

PRIME MINISTER

cc: Mr Bourne

ELECTRICITY PRIVATISATION: NUCLEAR POWER

You are meeting the Secretaries of State for Energy, Scotland and Trade and Industry and the Chancellor of the Exchequer, to discuss the Energy Secretary's paper below.

There is some urgency to define the 'nuclear obligation' to be placed on the privatised Electricity Supply Industry (ESI). This affects the drafting of the Bill which Mr Parkinson wants to put to Legislation Committee on 14 November, though this timetable can probably slip a week or two.

In summary, the issues are as follows:

1. It is common ground that the privatised ESI cannot rely solely on fossil fuel generation - because of Scargill, if for no other reason. Hence Mr Parkinson's announcement about a continuing key strategic role for nuclear power achieved by requiring the Big G Company to maintain a certain level of nuclear capacity.
2. We need to decide now:
 - i. the extent of the nuclear obligation;
 - ii. how long it will last;
 - iii. who will pay for it?

Underlying these three issues is the uncomfortable fact that nuclear generated electricity will be more expensive than that generated from fossil fuel. You will want to press Mr Parkinson for his judgment of the size of the cost differential. His paper suggests (paragraph 4) that four PWRs are likely to put up the price of electricity by at least four per cent by 2000. Is this an underestimate?

But the costs of the nuclear obligation are uncertain because, for example, they depend on:

- a. the efficiency with which Big G Company builds and runs the nuclear stations. This will in part be dependent on the incentives on Big G to act efficiently. If Big G is allowed, by the regulator, to pass all costs through to consumers, the company will have no incentive to reduce them. Mr Parkinson therefore proposes that, to promote efficiency, some risk associated with nuclear contracts should remain with Big G;
- b. the difficulty of forecasting some future costs associated with nuclear generation, such as 'back end' costs, e.g. for reprocessing and decommissioning costs.

On the extent of the nuclear obligation, the assumption has been that non-fossil fuel capacity should be maintained at broadly its present level - which would require four new PWRs (including Sizewell B), assuming supplies from the French link are counted as non-fossil fuel capacity. Your meeting will want to consider whether this level of nuclear obligation is the right one, bearing in mind the extra costs of nuclear power and that every nuclear station built by Big G Company preempts the other companies, including new entrants to the market, from building new stations.

On the duration of the obligation, the financial advisers advise that the prospectus will need to set out the policy. Various options are given in paragraph 33 of the officials' paper attached to Mr Parkinson's. Mr Parkinson recommends that the non-fossil fuel obligation at 2000 should be set at 12.2 GW - leaving it to future Governments to take decisions beyond 2000.

On who will bear the costs, the issues here are broadly two-fold:

a. large industrial firms will be free, in the privatised regime, to contract directly with private generators. The private generators will have no (higher cost) nuclear obligations so their electricity supplies will, other things being equal, be cheaper than Big G's. That would put Big G under a competitive disadvantage and would reduce privatisation proceeds, perhaps very considerably. Mr Parkinson therefore proposes that there should be a formula (probably very complex) whereby some of the costs of the nuclear obligation carried by Big G would be passed to the private generators;

b. the financial advisers say that a successful flotation of the ESI requires HMG to cap increases in unforeseen 'back end costs'. The Government would meet the major part of this unforeseen increase, with Big G and BNFL meeting a proportion.

The above is a simplified summary of the issues in Mr Parkinson's paper. I suggest that you should consider them in the order listed above. It seems doubtful whether Ministers can reach a decision at one meeting. This first discussion might therefore be regarded as a second reading discussion with decisions to be reached at a second meeting of the group or at a meeting of E(A).

N.L.W.

N. L. WICKS

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