costs of gas field development and new pipelines should be borne by the governments of the EEC and the Continental members of NATO (largely the same countries). The oil companies involved could be required to pay for the gas fields and pipeline facilities as and when they come to use them for commercial exports. The details of such a financing and repayment scheme need not concern us here, but are easily demonstratable when required.

Such a scheme should do much to cement EEC relationships, and NATO solidarity, and would also be well received in the United States for obvious reasons. It would give Britain, and Norway, a chance to demonstrate far sighted political statesmanship. Further, it would be a major and much needed boost to the British economy, and especially the under-utilised North Sea supply industry. It merits the most serious consideration.

e) <u>The Need for Norwegian Co-operation</u>

The major gains from these recommended policies require the most imaginative approach to the Norwegian government, including the unqualified offer of joint ownership to any gas pipeline systems in Britain or British waters which transport Norwegian gas. Such systems must freely permit Norway open access to West European markets as well as to the BGC and British industrial consumers.

f) Being Wise in the Face of Necessity

Perhaps the Treaty of Rome will compel Britain to allow exports to EEC countries when the oil industry is free to sell direct to UK industrial customers. How much better it would be to take the initiative and freely offer exports, plus the hope of helping to get some future Norwegian gas more cheaply to the Continent. The economic benefits, and the greater supply of politically secure gas to Western Europe would be widely welcomed.

g) The Need for Government Resolution

It is hoped that the British government, having gone so far to introduce competition in gas, will take the further step and allow exports thus reaping very major additional benefits. Gas has a contribution to make to Britain second only to that which has hitherto been restricted to oil.

5. Conclusions and Recommendations

a) The government's recent and welcome changes in introducing more competition in the supply and sale of offshore gas to industrial consumers is not sufficient to provide the optimal national benefits - that requires lifting the ban on exports.

b) The principal argument against allowing exports is the fear that there may be insufficient gas for British needs, an argument not accepted by those most likely to know, the international oil industry. For a dozen years there has been, and there still is, insufficient incentive to look for British offshore gas, or to prove up any gas found there. No sound judgment of likely maximum reserves is possible in these conditions. If, however, the oil industry are given the same economic conditions for gas as have always existed for oil then the proving up of known gas reserves and the active exploration for more gas would soon dispel any misgivings, as it has done in similar circumstances for natural resources in other countries.

c) To maximise the nation's benefit the government should consider its offshore gas policies in the widest context, embracing not just UK consumers, but the whole UK economy, and our economic and political relationships with Norway and the EEC/NATO. If this is done the case for allowing exports is very strong. The general gains to industry and employment, the increased tax and royalty earnings of the Treasury, the enhancement of export earnings, and the benefits to our allies should all be very substantial.

d) Above all else immediate consideration should be given to the strategic development of standby gas fields in British and Norwegian North Sea waters, plus pipeline links to the Continent to neutralise potential Soviet and OPEC pressure on Western Europe. The benefits to Britain, Norway, the EEC and NATO are very considerable strategically and economically. Its achievement calls for the highest and most imaginative order of British statesmanship.

Europe Pays for Its Pipe Dream

By GORDON CROVITZ

The Soviet natural-gas pipeline to Europe will be switched on next month. President Reagan's sanctions of last year forced the Soviets to substitute pumping equipment from their domestic gas lines, increasing the project's cost to the Russians. But the more important effect of the sanctions was to force the West to look more closely at the project. Europeans should now consider the economic effects, which are devastating.

In retrospect, it's clear that even when European governments agreed to the project in 1981 the deal was on questionable economic ground. Subsidized loans, credit guarantees and pricing concessions were offered out of a detente-era desire to engage in East-West trade—even when the "trade" involved no mutually beneficial exchange.

Recent evidence shows that the relative negotiating positions made it extremely unlikely that the Europeans could benefit even if they had pushed harder for a good deal. Soviet negotiators successfully took advantage of their position as a single negotiator faced with several competing traders.

Three Delegations

The Soviet Union was a monopsonist, the sole "buyer" of pipe and equipment from Europe, and the sole supplier of gas to several competing buyers. All the information was held by the Soviets, who—at least in theory—should have been able to hold out for the best deal from each of the European countries.

This is precisely what they did. The Soviets appointed an expert committee to handle each part of the negotiations. Three standing delegations were created to deal with Western exporters of pipe and equipment, the Western banks that are to finance the project in cooperation with European governments, and the state-controlled European gas importers.

The Soviets played off the European bidders against each other on each aspect of the project by announcing the best offers, then inviting more competition. Axel Lebahn, until recently the Moscow representative of Deutsche Bank AG, which led the German consortium that provided the largest share of the pipeline's financing, recently reported that Western exporters of equipment were forced to cut their prices by as much as 60% because of their weak position as independent bargainers against the U.S.S.R.

In addition, the Soviets were able to take advantage of their monopsonist position when it came to arranging for below-market credits. The French offered the cheapest credit for the pipeline deal. At a time when the interest rate in France was 16%, the French offered the Soviets 7.8%. This generosity is not surprising coming from the French, who historically have had difficulty grasping the concept of non-subsidized export-credit terms.

Other European governments, especially West Germany's, view subsidized credit to the Soviets with more skepticism. But since the French offered a basement rate, everyone else felt compelled to do so. For example, Hermes, the German government's insurance agency, guaranteed $3.66 billion in loans at real rates far below what the government would have to pay to borrow the funds in the money markets. European investment in Europe has been crowded out by huge borrowing on behalf of the Soviets.

The economics of the pipeline project can be understood only as neo-Keynesianism. The goal, which fit in nicely with detente's encouragement of East-West trade, was to create government spending—regardless of the fact that the money could have been better spent in creating real growth in European economies rather than in the Soviet economy. European governments reasoned that spending in a recession would reduce unemployment, and billions of dollars invested in the pipeline would appear to help halt the growth in joblessness. In fact, the pipeline had little to do with producing natural gas. Alternative sources of gas from Norway and the Netherlands, the North Sea and Africa were available at lower economic and political costs.

But of course government spending often impedes growth. In cases like the pipeline, the "jobs" created in steel and other industries are not real jobs, in that they would not exist in a competitive market. The jobs are make-work rather than productive, restraining economic growth through the inefficient use of resources.

Changes in world energy prices have been the worst news so far for Europeans. Under the supply contracts, they accepted the risks of the fall in the world inflation rate and the chance that the Organization of Petroleum Exporting Countries cartel might begin to lose its hold on the oil market.

The contract price for the gas starts at $4.70 to $5 per million British thermal units, depending on the transportation costs to the purchasing country. The Soviets also insisted on a clause that European negotiators most likely doubted would ever be applied. What if oil prices and inflation fell from their 1981 levels? The contracts include a "floor price" clause, which states that the price Europeans will pay will increase at a minimum rate. The Soviets are therefore, for example, guaranteed a floor price of $5.70 per million BTUs from the West Germans by the end of the decade, regardless of what has happened by then to either the inflation rate or the ability of OPEC to control oil prices.

In addition to the floor-price clause, there is a term of the contract that determines the minimum amount of gas the Europeans must buy regardless of the future cost of alternatives. This "take-or-pay" clause means European buyers must take or pay for 80% of the contracted volume of gas.

Western entities mustn't compete with each other to the degree that all risks fall on the West, not the Soviets.

Consider the combined effect of the floor-price and the take-or-pay clauses on, say, the French. The French supply contract provides for a floor price beginning at $5.50 per million BTUs. This is equivalent to about $34 per barrel of oil—perhaps a reasonable price in 1981, but not now, when the price of oil is $29 a barrel. Even worse news for France, like many countries in Western Europe, is that its government has squandered one source of economic recovery—the capital saved through energy conservation—by its too-rosy prediction of economic growth. France's economic growth was 0.3% in 1981, 2% in 1982 and around zero this year, and energy consumption has fallen nearly 10% since 1979. But, largely due to the Siberian gas contracts, France has signed up for the equivalent of 29 million tons of petroleum in natural gas by the end of the decade. The nation's planning ministry now estimates usage will be no more than 22 million tons' worth.

The European press has reported that the West Germans and French hope to renegotiate the pricing clauses of their contracts with the Soviets. It's easy to see why they would want to, but it's not at all clear what incentive the Soviets would have to accept lower prices or waive the take-or-pay clause.

For that matter, say European countries do offer the Soviets some sort of quid pro quo that includes a price reduction and/or a volume reduction. While European gas consumers would benefit, the same people, as taxpayers, would lose: The result of such a renegotiation would be a reduction in the earnings of the pipeline, which in turn would mean that the Soviets could not pay back the loans at the expected rate. European taxpayers would then be forced to bail out the bankers who made the subsidized loans. If the price is reduced, it seems likely that the hard-currency-starved Soviets would insist on an increase in the volume to be purchased. But the loan repayments would still have to be stretched out.

In any case, if some agreement is made between the European governments and the Soviets to reduce the price or volume of gas, one must ask what sort of deal this might be. It is hard to imagine any purely economic incentive the Europeans could offer. The Soviets are in no position to make any purchases of Western goods, even at a discount. And Europe simply has no demand for other goods the Soviets might offer to sell.

Some Lessons

Politics is the most likely basis of a renegotiation. It's possible to imagine all sorts of deals that the Soviets might make once European leaders scale the slippery slope of political deals for economic redemption. Delay further deployment of U.S. missiles? Extend more credits at even more favorable rates?

There are some better-late-than-never lessons from the pipeline disaster. The West must take a more clearheaded approach if it ever again pursues a project of this magnitude with the Soviets. In particular, Western companies and governments must not compete against one another to the degree that in the end all the risks fall on the West, not the Soviets.

Western governments must agree to leave East-West trade to the traders. European governments intervened in the pipeline contracts at every step, most significantly when it came to financing the project. Without the bad detente politics that led to bad economics, the pipeline never would have been built, and Europeans would have been better off.

Mr. Crovitz is editorial page editor of The Wall Street Journal/Europe. His "Europe's Siberian Gas Pipeline" was just published by the Institute for European Defense and Strategic Studies, London.

ECNO

SCOTTISH OFFICE

WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1 3AG

Dr 2/2

31 January 1984

Dear Peter,

I wrote to you on 14 December 1983 about the external financing limits of the Scottish Electricity Boards, which seemed likely to result in the Boards having to make price increases at or above the rate of inflation and well out of line with those proposed for England and Wales. You replied on 23 December refusing to increase the EFLs.

You concentrated on changes in the Boards' capital expenditure proposals compared with the baseline for the 1983 IFR. Capital expenditure is only part of the picture, since the EFL is set by reference to the net cash requirements for the business as a whole. In the absence of updated financial forecasts during the IFR process - in which respect I acknowledge that the SSEB in particular has not been helpful - it is often convenient to make the assumption that cuts in the EFL will be reflected in cuts in the capital programme and that is why the figures you were able to quote show such variations. I must stress, however, that I did not agree to any specific levels of capital expenditure during our bilateral discussions. In fact SSEB's own forecasts throughout last year have only increased to a small extent and this is hardly surprising in a capital programme dominated by a single major project such as Torness. The bulk of this increase was due to my own decision following a public inquiry into the route of the transmission lines; while for NSHEB the increase is mainly due to the need identified before our bilateral for extra expenditure on parts of the local distribution system - a need we can scarcely deny following the supply interruptions in the recent adverse weather. It is to operating costs that we must look in the short term at least for savings to meet EFL reductions and, as I explain below, the Scottish Boards' latest figures for next year show that they are making every effort to achieve this.

Secondly, you suggested that any difficulties about larger price increases north of the Border were the Scottish Boards' own faults. It is clear that they are making every effort to produce operating cost savings as well as savings in administrative costs and you should not lose sight of the fact that the recent efficiency audit gave them a comparatively clear bill of health. You went on to mention the possibility of increased trading between the Scottish Boards and CEGB. As you say, this is something which in my recent discussion with John Moore I agreed to consider, and I will shortly be receiving a report from SSEB. But I approach increased trading on the basis that it would be beneficial to Scotland: it would involve greater use of our relatively more efficient coal-burning plant (which would increase the total coalburn, a sensitive point in Scotland) and would improve the SSEB's cash flow and profits. You now appear to be suggesting that the effect of increased trading should be to raise Scottish prices, a proposition which I find quite unacceptable.

Turning to next year's EFLs I now have the Boards' latest forecasts, and my officials will let yours have any further details of these which are required. The figures show that the Boards are making every effort to live with the tight EFLs we have already announced. As I have said, the capital programe is dominated by Torness and I am satisfied that other elements in it have been constrained to the greatest possible extent. The assumptions which have been made on operating costs are extremely optimistic, with nuclear availability at the high end of the possible range and with increased thermal efficiencies. Administrative costs and other overheads have been scrutinised and held down so far as practicable.

When I wrote to you on 14 December we were facing the possibility of a price freeze in England and Wales, and I wanted to ensure that any price increase in Scotland was below the rate of inflation. Since then the position has eased considerably with the Electricity Council proposing small tariff increases. SSEB are now proposing to increase tariffs next year by an average of about 4.5% and the NSHEB tariffs seem likely to increase by a similar though slightly smaller percentage.

In the circumstances, while there may be a presentational difficulty in Scotland, particularly on industrial tariffs, I am content not to press you further for a relaxation of the EFLs. They remain very tight however and I may need to come back to you if they seem likely to threaten progress on Torness.

I am copying this to the recipients of our earlier correspondence.

Yours ever,

George

Nat Ind Gas & Elec
Pt 9

Prime Minister
To note, X in particular

AT 31/1

PRIME MINISTER

Philip Jones has now reported to me on the decision taken by the Electricity Council on prices for 1984/85.

The Council decided to recommend to the twelve Electricity Area Boards in England and Wales that all quarterly tariffs should be increased by 2 per cent from 1 April 1984. The Council also agreed that monthly published tariffs should be held at the present level until 31 March 1985, except for fuel cost adjustment which will continue to operate according to the prevailing price of fuel to power stations. "Quarterly billed consumers" include all domestic consumers and small commercial and industrial consumers who do not have the fuel price adjustment clause in their tariffs. This increase will not apply to the standing charge component in quarterly tariffs. The Council considered that because this is a particularly sensitive issue, it would be desirable to leave standing charges unchanged for the time being. I understand that the yield of this domestic increase in 1984/85 will be roughly £60m.

I regard this as a satisfactory outcome, fully reflecting the Cabinet's wishes. Philip Jones has told me that despite the reservations expressed by a number of the members, he believes that all Area Boards will accept the Council's recommendation. He has stressed, however, that this is legally a matter for their own decision.

X Since he wrote to me, the London Electricity Consultative Council have announced that they are considering legal action to prevent the London Electricity Board from raising tariffs. The legal position is far from clear, and the Boards may still run into difficulties. You may remember that I drew attention to the risk of a legal challenge when we took our decision on prices. The Select Committee also seem likely to examine this question.

One further point is that the Council has emphasised to me the importance it attaches to forthcoming discussions about its financial target for the period beyond 1984/85. Essentially it is seeking a settled financial framework for a period of three years. This is a matter which I shall need to consider further in consultation with the Chancellor.

I am copying this minute to Cabinet colleagues.

SECRETARY OF STATE FOR ENERGY

30 January 1984

cc ✓10

2.

NBPM

AT 26/1

01 211 6402

Sir Robert Armstrong GCB CVO
Secretary to the Cabinet
70 Whitehall
LONDON SW1A 2AS

25 January 1984

Dear Sir Robert

WITHSTANDING A STRIKE IN THE GAS INDUSTRY

See Pt 8

My Secretary of State has asked me to let you know that he has seen your minute of 21 December addressed to the Prime Minister and the attached report of MISC 98. He has asked me to say that he agreed with the Group's recommendations referred to in your minute, and in particular with the need to consider all these issues carefully in the context of the proposals on privatisation, which he will shortly be bringing forward. He has also asked the department to take forward the work recommended in paragraph 5.12(iv) of the Group's report.

I am copying this letter to the Private Secretaries of the Ministers who received your minute.

Yours sincerely

Michael Reidy

M F REIDY
Private Secretary

NAT IND
Gas + Elec
Pt 9

file

MR TURNBULL

23 January 1984

GAS PRICES

Although we sympathise with the Treasury's concerns about Peter Walker's letter of 19 January, we do not consider that a No 10 intervention would be helpful.

Your letter of 19 October 1983 clearly stated that the Prime Minister is hoping that agreed criteria can be put to her on what would be implied by the adoption of economic pricing. The implications of moving towards economic pricing during this Parliament and the timescale to be adopted could then be considered.

This puts a clear mandate upon both Energy and Treasury and does not give Peter Walker any flexibility to move away from economic pricing even if he wishes to propose a different interpretation.

It was also clear to all parties when the financial target was set, that this could be revised in the light of any future decisions on pricing.

We also do not see the prospect of privatisation as a problem. Economic pricing is essentially a surrogate for prices which would apply in a competitive market environment.

DLP.

DAVID PASCALL

cc NO

Prime Minister

To note that D'En and Treasury have agreed that there is no point now in a collective discussion of the BGC 1983 Corporate Plan. Work is continuing on

(i) pricing principles

(ii) gas exports.

AT 19/1

01 211 6402

CONFIDENTIAL

The Rt Hon Peter Rees QC, MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

19 January 1984

BGC 1983 CORPORATE PLAN

Thank you for your letter of 29 December.

I agree that there is now no point in collective discussion in E(NI) of BGC's 1983 Corporate Plan, which has been overtaken by events, although, as you say, important issues in this area on which we need to make early progress remain unresolved. My officials have been working closely with yours and with BGC in the context of the Corporate Plan with this aim in mind.

I agree that officials should continue to work together on the pricing principles which should govern gas pricing over a longer period. I say "pricing principles" advisedly, because I think the term "economic pricing" is not a particularly precise concept and can mean different things to different people. I certainly favour early progress on this, as you do, but it is important that the intended paper should be based on a thorough analysis of the relevant facts including the structure of the industry's costs. In preparing and discussing this paper we shall have to bear in mind two factors which were not before the Prime Minister's meeting on 13 September 1983. One is that the Government has now given BGC a financial target for the 4 year period 1983/84 to 1986/87 which has been publicly announced, although it was made clear to BGC that the target could be subject to revision. The other is that a prospect of privatisation within the next few years would inevitably limit the Government's freedom of manoeuvre on gas pricing.

On the gas exports issue, you may know that the question whether a controlled export regime would be compatible with the Treaty of Rome was put to the Law officers some months ago; we are expecting to receive their Opinion fairly soon. And there are of course other considerations we shall have to take into account in any decision we take on gas exports.

I do not think we can say flatly that we cannot take decisions on the purchase of foreign gas until the issue of exports is resolved. We cannot now be sure about the nature of the questions facing us on a foreign gas purchase and the export issue itself could well prove very complex. But I agree that we need to complete our examination of the export question as soon as possible and my officials are working on it with that in mind.

I am copying this to the Prime Minister, other members of E(NI) and to Sir Robert Armstrong.

PETER WALKER

NAT IND: ~~Policy Pt 8~~
Gas pt 9

(Answered by the Prime Minister on Tuesday 17 January 1984)

UNSTARRED NO. 125 Mr Jerry Wiggin: To ask the Prime Minister, what steps she proposes to take to remove the present overlap in gas safety responsibilities between the Secretary of State for Energy and the Secretary of State for Employment.

It is intended that, as from 1 February 1984, the gas safety responsibilities which are now exercised by the Secretary of State for Energy should be transferred to the Secretary of State for Employment. Broadly, these responsibilities involve the power to make gas safety regulations under S 31 of the Gas Act 1972 and the associated powers on penalties and prosecutions under S's 42 and 43: and the enforcement of the Gas Safety Regulations 1972 and the Gas Safety (Rights of Entry) Regulations 1983. The Secretary of State for Employment will also become responsible for making gas appliance safety orders under the Energy Conservation Act 1981 and for associated questions relating to gas appliance safety, including European Community activities in this area.

I understand that the Secretary of State for Employment intends to make an agency agreement with the Health and Safety Commission to carry out most of these functions on his behalf. In additio, the Secretary of State for Energy proposes to make a separate agreement with the Health and Safety Commission to cover the issue of consents under S29 of the Gas Act 1972, since currently safety is the only consideration

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

Tim Flesher Esq
Private Secretary to
The Prime Minister
10 Downing Street
LONDON SW1

16 January 1984

Dear Tim,

GAS SAFETY: TRANSFER OF MINISTERIAL RESPONSIBILITIES

I understand that Graham Davey, our Parliamentary Clerk, has spoken to you and Charlotte Stevens earlier today about the attached text of the arranged question and answer on gas safety responsibilities.

As you know the Table Office has refused to accept the Question for answer by our Secretary of State. I should therefore be most grateful if you could arrange for the question to be tabled today for ordinary written answer, by the Prime Minister, tomorrow.

The question and answer have already been cleared with you (in David Barclay's letter to Michael Reidy of 22 December).

Yours ever,

John

J S NEILSON
Private Secretary

DRAFT QUESTION AND ANSWER

Q. To ask the Prime Minister what steps she proposes to take to remove the present overlap in gas safety responsibilities between the Secretary of State for Energy and the Secretary of State for Employment.

A. It is intended that, as from 1 Feburary 1984, the gas safety responsibilities which are now exercised by the Secretary of State for Energy should be transferred to the Secretary of State for Employment. Broadly, these responsibilities involve the power to make gas safety regulations under S 31 of the Gas Act 1972 and the associated powers on penalties and prosecutions under S's 42 and 43: and the enforcement of the Gas Safety Regulations 1972 and the Gas Safety (Rights of Entry) Regulations 1983. The Secretary of State for Employment will also become responsible for making gas appliance safety orders under the Energy Conservation Act 1981 and for associated questions relating to gas appliance safety, including European Community activities in this area.

I understand that the Secretary of State for Employment intends to make an agency agreement with the Health and Safety Commission to carry out most of these functions on his behalf. In addition, the Secretary of State for Energy proposes to make a separate agreement with the Health and Safety Commission to cover the issue of consents under S 29 of the Gas Act 1972, since currently safety is the only consideration.

CC/NO

Prime Minister ②

Relations are improving

AT 13/1

01 211 6402

MV

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

13 January 1984

Dear Nigel

SELECT COMMITTEE ON ENERGY

attached

Thank you for your letter concerning the Select Committee on Energy. I agree of course that our objective must be to present a coherent view of Government policy.

I am perfectly happy for my officials to attend with yours. However it is worth considering whether a strong request by you that this happens might not be exploited by the Committee. If they look upon it as a major request they may well endeavour to use the presence of both lots of officials at the meeting to try and expose some differences of emphasis.

It strikes me that if the presence of my officials with yours could be presented as an unimportant event, one in which ours are accompanying yours due to their detailed expertise and the fact that in any case they always work with your officials, it might have less impact on the attitude of the Committee.

I am quite happy for you to decide whatever way you wish to handle this.

I am copying this to the Prime Minister and to Willie Whitelaw.

Yours
Peter

PETER WALKER

NBPM

AT 17/1

MO 19/1

PRIME MINISTER

WITHSTANDING A STRIKE IN THE GAS INDUSTRY

Sir Robert Armstrong sent me a copy of his minute to you of 21st December about a report of the Official Group on the gas industry. I am content with his suggestion that we should, for the time being, simply take note of the conclusions and main recommendations of the report. Sir Robert, however, draws particular attention to two detailed recommendations, one of which is very much of concern to me: that the investigation of the possibility of Service assistance for the maintenance of the compressor stations. I agree that it would be useful to have this work done and I have therefore given the necessary instructions to have it set in hand.

2. I am sending copies of this minute to the Home Secretary, the Chancellor of the Exchequer and the Secretaries of State for Energy, Scotland, Trade and Industry and Employment and to the Secretary to the Cabinet.

Ministry of Defence
12th January 1984

Nat Ind Gas + Elec
Pt 8.

17 JAN 1984

4.29 CONFIDENTIAL

Prime Minister ②
I hope this can be achieved
AT 10/1

CC NO 11/1/84

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

9 January 1984

The Rt. Hon. Peter Walker MBE MP
Secretary of State for Energy

Dear Peter

SELECT COMMITTEE ON ENERGY

We need to consider quickly how to handle the enquiry into electricity and gas prices on which the Select Committee on Energy have embarked.

As you know, the Treasury has received a request from the Committee for answers to a number of questions, most of which are in identical terms to those which they have addressed to your own Department; and the Committee have asked Treasury officials to appear before them to give oral evidence on Thursday 19 January, in advance of your own appearance on 1 February. Our officials are already in touch about the written questions, but we need also to agree on matters of handling.

Whatever differences there may have been on recent issues, I am sure you will agree that the overriding need now is to present a coherent view of Government policy in this area, on the basis of the decisions Cabinet has recently taken, and to resist firmly any attempt by members of the Committee to seek to expose divisions within the Government. In my view, those objects would be best served if we were to submit written replies to the Committee's questions jointly in the names of the Department of Energy and the Treasury wherever the questions to our Departments are in substance identical. Those questions addressed solely to the Treasury or the Department of Energy could then be answered by the relevant Department in each case. I hope you will agree. I cannot see that the Committee would have any cause to object; indeed the parallel letters from the Clerk to the Committee recognise that joint answers would be appropriate on some questions.

Similarly, I think much the preferable course would be for our two Departments to appear jointly before the Committee to give oral evidence. This would make it easier to maintain a common front and would reduce the risk of misunderstanding or differences of emphasis which might otherwise occur. I appreciate that the Committee's invitation is to you personally, while that to the Treasury is addressed to officials. But I do not see that this need prove to be an insuperable obstacle if we are agreed that a joint approach is desirable.

Thus, provided you see no objection, I should like to suggest to the Committee that when Treasury officials appear before them later this month, they should be joined by one or more of your own officials. We should invite the Committee to regard this opening session as an initial hearing, supplying the necessary background for your own appearance in February, when they would no doubt expect to concentrate more on matters of policy. As with joint written evidence, I do not think the Energy Committee would have any cause to complain if the position was properly explained to them. They would still be having two Sessions; with Treasury witnesses appearing at the first, though not alone.

If you agree that this is a sensible way to proceed, my officials will have a word with the Clerk to the Energy Committee to ask him to put these proposals to the Chairman, Ian Lloyd. If he was at all unhappy about the idea, one or other of us might need to have a word with him. But I hope that would not be necessary. Similarly, if you find any difficulty in what I am proposing, we could perhaps have a word.

I am sending a copy of this letter to the Prime Minister and to Willie Whitelaw.

Yours
Nigel

NIGEL LAWSON

PART 8 ends:-

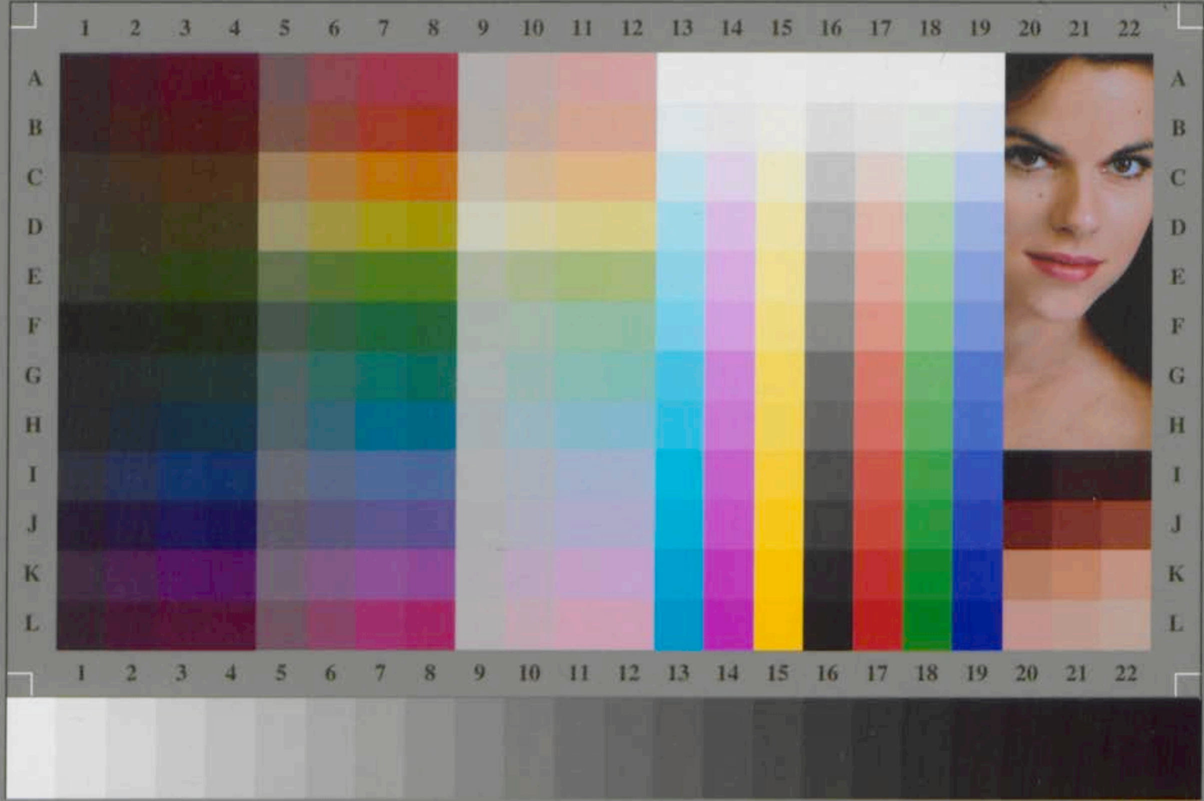
DB to RTA [18] 30. 12. 83

PART 9 begins:-

Ch/Ex to SS/Energy 9.1.84

KODAK Q-60 Color Input Target

C M Y



IT8.7/2–1993
2007:03

FTP://FTP.KODAK.COM/GASTDS/Q60DATA

Q-60R2 Target for
KODAK
Professional Papers