PO-CH/NL/0247
PART A

Pax. A.

SECRET

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APPOINTMENTS COMMERCIAL - IN - CONFIDENCE.

Begins: 13/2/87.
Ends: 29/9/88.

PO -CH /NL/0247
PART A

PO -CH /NL/0247
PART A

Chancellor's (Lawson) Papers:

BRITISH STEEL
CORPORATION
PRIVATISATION

Disposal Directions: 25 Years

26/9/95.

1. Debbie - to note
2. b/f 1/6

CH/EXCHEQUER
REC. 13 FEB 1987 13/2
ACTION FST
COPIES TO

CONFIDENTIAL

(I wd like an internal HMT review of the BSC position immediately after the GE.)

PRIME MINISTER

13/2/87.

BRITISH STEEL CORPORATION : PRIVATISATION

I am writing to let you know the way things are developing on the preparations for privatisation of BSC, about which you have asked for a report by the end of April.

2 BSC have appointed Barclays de Zoete Wedd as their advisers on privatisation, and we have appointed Samuel Montagu to advise the Government. Although both merchant banks are at a very early stage of their work, it is clear that the difficult issue of the future of the Ravenscraig steelworks will need to be addressed in any realistic assessment of BSC's privatisation prospects.

SG/DT. TO PM 13 FEB

3 I have made it clear to the BSC Chairman, Bob Scholey, and to the members of the BSC Board, that there can be no question of reopening the Government's decision, announced in August 1985, that the future of steelmaking at all five integrated steelworks was guaranteed for at least three years, i.e until August 1988. I have also indicated that the Government will not wish to take any decisions about the future of Ravenscraig before the Election.

4 BSC expect to make profits of at least £160m in their current financial year, ending March 1987. This is a tremendous achievement but will not be enough for privatisation. Substantial further improvements will need to be secured. BSC will need to discuss with the merchant bank advisers the ways in which further improvements can be

JF5BRN

CONFIDENTIAL

achieved. The options examined are bound to include some major closures, including that of Ravenscraig. But we intend to ensure that no recommendation from either merchant bank about the future profitability of BSC makes specific reference to the future of Ravenscraig.

5 BSC are disappointed that the Government are not prepared to reopen the Ravenscraig issue in present circumstances: they had hoped to offer the closure of hot strip mill capacity equivalent to that at Ravenscraig under the current exercise being undertaken by the major European Steelmakers Federation, Eurofer, to identify further capacity closures in Europe. BSC's enthusiasm for the Eurofer initiative stems from their fear of a further price war in Europe because of continuing over-capacity, and the damage this would do to their prospects of privatisation, which they strongly advocate. Nevertheless, at my request, BSC have dropped the idea of offering hot strip capacity in the Eurofer initiative. The five-site commitment will inevitably affect the timing of privatisation.

6 For the moment I am copying this minute only to the Chancellor of the Exchequer and the Chancellor of the Duchy of Lancaster.

PC

PAUL CHANNON
13 February 1987

DEPARTMENT OF TRADE AND INDUSTRY

PRIME MINISTER

JF5BRN

3683/2/020

SECRET

FROM: D J L MOORE
DATE: 13 MARCH 1987

08

FINANCIAL SECRETARY

cc: PS/Chancellor
PS/Chief Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Monck
Mr Scholar
Mrs M E Brown
Mr Colman
Mr McIntyre

BSC PRIVATISATION

Mr Heywood's minute of 12 March below on Water records your comment that perhaps you ought to press Department of Trade & Industry to get on with Steel.

2. I do not think there is anything to be gained from doing so just now. Barclays de Zoete Wedd are making their first report on the options to BSC later this month and this will be discussed by the Board on the evening of 31 March and on 1 April. Samuel Montagu are reporting to DTI in time for a discussion with them and us on 31 March. Until these reports have been discussed we cannot start to firm up our ideas on timing etc. In the meantime the assumption is not before 1989.

3. As we have advised before there could, however, be advantage in having the Steel Bill by the end of the first post-Election Session rather than in the second. This could be sensible anyway if 1989 turns out to be a real prospect. And the case will be reinforced if there is a risk of bids for Water <u>and</u> Electricity Bills in the Second Session. Even though Steel should be relatively short and simple, it would obviously be useful to have it out of the way.

D J L MOORE

3685/004

SECRET

NL. Whatever happens, a privatised BSC will want to close R'craig, & the price will reflect that. Anyway a closure in 1988/89 would be better than now, or drag on.

FROM: D J L MOORE
DATE: 23 MARCH 1987

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Monck
Mr Colman
Mrs M E Brown

BSC AND POST OFFICE

I understand that Mr Channon may speak to you tomorrow about the possibilities for privatising BSC and the Post Office.

<u>**BSC and Ravenscraig**</u>

2. Barclays de Zoet Wedd are reporting to BSC, and Samuel Montagu to DTI, at the end of this month on their preliminary ideas for privatising BSC. Both have been instructed not to refer to the possibility of closing Ravenscraig; this is to guard against pre-Election leaks.

3. However, I know that BZW think it might be possible to privatise BSC in 1989 (perhaps 51% then) but that proceeds will depend crucially on whether a decision has been announced beforehand to close Ravenscraig with savings of £100 million per annum. On their very rough and provisional figures which may well change, and which must not be quoted against them, the difference could be £1.3 billion against nearly £2 billion.

4. The present pledge given by Mr Tebbit in August 1985 is that "barring unforeseen changes in underlying market conditions, steelmaking will continue at all 5 of BSC's main integrated sites for at least the next 3 years" i.e. Ravenscraig carries on until at least August 1988.

5. If there is to be a successful privatisation in 1989 or thereabouts, the main points for the moment are:

(i) nothing should be said before the Election to extend the present pledge on capacity;

(ii) as soon as possible after the Election, action should be taken to clarify BSC's capacity plans with whatever that implies for Ravenscraig.

Quite apart from the potentially large difference to proceeds, I do not see how it would be possible to make progress on privatisation, and in due course write a prospectus, without facing up to the capacity question.

Post Office

6. Mr Channon plans to go ahead with the sale of Giro soon after the Election, though it is crucial that this is kept quiet. It could be sold either to an existing bank or building society or to a company wishing to move into the banking sector.

7. The real question is whether to plan to privatise the rest of the Post Office. As I have reported before, Ron Dearing assumes this is what the Government wants and, if he goes in October, his potential successors will presumably want it clarified.

8. The broad options for the next Parliament are either:

(i) to plan for a privatised Post Office with a regulator concerned with letter mail, or

(ii) to shake up the Counter services (switching much more from Crown to sub-offices and extending the range of goods and services which can be offered).

9. From the point of view of planning the programme we could have enough for the moment - in terms of pressure on the legislative programme and on the subsequent sales programme - with Water, Electricity, BSC and Coal as soon as practicable. For that reason you may not want to press for early moves on the Post Office. But the Government will have to make clear what its intentions are by no later than the Giro sale when the unions will be jumping up and down.

10. It would be useful to know what Mr Channon thinks about the scope for privatisation; about Dearing's successor; and about revamping the Counter services.

DJM.

D J L MOORE

3956/4.ms

Pps NL

CONFIDENTIAL

FROM: J G COLMAN
12 June 1987

1. MR D J L MOORE Note at end
JGM 12/6

2. CHANCELLOR

Ch/ I agree with Mr Moore's comments. The problem is Ravenscraig. The best bet, even tho' it would depress the proceeds, would be for BSC to prune X (para 18) as a matter of urgency. When [illegible] have [illegible] to [illegible] I would like [illegible] a [illegible] way on this.

Financial Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Monck
Mrs M E Brown
Mr Lyne
Mr Hood

COLMAN TO CH/X 12 JUNE

<u>BSC : Privatisation</u>

You asked for an internal Treasury review of the position as regards the privatisation of BSC.

2. The public position which the Government has taken is that privatisation of BSC is being studied. The appointment in February of Samuel Montagu to give preliminary advice to HMG was announced, as was BSC's appointment of BZW for a like purpose. Both banks have presented reports. Ministers have not given a clear public statement of the priority attached to this privatisation, or its likely timing.

3. We assume that it will now be the Government's intention to proceed with BSC's privatisation as soon as possible on the grounds that there is no reason why BSC's activities should continue to be carried out in the public sector. We assume also that it will be the intention to privatise the whole of BSC (though not ruling out a sale of less than 100% of the equity), so that HMG would not be left with an unsaleable rump.

<u>Whole or parts?</u>

4. It is generally simpler to privatise nationalised industries as single entities: the existing top management are much more co-operative; only one sale has to be arranged rather than several; and sale as a whole is frequently better for proceeds. BSC was originally formed from a large number of separate companies, however, and its various businesses are capable of being split up in several ways. We have to consider whether there would be any gains to competition in the steel industry if BSC were sold in parts.

5. In the UK, BSC is of course the dominant producer. BSC's management have sought to increase BSC's power in the market by taking or maintaining an interest in a variety of joint ventures (notably the Phoenix schemes), and in overseas stockholding companies. They have also tried to take over some UK stockholders but DTI Ministers have refused to allow this.

6. Both BZW and Samuel Montagu point out, however, that the steel market is an international one. BSC's competitors are the large integrated steel businesses of the other EC member states, Japan and the USA. The prospects for the steel market are thought to be flat demand and overcapacity. In the view of both banks, it would be undesirable to split up BSC, as it would weaken the ability of the UK industry to compete worldwide. We agree.

7. In the light of this conclusion two issues arise:

a. should BSC be permitted to invest in UK stockholders?

It is arguable that BSC's profitability would be improved if they were permitted, like their competitors, to acquire stockholding businesses in their home market. DTI Ministers have hitherto resisted this on the grounds that whilst BSC is in the public sector such action would be criticised by the private sector stockholders. Samuel Montagu recommended that the policy here should be reviewed. DTI have that in hand;

b. should the planned sale of Allied Steel and Wire go ahead?

This sale is in accordance with the policy of disposing of BSC's peripheral activities which pre-dated the decision to consider privatisation of BSC as a whole. ASW is a joint venture with GKN. Until this week, it had been expected that a management buyout would be concluded shortly, but it now appears that GKN are not willing to sell at below net asset value to the management. If it remains Government policy for a sale of ASW to proceed, that seems more likely to be delayed and to take the form of a flotation. Here too, there may be a case for a change of policy, if the main aim is to secure a successful privatisation of BSC as a whole. BSC say that if they were left to themselves they would not dispose of their share in ASW, and BZW said that that would be their advice to BSC. Given that the disposal of ASW is not now imminent there is an opportunity to consider the issues again. If ASW is not sold, of course, BSC lose the sale proceeds in the short term which has public expenditure implications. There will also now be an opportunity to consider whether BSC might acquire GKN's share of ASW as a prelude to BSC's privatisation.

Methods of sale

8. It is not necessary to choose which method of sale to adopt until much nearer the time of sale, but it is worth giving thought to HMG's likely preferences. Samuel Montagu give three reasons for choosing a public offer for sale:

a. it is HMG's customary route for privatising largescale nationalised industries;
b. it would involve least change for BSC;
c. BSC's management would prefer it.

9. BZW argue that a public offer is likely to be the only feasible way of privatising BSC, there being few, if any, potential UK corporate purchasers, and BSC being too big for a management buyout. They assume, as do we, that HMG would not favour sale to non-UK corporate purchasers.

10. If, despite BZW's views, there did turn out to be acceptable potential corporate purchasers of BSC, it may be that a sale to such a purchaser could be feasible at a lower level of profitability than would be credible in a public offer for sale. If at the time of the sale there are any companies wishing to

diversify into steel, they may be prepared to do so making their own assumptions about profits growth of BSC's business under new management. It follows that a corporate sale might be feasible earlier than a flotation would be or without such largescale closures (especially of Ravenscraig) - see paragraph 16.

11. We assume that Ministers would prefer the public offer for sale route, if that is feasible, but that we should continue to bear in mind the various options for a corporate sale, unpromising as they may seem to be.

Pre-conditions for a successful sale

12. Both banks were asked if they saw any essential pre-conditions to any privatisation of BSC. Although they were expressed in different language, the pre-conditions were the same in substance, as follows:

a. stable political context providing some assurance that BSC would be unlikely to be renationalised;

b. reasonable freedom for BSC's management to manage: it would be accepted by investors that BSC will continue to be subject to some Government control, eg to ensure adherence to EC steel regimes. Investors are now familiar with regulatory regimes for other privatised companies (although it is not suggested that such a regime would be appropriate for BSC). But continued Government control over eg plant closures would not be understood by investors;

c. financial viability, especially in the face of potential threats from

i. instability in the steel market following the ending of the present EC quota regime;

ii. unfair trading by state-aided steel companies overseas;

iii. currency fluctuations.

Financial viability

13. Although BSC is currently trading profitably, both banks and BSC itself consider that profits would need to be increased substantially for a flotation to be feasible. I attach a chart which shows BSC's profit record, and their projections for the next 4 years. There is considerable room for debate as to what degree of increase in profits would be required (BZW and Samuel Montagu disagree), but the basic argument is that BSC will need to generate enough cash to finance capital investment and increases in working capital (as now) and, in addition, to pay a dividend, and that BSC's ability to borrow for these purposes is likely to be tightly constrained. Depending on assumptions about the size of BSC's dividend and dividend cover, it is possible to calculate the increase in profits which would be required. Samuel Montagu put the bare minimum profits for BSC to meet this requirement as £300m a year (compared with around £240m in BSC's middle case projection), and go on to say that investors will actually require more than this, on a rising trend, for a flotation to be feasible.

14. Samuel Montagu's arguments, on the face of it, leave open the possibility of floating BSC on a very modest dividend (but for the dividend payment, BSC is expected to be self-financing over the period covered by the projections). We have discussed with Samuel Montagu whether it would therefore be possible to sell BSC at some price even if no action is taken to increase BSC's profits any further. Their view is that a flotation would be ruled out because the existing level of BSC's earnings implies in the eyes of the new issues market a certain minimum price: if the prospective p/e ratio is too low, Samuel Montagu believe that institutional investors will regard the offer with suspicion. Samuel Montagu's calculation of required profits depends on the assumption that BSC would be sold on a p/e ratio of no less than 5, which would imply proceeds of £1.5 billion or so.

15. Both banks agree that BSC will need a substantial capital reconstruction before sale, mainly to write off past losses, and that BSC should also receive a substantial capital injection at the time of the sale to provide a safeguard for BSC against a downturn in its profits. In our view it is very likely that BSC will need this, but the financial arguments will, as usual, need to be looked at very closely nearer the time of the sale.

Closing Ravenscraig

16. But for the Government's pledge safeguarding Ravenscraig until 1988, it is very likely that BSC would by now have put forward proposals for its closure. Although no such proposals have been made, BSC have produced costings of one option involving the complete closure of Ravenscraig, and the replacement of the plate mill at Scunthorpe. BSC reckon that closure would increase profits by over £100m in a year, and the new plate mill would add another £40m, at a cost of £230m.

17. Ravenscraig employs some 3200 workers, and is currently operating at quite a high capacity utilization. BSC consider however that overall they have so much spare capacity that one integrated works should be closed. Ravenscraig would be their candidate for several reasons, including its location, and the obsolescence of its equipment.

X 18. There certainly are variants of the option BSC have costed which do not involve total closure of Ravenscraig. For example, the new plate mill might be located there (or near there). These variants have not yet been fully costed.

Timing

19. If it is accepted that the closure of Ravenscraig must be firmly in hand before BSC can be privatised, the sale cannot take place before mid-1988 when the existing pledge on Ravenscraig's future lapses. After that, there may be a case for waiting long enough for BSC's consequential increased profits to show through. BZW think that a sale in mid-1989 would then

be feasible (subject, of course, to the state of the equity market, as well as that of the European steel market). Samuel Montagu would go for no earlier than 1989-90, on the grounds that investors will want to see the actual results of closing Ravenscraig.

20. It does however appear that the closure of Ravenscraig would increase profits by more than the minimum amount which the banks suggest. It may be, then, that BSC can find a cost-reduction programme which would both be sufficient to secure privatisation and avoid closure of Ravenscraig. DTI officials think that over the next 6-9 months detailed work with BSC will be needed to establish the full range of options for cost-reduction. We agree.

Conclusions

21. The next step will be for Ministers collectively to agree on the handling of the Samuel Montagu report. This will imply an early start on

a. confirming the intention to privatise BSC as early as possible;

b. bidding by DTI for an early place in the legislative programme for the (relatively short) Bill which is almost certain to be required whatever the form of BSC's privatisation;

c. study of options for cost-reduction (paragraph 20). This will involve BSC, DTI and ourselves;

and, in due course,

d. decisions on the form of BSC's privatisation;

e. the appointment of advisers to handle the sale itself.

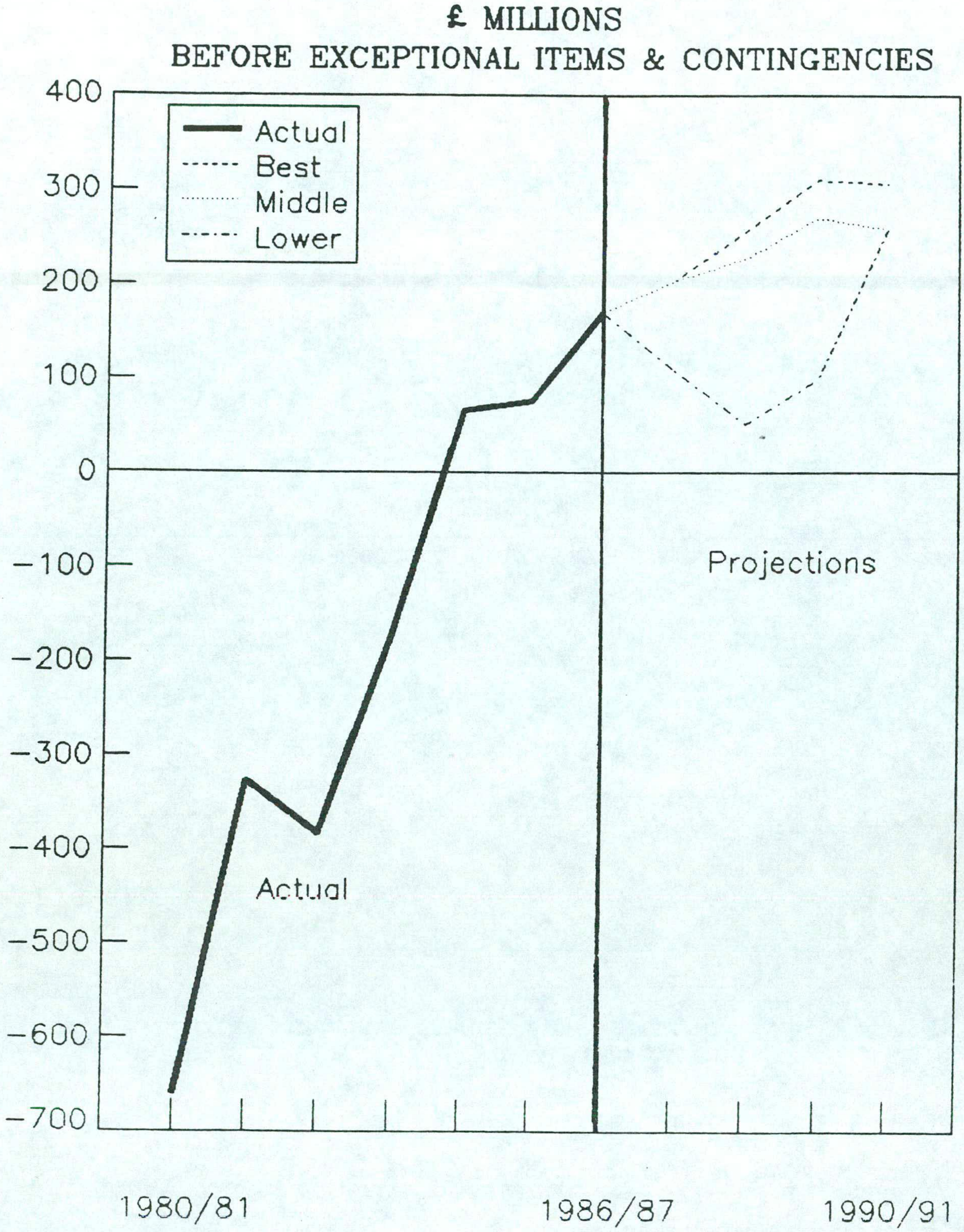
Samuel Montagu would clearly be at an advantage in the competition for this, but there is no obligation to appoint them.

J.G.C.

Enc

J G COLMAN

CORPORATE PROFIT AND LOSS



Note: Actual results for the total Corporation are as published in the Annual Accounts. The result for 1984/85 excludes the estimated effect of the NUM strike at £180m.

A year or so ago the Board could not take seriously the thought of privatisation of BSC in the 1980's. But there has been a remarkable turnround in their approach as their self confidence has grown with the return to profitability for the first time since 1974-75. They are now fully committed to privatisation, provided that it is of the corporation as a whole (and since they are already in a very competitive market I see no objection to that). They want to be in the private sector, free from ministerial control but they fear that the Government may be reluctant to let them go ahead with the major cost reductions, through closures as well as manpower cuts, that they see as essential prior to privatisation, and indeed if they were to remain in the public sector and operate efficiently. In particular they worry that the Government will not let them act on Ravenscraig or, if that were so, on other painful options which they might have to bring forward.

If the objective is the efficient and early privatisation of the corporation, the previous policy of selling bits and pieces becomes much less important and could be damaging to the main objective. I agree with the points in Mr Colman's paragraph 7 that we should be ready to look again at the proposed sale of ASW and to consider the case for letting BSC invest in UK stockholders.

If their markets hold up, I hope that BSC can be sold by 1989. Anything later could mean that their sale was competing for scarce slots with the series of water and electricity sales.

DJLM

D J L M

SECRET

CH/EXCHEQUER
REC. 24 JUL 1987
ACTION Mr DJL Moore
COPIES TO FST
Sir P Middleton
~~Mr Monck~~
Mr Colman

PSU [?] fix 5 min mtg with Mr Moore

CST, surely, SW also see this.

TO:
PRIME MINISTER

FROM:
KENNETH CLARKE

24 July 1987

BRITISH STEEL CORPORATION : STRATEGIC ISSUES AND PRIVATISATION

I promised to let you have some further thoughts about how we might handle the consequences of restructuring BSC in Scotland, should that be the preferred option arising from Bob Scholey's current review.

2 Understandably, some will represent any substantial reduction in steelmaking at Ravenscraig as a major blow to Scottish industry. In fact it will provide an opportunity to look to future economic growth rather than rely on the declining industrial structure of the past. A rationalisation in steel capacity would increase the net worth of BSC; as we suggested at our previous meeting, part of the increased proceeds from privatisation could be used to offset the cost of stimulating and supporting the necessary change.

3 However the advantages of such an approach would be lost if we do not take the initiative well before any closure is formally announced, let alone implemented. This means committing substantial funds - perhaps up to £50 million per annum - in advance of receiving any proceeds from the sale. I attach a very brief outline of a possible proposal. It is only a first stab at what we might do and obviously needs

KC1ABE

working-up further. As soon as possible we would want to sit down with one or two substantial Scottish industrial figures to produce a well-judged plan and decide exactly how we are going to attract significant new business activity to the area. We will need to consider possible names of a handful of very prominent industrialists who might be involved. We need to be able to call on substantial private sector resources and commercial expertise to have any prospect of success.

4 I do not think that it is possible to go much further with the detail without bringing Malcolm Rifkind into the discussions. He may well be concerned that even to discuss an enterprise initiative in Scotland may be to concede effectively that plants will close. I think it will be important to convince him that our discussions on BSC strategy must be based on a commercial evaluation of the various options open to BSC and that the initiative outlined above represents a real opportunity for Scotland. He will be well placed to suggest individuals who might be sympathetic to this approach. If we wait until the results of the Scholey review are complete, it may well be too late to put the necessary preparation in hand. On the other hand to approach people too much in advance runs the risk of premature disclosure. You will wish to consider how to take the matter further. I should of course be pleased to attend a further short meeting if you would find this helpful.

5 I am copying this minute to Nigel Lawson and David Young.

L

K C

KC1ABE

DEPARTMENT OF TRADE AND INDUSTRY

THE SCOTTISH ENTERPRISE COMPANY

Form

1. An Enterprise Company - limited by guarantee - would operate for a set period (say 7-10 years) in the West Central belt of Scotland. It would be headed by a private sector (Scottish) Executive Chairman and would have relatively few staff, instead making extensive use of existing agencies and private sector skills. The Company would channel significant private and public funds, including any relevant EC assistance, and - without duplicating mechanisms already in place (e.g. the SDA, BSC (Industry), Enterprise agencies) - provide a focal point for activities to alleviate the problems arising from the closure of Ravenscraig.

Tasks

2. Its main aim would be to bring together all the activities which could generate new business in the area, and assist existing businesses to expand. As a priority, the company would, therefore, seek to secure the involvement of the private sector in the economic development of the area.

3. Its first task would be to assess the characteristics of the workforce (e.g. age, skills, sex, etc), since these clearly influence the type and scale of programme to be provided. This process would include an assessment not just of those directly employed at Ravenscraig, but also of those affected indirectly by the closure.

4. The Company would provide support to BSC and other affected businesses in counselling individuals made redundant (perhaps using a private agency such as FOCUS). It would then offer a variety of forms of assistance to act as a catalyst in the revitalization of the area:-

(i) **Training**

The Company would promote training in relevant skills - preferably working with potential employers - by linking MSC funded training to specific vacancies;

(ii) **Encouraging self-employment**

The Company would aim to maximize the contribution to promoting self-employment made by the Government's Enterprise Allowance Scheme;

(iii) Advice to new businesses

The Company would provide advice to new small businesses, for example by working through local Enterprise Agencies and Business Innovation centres;

(iv) Finance for small companies

The Company would encourage the provision of finance through loan and equity to small businesses, through the development of new local equity funds, and through 'marriage bureaux' (perhaps of the type set up by LENTA) which would link potential investors to people wishing to set up new projects;

(v) Developing new business ideas

The Company could seek to facilitate the generation of ideas for new business by capitalizing on innovations developed by larger companies which do not themselves wish to exploit them;

(vi) Encouraging Inward Investment

The Company would seek to promote inward investment, perhaps through the designation of an Enterprise Zone, and by drawing upon existing SDA powers;

(vii) **Encouraging industry/education links**

As a longer term strategy to inculcate more enterprising attitudes, the Company would seek to forge closer links between the worlds of education and industry.

(viii) **Encouraging small workshop developments**

The Company would oversee, in conjunction with the SDA, the building and management functions of small workshop developments.

(ix) **Providing work experience**

The Company could help to cushion the impact of unemployment for those who did not immediately find new jobs by providing work experience on the Community Programme.

FROM: N MONCK

DATE: 27 July 1987

CHANCELLOR OF THE EXCHEQUER

cc Financial Secretary
Sir P Middleton
Mr Burgner
Mr Hood

BRITISH STEEL CORPORATION : STRATEGIC ISSUES AND PRIVATISATION

Mr Clarke's minute of 24 July.

Telling Mr Rifkind

2. Mr Clarke is likely to propose that Mr Rifkind should be brought into the discussions. But DTI fear that the Scottish departments will leak, unless knowledge is confined to two or three named officials. It seems sensible to tell Mr Rifkind on this basis. But whether it is sensible to tell him now or wait till early September depends on whether officials can do useful work on the options for an initiative in the Ravenscraig area between now and then. It would probably be quicker and more secure to start that work in September when officials are mostly back from leave and do not need to hand over to substitutes etc.

3. There is time for that because BSC are unlikely to produce their "rough cut" report on the options before the end of September. When Ministers have reacted to it, BSC will do further more detailed work in the period from November to the end of January.

Mr Clarke's bid for an initiative costing up to £50m a year

4. Around 5,000 jobs are at risk (see annex). But £50 million a year looks high even if it is meant to include the hoped for private money as well as switching from existing programmes, notably DE's. British Shipbuilders' Enterprise arm has so far spent less than half its £5 million budget in dealing with 3,500 redundancies.

5. **You should resist** any such figure being mentioned to Mr Rifkind or indeed being given any status by this meeting. A decision on whether any new public expenditure should be provided and, if so, how much cannot sensibly be taken until at least a provisional decision on Ravenscraig has been taken (and I understand DTI Ministers are keeping their options open on that). But meanwhile official work on the options can be done by a cut-down version of the Official Group on Measures to Relieve the Effect of Major Redundancies. DE chairs this. The Scots, DTI and the Treasury

(IAE) would need to take part. Other members could be left out at least initially (Defence, Environment, Transport, Agriculture and Wales). The work should be ready at the same time as the BSC "rough cut" report. It should set out a range of options, distinguishing between switching existing provision and new funds; and considering the role of different agencies including the SDA and BSC (Industry) which already exists, as well as proposing private sector names. The right time to initiate this work is probably the beginning of September.

N MONCK

195/019

ANNEX

	Present employment
Ravenscraig (of which Strip mill only 6-800)	3,100
Clydesdale Tube mill	1,400
Dalzell Place mill	750
Total	around 5,000*

* excluding knock on effect on supplies. This should be much less than the conventional 1 for 1 assumed for cars or ships which have a large element of assembly operations.

Unemployment (not seasonally adjusted)

	May 1986	**May 1987**
Strathclyde	18.5	18.2
Lanarkshire	20.9	19.6

FINANCIAL SECRETARY TO THE TREASURY

8

FROM: J J HEYWOOD
DATE: 27 July 1987

PS/CHANCELLOR

cc Sir P Middleton
Mr Monck
Mr Moore
Mr Colman o/r

BRITISH STEEL CORPORATION : STRATEGIC ISSUES AND PRIVATISATION

1. The Financial Secretary has seen Mr Clarke's minute to the Prime Minister. He has commented:

> "I am not sure that the Scots would not prefer the Scottish Development Agency to do this. Why have yet another body?"

9.12

JEREMY HEYWOOD
Private Secretary

A good point. Let's discuss this. But I have felt a [illegible] need [illegible] as a special measure — & a [illegible] technically [illegible] BSC [illegible]

[illegible]

SECRET

CH/EXCHEQUER
REC. 05 OCT 1987 ✓5/10
ACTION MR MOORE
COPIES TO FST
SIR P MIDDLETON
MR MONCK
MR COLMAN
(NO FURTHER COPIES TO BE TAKEN)

I strongly [illegible] support privatisation

To:

PRIME MINISTER

Ch.
To see. You are to have a bilateral on steel with Mr Clarke after the Party Conference.
5/10

From:

KENNETH CLARKE

2 October 1997

CLARKE TO PM 2/10

BRITISH STEEL CORPORATION

1 I reported to you on 6 July that I had asked Bob Scholey to put in hand a study of a wide range of strategic options for the period following August 1988 when our guarantee on BSC's present plant configuration expires. The background to this was the advice which we had received from the banks that further plant rationalisation looked essential if BSC was to reach the level of profitability which would be required for privatisation - (£300 million plus). BSC have now provided a preliminary assessment of their strategic options. I have been discussing this with Bob Scholey and I met him again earlier today to hear his Board's view of the way they wish to proceed.

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2 I have set out in an annex the background to BSC's present assessment. In certain key respects, the position has changed markedly since we discussed this issue in June. In particular the Corporation's financial performance has continued to improve dramatically. Their half year results will be announced in November or early December and could reach £190m with full year profits of about £350m. They are increasingly confident of operating at this level into the future. Both sets of Bank advisers accept that these levels of profits look sufficient for privatisation and that a major plant closure is no longer a necessary precondition. Indeed BSC now say that, because of the strong demand which lies behind their improved profitability, they need Ravenscraig's continuously-cast steel making capacity for at least four years and possibly as many as ten. This does not, however, apply to the Hot Strip Mill at Ravenscraig which is now surplus to requirements.

3 Against this background the Corporation are now considering an approach along the following lines:

(i) the announcement of the early closure of the Ravenscraig strip mill(certainly within 3 years) with the loss of some 400 jobs;

(ii) a public commitment - and possibly some investment - by BSC (not the Government) to the continued operation of Ravenscraig iron and steel production for at least four years, with the possibility of an extension, depending on developing market demand;

(iii) early privatisation. BSC strongly favour flotation in November/December 1988 rather than summer 1989 for which we were formerly planning;

(iv) a programme of job creation in the Ravenscraig area, possibly with help from Government with funding;

(v) the deferral until after privatisation of a decision on a new plate mill (which I touched on in my minute of 6 July). The plate mill at Dalzell (near Ravenscraig) would continue in operation for some years and a public commitment could be given to this;

(vi) further consideration of the seamless tubes business, (this will deal with their Clydesdale mill in Scotland).

Assessment

4 BSC's improved profitability is very good news, and I believe that this makes it possible for us to plan for privatisation with increased confidence.

5 The principal attraction of BSC's proposal is, of course, that it offers a way forward to privatisation without the total closure of Ravenscraig in advance. Moreover, by basing the case for keeping Ravenscraig open on commercial grounds, rather than as a result of a Government political commitment, it demonstrates that the strategy of the Corporation is being driven by the needs of the industry rather than our wish to privatise - which itself makes privatisation easier. Moreover, being able to close the strip mill would strengthen my hand in negotiating a satisfactory settlement of the European steel policy in December.

6 There are clear risks and difficulties;

(i) BSC's announcement of the strip mill closure and the refusal to give any further guarantee to Ravenscraig's continued existence beyond the four or five year period would confirm Scottish opinion that the plant as a whole was doomed. This makes major political controversy inevitable.

(ii) Privatisation at any date before the summer of 1989 would require the necessary legislation to be enacted before the end of 1987/88 session. My officials are working on a contingency basis to meet that deadline.

(iii) BSC's profits are greatly improved but would still be threatened by a disorderly market. A satisfactory outcome to the European discussions is therefore important for what is now proposed.

I agree

7 In my opinion, at this stage, the possibility of early privatisation is looking increasingly attractive. I have asked my officials to ensure that the Corporation's proposals should be worked up and taken further as quickly as possible. They could provide the basis for an appealing political and financial package.

8 I am copying this minute and annex to Nigel Lawson and David Young. I would welcome a further discussion later this month to allow me to give Bob Scholey fuller reaction to the Board's thinking before November. I am anxious to bring Malcolm Rifkind into our discussions at the earliest possible moment.

Peter Smith

pp KENNETH CLARKE

(Approved by the Chancellor and signed in his absence)

ANNEX

THE OPTIONS EXERCISE

1 Since the Spring BSC have been examining a range of options for the future strategy of the Corporation. This examination has been partly driven by the need to begin work on an agreed strategy to replace the existing one which runs out in August 1988. But it has also been driven by the Corporation's need to achieve viability, that is to generate sufficient profits first, to meet its capital investment and working capital requirements, second, to enable it to pay a dividend to investors and third, to enable BSC to build up a reserve. It has been made clear to the Corporation that their consideration of possible options should be conducted on solely commercial grounds, with the aim of achieving viability as soon as possible. Viability would, of course, be a necessary pre-condition for privatisation.

Position in March/April

2 Although no exact figure can be placed on what level of profits would constitute viability, both the Department's merchant bankers (Samuel Montagu) and those of BSC (Barclays de Zoete Wedd) suggested profits of at least £300m would be needed. BSC's financial projections, however, (completed in March this year) suggested that such profits could only be achieved by

1990/91 and then only on a 'best case' set of assumptions. Both banks, therefore, recommended that a significant change in plant configuration would be needed to achieve viability.

Rough-cut Option Exercise

3 BSC accordingly considered various options for changes in plant configuration which would generate the improved profitability required for full viability - and ultimately, privatisation. The key issues which have been addressed are the heavy overcapacity in hot strip mills; their relatively outdated plate mills; and, in the slightly longer term, overcapacity in liquid steel manufacturing, which would result from a reduction in strip output.

4 In hot-strip, BSC currently have hot strip mills on four of their five integrated sites, namely Ravenscraig, Llanwern, Port Talbot and Lackenby (Teesside). Their current utilisation is running at only about 69% of the capacity of these plants and this is not expected to increase significantly. Closure of the larger strip mills at Llanwern or Port Talbot would remove too much capacity, so the effective options to reduce capacity are either Ravenscraig or Lackenby.

5 For plate, BSC are faced with the problem that their two existing plate mills (Scunthorpe and Dalzell, part of the Ravenscraig complex) are ageing and uncompetitive. A new plate mill is needed ultimately to replace both existing mills. Options for location are Teesside, Scunthorpe and Ravenscraig/Dalzell.

6 If BSC reduce hot strip mill capacity, they will in due course require less liquid steel making capacity. In addition, there is a market requirement for BSC to increase the percentage of concast output (ie continuously cast steel which customers increasingly prefer to steel produced by the ingot route) from the S Wales integrated plants by investing in a new concaster in S Wales. In addition, BSC would in general terms gain by concentrating its resources on fewer locations. On this basis the candidates for a reduction in liquid steel production would be Ravenscraig and Scunthorpe.

Short-Listed Option

7 The Corporation initially considered a whole range of options against the above background but have identified the following short-list of options for detailed evaluation:

	STRIP MILL CLOSURE LOCATION	BLAST FURNACES CLOSED	EXTRA CONCAST IN SOUTH WALES	NEW PLATE MILL FACILITIES
1	Ravenscraig	None	No	Teesside or Scunthorpe
2	Ravenscraig	Ravenscraig (2)	Yes	Teesside or Scunthorpe
3	Lackenby	Scunthorpe (1)	Yes	Teesside
4	Ravenscraig	Ravenscraig (1) Scunthorpe (1)	Yes	Ravenscraig

Note: Ravenscraig currently has two blast furnaces.
Scunthorpe has three.

8 BSC's initial projections - which would need to be confirmed by detailed analysis - show the cost implications of these options as follows;

£m (April 1987 price)	**Increase in profit from implementation (per annum)**	**Capital cost of implementation (Total)**
Option 1	35	120
Option 2	125	210
Option 3	65	270
Option 4	80	225

9 Option 2, therefore, (total closure of Ravenscraig; new concaster in S Wales; new plate mill at Teesside or Scunthorpe) offers BSC the greatest improvement in profit. Its capital costs are less than those other options which would maintain a long-term presence at Ravenscraig (except for Option 1 which maintains the Ravenscraig iron and steel making but generates little profit improvement). The BSC Board, therefore, saw Option 2 as most likely to emerge from the detailed evaluation with the greatest economic benefits.

Improvement in BSC Profit Performance

10 Since the financial projections of April, BSC's profit performance has improved considerably to the extent that they are now anticipating profits in the current financial year of about £350m, above the figure which was considered the minimum figure for viability earlier this year. The main reason for this improvement has been the growth in demand (largely within the UK economy), together with continued improvements in manufacturing efficiency.

11 This improvement in performance has implications for both the timing of privatisation and the timing of changes in plant configuration. It also greatly increases the confidence within the Corporation in the future and strengthens their belief that the considerable improvement in profit in recent years can be maintained, though much is still critically dependant on a satisfactory outcome to the discussions in Europe. (It is estimated that a 10% fall in steel prices - a possible outcome of an unregulated European market without restructuring - would cost BSC some £175m a year, making viability almost impossible to achieve.)

12 This improvement in performance does not change the basic economic case for Option B. But it does have a significant effect in that it is clear that even with an early closure of the Ravenscraig Hot Strip Mill (the case for which is not affected by this profit improvement), BSC could not manage without the concast steel output from the Ravenscraig blast furnaces until the investment in a new concaster in S Wales has taken place and the additional concast output from S Wales becomes available. Given the need for a full Government investment approval of that investment (as required by the current procedure) and a further three years for construction, BSC can predict, with some confidence, that they will not be in a position to do without the Ravenscraig liquid steel output for at least four to five years. Even beyond that, if demand were to improve beyond existing levels, there could be a need to keep Ravenscraig open for a further period. In the long run, however, it is unlikely that BSC would wish to keep Ravenscraig open in preference to increasing liquid steel output in S Wales.

13 The Board remains concerned about the limitations of their two obsolescent plate mills. Resulting quality problems are likely to affect their position in the market place, and the Board recognises the need for a new plate mill - (about

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£150 million) - in due course. However their preference at this stage is to defer this investment until after privatisation, and it does not feature therefore in their current options analysis. The siting of a new plate mill will inevitably be a matter of great political controversy; there is likely to be strong pressure for the issue to be re-opened and for the new plate mill to be sited in Scotland.

Seamless Tubes

14 Consideration of BSC's seamless tubes business has not formed part of the consideration of Strategic Options review and is not covered by the existing Corporate Plan for the five integrated works. It is, however, the one main area of BSC which continues to be loss-making and is thus a drain on BSC's financial performance.

15 These losses are not significant - month to month seamless tubes almost break even and the Tubes division as a whole is in surplus - but the Clydesdale plant, employing some 1,780 people, is at the end of its life and the prospects for seamless tubes demand (largely from N Sea oil exploration) make unattractive the significant investment, which would be needed to make Clydesdale efficient, particularly in a market where there is

already considerable over-capacity. However, failure of Clydesdale would also undermine the prospects for the other two seamless tubes plants at Wednesfield and Bromford (both West Midlands: total employment 1,550) though Bromford might be sold as a going concern. BSC are accordingly studying options for the future of the seamless tubes business and will report to Government shortly.

DTI

October 1987

FINANCIAL SECRETARY TO THE TREASURY

BP 9/10

PUP

PS/FST TO PS/CH 6/10

FROM: J J HEYWOOD
DATE: 6 October 1987

PS/CHANCELLOR

cc Sir P Middleton
Mr Monck
Mr D J Moore
Mr Colman

BRITISH STEEL CORPORATION

1. The Financial Secretary has seen Kenneth Clarke's minute to the Prime Minister of 2 October.

2. The Financial Secretary thinks we should privatise BSC as soon as we can - since the opportunity may go away if we do not seize it.

JH

JEREMY HEYWOOD
Private Secretary

For meeting PM

CH/EXCHEQUER
REC. 23 OCT 1987 ✓23/10
ACTION MR COLMAN
COPIES TO FST
SIR P MIDDLETON
MR MONCK
MR MOORE

(NO FURTHER COPIES TO BE TAKEN)

TO:

PRIME MINISTER

I await advice. M.

FROM:

KENNETH CLARKE

22 October 1987

BRITISH STEEL CORPORATION

1 In my minute of 2 October I set out the BSC Board's assessment of their future strategy, and reported my own favourable reaction to their proposals. I have now received (copy attached) a helpful letter from Sir Robert Scholey which sets out some useful background for our meeting on 27 October.

2 BSC is continuing to work on the detailed analsis on which formal confirmation of this proposed strategy depends. But there are a number of issues on which we need to take a preliminary view before we discuss the issue more fully with Malcolm Rifkind.

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(i) I believe that we should endorse the Board's commitment to work for the Corporation's early privatisation (November or December 1988) and find space in the current Legislative Programme for the necessary BSC Bill.

400 people

(ii) We and the Corporation should be prepared to make an early announcement of the decision to close the Ravenscraig Hot Strip Mill after August 1988. I accept the Corporation's commercial case for retaining Ravenscraig steelmaking - and the Dalzell plate mill - and I fully expect the Board to make clear (and repeat in the prospectus) its expectation that steelmaking at Ravenscraig, and possibly the Dalzell plate mill, will continue for at least 4 years.

(iii) It is important that if possible I should have announced these decisions to Parliament before the next Industry Council on 8 December, in order to avoid the risk of appearing to react to European pressure to close the mill. Other European steel producers know that the mill is surplus to any commercial requirement and there is a real risk that that sensible opinion will be pressed at the Council. If we have made our own decision ahead of the Council, I will be in the best possible position to seek to secure closure commitments from other Member States and the best possible terms for BSC in a future quota regime. The achievement of these objectives is a necessary part of the preparations for privatisation.

(iv) Although there are some commercial pressures to invest in a new plate mill, the Corporation have decided to postpone consideration of this issue. I think we should live with this delay particularly if, as they have agreed, location in Scotland is not ruled out at this stage. However we must recognise that the building of a South Wales concaster and the closure of the Hot Strip Mill will signal to informed Scottish opinion that the plate mill will, in all probability, be sited elsewhere.

(v) Although BSC's Seamless Tubes business is not strictly related to the wider issue, Scottish opinion will probably be concerned about the future of the Clydesdale mill. It is 10 miles from Ravenscraig and provides 1780 jobs. BSC have made clear that this business is extremely fragile. I think we should support the Corporation remaining free to take a strictly commercial approach to this problem even in the face of the obvious political problems that it would create. I would hope the Board might decide to leave open any decision about the future of Clydesdale until after privatisation although this may not be possible if there were a significant downturn that would result in major losses. I have, however, asked the Corporation to continue to look for any option which might provide an alternative to the eventual closure of Clydesdale and which has prospects of viability. We can, if necessary, return to this issue when we have discussed the position with Malcolm.

?

(vi) I believe that an attractive package of enterprise measures, involving a co-ordinated approach to shipbuilding and steel redundancies in Scotland, remains necessary and will provide a clear demonstration of our commitment to regenerating the Scottish economy. I hope that Malcolm can be brought in quickly to develop these preliminary thoughts. I have also asked my officials to examine whether a similar idea (based on an Enterprise Company) might be used in the North East.

R'craig stays open, so only if BS close

3 Copies of this minute and its attachment go to Willie Whitelaw, Nigel Lawson, and David Young.

Peter Smith

pp KENNETH CLARKE

(Approved by the Chancellor and signed in his absence)

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CHANCELLOR OF THE
20 OCT 1987
DUCHY OF LANCASTER

BRITISH STEEL CORPORATION

SIR ROBERT SCHOLEY, CBE, D.Eng

20th October, 1987

STRICTLY PRIVATE AND CONFIDENTIAL

The Rt. Hon. Kenneth Clarke QC MP,
Chancellor of the Duchy of Lancaster
and Minister of Trade and Industry,
Department of Trade and Industry,
1 - 19 Victoria Street,
London SW1H OET

Dear Chancellor

When Merchant Bankers made their presentations to Paul Channon in April this year it was clearly established that the announcement of a significant cost cutting exercise affecting basic configuration was a major pre-requisite to establishing a sufficiently robust level of profit to permit privatisation to take place.

Given the sensitivity of this issue for Government and ourselves, Paul Channon requested the Corporation to advise him if there might be more than one way of achieving the cost cutting objective.

Since that time we have developed the exercise and looked overall at some 16 options. The summary of the features of the main options considered is given in Attachment I, whilst Attachment II provides a qualitative appreciation of the relative benefits and disadvantages.

In the next stage of the work we considered whether each of these options:

- undermined efficient production and competitiveness;
- required investment disproportionate to benefits;
- restricted flexibility in the longer term.

In the best interests of the Corporation we were determined that we should not endorse any solution which might solve immediate problems and have shorter term attractions but created new longer term problems in any of the above respects.

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9 Albert Embankment London SE1 7SN Telephone: 01.735 7654 Telex No. 916061

We concluded that a number of the options could be readily discarded on a qualitative assessment which would not require evaluation to determine their exclusion. On this basis, the choice was narrowed down to four which we decided to evaluate, in broad terms, to establish orders of magnitude of financial difference. The four configurations selected were:-

	1	2	3	4
Strip Mill Closure Location	Ravenscraig	Ravenscraig	Lackenby	Ravenscraig
Blast Furnaces Closed	None	Ravenscraig(2)	Scunthorpe(1)	Ravenscraig(1) Scunthorpe(1)
Extra Concast in South Wales	No	Yes	Yes	Yes
New Plate Mill Facilities	Teesside or Scunthorpe	Teesside or Scunthorpe	Teesside	Ravenscraig

The first, which involves the early closure of Ravenscraig Hot Mill (jobs involved 700) and transfer of concast slabs to South Wales for rolling in the hot strip mills there, is regarded as a stepping stone to number 2 - the eventual complete closure of the rest of Ravenscraig, when appropriate (a further 2370 jobs involved). In the third case the Lackenby coil plate mill is closed and a new plate mill installed at Teesside (net jobs: 1440). In the fourth configuration Ravenscraig Hot Mill is closed and a new plate mill installed at Ravenscraig (net jobs: 2340).

We recognise that Scottish interests would be likely to press for consideration of retention of the hot strip mill in Ravenscraig, as well as the addition of a new plate mill there. However, that course of action is not a serious runner as it would jeopardise not one, but two, other integrated works (i.e. Scunthorpe, and either Teesside or Llanwern) whilst being far less robust from BSC's best-case viewpoint. (We can fill out this view for your officials without difficulty).

Most of the considerations as to which steel works should be closed have not altered fundamentally from the time of the 1985 review and have if anything hardened since that time. Although I appreciate the need to update the detail supporting this view the key points from the appendix to that review, at Attachment III, set out the reasons as between the two Strip Mill works we consider to be most at risk : Llanwern and Ravenscraig. (Being a coastal site and with its substantial modern investment Port Talbot is unarguably the banker plant of the three integrated works in the Strip Products Group. The Lackenby Coil Plate Mill is the lynch pin of adequate volume to sustain Teesside's highly efficient low cost steelmaking. Moreover the closure of the Corby steelworks was dependent on forging a new steel supply for its major and efficient welded tube interests and Lackenby was strategically determined as that link).

The following table sets out the results of the broad evaluation of the four options. It is important to appreciate that at this stage the profit figures represent only the annual incremental benefits from each option when all the changes involved in bringing it about would have occurred. The cash figures are confined to the capital expenditure over and above our normal projected programme to bring the changes about and the one-off costs of associated manpower reductions. Both of these sets of financial figures represent the better profit or increased cash cost of change when measured against the "do-nothing" base case, as included in the Financial Projections on which our Merchant Bankers reported in April.

	Options			
	1	2	3	4
		£ Million		
Increased profit over base case level	35	125	65	80
Additional capital expenditure over base case level	110	170	240	190
Redundancy costs of manpower rationalisation	10	40	30	35
Total cash requirements in excess of Base Case	120	210	270	225

As will be seen, the incremental profit return is substantially the best in case 2 which also represents the best return on the incremental cash outlay. This position is the same as was apparent from evaluation of the many options considered at the time of the last strategy review in March 1985, and the best course for BSC would remain the completion of actions recommended by the Board at that time.

I said at the beginning of this letter that the objective of the cost cutting exercise was to find the means of achieving the major increase in profits necessary to make privatisation possible. Since April 1987, there has been a dramatic improvement in the Corporation's financial position with a very pronounced step change in profits. Whilst further work is necessary to confirm that our profit can be maintained on this higher path over the next few years, the Corporation's advisers agree that the economic assumptions on which the Corporation is presently basing its future forecasting work make this a reasonable expectation, and are not unduly optimistic. The Board accepts this advice. (Incidentally, the assumptions I here refer to are more current than those on which the Financial Projections the Merchant Banks reported on were based. Nonetheless, I would not expect their application to result in any significant change in the relationship or the order of magnitude of the incremental profit and cash positions as between the four options).

As a consequence, the cost reduction exercise stemming from the options is no longer a fundamental prerequisite to achieving privatisation profit levels. In fact the higher levels of demand which have been a key factor behind the profit step change mean that consideration has to be given to revising the timing in which configuration changes could now take place. This is because, although the Ravenscraig option (Options 1 and 2) would still be the right one to pursue in the Corporation's best commercial interest, it would take time to implement and cannot now be contemplated at one fell swoop in the short term. Whilst the hot strip mill could in practice be closed within six months of a decision, the combination of higher demand levels, and the rate at which the market is demanding continuously cast products, together necessitate the retention of Ravenscraig steelmaking at least until another continuous casting machine has been built and worked up in South Wales - 3 years at the minimum from the date of a decision to proceed, and possibly even longer.

We consider it essential to deal with our hot strip mill problem because:-

- in contrast to other product areas historically our utilisation rate in this particular process has been below 70% and amongst the lowest in the EEC. (This contrasted sharply with our relatively much higher utilisation of plate and sections mills both in actual terms and in comparison with other EEC producers).

- BSC's actual hot strip mill capacity is substantially higher than the level registered with the European Commission and even with current high output levels, well in excess of quota, our true excess capacity is some 2 million tonnes in this product.

- We are currently not able fully to utilise our most modern facilities with consequent adverse effects both on product consistency and cost performance.

Not only is an early decision to tackle this problem necessary, but it would in my view also lend considerable force to your position in the Council of Ministers, which is otherwise somewhat difficult in this respect especially when there is so little to bargain with in support of the very firm line on restructuring and quotas you have quite properly been taking.

From our point of view as an employer (not only in Scotland) my Board and I are acutely aware of the difficult nature of the Scottish situation and of the need to react in a responsible way as regards the local community. Principally for this reason we believe we can postpone a decision on a new plate mill for at least a limited period of time. There is, of course, a direct and very satisfactory link between Ravenscraig as a steelmaker and the adjacent Dalzell plate mill which would not be threatened while steelmaking continued at Ravenscraig. We are keen to avoid the Dalzell plate mill being seen to be at risk although we would wish to make it quite clear that no view has been taken on the siting of a new plate mill were the Board to approve that investment in due course. However, I should emphasise that amongst the considerations that would have to be borne in mind in siting a new plate mill would be the following:-

- It would be totally uneconomic to perpetuate five integrated sites in the long term;

- It would be ill advised and unnecessarily costly to spread our constructional steels business over three main sites;

- The scale of operation in Ravenscraig as an integrated plant with a plate mill, but no hot strip mill, would put a new plate mill at a significant cost disadvantage from the outset and negate much of the cost reduction otherwise attainable from such new investment.

We believe that actions are possible which could give reasonable prospects for the future of Dalzell for some years to come and, if this proves to be the case, an appropriate statement could be made publicly. I should emphasise, however, that for this strategy concerning Dalzell to be followed successfully it is important that we are able to buy plate quota in any extended quota scheme and also, for reasons of customer satisfaction, to consider the means of attaining a source of accelerated cooled plate pending the provision of our own new mill.

In the interests of completeness, I should draw your attention to the fact that the Board remains very concerned about the fragility of our Seamless Tubes business because of the obsolete tube mills in Clydesdale. Whilst not the most immediate problem, without investment in its mills Clydesdale (1780 people currently employed) would be in jeopardy at some point in time and this could in turn spill over to affect the Midlands seamless plants at Bromford, Wednesfield and Corby (involving a further 1550 jobs). Although investment of the order of £65 to £75 million would correct the problems of the Clydesdale mills, because of the major excess capacity worldwide in this product, exacerbated by the provision of significant Japanese new capacity installed since 1980, the business would still have to compete in a sector where profit prospects and the return on any new investment would at best be modest. As I said this information is presented to complete the picture but I am not making any proposals on Clydesdale at this point in time.

It would seem that our present trading position and prospects open up the potential for privatisation earlier than the target of mid 1989 as we had been previously advised. My reasons for taking this view are that:-

- Profits are now at a level to attract investors to BSC as an income stock.

- The economic indicators for U.K. manufacturing (our biggest market) and exporting are favourable to us.

- The major financial losses incurred by our continental competitors in the last year or so appear to have created a climate in which companies are less inclined to put themselves at risk through unnecessarily disruptive market practices. The prospects for a more orderly scene in Europe are therefore rather better.

- UK steel demand, which is estimated to be at a peak in 1987 and 1988, is expected to have some, albeit modest, cyclical regression in 1989 and this could impact adversely on the attractiveness of privatisation in 1989/90.

Further advantages flowing from privatisation in such a timescale are:-

- A flotation in the near future would be distanced from the actual major configuration change if, as is likely, this can be deferred for some five years.

- By distancing privatisation from operational and investment issues (e.g. plate mills, further concasting etc. - all of which will come to the fore in the period beyond 1988) the Corporation will have optimum plant and commercial flexibility.

- An early privatisation would enable total commercial freedom without regard to political considerations in the first instance (e.g. increased UK distribution outlets). (No business can be adequately robust unless its Board and management are free to move in what they regard as its best commercial interests.)

- I understand there may well be a limit to the availability of funds for investment in new issues and a clash with electricity or water later in the current Parliament. This could result in a later BSC flotation being crowded out of this Parliament altogether.

- Last, but by no means least, early privatisation is very important to maintaining the current high level of motivation in management and workforce and to retaining (and recruiting) able young management who are not only attracted to the prospect but are also highly marketable with our increasing success.

For all these reasons, which our advisers Barclays de Zoete Wedd strongly support, it seems to me and the Board highly desirable that we should aim at privatisation in late November/early December 1988.

I have sought in this letter to bring together the need to address the issue of options and a solution to the difficulties in Scotland in a way which would gain broad acceptance from many points of view while being consistent with fulfilling my remit and yet dealing with BSC's problems in the best commercial way. I feel I should underline the Board's strong commitment to privatisation not only in the context of my remit as Chairman but also, more particularly, having regard to the step jump in profits recently attained which there is every indication can be maintained.

I have not dealt with the issue of alternative job creation although you are aware of my views on this, and of the considerable and well acknowledged efforts of BSC Industry in these respects and our clear commitment to join in and support any new initiative for the areas that would be affected. Indeed, the way in which it is possible to distance the announcement of decisions from the actual events bringing about job losses provides a unique time frame in which to launch a significant job creation initiative well in advance.

Yours sincerely

Bob Scholey

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SUMMARY OF MAIN OPTIONS

Option:	Base Case	Ravenscraig HSM closed	Ravenscraig Plate mill options			Teesside Plate mill options		Ravenscraig full closure		Llanwern closure except cold mill
Note: Options rejected are marked []	[a]	b	[c]	[d]	e	[f:0]	f:1	g	[h]	[i]
MILLS										
NEW PLATE MILL, sited at	NONE	EAST SIDE	RAVENSCRAIG	RAVENSCRAIG	RAVENSCRAIG	TEESSIDE	TEESSIDE	EAST SIDE	RAVENSCRAIG ("island" site)	EAST SIDE
STRIP MILL CLOSURE, at	NONE	RAVENSCRAIG	RAVENSCRAIG	RAVENSCRAIG	RAVENSCRAIG	LACKENBY	LACKENBY	RAVENSCRAIG	RAVENSCRAIG	LLANWERN
BLAST FURNACES IN USE:										
RAVENSCRAIG	2	2	2	1	1	2	2	-	-	3
LLANWERN (Large/Small)	1(L)	1(L)	1(L)	1(L)	2(L+S)	1(L)	2(L+S)	2(L+S)	2(L+S)	-
SCUNTHORPE	3	3	2	3	2	3	2	3	3	3
EXTRA NEW SOUTH WALES CASTERS	-	-	-	-	1	-	1	1 (second caster is a possible variant to these options)	1	1
SLAB TRANSFERS:										
Ravenscraig to South Wales	Minor	Major	Major	-	-	-	-	-	-	-
Teesside & Scunthorpe to S/Wales	-	-	-	Major	-	Major	-	Minor (eliminated with a 2nd caster)	Minor	-
Scunthorpe to Ravenscraig	-	-	-	-	-	-	-	-	Major	-
SLAB PURCHASES	-	-	0.5mtpa	0.5mtpa	-	-	-	-	-	-
SELECTED OPTIONS (revised designations):		OPTION 1			OPTION 4		OPTION 3	OPTION 2		

ATTACHMENT I

BENEFITS AND DISADVANTA[...] OF INDIVIDUAL OPTIONS

Options. For descriptions, see Figure 1 (Note. Options rejected are marked ( ))	Base Case	Ravenscraig HSM closed	Ravenscraig Plate mill options			Lackenby Plate mill options		Ravenscraig full closure		Llanwern closure except Cold mill
	(a)	b	(c)	(d)	e	(f:0)	f:1	g	(h)	(i)
1. Ability to meet market requirements	No (plates)	Yes	Yes, with support from imported slabs.		Yes	Yes	Yes	Yes	Yes	Yes, with major investment at Ravenscraig
2. Elimination of Plate mill weaknesses	No	Yes	Yes technically but would not be in world's top league costwise because of Ravenscraig's relatively high steelmaking costs.			Yes	Yes	Yes	Yes technically but would suffer on cost grounds	Yes
3. Utilisation of hot strip mill capacity	70%	90%	90%	90%	90%	87%	87%	90%	90%	90%
4. Utilisation of upstream capacity	Heavily under-utilised	Heavily under-utilised	Minor improvement with one blast furnace closure		Significant improvement	Heavily under-utilised	Some improvement	Optimum utilisation	Optimum utilisation	Optimum utilisation
5. Imbalances in works' production flows requiring costly transfers of slabs	Minor transfers to South Wales	Major transfers of slabs from R'craig/Scunthorpe to South Wales detracts from improved utilisation benefits			None	Significant slab transfers from Scunthorpe	None	None	Significant slab transfers from Scunthorpe	None
6. Location of Hot strip mills for optimum distribution	Relatively poor (Ravenscraig)	Good	Good	Good	Good	Poor , with increased sourcing from Ravenscraig and more distant transfers to Corby		Good	Good	Good
7. Avoidance of costly "island" sites	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No (Plate mill)	No (Llanwern CRM)
8. Maintenance of individual sites' optimum product costs			Scunthorpe costs undermined		Scunthorpe costs undermined		Scunthorpe costs undermined			
9. Restrictions on operational flexibility	No			Potential lack of flexibility one BF/mill configuration						
10. Requirements for capital expenditure additional to the new Plate mill which is in all options. (compared to Base Case)		Modest requirements	Modest requirements	Modest requirements	Extra caster	Major refurbishment of Ravens-craig HSM, partly offset by saving from L'by CPM closure	Extra caster	Extra caster	Extra caster	Major investment at Ravenscraig for volume as well as quality
11. Employment implications		Impact on Ravenscraig	Significant impact on Scunthorpe	Significant impact on Ravenscraig	Significant imp-act on R'craig and Scunthorpe		Significant impact on Scunthorpe	Major impact on Ravenscraig		Major impact on Llanwern
12. Potential implementation problems			Possible delays if new Plate mill has, because of lack of space, to replace hot strip mill (Lackenby or Ravenscraig) in situ							
13. Committed retention of 5 steelmaking sites	Yes (support for all hot strip mills)	Possible stepping stone to full closure	Yes	Yes	Yes	Yes	Yes	No	No	No
14. Economic stability of configuration and elimination of uncertainties to potential investors								Yes	Yes	Yes
15. Sensitivity politically								Very significant politically		

ATTACHMENT II

ATTACHMENT III

Factors adversely affecting Ravenscraig.

1.	Market Considerations.	:	Customer preference for South Wales Works.
2.	Location	:	Less than 3% of Ravenscraig total deliveries to Scottish customers, therefore increased carriage costs.
3.	Harbour	:	Heavily underutilised with resulting excess costs.
4.	Plant Considerations	:	Compares adversely with South Wales plants in terms of:- - scale and logistics; and - modernity.
5.	Cost Base	:	Inherently higher than other integrated plants.
6.	Headroom	:	Constrained by comparison with other integrated strip mill works.

SECRET AND PERSONAL

NO FURTHER COPIES TO BE TAKEN

CH/EXCHEQUER
REC. 29 OCT 1987
ACTION Mr Colman
COPIES TO FST + to CST.
Sir P Middleton
Mr Monck
Mr Moore

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

27 October, 1987.

Dear Peter,

BRITISH STEEL CORPORATION AND BRITISH SHIPBUILDERS

The Prime Minister this morning held a meeting to discuss the future of the British Steel Corporation on the basis of the Chancellor of the Duchy's minutes of 20 and 22 October, and British Shipbuilders on the basis of his minute of 20 October. There were present the Lord President, the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, the Chancellor of the Duchy of Lancaster, Mr. Richard Wilson (Cabinet Office), and Mr. George Guise (No.10 Policy Unit).

The Chancellor of the Duchy said he had concluded that it would be right now to seek to privatise the British Steel Corporation before the end of 1988, with mid-1989 as a fall-back. The hot rolling mill at Ravenscraig would be closed, but BSC would make clear their expectation that the liquid steel capacity of Ravenscraig would be needed for at least four years, and it might be possible to induce them to extend this expectation. The future of Ravenscraig would nevertheless remain an emotional issue for Scotland. It was clear that British Shipbuilders should cease trading. This would mean the closure of most of the yards, though Appledore might possibly be privatised. It was also relevant that Scott Lithgow would probably move to a care and maintenance basis by February next year, and 1,000 redundancies were likely at Yarrow in mid 1988. It would be right to transfer AOR1 from Harland and Wolff to Swan Hunter. It would be necessary to develop substantial proposals to help those who would lose their jobs in Scotland and the North East as a result of the changes at British Steel and the closure of British Shipbuilders.

NORGROVE TO SMITH 27.10.87

The Chancellor of the Exchequer noted that privatisation of BSC in 1988 would be welcome both for itself and for the way in which it would help maintain the momentum of the privatisation programme. British Shipbuilders had no future, and the nettle of closure should now be grasped. Even though Ravenscraig would not be closed, the Chancellor agreed that a package of enterprise measures should be developed.

SECRET AND PERSONAL

The Lord President pointed to the pressures on the legislative programme in 1987/88. However, if the Government decided that privatisation should go ahead, room would have to be found for the Bill which would be needed.

After further discussion, the Prime Minister said that the Chancellor of the Duchy should now discuss with the Secretary of State for Scotland his proposals on steel and shipbuilding. It would be important in giving any undertaking about the future of Ravenscraig that this should be seen as a commercial decision made by BSC, and not a political commitment. On shipbuilding, care would be needed to make sure that people were not left with the impression that the whole of the UK's shipbuilding capacity would be lost with the closure of British Shipbuilders. Substantial capacity for the construction both of civil and military tonnage would remain. Measures to help those who would lose their jobs would need to be discussed with the Secretary of State for Scotland. One possibility would be to place a frigate order with Yarrow and another with Swan Hunter. A difficulty would be the wish of MOD to place such orders after a competition. But frigate orders would offer less nebulous help than an enterprise package. The possibility of such orders should not, however, be discussed with the Secretary of State for Scotland at this stage. The timing of announcements would need to be further considered.

I am sending copies of this letter to the Private Secretaries of those present.

Yours,

David.

David Norgrove

Peter Smith, Esq.,
Office of the Chancellor of the Duchy of Lancaster.

SECRET AND PERSONAL

PP3 p!

TO:

PRIME MINISTER

FROM:

KENNETH CLARKE

29th October 1987

CH/EXCHEQUER
REC. 29 OCT 1987 29/10
ACTION Mr D J L Moore
COPIES TO FST
Sir P Middleton
Mr Monck
Mr Colman

I agree throughout, with the exception of para (7). Where whether [illegible] policies [illegible] (a) or [illegible] with dept [illegible] Enterprise package (a) or (b) on which deal can be done with Mr. Rifkind.

BRITISH STEEL CORPORATION AND BRITISH SHIPBUILDERS

I have had a meeting with Malcolm Rifkind on the subject of steel and shipbuilding. We discussed my proposals in a friendly and reasonable atmosphere, but after debating the issue thoroughly for an hour, I am afraid we failed to reach agreement.

Steel

2 Malcolm does not accept the proposal that the hot strip mill at Ravenscraig should close if it is accompanied only by BSC assurances that steel making is safe there for some years. He says it would not be credible and would be seen

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CLARKE to PM 29.10.87

as the next step in a process of steady erosion. He insists that every MP of every Party in Scotland would oppose such a policy.

3 He argues, correctly, that the closure of the hot strip mill will not make an enormous difference to the profitability of BSC as a whole (approximately £10m per annum). It is, however, a step that has to be taken. There is manifest excess capacity in the UK, let alone the EC. I see closure of this mill as the absolute minimum price we will have to pay to achieve the restructuring of European steel that is an essential precursor to a privatised BSC. Nevertheless I judge that Malcolm could come to accept the case for it if BSC would agree to a large investment in a new or refurbished plate mill at Dalzell which is a site immediately next door to Ravenscraig.

4 This approach would be hotly resisted by Bob Scholey and the BSC Board. They had agreed that they would postpone any decision on the new plate mill until after privatisation. There is then a choice to be made between putting the new mill that they undoubtedly require at Dalzell (or Ravenscraig), Scunthorpe or Teesside.

5 Investment in a new plate mill would involve substantial expenditure (capital cost of around £170m). The total cost to BSC of the option they had previously identified which would embody Malcolm's proposal for the plate mill would be £225m. While this is only about £15m more than the initial cost of BSC's preferred option, which is likely to be to site the plate mill at Teesside near to their markets and to their much more efficient steel making plant, it would result in a continuing reduced level of profits of £45m a year. This would have a major adverse impact both on privatisation proceeds and subsequently on British Steel. There would also still be major job losses, probably at Scunthorpe which is another sensitive area.

6 This issue is actually an old one which goes to the heart of the problem. Investment in the new plate mill at Dalzell would commit BSC to a long term need for steel-making at Ravenscraig and make the five plant configuration of the Company a permanent structure. I know that the key to the desire of Bob Scholey and the Board to close the hot mill at Ravenscraig and to put the new plate mill at Teesside is to pave the way to eventual closure of the blast furnaces at Ravenscraig if total demand does not sustain the need for its steel-making capacity.

7 The Board would get very heated about any demand that they put their new plate mill at Dalzell or near Ravenscraig. Some members of the Board would react very strongly and might even resign. They would regard a political choice of Dalzell as a return to what they call the "Macmillan policy" of spreading key facilities around the country which has done them so much damage in the past. In my opinion, well-informed potential investors in British Steel would share their view and recognise that a political rather than a commercial solution had been imposed on the Corporation on the eve of privatisation. This could wipe hundreds of millions of pounds off the proceeds of the flotation.

8 I see no way in which I am going to talk Malcolm into accepting the commercial approach which you agreed should form the basis of our discussions. I see no price which he would accept for dropping his stand. I feel strongly that we cannot accept his demand and that we should not saddle ourselves with a weaker steel industry and ruin the privatisation on this issue.

9 I would like to argue the case by getting Bob Scholey to give a clear commitment to the future of steel-making at Ravenscraig for seven years. I am sure that BSC need it for that time and he will agree with that. Thereafter I would argue that the future would depend on the level of demand for steel and the performance of the Company at that time. No sensible person would seek to guess at either feature so far in advance. We also need to press ahead with proposals for a new Enterprise Company. The key to presenting our case is that people should look away from the old dying industries to alternative enterprise which can offer a real future to the communities affected. Malcolm seemed initially attracted by this but we need to engage his full support in order to work up a detailed case.

10 I understand that Malcolm has regular meetings with Bob Scholey. He was due to have one today (Thursday) but as it happened Bob Scholey has had to pull out because of illness. The next meeting will however take place soon and I doubt that they will seek to keep away from what is the real main issue to both themselves and the public.

Shipbuilding

11 Malcolm does not accept my proposals on shipbuilding. He says that we cannot announce closure of Govan whilst there is work in the yard. He would accept a rigid application of the Sixth Directive limits on subsidy to future searches for orders. He would accept closure if no order was won on that basis so that there was no order to follow the Chinese ships in two years time.

12 This was my first instinct when I started to look at shipbuilding. I suspect that John Lister, our Chairman of BS, would accept a deal of this kind. From my talks with him, I guess that Tom King would like to settle for something of the kind on Harland and Wolff.

13 It is very tempting. However I am quite satisfied that it will not work. John Lister has told me that BS cannot get an order and deliver it within Sixth Directive limits. It will simply not be possible to enforce those limits on their order-taking over the next two to three years.

14 The only orders they will be able to seek will not be for simple off-the-peg ships, easy to cost and calculate subsidy for, but one-off customised specialist ships to be designed and built. They will be bid for at prices which in all probability will lead to huge over-runs and losses over and above the intervention support.

15 We know how Harland and Wolff misled Touche Ross and the Government about the true cost of their building the AOR1. There have been endless examples of that in the merchant shipping field. I do not believe we would withstand enthusiasts within BS and lobbyists outside all the time up to 1990. We would be under constant pressure to fudge and we would have the greatest difficulty in weaning the affected communities away from their dependence on continuing subsidies. If we do not grasp the nettle and announce that BS will cease trading soon, we will keep on acquiring Chinese type ship orders into the 1990's.

16 We will need a meeting of the small group with Malcolm under your Chairmanship to try to sort these matters out. If they simply drag on, they will put off BSC privatisation indefinitely and do commercial and political damage.

17 Finally, if we collectively agree to go ahead with my proposals, I am very doubtful about the idea of one big announcement in December. In my opinion, this would be heroic but not good politics. There is room for some step-by-step gradualism. I would like to make an announcement on Steel (particularly on the hot strip mill closure) in early December before the Industry Council on 8 December. The Shipbuilding announcement can be left until February 1988.

18 I am copying this letter to Willie Whitelaw, Nigel Lawson and David Young. I would ask that, as before, they ensure that it is kept on a strict need to know basis.

KENNETH CLARKE

3696/6/sh

CONFIDENTIAL

FROM: W HOOD
DATE: 18 JANUARY 1988

1. MRS BROWN 18/1
2. FINANCIAL SECRETARY

I agree that we should retain maximum flexibility on BSC tax losses carried forward after privatisation: this means a special provision in the Bill. MEB 18/1.

cc Chancellor
Sir P Middleton
Mr Monck
Mr Scholar
Mr Culpin
Mr Moore
Mr Lyne
Mr Cropper
Mr Call

PS/Inland Revenue

Might it not be more sensible to leave this provision in the 1988 FB, so as to keep the Steel Bill as short as possible? NL

BRITISH STEEL BILL: TAX LOSSES

An issue has arisen with the British Steel Bill which requires early resolution. The issue is whether to allow existing legislation on the carry forward of tax losses to remain in force for the purposes of BSC privatisation, or to override existing legislation for these purposes and insert into the Bill a specific provision on tax losses. This would enable the Secretary of State, with the consent of the Treasury, in effect freely to determine the amount of tax losses available to the privatised BSC, up to the maximum level of actual tax losses accumulated. The Inland Revenue have been closely involved in discussions on this question and in the preparation of this submission.

2. Although there are arguments on both sides, I recommend that you agree to such a provision in the Bill; this course will give Ministers the maximum discretion over the level of tax losses and the capital structure of BSC at the time when decisions are taken close to the sale. There is some flexibility to determine the level of tax losses carried forward under existing legislation, but in our view it will restrict Ministers' discretion in some important respects.

Background

3. Following Instructions from DTI, which were prepared in consultation with Treasury officials, Parliamentary Counsel produced

a draft British Steel Bill just before Christmas. The current timetable is for the Bill to go to L Committee in early February and to be published in mid-Febraury. Our principal aim, and that of DTI, has been throughout to leave as much flexibility as possible for decisions to be taken close to the time of the sale. Since unexpected delays can occur to flotations even after vesting has taken place (BA is the classic example) we wish to avoid if at all possible having provisions in the Bill which might unnecessarily commit Ministers to a particular position.

Assessment

4. The problem is to find a means by which Ministers can ensure that at the time of flotation BSC plc will be able to carry forward tax losses which are both:

i. sufficient to provide investors with such comfort on BSC's actual tax position as is necessary to help the success of the sale; and

ii. adequately reflected in the sale proceeds.

5. In their report of April 1987, Samuel Montagu gave their preliminary view that some or all of BSC's tax losses might need to be passed on to the successor company. That would point to retaining maximum tax losses at this stage. On the other hand, BSC's improved profitability and prospects may now mean that this is not such a crucial consideration for the success of the sale. Investors can be expected to discount heavily tax losses other than those which will be used fairly soon after the sale, so that in terms of net benefit to the Exchequer there is probably a point beyond which additional tax losses are <u>not</u> adequately reflected in the sale proceeds.

The position under current legislation

6. We and the Inland Revenue have considered what would be the effect on BSC's tax losses of applying the existing relevant tax legislation, essentially Section 48 of the 1981 Finance Act,

assuming that vesting and flotation take place during 1988-89. It is estimated that BSC's unrelieved tax losses will stand at £1.7 billion at 31 March 1988. BSC's present capital amounts to £4 billion, and it is expected to have accumulated losses (negative reserves) of £600 million at 31 March 1988. In order to provide BSC with an acceptable balance sheet on vesting, these past losses will need to be written off against existing capital - ie reducing it to £3.4 billion. In accordance with normal practice a small amount of this would initially be constituted as share capital held by HMG in the new plc, with the balance held as reserves.

7. Under Section 48, the write-off amount of any Government investment, except to the extent that it is replaced "by money lent on a subscription for shares ....", reduces tax losses available to the enterprise concerned. In BSC's case the write-off of the whole £4 billion of capital - less only the small initial amount of new share capital - would thus be taken into account in reducing tax losses.

8. As the accumulated tax losses (£1.7 billion) are substantially less than £4 billion, not only would past losses be extinguished, but the excess would reduce any <u>future</u> tax losses also. This situation would, so far as we are aware, be without precedent for a public company and would probably affect proceeds adversely. We and the Inland Revenue believe that Section 48 operates unduly harshly in this way and we assume that you would wish to prevent this outcome.

9. Samuel Montagu have suggested a variation on the above procedure which could bring more flexibility into the arrangements, whilst remaining within Section 48. The Inland Revenue have confirmed that they would regard a Share Premium Account as being "a subscription for shares". Accordingly part of BSC's reserves could be constituted as such an Account, with the result that tax losses would be reduced by a lesser amount.

Disadvantages of relying on exising legislation

10. However, this route does not solve all the problems. First, the decision on the amount of tax losses must be made at the point

of vesting rather than as we would prefer close to flotation (unless we legislate specifically on this point). On current plans, where the time gap between vesting and flotation may be only a few months, this might not be a serious difficulty. But, if flotation were delayed for some time after vesting, the level of tax losses determined at vesting is likely to be inappropriate at flotation.

11. Second, as noted already, the £600 million of accumulated losses which will be written off at vesting also reduces the tax losses available to BSC plc by the same amount, and means a further loss of flexibility at this stage.

12. Third, there are disadvantages in constituting too much of the Reserves as Share Premium Account. Other reserves may be needed to offset unrealised losses arising from revaluations (downwards) of any of its fixed assets. (Samuel Montagu have suggested that such a revaluation may be appropriate.) BSC are anxious that there are sufficient reserves available to enable them to pay a dividend (assuming the cash is available) even if there has been a trading loss in a particular year.

13. Finally, there may be some doubt within BSC whether the Inland Revenue would in practice treat the Share Premium Account as a subscription for shares and hence whether this route would "work". A Ministerial statement (or Inland Revenue assurance) to this effect might be required at some stage, possibly during the passage of the Bill.

14. It is for the above reasons that DTI wish to include a clause in the draft Bill which allows the Secretary of State, with the consent of the Treasury, to determine at any time before flotation the amount of tax losses available to the privatised company at any level up to the amount available to BSC at the end of the previous accounting period. The clause would also prevent Section 48 applying to restrict BSC's tax losses. This clearly overcomes the difficulties outlined above of relying on existing legislation.

Inland Revenue's advice

15. The Revenue recognise that a provision of this kind would

assist in the efficient management of the BSC privatisation. But they are not aware of any precedent for a legislative provision empowering Ministers, in effect, to alter a particular company's tax liability. Although the Clause would not impinge on the Board's statutory responsibilities for the care and management of the taxes, it would nevertheless be almost certain to raise what is seen as the "constitutional" issue that Ministers do not intervene in the affairs of individual taxpayers. In addition, Ministers would need to consider whether they could reconcile such a provision with Government's declared public stance that a company being privatised should be in no better or worse a tax position than an equivalent private sector company. (This does of course still leave scope for legislative provisions to prevent tax charges on a conversion to a plc which would not have arisen if the nationalised industry had always been a private company - and the Revenue will be sending you in due course a separate note on what needs to be done in this area in respect of BSC - but the proposed Clause would go beyond these arrangements.)

16. The Revenue believe, therefore, that this would inevitably be a highly controversial departure which could potentially be very awkward to handle during the passage of the British Steel Bill. They would expect that, shortly before flotation when the amount of allowable losses would have to be decided, Ministers could well come under political pressure, as well as pressure from BSC management and unions, not to make any restriction in the loss relief.

17. The alternative would be to allow Section 48 to apply in the normal way. While that would avoid criticism of the kind mentioned above, it could adversely affect proceeds and reduce Ministerial flexibility - particularly between vesting and flotation - in arriving at the most attractive commercial structure for the privatised company.

Conclusion and Recommendation

18. On balance, I recommend that you agree that we should write into the Bill a provision which effectively gives Ministers

discretion to determine, on value for money or other grounds, at any time up to flotation, the level of tax losses to be carried forward on flotation within the amount available before flotation. This does not prejudge the amount of tax losses actually to be allowed to BSC on privatisation. It simply retains maximum flexibility to determine them within the total amount available.

19. Inland Revenue feel that you should be aware that the measure could be highly controversial and may not be easy to reconcile with the Government's declared policy on the tax aspects of privatisation, but recognise the flexibility this provision would allow Ministers in handling the BSC privatisation.

Warwick Hood

W HOOD

853/49

APPOINTMENTS IN CONFIDENCE

FINANCIAL SECRETARY

FROM: MRS M E BROWN
DATE: 22 January 1988

cc Chancellor
Sir P Middleton
Mr Anson
Mrs Lomax
Mr Moore
Mr M L Williams
Mr Lyne
Mr Bent
Mr Hood
Mr Tarkowski
Mr Call

* Before accepting this, I wd like to know who the S. Montagu team were &c. N

STEEL PRIVATISATION: APPOINTMENT OF ADVISERS

This minute is to inform you of recommendations which DTI officials are putting to their Ministers today.

Merchant bank

2. Samuel Montagu provided initial advice on the feasibility of steel privatisation, having been selected in open competition. DTI have been very satisfied with Montagu's performance and wish to re-appoint them. We have agreed that a further competition is not necessary, provided a satisfactory agreement is reached on fees for the flotation.

3. We have been involved with DTI officials in the fees negotiation, and are content with the outcome. Montagu will receive a fixed fee of £750,000 on completion of the sale of BSC, and an additional fee of 0.075% of any net proceeds above £1.25 billion, subject to a cap on total fees payable of £1.5 million. This builds in an incentive element, which both we and Montagu's were keen on. The threshold figure of £1.25 billion will be adjusted to reflect movements in the equity market between the date of appointment and Impact Day, if those movements exceed 10 per cent. We would review the fees if privatisation were postponed beyond Easter 1989.

Brokers

4. DTI advertised for this appointment and shortlisted three firms:

- Rowe and Pitman
- Phillips & Drew
- Wood Mackenzie.

I was on the panel which interviewed them this week. Our clear preference was for Rowe and Pitman (owned by Warburgs). They had put in the best written presentation and gave a competent - though not sparkling - performance at interview. We felt that their reputation and placing power would be very positive assets in this flotation. In response to questions, they assured us that if they were appointed as the Government's broking advisers for either the electricity or water sales, and if for any reason steel were delayed, they would have the capacity to cope with two privatisation exercises at the same time. They proposed a commission of 0.0625 per cent: lower than in any previous primary Government sale.

5. Phillips & Drew had put in a thin written presentation, but came over well at interview. They are on the short-list which British Steel are considering for company broker. Wood Mackenzie had put in a good written presentation, but fielded a rather poor team. Even without their settling-in problems at County, we did not think they would do a good enough job.

Mary Brown

MRS M E BROWN

42/2.BTW.4375/31

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

→ Jonathan?

FROM: J J HEYWOOD
DATE: 25 January 1988

PS/CHANCELLOR

[illegible]

cc Sir P Middleton
Mr Monck
Mr Scholar
Mr Culpin
Mr D J Moore
Mrs M E Brown
Miss Sinclair
Mr W Hood
Mr Lyne
Mr Cropper
Mr Call
Mr Jenkins OPC
Mr McGivern IR
Mr Reed IR
PS/IR

BRITISH STEEL BILL: TAX LOSSES

The Financial Secretary has read Mr Reed's minute of 22 January.

2. His own view is that it would be better to leave the tax provisions in the British Steel Bill.

J.H.

JEREMY HEYWOOD
Private Secretary

858/50

CONFIDENTIAL

1. MR MOORE
2. FINANCIAL SECRETARY

I think that we are making generally good progress on this sale.

[signature] 25/3

Mr X I wd not @ this 'stage' see major Budget disclosure problems, in wh. case Feb 1989 ~~sale~~ would be attractive. Can we discuss the options & keep options open –

FROM: MRS M E BROWN
DATE: 25 March 1988

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mrs Lomax
Mr Odling-Smee
Mr Lyne
Mr Bent
Mr Guy
Mr Call

BRITISH STEEL PRIVATISATION

Mr Clarke wrote to you on 17 March about the objectives and initial planning assumptions for this sale. These are acceptable so far as they go, but they do not address many of the major issues concerning the sale: DTI Ministers will be raising these with you over the next few months. I suggest that in your reply you emphasise the importance you attach to the retail market - even though this is unlikely to be a Sid-type sale; and raise markers about certain other main aspects of the sale.

Background

2. Planning for the sale is now going ahead at full speed. All the main advisers are in place, and Treasury officials are working closely with DTI and the British Steel Corporation. The Steel Bill is in Committee, with the guillotine on that stage likely at the end of April. The present target date for the sale is late November (but see (i) below), and there is no logistical reason at present why that should not be met. As Mr Clarke points out, however, both the nature of the steel business and the market conditions now prevailing mean that there are more risks and uncertainties surrounding this sale

than in a number of previous primary offerings. It will be important to preserve flexibility in the planning assumptions until a late stage.

3. Mr Clarke raises the following issues:

(i) **Timing**

DTI's objective is to hold a public offer by August 1989, and to aim for the end of 1988.

You will wish to make clear (as the Chancellor has pointed out) that August 1989 must be regarded as the very latest target date and that you hope the sale will in fact take place before Christmas 1988. DTI officials are currently considering the pros and cons of a November versus a January sale. There might be a more bullish profit forecast in January, but we have to balance this against budget disclosure problems. Mr Clarke will be writing to you when he has reached a view, but I suggest you put up a marker for November now.

X

As you know we have pencilled in a BT sale for summer 1989, and while a BT and BSC sale could be possible between May & July 89 we really want BSC done by January 89 at the latest. JWT.

(ii) **Marketing target**

Objective (b) in Mr Clarke's letter is "To maximise the net proceeds of sale consistent with the achievement of a healthy after market". There is no reference to achieving a reasonably wide spread of shares, and I suggest that you press for this to be included.

You can agree with Mr Clarke that this sale should not be planned as a popular share issue on the Gas or Telecom models. The cyclical nature of BSC's business, exchange rate risks, uncertainty about EC quotas, and more general market uncertainties since the October crash, all point to an approach which does not actively promote Steel shares to the inexperienced investor. But that does not mean ignoring the retail market - that would be an undesirable signal in this first Government sale since BP, as well as cutting off an important potential source of demand. DTI officials are receptive to these points, and we are working with them on how best to inform the market (retail and institutions) about BSC's business and the coming share sale, and to distribute the shares - for instance by utilising the banks' and building societies' retail networks more effectively. We will keep you in touch with progress in this area. The attached draft letter sets out the objectives as we see them for providing for private investors and employees to participate in the sale. BSC are very keen on the employee offer and are putting a good deal of work into it.

(iii) **Overseas sales**

Mr Clarke is predisposed to overseas placings rather than full registered offerings. We agree. There will need to be an extensive educational and marketing campaign to UK investors, and BSC's management will be fully stretched by that. Open overs overseas would divert these efforts. DTI's advisers, Samuel Montagu, are currently assessing potential overseas demand, and you can wait to hear from Mr Clarke further on this.

(iv) **100% sale**?

Mr Clarke proposes to plan for a 100% sale, although he does not close off the option of a phased sale. We agree. BSC's current strong performance points to a 100% sale now, and that is the assumption we have used in planning for privatisation proceeds overall. But it is conceivable (though unlikely) that market or proceeds considerations might change, so it is worth keeping open the possibility of selling less than 100%.

4. I suggest you comment on the following additional issues:

(v) **Structure of sale**

Mr Clarke does not raise questions such as whether there should be a tender element in the sale, and whether there should be any firm placing with institutions. Officials and advisers are doing preliminary work on these issues. I suggest you stress to Mr Clarke the importance you attach to getting a full price out of professional investors, whilst structuring the sale with an eye to retail and employee participation too. You will also want to ask DTI to examine ways of encouraging retail purchasers to retain their shares: the PAC has indicated at recent hearings that it believes there should be a more rigorous assessment of the costs and benefits of loyalty bonuses.

(vi) **Capital structure**

Final decisions, including the question of any capital injection, will not be taken until closer to the time of the sale. But I suggest you tell DTI Ministers that you will want to start discussing the issues soon.

(vii) **Underwriting**

We are currently consulting the Bank.

Mr Clarke refers briefly to this at the end of his letter. You can tell him that the likelihood is that we want to separate the role of financial adviser from that of lead underwriter. Montagus were appointed on this understanding.

5. A draft reply is attached.

Mary Brown.

MRS M E BROWN

858/49

CONFIDENTIAL

DRAFT LETTER FROM THE FINANCIAL SECRETARY TO THE CHANCELLOR OF THE DUCHY

BSC PRIVATISATION

Thank you for your letter of 17 March about the objectives and strategy for the British Steel privatisation. I agree that the nature of BSC's business, and the more uncertain market conditions now prevailing, make it important to preserve flexibility in planning for this sale.

I agree with your objectives, subject to two points.

First, I regard end-July 1989 as the very latest target date (and we would very strongly prefer not to have BSC ~~as late as~~ in summer 1989 which we have provisionally earmarked for a BT sale. I hope the company can in fact be floated before Christmas 1988: as you know, we run into the possibility of Budget disclosure problems after Christmas. I note that you will be writing separately about that.

Secondly, there is the question of the marketing target. I agree that we should not begin with the presumption of a popular share issue on the Telecom or Gas model. At the same time, I am sure we should not aim exclusively ~~nor even primarily~~ at the institutions. Given our overall policy of widening and deepening share ownership, I would see our objectives as being to ensure that all potential investors are fully informed about the company and - at a later stage - about the sale itself; to enable employees to acquire shares; to consider the most effective ways of distributing shares to those private investors who do wish to buy; and to ensure that the sale is structured with an eye to retail as well as institutional participation. I believe there is a particular opportunity in this sale to review the arrangements for share distribution and dealing, and I know that our officials are already considering the possible use of bank and building society networks, and of nominee systems such as Barclayshare. It will also be important to assess carefully how best to encourage investors to retain their shares - whether through loyalty bonuses or other means. Against this background, I hope you would agree that objective (b) in your letter should refer not only to maximising proceeds and achieving a healthy after-market, but also to achieving a reasonably wide distribution of the new British Steel shares. That is consistent with the basis on which our officials are now planning.

On overseas sales, I share your pre-disposition to placings rather than full registered offerings. Provided your advisers are satisfied that there is likely to be sufficient overseas demand, this can make a useful contribution to the tensions of the sale, and therefore to proceeds.

I agree that we should plan for a 100% sale, but that we should not close off the possibility of selling a lesser proportion if proceeds or market considerations started to point that way.

Perhaps I could comment at this stage on three further aspects of the sale. On the structure of the sale, I have already mentioned the need to take account of retail participation. It will also be important, so far as is consistent with that, to achieve a full price from professional (including overseas) investors, and to avoid any excessive premium in the after-market. For these reasons the case for at least a partial tender, and for modifying or dispensing with the guaranteed placing of shares with institutions, will need to be carefully considered. Market considerations will of course have to be taken fully into account also. On capital structure, I will have a close interest and should be grateful to be kept in touch with your thinking as soon as possible. Finally, we have not quite completed our analysis of the lessons from the BP sale, but it is very likely that we will decide that the roles of financial adviser and primary underwriter should be kept separate. I know that Samuel Montagu have accepted their appointment on this basis provisionally. I will confirm our conclusions to you as soon as possible.

NORMAN LAMONT

17 MAR 1988

dti

the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Rt Hon Norman Lamont MP
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5147
Our ref
Your ref
Date 17 March 1988

MR GUY
PS, CST
Sir P. Middleton
Mr Anson
Mr Monck
Mrs D.J.L. Moore
MR Brown Mr Call.

Dear Norman,

BSC PRIVATISATION

As you know, we are now moving into the detailed planning of the privatisation of BSC. I thought it would be helpful, therefore, at this relatively early stage to set out my general view of our objectives and strategy for the British Steel privatisation. In doing so, I should make clear that I would not wish these matters to be set in stone at this stage. BSC will not be an easy privatisation both because of the nature of the business and because of the rather more uncertain market conditions when compared to those prevailing a year or so ago. While we need planning assumptions to take the work forward, therefore, we will also need to keep those assumptions under constant review.

With that in mind, I see the following as the three key objectives of the BSC privatisation:

a) Subject to market conditions, to return the Corporation to the private sector through a public offer for sale by August 1989 and to aim for the end of 1988;

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b) To maximise the net proceeds of sale consistent with the achievement of a healthy after market; and

c) To relinquish all financial obligations including existing commitments at the date of privatisation.

I would welcome your agreement to these objectives, subject, as I have indicated, to their being kept under review as we proceed.

We also need to give some guidance to those working directly on the marketing of the issue as to the nature of the target market. In considering this issue, we need to be very conscious of two difficulties. First, BSC operates in an industry which is associated with heavy losses and cyclical downturns. Generally, we can expect investors' perceptions to be fairly negative. Second, the October downturn in the stockmarket and the consequent lack of public support for the BP offer, suggests that we may have a harder task than previously to stimulate demand.

I therefore feel it would be appropriate to concentrate our early marketing efforts on the institutions and, perhaps to a lesser extent, the experienced private investor. That in itself would lead to a more research orientated sale and a less obviously "popular" campaign than has been the case in some other privatisations. That does not mean, of course, that the small private investor would not be encouraged to invest or, indeed, that as the work progresses and confidence in the stock exchange hopefully continues to return, that we might not broaden the marketing thrust. Indeed, we fully recognise the beneficial effect on valuation of encouraging popular demand. But I think it would be wrong for us to begin with the presumption of a popular share issue.

I should also mention at this stage the question of overseas participation. Officials are currently seeing, together with our merchant bank advisers, a range of overseas banks to assess the potential level of interest and possible ways forward. Once those meetings have taken place, we will review the position formally. For the present, however, I am pre-disposed against full registered overseas offers, though rather more attracted to the prospect of overseas placings with institutions. The thinking behind this view is that we would not wish unnecessarily to incur the extra costs and disclosure requirements of an overseas registered offer unless the benefits were clear.

A further specific area I would wish to mention is the phasing of the sale. On this issue, I feel strongly that if we can satisfy ourselves that there is sufficient market capacity and interest to absorb the offer, then we should aim for a 100% sale. I would not wish to see a hangover of continuing Government involvement in the Corporation which we would need to dispose of at a later stage. I recognise, however, that circumstances could arise in which there could be pricing advantages in proceeding with a phased sale. We will need to keep this issue under review, but I thought it important to make clear my present view.

There are obviously a wide range of other issues that we will need to consider as we move forward. The detailed underwriting arrangements and related issues will, for example, need to be considered in considerable detail in the light of recent experience. I also expect to write to you shortly concerning the choice of a target Impact Day for BSC. I hope, however, that you see no difficulties with the way forward I have outlined in this letter.

Yours ever,
K.

KENNETH CLARKE

IS1AAF

854/26

CONFIDENTIAL

FINANCIAL SECRETARY

FROM: MRS M E BROWN
DATE: 6 May 1988

I suggest ~~the~~ deleting one sentence from the draft letter, which overstates the pre-Budget problem. M.

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Odling-Smee
Mr Sedgwick
Mr Turnbull
Mr Lyne
Mr Bent
Mr Guy
Mr Rutnam
Miss Wheldon - T.Sol

BRITISH STEEL PRIVATISATION:
(i) TIMING OF IMPACT DAY
(ii) COST SHARING
(iii) ADVERTISING

(i) Impact Day

Mr Clarke wrote to you on 21 April about the timing of Impact Day. He concluded that planning should proceed for 22 or 23 November, though the arguments between a sale in November 1988 or January 1989 were finely balanced. We recommend you to agree that Impact Day should be on Tuesday ~~21~~ 22 November.

2. Mr Clarke says that the marketing and proceeds arguments favour January. We are less sure. A later date would certainly allow longer for publicising and planning the sale. But Christmas would intervene, and early January (when the pathfinder would issue) is traditionally a dead time on the Stock Exchange. BSC themselves favour a pre-Christmas sale, and we will rely strongly on the commitment of their top management to make the sale a success. The argument on proceeds is that there would be a more up to date and bullish profits forecast in

January (the year-end is March 1989). However, we understand that BSC will have a considerable measure of certainty about their order book to the year-end by the third quarter. The Corporation do not consider that the later date would make a material difference to their forecast.

3. The main considerations against a January sale are Budget disclosure problems. Discloseable matters include decisions on tax changes, decisions on interest rates and exchange rates and assumptions on economic indicators used by the Treasury. On tax changes, legal advice is that the prospectus must disclose decisions about matters specific to the company or of particular relevance to its business, but that matters affecting companies and investors generally need only be disclosed if not to disclose them in the prospectus would create a misleading impression. However, disclosure clauses in the underwriting agreement, which would be difficult to change, require the disclosure of these more general categories of information also. Our conclusion is that although a January sale is not impossible, it is highly undesirable because of the possible constraints it could place on the Budget decision-making process.

4. A November sale would not be free of disclosure problems, but we think they are much more tolerable. The main aim is to issue the prospectus after the Autumn Statement, both to avoid market uncertainties before the statement is made, and to avoid having to reveal any sensitive matters it may contain. GEP's advice is that it would be safe to plan for Impact Day on 22 November. If 3½ weeks are allowed after the Party Conference for Star Chamber discussions, the final public expenditure Cabinet would be on Thursday 10 November, and the Autumn Statement on Thursday 15 November. (Last year, in favourable conditions, the Star Chamber phase was completed in 2½ weeks). It is possible that Parliament might be in recess on 15 November, but in that case GEP suggest that the 1986 practice could be followed of making an announcement on the afternoon of Cabinet (ie. 10 November). The only risk of 22 November would be if Cabinet could not agree the Statement on 10 November, and needed another bite in the following week.

But again it would be possible to make an announcement immediately following the second Cabinet - ie. before 22 November.

5. We do not want to defer Impact Day to later in November, because the posting of allotment letters and the start of dealings would come too close to Christmas. The timetable therefore means that the pathfinder prospectus would have to be issued before the Autumn Statement. Ideally the pathfinder should be identical to the final prospectus, omitting only the share price. But if changes did have to be made as a result of the Autumn Statement (eg. revised exchange rate assumptions) we think this would be tolerable.

6. Mr Clarke suggested either 22 or 23 November. We strongly recommend 22 November. The Queen's Speech may be on 23 November, and would hog the headlines. We do not see disclosure or market confidence problems in going before the Speech.

Cost sharing

7. Agreement has been reached with BSC that the Government will pay 60 per cent of public relations and advertising costs (covering the corporate and flotation phases), and that all other shared costs (eg. receiving banking and registration costs) will be on a 50:50 basis. We consider that this is a satisfactory outcome.

Advertising

8. We are working closely with DTI officials on the marketing strategy of the sale. As Mr Clarke explained in his earlier letter to you of 15 April, DTI do not think it likely that the sale can be directed primarily to the retail market. They want to preserve flexibility on the actual amount of retail demand to be tapped. They believe, in any case, that both institutional and retail investors still know very little about British Steel, and that their image of it (if any) is of losses and uncertainty. DTI therefore consider that a relatively

long corporate advertising campaign is required to build up the company's image. They envisage that this would be followed by a fairly short phase of flotation advertising, starting in early September. This would be more factual than previous flotation campaigns, partly because the sale is likely to be focussed on institutional investors, partly because of the requirements of the Financial Services Act and the tightened approach to financial advertising which the advertising and broadcasting authorities are now adopting.

9. We are broadly content with this approach, but want to leave open the possibility of a longer flotation advertising period if it appears during the summer that there is more retail interest in the sale than currently expected. DTI propose to review advertising commitments on a monthly basis, so we are content that there is enough flexibility here.

10. Two immediate issues arise. DTI officials are consulting their Ministers urgently on these, and we should be grateful to know that you also are content:

(i) There has been a hiatus in the BSC corporate advertising campaign whilst the cost sharing arrangements referred to above have been sorted out. BSC are most concerned that the advertisements being shown until a month or so ago should be revived. Although final agreement on a total advertising budget has not yet been reached (see further below), we think it highly desirable that the corporate campaign should get underway again.

(ii) Appointment of advertising agents
Dewe Rogerson have been selected in competition as PR advisers to the sale: their costs will be shared equally by Government and BSC. They are already acting as advertising agents for BSC. DTI officials are recommending that they should be retained as joint advertising agents for the corporate phase of the advertising campaign. This is in line with the decision on the BP sale to retain Saatchis (who were BP's advisers) for the corporate phase.

The intention would be to hold an open competition to appoint agents for the flotation phase.

11. Discussions are in progress with Dewe Rogerson about the total costs of the advertising campaign. DTI currently envisage total advertising expenditure of around £6-10 million on the corporate phase, and up to £4-8 million on flotation advertising itself: in both cases HMG would pay 60 per cent. These are relatively high sums by comparison with other sales, and we will want to go through them very carefully with DTI. For the time being there is no firm decision required, and we do not think that the authority to resume corporate advertising need be held up pending agreement on total costs. A further submission on advertising costs will be put to DTI Ministers and to you. DTI officials are also asking their Ministers whether they would like a presentation of Dewe Rogerson's current and proposed advertising plans. We have asked that you be invited to any presentation.

Conclusions

12. We should be grateful to know that you agree to

(i) a 22 November Impact Day;

(ii) resumption of the corporate advertising campaign.

13. A draft reply to Mr Clarke about the timing of Impact Day is attached.

Mary Brown

MRS M E BROWN

CONFIDENTIAL

DRAFT LETTER FROM THE FINANCIAL SECRETARY TO THE CHANCELLOR OF THE DUCHY OF LANCASTER

BSC PRIVATISATION: TIMING OF IMPACT DAY

Thank you for your letter of 21 April.

Like you, I recognise that the balance of arguments between a pre-or post-Christmas sale is quite fine. But I believe that the practical and political considerations point us to November. That gives us a clear run-in on planning the sale, without the interruption of Christmas. It is the earliest possible date - and we have said we wish to privatise the Corporation as soon as possible. British Steel themselves favour November, and we do of course rely on the enthusiasm of their top management to boost the success of the sale. Moreover, there are, as you know, very real difficulties for us in conducting equity sales in the 2-3 months before the Budget, because of prospectus disclosure requirements. ~~For this reason we would not want to consider a January date, even as a fall-back, unless there was absolutely no alternative.~~

I note that it is has been suggested that a profit forecast for a January flotation might be less consservative than one made two months earlier, and that this could affect proceeds. I understand, however, that it has been impossible to quantify this effect, and that the Corporation themselves do not consider that the difference would be material. Proceeds arguments do not, therefore, seem to outweigh the other considerations I have mentioned.

As between 22 or 23 November, I understand that the advice from our officials, and considerations relating to the Parliamentary timetable, point to Tuesday 22 November. I am content with that.

NORMAN LAMONT

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the department for Enterprise

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The Rt. Hon. Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

2 APR 1989

Rt Hon Norman Lamont MP
Financial Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET
Switchboard 01-215 7877
Telex 8811074/5 DTHQ G
Fax 01-222 2629

FINANCIAL SECRETARY
REC. 21 APR 1988
ACTION Mrs. M. E. Brown.
COPIES TO PPS, CST
Sir P. Middleton.
Mr. Anson Mr. D. J. L. Moore
Mr. Odling-Smee, Mr. Lyne
Mr. Bent
Mr. Guy
Mr. Call.

Direct line 215 5147
Our ref
Your ref
Date 21 April 1988

Dear Financial Secretary

BSC PRIVATISATION: TIMING OF IMPACT DAY

As I indicated in my letter of 15 April, I am now writing about the precise timing of Impact Day.

Your officials will know that we have been examining this in some detail. For a variety of reasons - the length of time needed for preparations, disclosure problems on the Autumn statement and the Budget, and the Christmas holiday period - there are effectively two possible "windows" for BSC privatisation if we are to privatise BSC this winter, which as we have agreed is very much our first preference. These two options are in late November or late January (specifically a Target Impact Day of 22/23 November or 24/25 January). We now have to choose between these two dates. My letter of 15 April touched on my wish to keep summer 1989 in mind as a possible fall-back in the event of unexpected difficulties; but there is no need to discuss that further here.

As you know, our discussions to date have been based on the assumption of a November flotation and to the extent that this remains possible, it clearly remains attractive. During our

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consideration of this issue, however, it has become clear that the issues are far from clear cut. In broad terms, the arguments are;

(i) The political arguments favour November. We have always made clear our wish to privatise BSC "as soon as possible" and if November is possible we should work to that timetable. Certainly, BSC favour that date and I would imagine we would both wish to begin the privatisation programme again during this calendar year;

(ii) The marketing arguments seem to favour January. We would have that much more time to develop the marketing campaign and I understand that the market is usually slightly stronger in January than November and Christmas is less of a distraction. There would also be certain accounting problems with a November flotation in that we would need to proceed on the rather unusual basis of four or five months audited accounts together with a six month unaudited result, a combination which would need to be explained carefully to the market. January in contrast would cause no similar problems;

(iii) The proceeds arguments seem to favour January. This arises because a key element in valuation of the company will be a profit forecast for the full year to the end of March 1989. Other things being equal, a profit forecast for a January flotation will be less conservative than one two months earlier and with the multiplier effect of a PE ratio, this could lead to higher proceeds from a January sale.

It has to be said, however, that we have found it impossible to quantify this effect and it is certainly possible that it may not occur. It is rather more than a theoretical argument but equally it is by no means a conclusive argument in favour of January;

(iv) I understand that there are real difficulties which would be caused for the Treasury in planning for the 1989 budget if privatisation were to take place in late January, because of the problems of disclosure. I understand that this would not be an absolute bar to a January flotation if the arguments were conclusively in favour of that option, but we certainly recognise the difficulties that would cause.

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We have been trying to assess these various arguments. Having done so, we have concluded that we should continue to work towards a November flotation and specifically towards a Target Impact Day of 22 or 23 November. I would not wish to claim that any single argument is conclusive in reaching this view but take the broad view that if November is feasible then that is the course we should adopt given our wish to privatise as soon as possible.

I hope you would agree, therefore, that we should now plan on the basis I have suggested. There is perhaps a theoretical possibility that if the balance of arguments were to change in the next couple of months then we might re-consider the January option. But I do not regard this as likely, and that option would fairly soon disappear through the passage of time.

Rosalind Cole

pp KENNETH CLARKE

(approved by the Chancellor and signed in his absence)

AP3AAC

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RESTRICTED

FROM: A TURNBULL
DATE: 25 MARCH 1988

MRS M E BROWN

cc Mr Moore
Mr Gieve
Mr Dyer
Mr Bent

TIMING OF AUTUMN STATEMENT

In your manuscript comment on Mr Dyer's minute of 22 March you suggested that the BSC impact day could be on Wednesday 23 November which would allow the Autumn Statement to be as late as Tuesday 22 November. The ideal position for GEP is to have 3½ weeks between the Party Conference and final Cabinet plus a further week in hand which would take us to Tues 22 November. This prevents the Treasury from being forced to settle by pressure of time. However, the probability that we would not have the Survey sewn up in time for an Autumn Statement on Tues 15 November is, on the basis of the experience of recent years, very low. In extremis dispensing with the fallback week might be something Ministers were prepared to risk.

2. Mr Dyer warned that the Prorogation/Opening break could fall awkwardly. If this meant that an Oral Statement were not possible on 15 November, we would have to do what we did in 1986, ie have an Oral Statement immediately after the Cabinet meeting, (Thurs 6 Nov) with the published document to be issued as and when Parliament was available. In fact we adopted this practice in 1986 as a pretext; the real reason was that the outcome of the Survey was thought to be too market sensitive to wait until the following week.

AT

A TURNBULL

27 JUL 1988

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the department for Enterprise

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The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

.The Rt Hon Norman Lamont MP
Financial Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1P 3AG

FINANCIAL SECRETARY	
REC.	27 JUL 1988
ACTION	MS M.E. Brown
COPIES TO	PPS, CST
	Sir P. Middleton, Mr Anson,
	Mr Monck, Ms Lomax,
	Mr D.J.L. Moore, Mr Odling-Smee,

Mr Lyne, Mr Bent, Mr Guy, Mr. Call

Must ensure that institutions are not given too favourable a deal. [illegible] greatest potential was depressed because of [illegible] on state of stock mkt @ the time [illegible] wrong to [illegible] that these cannot be much rather [illegible]. The nature of BSC (BA-X) [illegible] similar to that of BA.

Direct line 215 5422
Our ref PS3BEN
Your ref
Date 27 July 1988

Dear Norman,

BSC PRIVATISATION

You will recall our exchange of letters around Easter on progres towards BSC privatisation. I though it might be helpful to write again before the summer break on the range of issues which have been discussed over the last few months and which need to be decided either now or in the early Autumn. We need also to give our officials and advisers a clear steer on the way we wish the British Steel flotation to be taken forward. I am writing separately on British Steel's capital structure.

In general, I believe we remain on course for a flotation in late November. There are, however, a number of uncertainties which could still affect this. The German industry's decision to take the European Commission to the European Court in respect of past aid to BSC remains a real concern. There remains a possibility of disruption in the European market following the abolition of quotas, though the signs here are reasonably hopeful; and there are difficult issues relating to BSC's marketing arramgments both at home and abroad. More generally, stock market conditions remain uncertain, and we cannot rule out difficulties arising from the capital markets between now and November.

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X Even leaving these factors aside, it is clear that we will not have the easiest of privatisations. This is a competitive industry operating in a cyclical market. Although the British Steel Bill has now completed its passage through the House, political issues continue to be raised, and this can be expected to continue until the flotation. In short, this is a privatisation where there is inescapably a higher degree of risk than in some recent sales; and it is this which has led us to believe that this sale will need to be primarily focused on the institutions and experienced private investors rather than "Sid". More generally, I think that this is the backcloth against which we must consider the key decisions on the sale.

Structure of the Offer

My pre-disposition is to support the view that a fixed price offer should be restricted to the UK retail market alone and that other markets, including the UK institutional market, should bid in competition for the remaining shares. I also tend to favour a partial tender approach similar to the BP arrangements, although our advisers are suggesting that they may ultimately feel obliged to recommend a fixed price offer in view of the uncertainty of demand among UK institutions. I should note in passing, however, that our advisers have also suggested that the possibility of a dual fixed price offer should be kept open, under which there would be an acknowledged discount for the UK retail market. If uncertain demand was to lead us to fall back to a fixed price offer then that route would seem to have attractions.

I should say, however, that I do not think an exact parallel of the BP arrangements will be possible. In particular, I think we may well be looking for a relatively limited public offer in the UK, possibly no more than 30% of the total equity, unless we are convinced that there is strong demand. In those circumstances, however, I do not think it will be possible to place the remaining 70% in an international/ institutional tender if that runs the risk of a high percentage of that offer going overseas. The position here is rather different to that on BP and, in short, I am reluctant to accept the risk of more than 20-30% of the offer ending up in non-UK hands, at least in the initial sale. That suggests, in effect, that we will have to look for some way of giving the UK institutions a guaranteed place, though this is clearly not incompatible with a tender offer among those institutions. Our officials will need to give further thought to this.

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Given the uncertainties to which I have referred above, I do not think we are in a position to take a final decision on this now. I am content to maintain our pre-disposition towards dual pricing and a tender element, provided that we are persuaded that it is feasible for us to proceed on this basis; and I believe that we should review the matter again in the early Autumn. What is clear is that our advisers must accept whatever mechanism the Government decides is right in this area; and this must apply in respect of underwriting arrangements as well. In this context, I should note that I am entirely content that we should proceed on the basis of separating the role of lead underwriter from that of adviser and sponser of the issue; I know that our officials are considering in detail the consequences for the appointment of a separate lead underwriter.

The Retail Market

I made clear in my letter of 15 April that, although I believe that this sale should be primarily directed at the institutions and experienced investors rather than "Sid", that in no way precludes the encouragement of a reasonably wide distribution of shares. This is desirable both in the interests of future privatisation campaigns and to ensure that the institutions do not have an easy ride on the sale. We believe, therefore, that the more experienced private investor should be very much the target for the public advertising campaign which, if conditions prove rather better than we currently expect, might not rule out the bandwagon effect of previous privatisations. I do not think that we need tie down our advertising budgets at this stage - that would be a matter for early September when I hope we might have a joint presentation from the advertising agency - but I would have thought a campaign in the £5-10 million range would be appropriate. As regards the tone of the marketing, I think we must encourage an informative and instructive approach which clearly avoids any suggestion that we are providing "hype" without substance.

I think there are a number of other items in the marketing mix which follow on from this. First, I think that the above approach argues for two rather than three instalments; and I feel that an early decision on that in principle would be welcome now, leaving the precise weighting between the two instalments, and the precise timing of the second instalment, until later. Second, I do not believe that there is any real case for loyalty bonuses on this issue. Although these have tended to feature in the majority of privatisations, I believe

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the department for Enterprise

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there is no obvious case of encouraging people to lock themselves into an investment in British Steel; and I doubt whether the absence of such a bonus would detract from the marketing, particularly given the proposed target audience. Third, I would have thought the approach suggests a rather higher minimum application than in some cases - perhaps between £550-£600 - though this is undoubtedly for later decision. The overall package on these matters would thus be something like Rolls-Royce, which I believe comes closest to previous privatisations to the approach which I would like to pursue in this case. I would however welcome your views on these matters though, with the exception of the principle of instalments, there is no need for firm decisions at present.

Overseas Offers

As you know, we have appointed advisers to consider the possibility of public offers or private placings in Japan, the USA, Canada and Europe, although no commitment has been made to offers in these markets. I must say that my initial reaction, on a political level, was that overseas offers were to be avoided if possible, given concerns about steel being a "strategic industry"; and as I have indicated, I do not think we can countenance a situation in which a majority of the shares end up in non-UK hands in the intial sale. Nevertheless, having heard the views of our advisers on this issue, I have sufficient reservations about the level of potential demand among the UK institutions to conclude that we need at least some overseas support. Indeed, given the possible relative lack of UK retail interest, I think that we must look overseas to drive up the demand among UK institutions and thus maximise proceeds. For that reason, I have concluded that we should proceed in the expectation of making registered offers in the USA, Canada and Japan and placings in Europe. I would not rule out modifying this approach at a later stage - and even at this point I would regard Canada as marginal, though it is a market in which BSC's commercial interests are particularly strong. But I recognise that there are risks in pulling out at a later srage and that tthe opportunities for doing so must be limited.

I would welcome your reaction to these points. We will clearly need to keep closely in touch, and you may wish to know that from September onwards I shall be chairing a regular internal group on the privatisation at which I hope that Treasury will normally be represented at official level to ensure that your concerns are fully covered.

I would welcome a reply before the Recess.

[signature]

the Enterprise initiative

42/46/JRF

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

Thanks - I think there will be no problem on X–

FROM: FINANCIAL SECRETARY
DATE: 31 August 1988

CHANCELLOR

BRITISH STEEL: EMPLOYEE SHARE OFFER

You will recall that I asked officials at the end of July to work up in greater detail the two options which might solve the problem of the taxation of employee priority shares in the BSC offer. I have now held a meeting to discuss them.

Option 1, which would introduce separate maxima for priority shares with a discount and those without, is presentationally better, as it allows us to preserve the figure of 10%. But it lacks flexibility since the maxima would apply to each category separately (so that, for example, limits of 15% and 5% would be ruled out); and the new implied limit of 20% would still probably be too low. In short, it wouldn't solve the problem.

Option 2 simply raises the 10% limit to 30% so that all the BSC priority shares can come within the scope of the section 68 exemption. This would enable us to meet our commitments to BSC; but <u>only</u> if market conditions are such that at least a third of the total sale were offered to the public at a fixed price. I am concerned there is a substantial risk that this might not be possible. It would therefore be wiser to set a higher percentage limit, with a corresponding reduction in the minimum proportion for the fixed price offer. But the Revenue argue that this opens up scope for abuse.

My own preference would be to interpret the limit in the legislation as applying to the whole of the offer and not just to the fixed price element. However, this is not possible, since it would allow employees to avoid a tax charge on the discount from the offer price, which is of course taxable and has been taxed in the past. I am therefore (reluctantly) drawn to some sort of solution along the lines of Option 2. But I believe the 30%/ one third split is too risky and I therefore asked officials to ascertain from Samuel Montagu whether there is a "bottom line" proportion for the fixed price element which they would be confident of being able to offer. Samuel Montagu have said that 25% should be possible; if market conditions deteriorated so that the proportion was likely to fall below that, they would recommend changing the structure of the whole offer. The Revenue will now reflect whether the resulting increased limit needed to meet our BSC commitments (40%) would be acceptable on anti-avoidance grounds. They will do this urgently given the tight timetable prior to privatisation.

X

NL

NORMAN LAMONT

pe.sh.guy.min13.9

CONFIDENTIAL

FROM: W GUY

DATE: 13 SEPTEMBER 1988

1. MRS BROWN

2. FINANCIAL SECRETARY

cc: Chancellor
Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Ilett
Mr Bent
Mr Lyne
Mr Rutnam

BRITISH STEEL: FLOTATION ADVERTISING

You are attending a presentation by Saatchis at 4.30 pm on Thursday at the DTI. Lord Young and Sir Robert Scholey will also be present. Saatchis will be presenting for approval their proposals for the Steel advertising campaign and the budget for media spending on it.

The Campaign

2. You will see rough edits of the TV commercials which are already in production. They are intended to highlight the ubiquity of steel products in various sectors of British industry, with the slogan "A share in British Steel is a share in British success" and backing from the first movement of Elgar's First Symphony.

3. Lord Young has suggested a snappier and stronger slogan, which has come to be known as the "imperative" version: "Share in British Steel; share in British success". But the lawyers fear that this is the wrong side of the line and Samuel Montagu think it is too hyped. SM also have doubts about the original version, and DTI officials will be putting to Lord Young the concerns that the "British success" message may be received badly at a time of rising interest rates etc, and that in any case commentators may

Amazing – but tell that to DTI.

Tim PS/FST

recoil from what they may see as the pushiness of the "success" theme in the first privatisation since BP/October.

4. We see nothing wrong in the original Saatchi version which, as you will see, they have managed to use to create commercials which are strong but restrained without the hoop-la overtones of BP. Lord Young's imperative version does seem unnecessary, however.

5. You will also see mock-ups of press ads. At time of writing this the press ads are still being worked up following discussion of first ideas last week. No mock-ups of posters are available: Saatchis regard posters as an optional extra in the campaign to be added in only if the budget is big enough (over £7 million media spend in their view).

The Budget

6. Saatchis recommend media spending of £9 million. Allowing about £0.75 million for production and 15% VAT, this translates into an inclusive cost of £11.2 million. The budget to be decided is for flotation advertising excluding prospectus advertising, for which a separate appointment is to be made.

7. Saatchis have proposed material exemplifying the campaigns which could be mounted at four levels of spending: £5 million inclusive (our proposal to DTI); £5 million exclusive (equivalent to £6.6 million inclusive) (DTI's original preference); £7 million exclusive (equivalent to £8.9 million inclusive); and £9 million exclusive (Saatchis estimate of what is required for the task).

8. Until last Friday, Saatchis were saying that £7 million exclusive would do the job. Dewe Rogerson were suggesting £6-7 million exclusive in their role as PR advisers. Logistics planning has been on the basis that £6 million exclusive would generate about 1.5 million applications at the end of the day. This is all finger in the air stuff. There is no way of objectively working out how much spending is needed to generate a given level of public interest.

9. There are no exact precedents in previous privatisations. The closest precedents are probably BAA, Rolls Royce and BA. Saatchis have got "Media watch" estimates of the flotation spending on these campaigns, which when uprated for media flotation suggest spending of about £4.5 million per £ billion proceeds. Taking £2 billion+ as Steel proceeds validates their budget proposed of £9 million (Annex A).

10. But another way of looking at Saatchis figures is to regard them as validating spending of around £3.50 per applicant. So if we wanted about 1.5 million applicants, which at £500 investment per head would absorb about one third of the sale, this would indicate media spending of £5.25 million exclusive.

11. None of this is very exact, but £5 million exclusive looks to be a better ballpark than £9 million. On Saatchis plans (Annex B) it would not run to including posters, and it would leave a 1½ week gap in TV exposure although we do not think that critical. It would give a reasonably heavyweight TV campaign during the share sale launch phase, followed by a 1½ week hiatus in which direct mailing to 4.7 million existing shareholders takes place, after which TV comes in again and runs to the end of the campaign.

12. DTI officials say privately that £6 million exclusive is about the right figure, but they warn that Lord Young may wish to go for £7 million. Scholey may also favour a higher figure; under the cost sharing agreement he only pays for 40%. For corporate image advertising we limited the HMG commitment to 60% of £5 million, but BSC topped this up and the gross spend may have been around £10 million.

13. A final factor to be taken into account is PAC scrutiny, which is likely to focus on the total HMG spend compared with previous sales. On BA we spent over £8 million, and on RR only £3 million. If we had an inclusive budget of £7 million for Steel flotation, this would translate into an HMG share of £4.2 million which taken with our share of the corporate image campaign would come to £7.2 million, plus prospectus advertising.

14. A complication in this is that on Lord Young's insistence DTI is not formally picking up any share of the corporate image campaign costs, although the corporation will get the £3 million back some other way, eg, by HMG picking up a bigger share of receiving bank costs.

Tactics

15 In discussion with Lord Young after the presentation I suggest you take the following line:

a. We need to have a good enough exposure for this share offer to allow retail interest to be engaged and to convince institutions that we are serious. We also do not want to seem shy about restarting the privatisation programme. But at the same time we are not aiming this sale primarily at "Sid" and we do not wish to be seen to do so.

b. Going over the top may be counterproductive in alienating commentators. Dewe Rogerson are very concerned about this and they are proposing media spending of around £6 million.

c. I think it would be right to go in below that. I originally had a figure of £5 million inclusive in mind. But I am persuaded of the merits of £5 million exclusive of VAT and production, which is equivalent to about £6.6 million inclusive. Our share of this would be about £4 million, which would be additional to the £3 million share of corporate image campaign advertising which we shall be picking up one way or another. This makes £7 million before we add prospectus advertising. That puts it up amongst the higher ranges of previous sales of a similar sort. It would buy adequate TV and press coverage.

d. £5 million media spending on the flotation would compare favourably with previous sales both in absolute amounts and costs per application.

e. If pressed. Could agree to a media spend of £6 million exclusive if at least £½ million of the addition went on a poster campaign. This would give up to an extra £½ million for TV, which is a much more expensive form of advertising "wallpaper" than posters.

f. Anything above £6 million exclusive would be very difficult to justify. NB DR have £6 million in mind, and Saatchis pitch only last week was only for £7 million.

16. These figures assume we are not going hard to chase retail interest. If you wished to, a higher figure could be justified.

17. If Lord Young is uneasy about the regional weighting (in favour of London and the South) in Saatchis TV plan, you will wish to defend it. For a sale of this sort it makes sense to concentrate on the shareholding population. You are holding a meeting to discuss all this at 4.30 pm today.

W GUY

ANNEX A.

PAST EXPERIENCE

	Media Spend * Flotation Advertising £m	Media Spend Adjusted to Oct/Nov 1988 Prices £m	Amount Raised £m	No of applicants	Spend per applicant
BA	5.1	6.8	900	1.1 m	£6.18
Rolls Royce	3.2	3.8	1,400	2.0 m	£1.90
BAA	4.1	5.0	1,200	2.2 m.	£2.27
					£3.45

Average spend per £1bn raised = £4.5m

* ex VAT, production, prospectus

£2bn [illegible]

600m
@£500

= 1.2 m applicants x £3.45 = £4.14 m.

1.5m " x [illegible] = £5.1[illegible]

ANNEX 3

SAATCHI & SAATCHI ADVERTISING

9TH SEPTEMBER 1988

BRITISH STEEL CORPORATION

ALTERNATIVE MEDIA PLANS

OUTLINE RECOMMENDATIONS

REVISION 2

INTRODUCTION

This document includes four media plans constructed to the following budget levels:

(1) £5 million including VAT and production

(2) £5 million media only

(3) £7 million media only

(4) £9 million media only

The plans revise those presented in the "outline recommendations" document (dated 6th September) to extend the period of television advertising during the pre-prospectus stage.

Options (1) and (2) allocate £1.5 million to October television activity with the remaining monies planned into November. On higher budget levels, where television is affordable throughout the period, recommended weights of activity scheduled in October are increased to cover the entire month thus spending more than the £1.5 million provisional limit.

(1) BUDGET £5 MILLION INCLUDING VAT & PRODUCTION

Two principle media vehicles are recommended, namely:

(1) National Newspapers to communicate specific information in a relevant editorial environment frequently used as an information source for financial decisions. Importantly press provides an opportunity for direct response through coupons.

(2) Television to target a wider audience in a high cover, intrusive and provenly effective medium.

The recommended weight of newspaper activity should ensure a weekly opportunity to see and incorporate an upweight at the launch and countdown stages.

In total, thirteen insertions are required to fulfill such planning objectives. However, by scheduling ten insertions over the same period it is possible to achieve an effective campaign albeit at a minimum level. On the lowest budget, ten insertions are scheduled in each of six core titles selected for their relevance and efficiency at reaching the key target markets.

Television is planned in all areas over as long a period of time as the budget will permit without compromising minimum weights of activity. It is stressed that at all stages, the level of television is planned to an acceptable minimum in terms of cover and frequency.

At least 100 adult ratings are scheduled in each week of advertising with significant upweights at the launch and countdown weeks. No more than £1.5 million is planned into October as discussed with client.

The media plan attached overleaf is schematic. To help clarify the timing of each television burst, a laydown plan is also attached.

SAATCHI & SAATCHI ADVERTISING

BRITISH STEEL CORPORATION

RECOMMENDED MEDIA PLAN

(1) BASED ON BUDGET £5 MILLION

INCLUDING MEDIA, VAT AND PRODUCTION

	SHARESALE LAUNCH	PRE-PROSPECTUS	PROSPECTUS & REMINDER	TOTAL WEIGHT OF ACTIVITY	COST (£)
	30/9 -9/10 1½ WEEKS	10/10 -22/11 6 WEEKS	23/11 - 30/11 1 WEEK		
DAILY NEWSPAPERS 6 titles: Financial Times The Times Daily Telegraph Independent The Scotsman London Standard	PAGE MONO 1½ weeks 2 inserts per title	PAGE MONO 6 weeks 4 inserts per title	PAGE MONO 1 week 4 inserts per title	10 inserts per title	874,000
TELEVISION	1/10 - 9/10	10/10 - 22/11	23/11 - 29/11		
Group 1 Areas: London, South	60"/40"(1:2) 1½ weeks 340 Adults 255 ABC1's	1½ wk gap 60"/40"(1:2) 4½ weeks 495 Adults 371 ABC1's	20"/10"(1:1) 1 week 260 Adults 195 ABC1's	1095 Adults (90% @ 12.2) 821 ABC1's (89% @ 9.2)	
Group 2 Areas: Central, Granada TSW, HTV, Anglia	40" 1½ weeks 262 Adults 197 ABC1's	2 wk gap 40" 2½wks 281 Ad 211ABC1 ½ wk gap 40" 1 wk 100 Ad 75ABC1	20"/10"(1:1) 1 week 200 Adults 150 ABC1's	843 Adults (89% @ 9.5) 632 ABC1's (86% @ 7.3)	2,822,000
Group 3 Areas: Yorkshire, STV, Tyne Tees, Grampian, Ulster, Border	40" 1½ weeks 210 Adults 157 ABC1's	2 wk gap 40" 2wks 204 Ad 153ABC1 1 wk gap 40" 1wk 100Ad 75ABC1	20"/10"(1:1) 1 week 160 Adults 120 ABC1's	674 Adults (87% @ 7.7) 505 ABC1's (84% @ 6.0)	
	(£1,000,000)	(£1,452,000) OCT = £500,000 NOV = £952,000	(£370,000)		

	3,696,000
PLUS VAT @ 15%	554,400
	4,250,400
RESERVE FOR PRODUCTION	750,000
	5,000,400

NT: BRITISH STEEL CORPORATION

DUCT: FLOTATION

PERIOD: 1st October – 29th November

SAATCHI & SAATCHI COMPTON LTD

Week commencing on MONDAY:

WEEK COMMENCING — OPTION 1: £5m INC VAT & PRODUCTION

		SEPT 26	OCT 3	OCT 10	OCT 17	OCT 24	OCT 31	NOV 7	NOV 14	NOV 21	NOV 28	TOTAL WEIGHT
1	LONDON TVS	10 DAYS 60"/40" 340 ADULTS 255 ABC1's			1½ WEEKS 60"/40" 170 ADULTS 127 ABC1's		3 WEEKS 60"/40" 325 ADULTS 244 ABC1's			1 WEEK 20"/10" 260 ADULTS 195 ABC1's		1095 ADULTS 821 ABC1's
2	CENTRAL GRANADA HTV, TSW ANGLIA	10 DAYS 40" 262 ADULTS 197 ABC1's				1 WEEK 40" 131 ADULTS 98 ABC1's	1½ WEEKS 40" 150 ADULTS 113 ABC1's		1 WEEK 40" 100 ADTS 75 ABC1's	1 WEEK 20"/10" 200 ADULTS 150 ABC1's		843 ADULTS 632 ABC1's
3	YORKSHIRE STV TYNE TEES GRAMPIAN ULSTER BORDER	10 DAYS 40" 210 ADULTS 157 ABC1's				1 WEEK 40" 105 ADULTS 78 ABC1's	1 WEEK 40" 99 ADULTS 75 ABC1's		1 WEEK 40" 100 ADULTS 75 ABC1's	1 WEEK 40" 160 ADULTS 120 ABC1's		674 ADULTS 505 ABC1's
EVISION BUDGET (£)		1,000,000			500,000		952,000			370,000		2,822,000
		TOTAL OCTOBER £1,500,000					TOTAL NOVEMBER £1,600,000					

2. BUDGET £5 MILLION MEDIA ONLY

The plan attached overleaf includes £1,304,000 previously allocated to VAT and production. A proportion of these funds are scheduled to buy page insertions in national newspapers capable of reaching a wider audience than the specifically targeted publications listed in Option 1. The Sunday Times, Guardian, Daily Mail and Daily Express are added at the same weight (10 insertions) as the core publications.

Television activity is increased during the countdown period by 75% on the minimum level to generate a dominant level of activity in the week before flotation.

SAATCHI & SAATCHI ADVERTISING

BRITISH STEEL CORPORATION

RECOMMENDED MEDIA PLAN

(2) BASED ON BUDGET £5 MILLION

MEDIA ONLY

	SHARESALE LAUNCH		PRE-PROSPECTUS	PROSPECTUS & REMINDER	TOTAL WEIGHT OF ACTIVITY	COST (£)
	30/9 - 9/10 1½ WEEKS		10/10 - 22/11 6 WEEKS	23/11 - 30/11 1 WEEK		
DAILY NEWSPAPERS						
10 titles: Financial Times The Times Daily Telegraph Independent Guardian The Scotsman London Standard Daily Express Daily Mail Sunday Times	PAGE MONO 1½ weeks 2 inserts per title		PAGE MONO 6 weeks 4 inserts per title	PAGE MONO 1 week 4 inserts per title	10 inserts per title	1,900,000
	1/10 - 9/10		10/10 - 22/11	23/11 - 29/11		
TELEVISION						
Group 1 Areas: London, South	60"/40"(1:2) 1½ weeks 340 Adults 255 ABC1's	1½ wk gap	60"/40"(1:2) 4½ weeks 495 Adults 371 ABC1's	20"/10"(1:1) 1 week 455 Adults 341 ABC1's	1290 Adults (91% @ 14.2) 967 ABC1's (90% 2 10.7)	
Group 2 Areas: Central, Granada TSW, HTV, Anglia	40" 1½ weeks 262 Adults 197 ABC1's	2 wk gap	40" 2½wks 281 Ad 211ABC1 ½ wk gap 40" 1 wk 100 Ad 75ABC1	20"/10"(1:1) 1 week 350 Adults 262 ABC1's	993 Adults (90% @ 11.0) 745 ABC1's (89% @ 8.4)	3,100,000
Group 3 Areas: Yorkshire, STV, Tyne Tees, Grampian, Ulster, Border	40" 1½ weeks 210 Adults 157 ABC1's	2 wk gap	40" 2wks 204 Ad 153ABC1 1 wk gap 40" 1wk 100Ad 75ABC1	20"/10"(1:1) 1 week 280 Adults 210 ABC1's	794 Adults (88% @ 9.0) 595 ABC1's (85% @ 7.0)	
	(£1,000,000)		(£1,452,000) OCT = £500,000 NOV = £952,000	(£648,000)		

	5,000,000
PLUS VAT @ 15%	750,000
	5,750,000

...NT: BRITISH STEEL CORPORATION

...DUCT: FLOTATION

PERIOD: **1st October - 29th November**

SAATCHI & SAATCHI COMPTON LTD

Week commencing on MONDAY:

WEEK COMMENCING — OPTION 2: £5m MEDIA ONLY

		SEPT 26	OCT 3	OCT 10	OCT 17	OCT 24	OCT 31	NOV 7	NOV 14	NOV 21	NOV 28	TOTAL WEIGHT
P 1	LONDON TVS	10 DAYS 60"/40" 340 ADULTS 255 ABC1's			1½ WEEKS 60"/40" 170 ADULTS 127 ABC1's		3 WEEKS 60"/40" 325 ADULTS 244 ABC1's			1 WEEK 20"/10" 455 ADULTS 341 ABC1's		1290 ADULTS 967 ABC1's
P 2	CENTRAL GRANADA HTV, TSW ANGLIA	10 DAYS 40" 262 ADULTS 197 ABC1's				1 WEEK 40" 131 ADULTS 98 ABC1's	1½ WEEKS 40" 150 ADULTS 113 ABC1's		1 WEEK 40" 100 ADTS 75 ABC1's	1 WEEK 20"/10" 350 ADULTS 262 ABC1's		993 ADULTS 745 ABC1's
P 3	YORKSHIRE STV TYNE TEES GRAMPIAN ULSTER BORDER	10 DAYS 40" 210 ADULTS 157 ABC1's				1 WEEK 40" 105 ADULTS 78 ABC1's	1 WEEK 40" 99 ADULTS 75 ABC1's		1 WEEK 40" 100 ADULTS 75 ABC1's	1 WEEK 40" 280 ADULTS 210 AEC1's		794 ADULTS 595 ABC1's
...LEVISION BUDGET (£)		1,000,000			500,000		952,000			648,000		3,100,000
		TOTAL OCTOBER £1,500,000					TOTAL NOVEMBER £1,600,000					

3. BUDGET £7 MILLION MEDIA ONLY

The agency recommends utilising the additional monies to extend the television activity in groups (1) and (2) across the entire campaign with group (3) receiving 7½ weeks of television activity across the 8½ week period.

Furthermore the increased budget is sufficient to buy a heavyweight poster campaign during November thus providing a high cover, cost efficient opportunity to achieve a ubiquitious presence in the market place.

SAATCHI & SAATCHI ADVERTISING

BRITISH STEEL CORPORATION

RECOMMENDED MEDIA PLAN

(3) BASED ON BUDGET £7 MILLION

MEDIA ONLY

	SHARESALE LAUNCH	PRE-PROSPECTUS	PROSPECTUS & REMINDER	TOTAL WEIGHT OF ACTIVITY	COST (£)
	30/9 - 9/10 1½ WEEKS	10/10 - 22/11 6 WEEKS	23/11 - 30/11 1 WEEK		
DAILY NEWSPAPERS 10 titles: Financial Times The Times Daily Telegraph Independent Guardian The Scotsman London Standard Daily Express Daily Mail Sunday Times	PAGE MONO 1½ weeks 2 inserts per title	PAGE MONO 6 weeks 4 inserts per title	PAGE MONO 1 week 4 inserts per title	10 inserts per title	1,900,000
POSTERS Circa 2,000 sites		November, 48 sheets Plus Supersites and selected specials			700,000
TELEVISION	1/10 - 9/10	10/10 - 22/11	23/11 - 29/11		
Group 1 Areas: London, South	60"/40" (1:2) 1½ weeks 400 Adults 300 ABC1's	60"/40" (1:2) 6 weeks 877 Adults 658 ABC1's	20"/10" (1:1) 1 week 455 Adults 341 ABC1's	1732 Adults (94% @ 18.4) 1299 ABC1's (91% @ 14.3)	
Group 2 Areas: Central, Granada, Anglia, TSW, HTV	40" 1½ weeks 308 Adults 231 ABC1's	40" 6 weeks 675 Adults 507 ABC1's	20"/10" (1:1) 1 week 350 Adults 262 ABC1's	1338 Adults (92% @ 14.5) 1000 ABC1's (90% @ 11.1)	4,400,000
Group 3 Areas: Yorkshire, STV Tyne Tees, Grampian, Ulster, Border	40" 1½ weeks 247 Adults 185 ABC1's (1 WK gap)	40" 6 weeks 540 Adults 405 ABC1's	20"/10" (1:1) 1 week 280 Adults 210 ABC1's	1067 Adults (90% @ 11.9) 800 ABC1's (89% @ 9.0)	
	(£1,176,000)	(£2,576,000) OCT = £1,288,000 NOV = £1,288,000	(£648,000)		7,000,000
		PLUS VAT @ 15%			1,050,000
					8,050,000

4. BUDGET £9 MILLION MEDIA ONLY

At the highest level the Agency is able to plan recommended weights of activity in newspapers, on television and on posters on a task-led basis.

The number of newspaper insertions is increased to thirteen per title and television runs at effective weights throughout the period.

SAATCHI & SAATCHI ADVERTISING

BRITISH STEEL CORPORATION

RECOMMENDED MEDIA PLAN

(4) BASED ON BUDGET £9 MILLION

MEDIA ONLY

	SHARESALE LAUNCH	PRE-PROSPECTUS	PROSPECTUS & REMINDER	TOTAL WEIGHT OF ACTIVITY	COST (£)
	30/9 - 9/10 1½ WEEKS	10/10 - 22/11 6 WEEKS	23/11 - 30/11 1 WEEK		
DAILY NEWSPAPERS					
10 titles: Financial Times The Times Daily Telegraph Independent Guardian The Scotsman London Standard Daily Express Daily Mail Sunday Times	PAGE MONO 1½ weeks 3 inserts per title	PAGE MONO 6 weeks 6 inserts per title	PAGE MONO 1 week 4 inserts per title	13 inserts per title	2,484,000
POSTERS					
Circa 2,000 Sites			November, 48 sheets Plus Supersites and selected specials		700,000
TELEVISION	1/10 - 9/10	10/10 - 22/11	23/11 - 29/11		
Group 1 Areas: London, South	60"/40" (1:2) 1½ weeks 400 Adults 300 ABC1's	60"/40" (1:2) 6 weeks 1360 Adults 1020 ABC1's	10"/20" (1:1) 1 week 455 Adults 341 ABC1's	2215 Adults 95% @ 23.3 1661 ABC1's 93% @ 17.9	
Group 2 Areas: Central, Granada, Anglia, TSW, HTV	40" 1½ weeks 308 Adults 231 ABC1's	40" 6 weeks 1046 Adults 785 ABC1's	10"/20" (1:1) 1 week 350 Adults 262 ABC1's	1704 Adults 93% @ 18.3 1278 ABC1's 91% @ 14.0	5,816,000
Group 3 Areas: Yorkshire, STV Tyne Tees, Grampian, Ulster, Border	40" 1½ weeks 247 Adults 185 ABC1's	40" 6 weeks 837 Adults 628 ABC1's	10"/20" (1:1) 1 week 280 Adults 210 ABC1's	1364 Adults 92% @ 14.8 1023 ABC1's 90% @ 11.4	
	(£1,176,000)	(£3,992,000) OCT = £1,996,000 NOV = £1,996.000	(£648,000)		
					9,000,000
				PLUS VAT @ 15%	1,350,000
					10,350,000

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FINANCIAL SECRETARY

Hope ✓ (we will see SCS on legal advice ASAP, i.e. perhaps from Law Officers on what govt presentation would be, & on a full scale out-of-court settlement (cf BA). N.

FROM: MRS M E BROWN
DATE: 13 SEPTEMBER 1988

cc
Chancellor
Chief Secretary
Sir P Middleton
Mr Lankister
Mr Monck
Mr Moore
Mr Odling-Smee
Mr Guy
Mr Call
Miss Wheldon - T.Sol

STEEL PRIVATISATION

1. You should be aware of a potential problem on this sale. DTI are hopeful that it can be dealt with; but if not, there is a risk that the sale could not proceed.

2. The German Iron and Steel Federation has alleged in two complaints to the European Commission that BSC has received more in state aid than necessary to restore it to viability, and more state aid than that authorised by the Commission. The complaints (which are publicly known but have not attracted much attention so far) relate mainly to amounts paid since 1983 which total £930 million. The case is between the German Federation and the Commission, not the UK Government, and is due to be heard in the European Court, but this may not be for another year or more. If the case went against the Commission, it would probably have to require reimbursement from BSC of £217m, and possibly more.

3. If the case goes ahead this contingent liability will have to be disclosed in the sale prospectus. Officials do not at present see any satisfactory way of providing financial cover for it. Apart from the public expenditure objections, Government guarantees are not on because they would constitute more state aid.

4. The two main solutions being discussed are:

(i) getting a letter from the Commission indicating that it is confident of winning the case, together with a UK Counsel's opinion on the strength of the Commission's case. These would be highlighted in the prospectus. DTI's legal and merchant banking advisers consider, in principle, that the sale could proceed on this basis without undue damage to proceeds. But much depends on the precise nature of the assurances received.

At a meeting with DTI officials at the end of last week, the Commission said they were ready to be as helpful as possible over the handling of this issue. They have not yet committed themselves to an exchange of letters, but will consider drafts prepared by the UK this week. DTI also asked for comfort on the amount of reimbursement which the Commission would seek from BSC if the case went against them, but the Commission are less likely to agree to provide this in any public form.

(ii) getting the complaint withdrawn - either by BSC putting pressure on the German Federation, or by a UK Government approach to the Federal German Government. DTI regard any diplomatic initiative as a final fallback, which they are keeping in reserve for the present. Since the case has been brought by the Federation not the Government, the chances of success are not very good.

5. DTI are anxious to establish that there is a way through this problem before the end of September. The flotation marketing campaign is due to be launched then.

6. Lord Young will be writing in the next week or so to the Prime Minister, the Chancellor and the Foreign Secretary to report the position. We will keep you informed of any developments in the meantime.

Mary Brown

MRS M E BROWN

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FROM: MRS M E BROWN

DATE: 20 SEPTEMBER 1988

FINANCIAL SECRETARY

cc Chancellor
Sir Peter Middleton
Mr Monck
Mrs Lomax
Mr Moore
Mr Illet
Mr Lyne
Mr Bent
Mr Guy
Mr Call

Ch, Some important discussion (para. 7 onwards) on how much to involve the lead underwriter in pricing.

21/9

BRITISH STEEL: APPOINTMENT OF LEAD UNDERWRITER

This minute reports progress in selecting the lead underwriter, and seeks your agreement to procedures for consulting the lead underwriter at the time of the pricing decision.

Background

2. You announced on 7 September the separation of the lead underwriter appointment from that of financial adviser to the Government. Since then Samuel Montagu have completed their visits to the main London merchant banks. They took soundings on each bank's willingness (a) to participate in the primary underwriting of the Steel Sale, and (b) to act as lead underwriter.

3. None of the banks said that they would not consider taking primary underwriting - and a number have indicated specific sums which at this stage they would contemplate putting up, amounting to over £1 billion. Of course, no commitments have been either sought or given at this stage.

4. The candidates for lead underwriter have been whittled down as follows:

(i) BZW (advising BSC) and Warburgs (advising the Government through Rowe & Pitman) are precluded from competing because of their association with the sale;

(ii) Samuel Montagu recommend that certain banks, eg British Linen Bank and Guinness Mahon, do not have a sufficient track record to be invited to compete;

(iii) Lloyds Merchant Bank, Lazards, Kleinworts, Charterhouse and Hambros do not wish to compete. They have given various reasons (eg Kleinworts are "too busy"), none of which indicate any fundamental hostility either to the sale or to the principle of making a separate lead underwriter appointment;

(iv) That leaves Barings, County Natwest, Robert Fleming, Hill Samuel, Morgan Grenfell, Rothschilds and Schroders. Treasury and DTI officials have told Samuel Montagu that we do not think Ministers would want to include Morgan Grenfell or Hill Samuel in the competition.

5. On Samuel Montagu's recommendation, DTI officials are writing to invite just the big three - County Natwest, Rothschilds and Schroders - to submit for the appointment. Each bank will be asked to indicate in advance its willingness to accept the structure of the offer which the Government decides; and to indicate the amount of underwriting it is willing to take and on what terms - these will constitute the lead underwriter's remuneration. The banks have not been given any precise indication of the likely structure of the offer, but have been told it may contain an element of dual pricing (I will be minuting you separately about the options for offer structure).

6. The banks will be interviewed next week, and Mr Moore or I will represent the Treasury. We will of course report to you again after that.

Lead underwriter's involvement in pricing

7. One question which all three banks are expected to raise is the extent to which they will be involved in the pricing of the offer. Our general intention is that the lead underwriter should not take part in preparations for the sale (eg he would not be a member of the various advisory committees). But he would be kept informed about the emerging structure of the sale and other key issues, and would see drafts of the prospectus. In other words, he will buy a "package deal", and - like any primary underwriter - will put his faith in the fact that the sponsor to the issue (the Government's financial adviser) has vetted all the detail and has signed off on the prospectus.

8. However, the lead underwriter does need to be satisfied with the offer price, since he will not only be committing his bank to a share of the underwriting but will be seen as giving a lead to the rest of the primary underwriters to come in to the offer. Moreover, he will be in a position of great strength at that moment: if the lead underwriter walked away from the sale, he would effectively kill it. In their discussions with Samuel Montagu, some banks said they would want a formal role, including a place at the pricing meeting. None of the three short-listed banks set that out as a pre-condition; but all said they would need to know what procedures were envisaged, and Schroders asked particularly what would happen if the lead underwriter did not agree with the price which had been set.

9. We will need to see what the banks say on this when they are interviewed. But I suggest that we should be prepared to agree the following:

(i) the lead underwriter will be kept informed by Samuel Montagu of the emerging structure of the sale and other key decisions from the time of his appointment;

(ii) in the week leading up to the pricing decision he will have access to Rowe & Pitman for information about their assessment of the markets. (Rowe & Pitman or

Samuel Montagu would, if requested, provide information about the assessments of overseas and retail demand, but the lead underwriter would not have direct access to overseas and PR advisers);

(iii) during the same week Samuel Montagu would take soundings from the lead underwriter on what might be an acceptable pricing range. Samuel Montagu would take this into account in preparing their advice to Ministers. If their final assessment was different from that of the lead underwriter, they would inform Ministers of the lead underwriter's views;

(iv) the pricing meeting with Ministers would be attended only by the Government's financial and broking advisers. But if Ministers decided on a price which was known to be unacceptable to the lead underwriter, arrangements would be made for immediate further consultation with him - <u>either</u> by Ministers personally <u>or</u> by officials and advisers on their behalf. Ministers would then take a final decision.

10. The implication of (iv) is that, if Ministers persisted in wanting a price which the lead underwriter found unacceptable, the lead underwriter would either have to resign or to change his view. The Government would in that case knowingly risk pulling the offer. The <u>reality</u> is that a compromise would probably be reached, and we would hope that the candidates for lead underwriter will recognise this. But we do not recommend giving any more explicit undertakings than those set out above.

11. We will need to agree these points with DTI (since Lord Young will be responsible for the pricing decision) later this week. I should be grateful to know whether you are content.

Mary Brown

MRS M E BROWN

CONFIDENTIAL AND COMMERCIAL IN CONFIDENCE

FINANCIAL SECRETARY

From: Miss J L Wheldon
21st September 1988

cc Chancellor
Chief Secretary
Sir P Middleton
Mr Lankester
Mr Monck
Mr Moore
Mrs Brown
Mr Call

'See my ~~[illegible]~~ comment @ X (a week ago). It is awful [illegible] of DTI [illegible] (legal advice). This ought to be done before the Commission [illegible] ...

STEEL PRIVATISATION: EC STATE AID

Mrs Brown minuted you on this subject on 13th September explaining that the German Iron and Steel Federation had alleged in two complaints to the European Commission that BSC had received more state aid than was necessary to restore it to viability, and more state aid than that authorised by the Commission.

The second complaint was thought by the DTI to be the more difficult to handle because it appeared likely to raise the question of whether a write-off at the end of 1980/1981 of NLF loans amounting to £509m, together with certain other items, constituted unlawful state aid. Although the Commission were fully prepared to defend the second complaint, they were proposing to do so on the basis of information which the DTI said was wrong.

The Germans do not now propose to proceed with the second complaint and the DTI, I think, hoped that this meant that the most difficult aspects of the state aid issue could be put on one side, although Counsel's opinion would still be needed on the question of how the first German complaint, and associated ECJ proceedings, should be dealt with in the prospectus.

I attended yesterday a meeting on the issues raised by the second complaint, chaired by the DTI Solicitor (Mr Hosker), at which the Cabinet Office Legal Adviser on EEC questions and a representative of the Law Officers' Department were also present. The meeting was unable, at this stage, to rule out the possibility that the £509m and other awkward items would surface in the course of the proceedings on the first German complaint, or indeed elsewhere. Nor could the meeting exclude the possibility that, if these items were exposed, the Commission would require BSC to repay the money involved as unlawful state aid. In view of this, the DTI have decided that they must approach the Commission urgently to determine whether the Commission is satisfied that the aid in question was properly authorised. The DTI believe that they should also consult Counsel about this course and its implications for the prospectus. The Attorney General will be informed of what is happening.

It is difficult for anyone outside the DTI to judge how serious a problem this will prove, not least because they have the papers relating to the critical period; but apparently they now feel that they may have overstated the likelihood that the items in question constitute unauthorised state aid. The timetable for clearing up the problem is however awkward on any basis.

Julie Wheldon.

Miss J L Wheldon

the de[partment]

EXCHEQUER
29 SEP 1988
ACTION FST
COPIES TO

28/9/88.

PRIME MINISTER

BRITISH STEEL PRIVATISATION

1 The British Steel flotation campaign is due to be launched next week, probably on Thursday 6 October.

2 I regard British Steel as one of the great successes of our economic turn-around. Its losses at the end of the last decade and the beginning of this have entered the history books. Yet they are now poised to rejoin the private sector as a major and successful company.

3 This is also a key step in our broader privatisation programme. British Steel is of course the first privatisation since the events of last October. It is of primary importance that the flotation should be a success, that it should restore confidence in our privatisation programme and pave the way for the even larger privatisations which lie ahead.

4 There remain, however, real uncertainties associated with the sale. Stock Market conditions remain extremely difficult and uncertain, and these have represented the backcloth against which all the key decisions on the flotation have had to be taken. In these circumstances, the extent of retail interest in the sale is very hard to gauge, but I very much hope that the offer will appeal to a significant number of private investors.

5 Other potential problems seem to have been satisfactorily resolved. Industrial action in the postal service would have raised severe difficulties, but it does look as if that dispute has now been settled. There was always uncertainty about what would happen following the removal of steel quotas in Europe in

June; but developments there have been very encouraging - demand remains strong and prices are broadly steady.

6 We have had a difficult backcloth against which to take the decision to proceed. I can in no sense at this stage guarantee a successful flotation. But I am sure we should proceed. Though there are real risks, some of which could in principle force us to abandon the sale, I believe that the prospects for success are very encouraging. The offer is scheduled to open on 22/23 November, and close at the end of the following week. I have every hope that by Christmas British Steel will be in the private sector.

7 I am copying this minute to Nigel Lawson, Geoffrey Howe, Peter Walker, Cecil Parkinson, Nicholas Ridley, Malcolm Rifkind, Norman Lamont and Sir Robin Butler.

DY

28 September 1988

DEPARTMENT OF TRADE & INDUSTRY

014JRF42.2

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: FINANCIAL SECRETARY
DATE: 28 September 1988

CHANCELLOR

cc Sir Peter Middleton
Mr Monck
Mrs Lomax
Mr Moore
Mrs Brown
Mr Ilett
Mr Lyne
Mr Bent
Mr Guy
Mr Call

NBL:-

BRITISH STEEL: APPOINTMENT OF LEAD UNDERWRITER

We had a word about the appointment of the lead underwriter in the British Steel sale. I have subsequently discussed this with officials.

2. The differences between the two methods may not be as great as it first appears. Whatever formal arrangements we have for the pricing decision, it is clear that we shall have to take considerable account of the lead underwriter's views in practice. It may not therefore make much difference if, at the time of the pricing decision, the lead underwriter is sitting directly across the table from Ministers or in a room down the corridor. The question is more the role of the lead underwriter in the period leading up to the sale and the extent to which he will assume that a guaranteed "place at the table" gives him a right to participate in preparations for the sale.

3. Obviously this is a matter for judgement; but I am still inclined to agree with Mary Brown. On balance, I would prefer the lead underwriter not to be formally present at the pricing meeting. I recognise that it may be that we will have to have a second meeting, not just one. But to give a guarantee now would give the wrong signals about his role in the sale, and encourage negotiation rather than consultation when it came to pricing the offer.

This is my first view. But we can reconsider this after officials have spoken to the candidates about how they see it.

NL

NORMAN LAMONT

pe2.bk/meb/29.9.5 CONFIDENTIAL

FROM: MRS M E BROWN

DATE: 29 SEPTEMBER 1988

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Sir Peter Middleton
Mr Monck
Mrs Lomax
Mr Moore
Mr Odling-Smee
Mr Lyne
Mr Bent
Mr Guy
Mr Call

[illegible]

STEEL PRIVATISATION: FLOTATION LAUNCH; LOYALTY BONUSES

(i) Flotation Launch

Lord Young's minute of today to the Prime Minister informs her that the Flotation Campaign will be launched next week, probably on Thursday 6 October. Lord Young will issue a press notice revealing that the sale is to be in the second half of November. Samuel Montagu will take a press conference describing the marketing and advertising campaign, and the setting up of the Share Information Office.

2. It is not essential that decisions on the structure of the offer are taken by the date of the launch (my separate minute of today refers), although Samuel Montagu would like to be as clear as possible by then about the way the Government wishes to proceed.

3. Lord Young warns that there are real uncertainties associated with the sale, particularly present market conditions. But his judgement is that the sale should proceed and that the prospects for success are very encouraging. Lord Young does not refer specifically to the EC state aids question: we are due to discuss that with you tomorrow.

4. Lord Young also comments that it is very hard to gauge the extent of retail interest in the sale. You will wish to note that DTI officials and advisers are recommending him to respond very carefully to any questions he receives from now on about retail demand. The recommended line is that the privatisation programme to date has shown many members of the public are keen to invest in British industry; that the Government will give them every opportunity to consider whether they wish to invest in British Steel; to avoid giving any indications of a target figure for retail applications; and to stress that overseas and UK institutional demand will also be very important in this sale.

5. There is no need to respond to Lord Young's minute.

(ii) Loyalty Bonuses

6. There have been press reports recently that the Government has definitely ruled out loyalty bonuses for this sale. Samuel Montagu would like to confirm this at next week's press conference, if Ministers agree. We understand that Lord Young does not wish to press for loyalty bonuses, and we have agreed to consult you on this.

7. In correspondence with Lord Young before the Summer holidays you said that your inclination was against loyalty bonuses 'provided our advisers do not tell us at some stage that unless we offer bonuses we will prejudice our chances of selling even 30% of the total stock to retail investors'.

8. Samuel Montagu hold out no guarantee that retail applicants will come forward for 30% of the offer, although they are planning in logistical terms for at least that many. However, their clear advice is that there is no case in present market circumstances for a loyalty bonus. They have reservations about its attractiveness to the sort of experienced investors likely to be attracted to this sale, and they cannot see a proper case in value for money terms for it. Moreover, they are concerned that now stories suggesting we are

not having a loyalty bonus have appeared in the press, it would appear a very defensive measure were the Government to change that line. It could well be interpreted as meaning that the Government was alarmed about low retail demand.

X 9. We recommend you to accept this advice. You will recall that the PAC in their recent report on privatisation sales concluded that a much better case for loyalty bonuses needs to be made out in future sales on value for money grounds. Since this is not intended to be a Sid sale, it seems appropriate that the shares should be sold on the basis of information about the company and its prospects, without bells and whistles.

10. I should be grateful to know whether you agree that there should be no loyalty bonuses in the Steel sale.

Mary Brown

MRS M E BROWN