NATIONAL AUDIT OFFICE

Report by the Comptroller and Auditor General

Department of Energy and the Industry Department for Scotland: Effects of Lower Oil Prices on the Electricity Supply Industries

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This report has been prepared under Section 6 of the National Audit Act, 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

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Comptroller and Auditor General

National Audit Office
4 May 1988

The Comptroller and Auditor General is the head of the National Audit Office employing some 900 staff. He, and the NAO, are totally independent of Government. He certifies the accounts of all Government departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies use their resources.

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Introduction

1. Electricity supply in Great Britain depends on a range of generating plant using various sources of power, mainly coal, oil and nuclear energy. The optimal mix of generating plant and fuels to meet demand most efficiently was affected by the sharp fall in world fuel oil prices in the first quarter of 1986. This required the Electricity Boards to reconsider the economics of their operations in view of the possibility that it could provide the opportunity for a substantial reduction in generating costs and thus in electricity prices.

2. This Report records the results of an examination by the National Audit Office (NAO) of the way in which the Department of Energy (DEn) and the Industry Department for Scotland (IDS) undertook their sponsorship responsibilities in respect of the electricity and coal producing industries during 1986. The NAO were concerned with:

(a) the effectiveness with which the two Departments had exercised their sponsorship roles in relation to the impact of the fall in oil prices, specifically in relation to the coal price agreements entered into between the National Coal Board (NCB) and the boards in the electricity supply industries and the special schemes for reducing electricity prices paid by large consumers; and

(b) how the Departments satisfied themselves that the price agreements and these special schemes were reasonable in the light of the interests of the taxpayer and electricity consumers.

In the absence of access to the records of the industries themselves, the examination was based mainly on information held within the sponsor departments. It did not cover the wider issues reviewed by the public inquiry by Sir Frank Layfield into the plan to build a pressurised water reactor nuclear power station at Sizewell. Nor did it consider the implications of lower fossil fuel prices for longer-term capital decisions in the choice of nuclear or conventional power stations.

Background

3. The electricity supply industry in England and Wales(ESI) consists of the Central Electricity Generating Board (CEGB) which is responsible for the supply of electricity in bulk; 12 Area Boards who distribute the electricity; and the Electricity Council (EC) which advises Ministers on questions affecting the ESI, coordinates the planning and investment by CEGB with that by Area Boards, and promotes and assists the development and maintenance of electricity supply. In Scotland two Boards, the North of Scotland Hydro Electric Board (NSHEB) and the South of Scotland Electricity Board (SSEB), are responsible for both generation and distribution of electricity.

4. The broad role and functions of the Department of Energy in relation to the ESI remain as set out in a previous NAO Report in 1984 (Appendix I). DEn also sponsor the coal industry and their sponsorship role and

objectives were contained in the Seventh Report of the Public Accounts Committee of the 1983-84 Session (HC 139) (Appendix 2). For the period under review the Government had also agreed strategic objectives with the Chairmen of the CEGB (Appendix 3) and the NCB (Appendix 4). A new formulation of DEn's objectives has recently been agreed (Appendix 5).

The supply of fuels

5. The availability of fuels used for electricity generation was seriously distorted by the coal strike. The CEGB Annual Report 1984-85 showed that during that period the Board made maximum use of its oil-fired generating capacity. This had resulted in an eight-fold increase in the consumption of oil.

6. In the period immediately after the strike the CEGB reverted broadly to the same pattern of fuel usage as before the strike. The consumption of fuel for electrical generation in England and Wales expressed in million tonnes of coal equivalent (mtce) from 1983-84 to 1986-87 was:

	1983-84		1984-85		1985-86		1986-87	
	mtce	%	mtce	%	mtce	%	mtce	%
Coal	77.2	80.8	40.5	41.7	79.0	78.4	77.0	77.0
Nuclear	13.5	14.2	16.0	16.5	16.4	16.3	16.2	16.2
Oil	4.8	5.0	39.9	41.0	5.1	5.0	6.8	6.8
Gas	—	—	0.8	0.8	0.3	0.3	0.0	0.0
	95.5	**100**	**97.2**	**100**	**100.8**	**100**	**100.0**	**100.0**

Note: mtce is used because different fuels have different heat contents per tonne.

7. CEGB obtained most of its coal from the NCB under a Joint Understanding covering the four years from 1 November 1983, which provided that the CEGB would take not less than 95 per cent of its estimated annual coal requirements from the NCB to be priced in two ways:

(a) the first tranche of deliveries (92 per cent of the total and 65 million tonnes in the first year) was to be supplied at a price reflecting the costs of UK production and the higher costs that would be involved in delivering imported coal to the CEGB's inland stations where practicable and escalated on the basis of a formula reflecting movements in the RPI and world market prices, subject to a ceiling and a floor; and

(b) a second smaller tranche (8 per cent) aligned to the price of imported coal delivered to the Thames.

The fall in oil prices

8. World fuel oil prices fell sharply in the first quarter of 1986 and the sterling price in March 1986 was less than half of that of a year earlier. There remained the capacity to increase oil-fired generation to at least the level of the oil-burn during the period of the coal strike, ie by some 35 mtce, with a further 5 mtce in Scotland. For the closing weeks of 1985-86, however, the CEGB negotiated a short-term agreement with the NCB to refrain from increasing the oil-burn in exchange for a discount on coal deliveries reflecting the international price of competing fuel. A similar temporary discount was negotiated for Scotland.

Revised coal price agreement

9. When lower oil prices appeared likely to persist, the need for a further continuing adjustment to the pricing arrangements became apparent. DEn told the NAO that, in such circumstances, it was the clear responsibility of the nationalised industries concerned to formulate their business strategy and to reach judgements on such issues as the balance of commercial advantage between short-term cost reductions and longer-term security of supply. The Department stated that the Government had nevertheless been concerned to ensure that the industries were aware of all considerations affecting the broader national interest and particularly the implications for public expenditure.

10. In the light of these factors, the two industries had opened discussions, but it had soon become clear that the positions of the industries were a long way apart. The CEGB, while recognising the desirability of ensuring continued long-term access to NCB coal, took the position that the fall in oil prices had highlighted a widening gap between the price paid by the CEGB for NCB coal and the prices charged for fossil fuels on the international market. The NCB was equally concerned to limit the financial implications of any reduction in coal prices necessary to deal with the changed situation. The industries had therefore approached the Government for guidance.

11. The Government, bearing in mind the objectives of the industries and taking account, in particular, of the financial implications for the NCB indicated that, given the uncertainties, a reduction in coal prices worth between £150 million and £200 million in the seven months to the end of October might be reasonable. But it was made clear that this was a matter for the industries to pursue and report back.

12. The CEGB and the NCB reached an agreement in May 1986 covering the five financial years 1986 - 87 to 1990 - 91 (firm for the first two years but expressed as a clear intention thereafter). In reaching this agreement the two Boards sought to balance the short-term advantages which the CEGB could obtain by increasing their consumption of oil and imported coal with their longer term views on the price and continued availability of coal and oil, and of the advantages of maintaining access to secure, competitive, indigenous fuel supplies at falling real prices for the future. Its main terms were:-

(a) First Tranche. The price of the first tranche was unchanged but its size was substantially reduced to 50 million tonnes in the first year and would be progressively reduced further over the period of the Agreement.

(b) Second Tranche. The second tranche (applying initially to 10 million tonnes a year) was on a new basis. Its price broadly related to the oil price and to the price of imported coal delivered to central power stations. It was guaranteed to be below the first tranche price and in the first year was 30 per cent lower than that price. The size of the second tranche was to increase as the size of the first tranche decreased.

(c) Third Tranche. The third tranche price, applying to 12 million tonnes in 1986 - 87, was to be calculated by reference to the price of imported coal supplied to the CEGB's coastal power stations, based on the CEGB's contracts and other relevant evidence. In the first year it represented a discount of 37 per cent on the main tranche price.

The net financial effect of this was to reduce the CEGB's coal bill by about £300 million in 1986-87 but the prices applicable under the format of the new agreement were subject to review from November 1987. (The NAO are not publishing in this Report details of the prices, as obtained from DEn's records, since the Department regard these as commercially confidential.)

13. DEn did not consider it appropriate to ask for a copy of the actual agreement between the CEGB and the NCB. The Department told the NAO that they had only sought sufficient details from the industries to enable an assessment to be made of its financial consequences. They regarded the remaining details of the agreement as a matter of commercial judgement decided by the two bodies in the light of market forces. And they emphasised to the NAO that, in performing their role, they considered it very important not to involve themselves in making detailed decisions which properly fell to the management of the two industries.

14. DEn consider that it must be stressed that prime responsibility for the conduct of their business lies with the industries themselves. They do not consider it part of the role of sponsor Departments to form a view on whether they would have reached identical judgements to those of the management of the industries. They informed NAO that in assessing the agreement, Ministers had taken the following main factors into account:

(a) The CEGB and the Electricity Council were both satisfied that the immediate tariff reduction, and prospective longer-term cost savings combined with continuing security of coal supplies, offered electricity consumers a reasonable deal. They regarded this as preferable to sharper, but probably unsustainable, tariff reductions which would have severely damaged the finances of the NCB.

(b) Both the ESI and the NCB valued the stability which the agreement provided for their business planning.

(c) The NCB expected the immediate financial consequences to be containable, by virtue of a programme of stringent cost reductions, within its published EFL of £730 million for 1986-87. (The later increase in the external financing requirement to £902 million was stated by the Department to be due to other factors.)

(d) The NCB also expected the target year for breakeven to be deferred only from 1987-88 to 1988-89: even so, there was a possibility of breaking even for part of 1987-88. These expectations have been reflected in the objectives agreed between the Department and the Chairman of the NCB, which were published on 11 March 1987 (Appendix 4).

(e) It was not inconsistent with what the Government had indicated to the two industries that they would consider reasonable.

In the light of these factors, the Government had seen no reason to attempt to override the commercial judgement of the industries.

15. The Department therefore believe that they properly exercised their sponsorship role in relation to both the ESI and the coal industry (as referred to in paragraph 4 above). In particular they:

(a) advised Ministers on the impact of decisions on lower prices on the coal industry and on the Government's short and longer term objectives for the industry.

(b) examined the ESI's corporate strategy with respect to the coal agreement and satisfied themselves that it met the Government's wish to see consumers benefiting from lower world fossil fuel prices together with the maintenance of a healthy coal industry.

16. In the absence of access to the industries' records (and without access to a copy of the agreement between the industries), NAO were unable to make their own assessments of the extent to which CEGB's savings under

(a) the second tranche (paragraph 12 (b)) compared with the savings it might have achieved by substantially increasing the level of oil burn as happened during the coal strike, when oil represented about 40 per cent of its fuel usage:

(b) the third tranche of the revised agreement (paragraph 12 (c)) compared with the savings it might have achieved through a substantial and systematic switch to using more imported coal — eg at coastal stations or where any resulting infrastructure costs would be less than the differential between domestic and imported coal prices.

17. NAO noted, though, that a number of calculations were made, both by DEn and the CEGB, showing a range of theoretical savings from the greatest possible switch to oil burning. Some of these indicated the possibility of substantially greater annual savings than the £300 million finally expected to be saved by the CEGB in the first year as a result of the revised coal price agreement. An additional switch to imported coal could have further increased the potential savings but at even greater cost to the NCB. (In evidence to the Energy Committee, the CEGB suggested that savings of up to £550 million a year might accrue from maximising its use of imported coal — taking account of transport costs but not the cost of investment in new import facilities.)

18. Clearly, however, the level of savings that might have been achieved would have been highly dependent on a range of assumptions concerning the sterling dollar exchange rate, the world price of oil and coal, and the effect of the CEGB's large-scale entry into the world oil or coal markets.

19. And more than short term issues were involved, of course. In reaching the coal price agreement the two Boards said that they sought to balance the advantages which the CEGB could obtain by increasing their consumption of oil and imported coal with the longer-term views on the price and continued availability of coal and oil, and the advantages of maintaining secure, competitive, indigenous fuel supplies at falling real prices for the future (memorandum 71 submitted on 30 June 1986 to the Select Committee on Energy).

The Scottish agreement

20. In Scotland, only SSEB has coal-fired generation capacity and there was an existing agreement with the NCB for coal supply pricing which did not expire until March 1988. This also provided for different tranches of coal deliveries to be priced according to certain principles but did not

commit the Board to any specific prices or minimum quantities. Following the expiry of the temporary discount agreed for February and March 1986 (paragraph 8) the NCB was not able to offer a sufficiently attractive inducement not to burn oil, and while negotiations continued SSEB made a partial switch to oil-fired generation which they calculated saved them just under £6 million in two months.

21. IDS papers indicate that the Government emphasised to the SSEB that negotiations with the NCB should be on a genuine commercial basis. Both the Government and the SSEB however shared a concern that pursuit of short-term price advantages in fuel purchasing should not obscure longer-term requirements for an assured supply of coal for electricity generation to stimulate competition and protect continuity of supply.

22. SSEB and NCB reached an agreement in July 1986 for 1986 - 87 only. This provided:

(a) for a rebate on the coal purchased from April to June and that from 1 July the recently-increased level of oil-burn would be reduced by 60 per cent and coal purchases restored to about two thirds of the annual level in 1985 - 86 (including restocking);
(b) that the price of two thirds of the main supplies would be at a pithead price aligned with that of the CEGB's main tranche for inland coal supplies, and the other third at a fixed discount on this price which would be very close to that applicable to 1986 - 87 deliveries under the CEGB's variable oil-related tranche; and
(c) that the price of the coal used for generating the electricity exported to England and Wales would be comparable with the tranche in the CEGB agreement related to imported coal.

Impact on prices

23. The CEGB expected the new agreement with NCB to reduce CEGB's costs by £300 million in 1986 - 87 and forecast further improvements in subsequent years. In June 1986, the EC recommended each Area Board to make immediate tariff reductions expected to result in average savings of some 3.5 per cent for basic domestic consumers, 5 per cent for industrial consumers, and 7 to 8 per cent for those on contracted load terms. Their 1986 - 87 Annual Reports indicate that reductions in the cost of fuel allowed the Scottish Boards to make rebates equivalent overall to about 3 per cent.

Prices for large consumers

24. In 1982 - 83 the ESI had introduced the Contracted Consumer Load Management Scheme whereby very large consumers paid at a very low unit rate for a minimum large annual load. They also received a reduction on peak time charges for reducing their demand by certain amounts during a limited number of periods identified at short notice by CEGB when maximum loads were expected. DEn considered that this produced a more accurate reflection of the costs involved in allowing large consumers to benefit fully from economies of scale and their ability to help with load management although it led to a consequential reduction in the ESI's revenue. In recognition of this, and to enable previous arrangements for large industrial users to continue, the Government therefore agreed to abate the rate of return required by the financial target (FT) (and also the negative external financing limit (EFL) since these should be compatible) thereby reducing the industry's repayment of public debt.

25. The initial estimate of the reduction in revenue as a result of the scheme was £120 million a year. Following further consideration of the reduction in revenue and of the financial target for the period 1985 - 86 to 1987 - 88 it was agreed that the target should be reduced from 3.16 per cent to 2.75 per cent. This was equivalent to £150 million a year on average over that period.

26. A new Intensive Users Scheme called the Qualifying Industrial Consumer Scheme (QUICS) has additionally been introduced from October 1986 following several years of complaints by very large UK users of electricity that they paid higher charges than their competitors in Europe; this particularly affected consumers in the chemical, steel, cement and paper industries. The Scottish Boards introduced a similar scheme from the same date.

27. The price paid for a unit of electricity was dominated by the price the CEGB paid for NCB coal. If these industries were to be able to purchase electricity at a price which did not put them at a competitive disadvantage, the price of coal would therefore have to be considerably less than the average price being paid by the CEGB for NCB coal. The initial joint CEGB/NCB proposal for a scheme in December 1984 was for the NCB to sell an amount of coal at a price related to the price of the cheapest international coal; but on the condition that it would be used by the CEGB to generate electricity specifically for exceptionally large customers. Some 25 consumers using more than 100 million kwh per year would have benefited from such an agreement.

28. It was hoped that this would reduce under-utilisation of existing electricity plant and avoid loss of existing industrial demand. It was also hoped to encourage conversions and investment in new plant; to avoid loss of new industrial demand abroad; and eventually to stimulate new demand from the 25 large consumers and others. Both the CEGB and the NCB thus hoped to derive financial benefit from demand which would otherwise be lost. Apart from these benefits, the immediate effect on CEGB's finances would however be neutral since any reduction in the charges to such users would fully reflect the lower cost of the coal so designated, and other electricity users would be unaffected; any cost would therefore fall on the NCB.

29. Inter-departmental discussions in 1985 - 86 considered the issues of who would meet the cost of the scheme; whether it involved undue preference as between different consumers of electricity; and whether it needed to be endorsed by Ministers. These discussions were overtaken by the revised coal price agreement in May 1986. At that time the Department understood that no provision was being made for the special treatment of industries which were intensive users of electricity, and that the issue had had to be set on one side while the overall problem of falling oil prices was dealt with. Shortly afterwards, however, the Department was informed that the NCB and CEGB intended to deal with the needs of intensive users within the framework of the revised coal price agreement and at no additional cost.

30. On 21 November 1986, the Electricity Council stated in a memorandum to the Energy Committee that, in determining the size of the

third tranche in the new agreement (12 million tonnes — see paragraph 12(c) above), the NCB and the CEGB had taken into account the discussions concerning a scheme for benefiting intensive users of electricity. The two industries' discussions had generally assumed that 4 million tonnes of coal would be made available by the NCB for the use of intensive electricity users in industry if the scheme were to proceed. At the time when the revised coal price agreement was reached, the details of the QUICS had not been finalised. When these were defined it had been found appropriate to separate out into a fourth tranche the tonnage (initially set at 4 million tonnes for the first year) dedicated to the qualifying customers. The Electricity Council considered that this ensured that the growth in consumption by these customers in future years, which it was hoped would follow from this stimulus for improved industrial competitiveness, would be matched by an increased tonnage for these customers from the NCB and not erode the low cost tonnage available for the general body of customers. The Electricity Council had earlier told the Energy Committee that QUICS' customers were expected to benefit by price reductions of up to 11 per cent with an average of about 6 per cent.

31. The DEn told the NAO that in addition to being informed by the CEGB and NCB that the QUICS formed part of the revised coal price agreement and that additional costs (above those agreed by Ministers in relation to that agreement, see paragraph 14) were not involved, the Department had also been assured by both industries that they considered the scheme to be in their commercial interests and that they were satisfied that there was no exercise of undue preference. The Department did not consider it appropriate to seek details of the understandings between the two industries about the QUICS and as in the case of the initial agreement in May 1986 was concerned only with the overall financial consequences.

32. In the absence of access to the industries' records (and without access to copies of the revised coal price agreement or the QUICS agreement), the NAO were unable to make their own assessments of the basis of the statements made by the industries about the QUICS, referred to in paragraphs 30 and 31 above.

Summary and conclusions

33. In relation to the specific issues covered by the examination (see paragraph 2), the NAO's main findings are:

(a) The price agreement between CEGB and NCB in May 1986 aimed to balance the short-term advantage which the CEGB could obtain by increasing their consumption of oil and imported coal with the longer-term views on the price and continued availability of coal and oil, and of the advantages of maintaining secure, competitive, indigenous fuel supplies at falling real prices for the future. CEGB secured coal price reductions from the NCB worth about £300 million in 1986-87 (paragraph 12) which enabled the Area Boards to reduce electricity prices in England and Wales by between 3.5 per cent and 8 per cent (paragraph 23).

(b) The NAO were not in a position to establish how the terms of the agreement compared with savings that might have been achieved by increasing oil burn or coal imports (paragraph 16). They noted estimates from CEGB and DEn that CEGB might have secured savings greater than those provided by the revised agreement through the greater use of imported coal and oil. But these calculations ignored some factors, and there are long term benefits to CEGB from having an assured British fuel supply (paragraphs 17 to 19).

(c) SSEB and the NCB also reached an agreement on lower coal prices following the fall in world oil prices. SSEB made a relatively larger switch to oil-fired generation than CEGB, however (paragraphs 20 to 22).

(d) The effect of reducing the financial target to take account of the Contracted Consumer Load Management Scheme and previous arrangements for large industrial users had reduced the ESI's net revenue and the industry's expected repayment of public debt by an average of £150 million per annum in the period 1985 - 86 to 1987 - 88 (paragraphs 24 and 25).

(e) Customers of the QUICS were expected to benefit from the revised coal price arrangements by securing price reductions of up to 11 per cent (paragraph 29) on top of the reductions of between 5 and 8 per cent already made (paragraph 23).

General

34. The Departments' objectives are couched in general terms, in DEn's view necessarily so. As a result there is no precise benchmark against which to measure the Departments' effectiveness in carrying out their sponsorship roles. It is clear though that they acted promptly to remind industries of the need to arrive at terms which would be fair to consumers and taxpayers, and which would have regard to the longer term requirements of an assured supply of coal for electricity generation to stimulate competition and protect continuity of supply.

35. Having issued this general guidance, Departments took the view that the detailed terms of the revised coal price agreement were for settlement between the industries (paragraphs 13 to 15). It was, therefore, left to the electricity supply industries and the NCB to come to an agreement within the general financial indications which the Government had given them and taking account of the longer-term issues referred to in paragraph 19. After hearing the industries' views on the expected financial consequences, the likely effect on consumers and the likely consequences for their strategies, the Government endorsed the agreement in general terms for the first two years.

36. In the absence of access to the industries' records (see paragraphs 16 to 19) the NAO were unable to make their own assessments of the extent to which the CEGB's savings compared with those that might have been achieved by increasing oil burn or coal imports; but the level of savings was in any event highly dependent on the assumptions made and on the judgement of long-term as well as short-term issues. Similarly, as explained in paragraph 32, the NAO were unable to make their own assessments of the basis of the statements made by the industries about the QUICS.

Glossary of Abbreviations

CEGB	Central Electricity Generating Board
DEn	Department of Energy
EC	Electricity Council
EFL	External Financing Limit
ESI	Electricity Supply Industry, England & Wales
FT	Financial Target
IDS	Industry Department for Scotland
KWh	Kilowatt-hour
Mtce	Million tonnes of coal equivalent
MW	Megawatt
NAO	National Audit Office
NCB	National Coal Board (now British Coal Corporation)
NSHEB	North of Scotland Hydro-Electric Board
QUICS	Qualifying Industrial Consumers Scheme
SSEB	South of Scotland Electricity Board

Appendix 1

The Department of Energy: Role and objectives in relation to the ESI (extract from HC 553 of 1983 – 84)

"14. The Department of Energy's main objectives with regard to their sponsorship of the ESI include:

(a) advising Ministers on policy formation and the exercise of statutory powers in relation to the ESI;

(b) assisting in and monitoring the implementation of that policy; and

(c) assisting the industry to conform to statutory requirements.

15. In pursuit of these objectives the Department regard their main tasks as:

(a) examining the industry's corporate strategy and its relationship to Government policies;

(b) developing, in conjunction with the Treasury, financial targets and performance aims, monitoring their achievement and, if necessary, encouraging the industry to take corrective action;

(c) developing in collaboration with the industry a broad framework of pricing policy reflecting the principles outlined in Cmnd 7131;

(d) advising Ministers on the settlement of EFLs, monitoring progress towards their achievement and encouraging corrective action where appropriate;

(e) reviewing the annual capital investment plans of the Board including examination of investment appraisal methods;

(f) encouraging the development of efficiency within the industry;

(g) advising Ministers on means of introducing, and if necessary supporting or regulating, private capital in the industry;

(h) advising Ministers on the performance of specific functions including the appointment of Board members or of auditors;

(i) operating effective systems of financial control over public funds advanced to or recovered from the industry."

Appendix 2

Department of Energy and the National Coal Board (extract from HC 139 of 1983 – 84)

"2.9 The Secretary of State for Energy is the Minister responsible for the operation of the Coal Industry Acts, and the Department of Energy act as the sponsor department for the NCB. The Department have not formally recorded their objectives with regard to their sponsorship of the NCB but my enquiries indicate that these include, within the resources available, the following:

(a) Advising Ministers on the formulation of the Government's objectives for the coal industry, on policies for the attainment of these objectives, and on questions arising out of the Government's interest in the strategies and key decisions of the industry.

(b) Assisting the NCB in carrying out its statutory duties and in achieving its financial objectives.

(c) Ensuring that the NCB contains the external financing requirement within the currently approved limit.

(d) Ensuring that the NCB's medium-term development plans appear sound and conform to Government policies and long-term strategy for the industry.

(e) Ensuring that the Board operates in accordance with the agreed development plans and takes prompt corrective action to restore performance to plan.

(f) Operating effective systems of financial control over public funds advanced to and recovered from the Board.

(g) Promoting the development and use of appropriate indicators of operational and financial performance including forward projections which will assist in improving efficiency and effectiveness.

(h) Maintaining a thorough understanding of the Board's operations and of its position and prospects at any time, and monitoring its progress against agreed plans and limits."

Appendix 3

CEGB's Objectives (extract from Official Report 18 March 1983 — cols 296 - 7)

"Mr Nigel Lawson:

.... The Central Electricity Generating Board's objectives were settled with Sir Walter Marshall, CBE, FRS, in the following terms:

This letter sets out the objectives which the Government wish you to pursue as Chairman of the CEGB. The objectives elaborate on the responsibilities and obligations placed by Statute on the Board as a whole, and in particular the development and maintenance of an efficient, co-ordinated and economic system for the secure supply of electricity in bulk.

1. Your prime objective must be to run the Board with maximum efficiency, ensuring that sustained and detailed attention to cost control extends through all aspects of the Board's activities. In this context:
   (a) challenging cost control targets should be set wherever practicable, and carefully monitored;
   (b) the Board should achieve its part of industry-wide performance targets which are set by Government;
   (c) every effort should be made to ensure that power stations are built to time and cost.

2. It must also be your objective to increase the scope for competition in electricity supply. You should review the prospects for the injection of private risk capital into areas of the Board's operations, and make positive recommendations to me wherever possible. In co-operation with Area Boards when appropriate you should seek to develop co-operation with private generators, ensuring that effective commercial and technical arrangements exist to take full economic advantage of their potential contribution to supply.

3. In developing proposals for capital investment, your objective should be the production and distribution of electricity at the lowest possible cost consistent with maintaining adequate standards, e.g. of security of supply. Capital investment proposals should be set out comprehensively for my approval, giving an account of the strategic framework against which they have developed. The Board should continue to pay close attention to the methodology used in capital investment appraisals.

4. You should ensure that the Board does all possible to explore and exploit the full potential of nuclear power to contribute to the cheap, effective and safe production of electricity.

5. The Board's plans for effective operation, and cost-reducing investment, should be developed within the framework of a corporate plan for the industry, which will be reviewed annually with Government. They should take full account of the financial targets agreed with Government and of the industry's External Financing Limits. The Board should ensure regular and effective information flows to assist the Government and the Electricity Council to monitor performance in relation to those targets and limits.

6 The Board should set its prices so as to reflect the costs at the margin of meeting demands on a continuing basis. It should pay careful attention to the impact of the bulk supply tariff on different categories of the electricity supply industry's consumers. In appropriate cases, the Board should be ready, subject to the provisions of Section 2(6) of the 1957 Electricity Act, to discuss with bulk industrial users and the Area Boards the possibilities of direct supply by the CEGB.

7. You should work closely with the Chairman of the Electricity Council on all major issues affecting the industry. I shall be sending him a copy of this letter for his personal information. The need for close working relationships within the industry as a whole was stressed in David Howell's statement of July 1980 which I attach.

Finally, I should make clear that the Government may wish to give further guidance to you at a later date or to impose constraints from time to time, for wider reasons, on your ability to achieve one or other of these objectives."

Appendix 4

NCB Objectives (Extract from the Official Report by the Standing Committee on the Coal Industry Bill 22 November 1983)

"The Under-Secretary of State for Energy, Mr Giles Shaw, in the course of the first session of the Standing Committee stage of the Coal industry Bill on November 22 1983 set down the objectives for the National Coal Board which had been agreed with Mr MacGregor when he succeeded Sir Norman Siddall as Chairman. These were as follows:

1. Although coal is one of the United Kingdom's major natural resources, in the Government's view the justification for coal production, like that for any other business, lies in the ability of those engaged in it to earn a satisfactory return on capital while competing in the market place. The basic objective for the National Coal Board, therefore, must be to earn a satisfactory return on its assets in real terms, after payment of social grants; and this return will need to be quantified in due course.

2. The National Coal Board should aim to maximise its long-term profitability by securing those sales which are profitable on a continuing basis, in competition with other fuels. it should plan its marketing, production and capital investment accordingly and bring productive capacity into line with its continuing share of the market.

3. The Board's objective should be to ensure that over the next five years its operating costs, including depreciation and capital charges but excluding interest, per tonne of coal produced, are reduced in real terms for deep-mined and for opencast production separately. In this calculation the GDP deflator should be used. This objective will be quantified in due course.

4. Either the Board or the Government may propose additional objectives from time to time, and any consequent adjustments to existing objectives would need to be discussed."

British Coal Objectives 11 March 1987

"Mr Hannam asked the Secretary of State for Energy if he has set objectives for the chairman of the British Coal corporation.

Mr Peter Walker: I have settled objectives with the British Coal corporation chairman, Sir Robert Haslam in the following terms:

1. Coal production, like any other business, must earn a satisfactory return on capital while competing in the market place. The basic objective of British Coal must be to earn a satisfactory rate of return on its net assets and achieve full financial viability without Government support. British Coal should accordingly aim to improve its profitability so as to achieve, after payment of interest and accrual of social grants, breakeven for the year 1988-89 as a whole (though it is hoped that a breakeven position might be attained during the latter part of 1987-88) and thereafter generate an increasing surplus on revenue account and to contribute increasingly to self-financing.

2. British Coal should aim to maximise its long-term profitability by concentrating on low-cost production and on those sales which maximise profit on a continuing basis in competition with other fuels. It should plan its marketing, production, capital investment and research and development accordingly, bring productive capacity into line with its continuing share of the market, and ensure an adequate return on new capital investment in accordance with the principles set out in the White Paper "The Nationalised Industries" (Cmnd 7131).

3. British Coal's objective should be to ensure that over the period to 1989-90 the operating costs of its mining activities per gigajoule of coal produced are reduced in real terms by at least 20 per cent, compared with the level recorded in 1985-86.

4. Either British Coal or the Government may propose additional objectives from time to time: any consequent adjustment to existing objectives would need to be discussed.

Appendix 5

Departmental objectives of DEn

Within the framework of statute and of Government policy, and having regard to our international obligations:

— to seek to ensure that the nation's needs for energy are met both now and in the future, whether from domestic or overseas sources, in the manner which makes the best use of both energy and other resources.

In particular to further these objectives

— by discharging effectively and economically the Department's responsibilities for safety, licensing, regulation and contingency planning in the energy field;

— through research and development, either by encouraging other entities, whether public or private to undertake it, or by itself funding R&D which would not other wise be undertaken, and by ensuring that the results of work funded by the Department are disseminated so that commercial development can take place;

— through encouragement of efficiency in the supply and use of energy in the UK;

— by maintaining, developing and implementing the appropriate framework of monitoring and control for publicly owned bodies in the energy field, and transferring them to private ownership if and when this is desirable;

— by ensuring a full and fair opportunity for the UK offshore supplies industry to compete effectively at home and abroad;

— by maintaining and developing an understanding of UK industries in the energy sector so that Government policies and actions may, so far as possible, take appropriate account of their circumstances and contribute to their efficient development;

— by maintaining and developing public understanding of the role of energy in the economy and the policies and activities of Government affecting the energy sector;

And, in pursuit of the above

— to manage the Department's resources efficiently, economically and effectively.