SUBJECT cc MASTER

DAIAGC

cc Policy Unit

Mtg Record

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

5 July 1989

Dear [illegible],

ELECTRICITY CONTRACTS, PRICES AND PROCEEDS

The Prime Minister held a meeting on 4 July to discuss the proposed contract arrangements in the privatised electricity industry. Those present were the Chancellor of the Exchequer, the Secretaries of State for Trade and Industry and Energy, the Minister of State, Scottish Office (Mr. Lang), Sir Robin Butler and Richard Wilson (Cabinet Office) and Greg Bourne (No.10 Policy Unit). The papers before the meeting were your Secretary of State's letter of 14 June and the enclosed memorandum, the Chancellor's letter of 20 June, the Secretary of State for Trade and Industry's letter of 23 June and the Secretary of State for Scotland's letter of 30 June.

<u>I should be grateful if you and copy recipients would ensure that this letter is given only a limited circulation and seen only by those with a strict need to know.</u>

<u>Nuclear Generation</u>

The Prime Minister said she was most concerned by the figures revealed in your Secretary of State's paper for the latest estimates of nuclear generation costs of some 7.0p/kWh. This estimate was greatly above earlier figures and it was unacceptable that the electricity industry had not been forthcoming about the true costs in the past. She felt it was essential that the reprocessing and decommissioning costs of the Magnox and the older AGRs were not a burden on the newly privatised company. These past costs which reflected previous Government decisions could not be recouped from consumers in the future.

Your Secretary of State said there had been a history of revisions to the figures for decommissioning costs. But it was only in mid May that the auditors had suggested a massive addition of some £6 billion. It was important to bear in mind that, although the reprocessing and decommissioning costs of Magnox and the older AGR stations were now much greater than expected, there was no evidence of similar problems or significant cost escalation for the PWR stations. A crucial difference was that the PWRs

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represented a technology already developed in other countries, whereas the Magnox and AGRs had been unique to the UK. He was urgently considering with the Chancellor alternative methods of dealing with the nuclear costs, and they would come forward with firm proposals as soon as possible. It was necessary to consider what could be done within the framework of the existing Electricity Bill.

In further discussion it was explained that the first of the Magnox stations, at Berkeley, had now been closed down with the remaining eight stations scheduled to go out of production by 2002. It was questioned whether the better approach would be to close all the Magnox stations now and tackle the full decommissioning programme as soon as possible. But it was also pointed out that this could lead to severe shortages of generation capacity over the next few years.

Summing up this part of the discussion the Prime Minister invited your Secretary of State and the Chancellor to consider urgently the best solution to the problem of nuclear costs and to come forward with proposals. It was essential however that the legal powers were available to implement whatever was finally decided: amendments to the present legislation should be prepared urgently if needed, with a view to tabling them in the House of Lords. Meantime if she faced questions in Parliament on this issue she would indicate that the Government was considering how best to meet the costs.

Implications for the Coal Industry

The Prime Minister said that she wished to consider the implications of the proposed five year transition for prices paid to the coal industry. The possible effects on the pits worked by the UDM had to be carefully considered, with a view to the impact on endurance in the event of industrial action elsewhere in the coal industry. The concerns felt by the UDM about the proposals for electricity privatisation had been brought out in the letter of 20 June that Mr. Roy Lynk had sent to her.

Your Secretary of State said that he was taking a wide range of measures to seek to assist the UDM, and British Coal had also done much to recognise the importance of the union. But the UDM could not be totally isolated from the need for change; for example some of the Nottinghamshire pits were now close to exhaustion. It would also be very difficult to persuade the privatised electricity companies to accept a transitional period longer than five years; the companies would be bound to ask how long they were expected to carry the coal industry. The electricity companies would want to move to a position in which a proportion of their coal supplies were imported, in order to apply competitive pressure on British Coal. This approach also had the advantage of increasing the electricity industry's endurance in the event of industrial action. Nonetheless your Secretary of State was confident that there were good prospects for a profitable British coal industry producing around 60 million tonnes. Taking all these factors into account he believed that the proposals put forward for a five year transition represented the best available balance. The Chancellor of the Exchequer said he agreed with this assessment.

In further discussion it was asked whether diversity of fuel supplies for the electricity industry could also be assisted by the development of gas-fired stations. It was suggested that gas provided the most energy efficient means of electricity generation. Indeed most of the new proposals for generation capacity were likely to be for gas firing, including those coming forward from new private generators.

Summing up this part of the discussion the Prime Minister said it was agreed that the proposals put forward by your Secretary of State represented the best balance available. It was nonetheless essential for your Secretary of State and British Coal to continue to consider the position of the UDM with particular care and sensitivity.

Large Industrial Customers

Your Secretary of State said that in the past large industrial customers had received their electricity supplies at extremely low prices. These prices provided no contribution to the overheads of the electricity industry, and indeed they barely covered the basic fuel costs. He did not believe this position could be sustained under privatisation, and it would therefore be necessary to make significant price increases for large industrial customers.

In discussion the following main points were raised:

- large customers already complained that they paid more than their counterparts in other Community countries, and they would mount vociferous opposition if they now faced substantial price increases;

- if other European countries provided larger subsidies to their large industrial customers, the right way to tackle this problem was to urge the Commission to investigate the position and insist that their subsidies were cut;

- if the large customers were dissatisfied with the price levels they faced in the future it would be open to them to develop their own generation capacity, for example from gas firing;

- there were difficulties involved in continuing with the QUICs scheme, as had been pointed out in the Chancellor's letter. This was an area where the Commission might well raise objection to UK practice. Your Secretary of State's proposals on this point should therefore be reconsidered;

- rather than proceeding with the present QUICs proposals an alternative approach would be to phase in increases in prices for large customers over a longer period. It had to be recognised however that a counterpart of this would be comparatively higher costs during the transition for domestic customers.

Summing up this part of the discussion the Prime Minister invited your Secretary of State to consider further the present proposals for large industrial customers, particularly in relation to the QUICs scheme. It would be helpful if he could come forward with the further proposals on all the issues raised in the discussion within the next week or so.

I am copying this letter to Alex Allan (HM Treasury), Neil Thornton (Department of Trade and Industry), David Crawley (Scottish Office), and Trevor Woolley and Richard Wilson (Cabinet Office).

Yours
Paul

(PAUL GRAY)

Stephen Haddrill, Esq.,
Department of Energy.