Prime Minister
Agree I may write as proposed by the Policy Unit? (Treasury think it may help; Mr Walker will no doubt see it as interference.)
DRN 3/10

MR NORGROVE — 20 September 1985

Yes mt

EFL OVERSHOOTS FOR ELECTRICITY AND GAS

Two forecasts for EFL overshoots in 1985-6 stand out in the Treasury's latest Monitoring Report - that of £710 million for Electricity (England and Wales) and that of £280 million for British Gas.

Last December/January there was a rancorous exchange between the Treasury and Department of Energy on the setting of the 1985-6 EFL for the ESI. The differences were not resolved, and the £710 million overshoot still does not reflect the outcome of the coal strike and its impact on the ESI. This means that the normal financial discipline of having to account rigorously for deviations relative to a tight, realistic EFL does not apply; the ESI is able to hide behind very large strike-related items like the £220 million additional interest charges and some £330 million for replenishing coal stocks.

The £280 million overshoot for BGC stems largely from a badly-framed contract for the purchase of Norwegian (Frigg) gas. Although BGC could have foreseen the consequent increase of gas supply costs, provision was not made in the EFL established last year. Unless accompanied by convincing corrective action, this unprecedented overshoot will put BGC in an unfavourable light in the run-up to privatisation.

Subject to the Prime Minister's agreement, you might consider minuting Peter Walker's office:

- Noting the £710 million EFL overshoot for the ESI, expressing concern at the lack of an updated EFL for 1985-6 and hence the lack of a tight financial discipline on the ESI; and urging that this is resolved rapidly with the Treasury, as again proposed in the Chancellor's note of 6 September 1985.

- Expressing concern at the implications for gas privatisation of BGC's unprecedented EFL overshoot, and asking what scope there is to compensate for this by tighter control of working capital, trimming capital expenditure, reducing operating costs, and selling inessential assets.

JW

JOHN WYBREW