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From: J B UNWIN
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LORD PRESIDENT

STAR CHAMBER: ELECTRICITY (ENGLAND AND WALES) (ESI)

HANDLING

Since (at the time of drafting this brief) we have still not got an agreed position paper, I think you may need to spend some time establishing the position reached and the figures on which debate takes place. This ought to be Mr Walker's revised bid of 20 August of:

	+647	+305	+591

less agreed savings principally on Sizewell and other power stations of:

	-197	-134	-164
net bids	+450	+171	+427

2. I suggest you then concentrate on revenue and aim to settle further savings on investment, working capital, costs as a balancing item. Mr Walker has previously mentioned possible unspecified savings of £40 million a year.

MAIN ISSUES

3. The ESI has proposed tariff increases of:

			%
	0	+0.75	+3
or in real terms	-3.5	-0.5	-2.0

The Chief Secretary argues that this aim is unreasonable at a time when the industry is:

(a) making a very large additional bid on public expenditure of over £1 billion over the three years;

(b) has a low profitability. ESI strategy is to expand turnover and compete with gas for market share rather than to increase profitability.

(c) a path of 0/0/0 for real prices is sound economically and acceptable politically.

Part of the additional bid represents necessary capital expenditure on extra construction costs and repairs for AGRs. But these ought to affect what can be afforded elsewhere.

4. Mr Walker will argue:

(a) he has no powers to force the ESI to adopt a different price path;

(b) the industry has massive negative EFLs already. Why should it put up prices more than it wants in order to send money to the Treasury? But the Treasury's proposal is not primarily to increase negative EFLs but to eliminate the additional bid;

(c) the ESI must hold down prices next year to compete with gas where a price cut is expected. But gas already earning a better return on capital (4 per cent real last year against 2½ per cent for electricity).

(d) that higher prices in 1987-88 will cause the target rate of return (the average of three years ending in 1987-88) to be exceeded. The industry envisaged only slow progress towards improved profitability - say a further 2 per cent over the next 10 years.

5. Mr Walker is probably right in arguing that he cannot (legally) compel the ESI to adopt a different price path. But it is not plausible that Ministers could not influence them. They have done in the past. As the Chancellor of the Duchy has already argued, price increases rising only with inflation would surely be acceptable politically. And it seems unlikely that any decently run private sector company would deliberately forego the opportunity of increased profitability because it has done better than expected in the past.

6. It is hard to say at this stage how far you might be able to go. You may, as with Mr Younger, be able to try out a no commitment compromise and ask Mr Walker to reflect on it.

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