CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

E(80) 76

24 JULY 1980 COPY NO. 55

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

CEGB WINTER FUEL STOCKS

MEMORANDUM BY THE SECERTARY OF STATE FOR ENERGY

---

1. Colleagues need to be aware that, following a fall in electricity demand, there is a risk of a higher CEGB fuel stock holding at the end of the financial year than was envisaged when the EFL was set. We need to consider whether to allow stock building to continue, or whether some reduction should be made.

REDUCTION IN DEMAND: IMPLICATIONS FOR ELECTRICITY EFL

2. When the EFL was set last November, the industry's forecast demand for 1980/81 was 232 terawatt hours. This was revised downwards in February to 226 Twh. Sales so far this year, however, have been even lower than expected, and the outturn is currently estimated at 219 Twh (a further review is due in the autumn). With this lower demand, the CEGB need to take action now to reduce fuel deliveries if they are to be reasonably certain of ending the year with a stock holding consistent with the EFL.

CONFIDENTIAL

3. Though there are considerable uncertainties about the actual rundown of stock over the winter, they estimate that with sales of 219 Twh they could end the year with up to 4 mtce more stock than the EFL can accommodate - implying a breach of up to £200m. This would represent a substantial claim on the Central Contingency Reserve. Reductions in oil deliveries and coal imports would provide a saving to the public sector. However

i) though it is possible that oil deliveries could be reduced by up to 1 mtce by agreement with the oil companies, this could create difficulties with refinery throughput and be difficult to reverse if the oil after all were needed in an emergency.

ii) though there is a chance that, because of delays to coal shipping programmes, coal imports may fall about ½mt below the 5mt which are planned, direct action on imports is otherwise undesirable (see below).

Action to reduce NCB deliveries (or defer payments) would not benefit the PSBR, since the NCB could not accommodate within their own EFL the extra financial requirements which would fall upon them. It is also important to preserve the CEGB/NCB understanding at least until the miners' settlement at the end of the year. (The NUM are currently expected to go to ballot before Christmas).

IMPLICATIONS FOR NCB EFL

4. The NCB EFL for 1980/81 of £834m assumed that the CEGB would take 75 mt of NCB coal during the year. If deliveries to the CEGB are curtailed the NCB would need an additional £30-40m of finance for every 1 mt below this figure. The NCB's latest forecast is for a stock build of 5 mt envisaged when the EFL was fixed. NCB officials believe that the Board would still be able to achieve their EFL by offsetting action but it is clear that they could not also accommodate a reduction in sales to the CEGB below 75 mt.

THE CEGB/NCB UNDERSTANDING

5. This provides for the CEGB to use their best endeavours to take coal from NCB at the rate of 75 mt per annum provided the price does not rise in real terms. Its ending could have serious effects. It would remove a force which both NCB and CEGB believe has moderated NUM wage demands. The CEGB attach importance to it,and fully understand that any cut back in their NCB coal take at present would remove an important restriant, through its price condition, on the miners.

6. This argues stongly for deferring any decision to reduce CEGB coal take until we know what happens on miners' wages and the consequences for NCB prices. By that stage, however, we are likely to be past the point at which it will be reasonable to cut down NCB coal deliveries drastically without serious disruption to both NCB an BRB.

IMPORTS

7. We could ask the CEGB to reduce their programme of coal imports. I would not favour this course. First, in view of all the uncertainti I believe that it is prudent to maintain diverse sources of supply. Second, there would be a financial cost to the Board in foregoing supplies, which may be up to £10 cheaper than the delivered cost of NCB coal to coastal power stations. Third, a reduction in coal import in the run-up to the miners' wage settlement would give the wrong message both to them and to the NCB. We must recognise, however, that there could be political risks if we were to maintain imports at the current level at the same time as breaking the CEGB/NCB understan

SECURITY ASPECTS

8. If no action is taken to reduce stock build, electricity endurance immediately after the New Year could be about 7-8 weeks of average January-February consumption. Reduction of deliveries by 2 mtce between now and Christmas would reduce endurance by about a week at winter peak. Last winter we encouraged the industry to provide for six weeks endurance. The practical advantages of the extra room for manoeuvre given by an extra 1-2 weeks stocks are not very great, though the cost is considerable. Furthermore the use that could be made of higher fuel stocks would be limited by the availability of ancillary materials. These are held at a level of about 6 weeks' peak stock: new deliveries could be affected by disruption to fuel supplies. (Actual endurance in an emergency would of course depend on a number of factors, including the speed with which supplies were lost, and whether action was taken from the beginning to reduce electricity consumption eg through cuts. The availability of nuclear plant and of increased oil supplies would also be important).

OTHER ECONOMIES

9. I do not believe that there is scope for the industry to offset the risk to the EFL of ending the year with excessive stocks, by taking action in other directions. The industry have made considerable economies and apart from the stock difficulty, will already be hard pressed to meet their EFL (see Annex). Any further price increase this year beyond the 10% in August we have already agreed would be unthinkable.

OPTIONS

10 There are three broad options:

i) to take no action to remedy the position.
This could result in an end year stockholding of up to 4mtce above that forecast for EFL purposes. A breach of the electricity EFL (of up to £200m) would be almost inevitable. Winter peak endurance could be as much as 7-8 weeks.

ii) to take immediate action to reduce stock-building.
The CEGB estimate that to establish a very high probability of achieving an end-year stocklevel commensurate with their EFL they need to commence action now to reduce deliveries by 4mtce. (Their preferred course would be to reduce oil take by 1 mtce and NCB coal take by 3 mt). Because it would create unacceptable disruption to NCB and BRB programmes, a reduction of this magnitude could not in the CEGB's view be achieved between January-March 1981. Their best estimate of the reduction which could be secured in that period is 1 mtce of oil and 1 mt of NCB coal. (They would not propose to reduce their take of imported or non-vested coal, which are both cheaper than NCB coal).

Under this option, their estimate of winter peak endurance would still be about 6 weeks. However, because the proposed reduction in coal take of 3 mt could not be accommodated within the NCB's EFL there would be no net benefit to the PSBR, and the CEGB/NCB understanding would be likely to terminate. This course could possibly in certain circumstances result in the lowest end-year coal stocks since the last strike.

iii) <u>to defer action until the outcome of the miners' settlement is known</u>

On the assumption that the NCB coal price rises in real terms from January, CEGB coal take would, as outlined above, be reduced in the New Year by about 1 mt, and oil take by 1 mtce. Endurance would remain at 7 weeks, or a little more. The industry could overshoot its EFL by up to £100m.

11 The CEGB are currently under great pressure, not only because of the discipline of the EFL, but because of falling sales. They are conducting an active campaign to reduce costs. They have indicated that left to themselves they would begin to take action to reduce fuel deliveries, and that they would be especially prompt to do so if they thought that failure to meet the EFL because of high end-year stocks would be regarded by us as a sign of inefficiency.

RECOMMENDATION

12 It is notoriously difficult to forecast end year stock levels. The margin of error is wide and the CEGB are right, from the point of view of keeping within the EFL, to propose early action to reduce deliveries. This course would however carry significant risks. Reduction in oil deliveries would have a disruptive effect on refinery runs, and be difficult to reverse if a crisis arose: heavy fuel oil is no longer readily available from existing sources at short notice as a substitute for coal. A reduction in coal imports would have the wrong psychological effect. Any cut back on NCB coal would undermine the joint understanding which is an important force for moderation. I believe that the right course is to postpone action to cut back deliveries until the out-come of the miners' settlement is known. If the effect of the settlement is to push the NCB's prices to the CEGB beyond general inflation, a reduction in the CEGB's take of NCB coal would be psychologically right, though we should need to consider the precise circumstances at the time. In adopting this course however we should be in no doubt that the EFL could be breached by £100m or more. (There are many uncertainties surrounding the figures and further reduction in demand could bring further problems).

13 I invite colleagues to agree that I should tell the CEGB

i) not to reduce fuel deliveries to power stations pending a further consideration of the situation at the end of 1980.

ii) that they will not be penalised for any consequent breach of the EFL; that we have indicated that EFL cannot be immutable in all circumstances; and that here too we will review the position at the end of 1980.

iii) in no circumstances should they allow winter peak endurance to drop below 6 weeks.

Department of Energy
24th July 1980

D A R H

ANNEX

ELECTRICITY (ENGLAND AND WALES) EFL 1980/81

1 The EFL for the electricity supply industry in England and Wales was set at £187m in November 1979. It was reaffirmed by E Committee in April 1980 (E(80) 14th meeting), following consideration of a number of adverse changes in underlying assumptions since the previous November. The Electricity Council had advised that, even after making substantial economies and with a 10% tariff increase in August rather than the previously intended 5% increase in October, they would need to make further economies of about £90m in order to meet their EFL. This they are committed to doing.

2 Boards are putting considerable efforts into achieving savings on revenue account eg by staff economies. They took exceptional measures (especially tightening of credit) to improve working capital at the end of last year. Similar pressure is being maintained this year. CEGB forecast capital expenditure has been reduced by £87m (over 10% of their programme) in two stages; £45m when the EFL was fixed in November, and a further £42m in the spring as part of the reappraisal and reaffirmation of the EFL. There is no obvious scope for further cuts.

3 Given the recent fall in sales, the outlook for the industry's EFL remains uncertain. As always, fuel stock movements will be critical.