

CONFIDENTIAL FILING

Proposed Acquisition by British
Steel Corporation ^{vs} Kaiser Steel
Corporation.

NATIONALISED

INDUSTRIES

DECEMBER 1981

| Referred to | Date | Referred to | Date | Referred to | Date | Referred to | Date |
|---------------------|------|-------------|------|-------------|------|-------------|------|
| 18.12.81 | | | | | | | |
| 21.12.81 | | | | | | | |
| 22.12.81 | | | | | | | |
| 11.1.82 | | | | | | | |
| 4.11.82 | | | | | | | |
| 8.11.82 | | | | | | | |

PREM 10/857

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Cabinet / Cabinet Committee Documents

| Reference | Date |
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| LCA to E(81) 39th Meeting, Minute 2 | 15.12.81 |
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The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate CAB (CABINET OFFICE) CLASSES

Signed AWayland

Date 25 October 2012

PREM Records Team



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Noted for

Prime Minister

(2)

COMMERCIAL - IN CONFIDENCE

The Rt Hon Patrick Jenkin MP
Secretary of State for Industry
Ashdown House
123 Victoria Street
LONDON
SW1E 6RB

Industry are postponing
the meeting you have

ms

8 November 1982

Offered
in order to consider the
points we have raised!

Dear Secretary of State,

BSC AND KAISER STEEL CORPORATION

MS 9/11

Thank you for copying to me your letter of 2 November to
Geoffrey Howe about the proposed BSC/Kaiser deal.

As you know I am extremely concerned about the present problems
facing BSC and, despite the possible difficulties about this
proposed deal to which colleagues have drawn attention, I think
that we should leave no stone unturned in helping the Corporation
to secure new orders and thereby improve its plant loading.

I therefore agree with the proposal in paragraph 8 of your letter.

I am copying this letter to the recipients of yours.

Yours sincerely

A.H. Wilson

Approved by the Secretary of State
and signed in his absence

Nat Ind, Dec '81, Kaiser Steel.

28 NOV 1982





10 DOWNING STREET

Handwritten: El M6 Nat Ind
or As below + 12 Verkes

From the Private Secretary

4 November 1982

Dear Jonathan,

BSC AND KAISER STEEL CORPORATION INCORPORATED

The Prime Minister has seen a copy of your Secretary of State's letter to the Chancellor of 2 November about two possible deals by BSC with US companies.

On the Kaiser deal, the Prime Minister has commented that she finds it difficult to see the justification for the use of public money, or public credit, to underwrite a takeover deal of Kaiser Steel by a new company owned by Kaiser's employees. Mrs. Thatcher has further commented that if we did wish to go ahead with such a bizarre scheme then since we know so little about it, we would be prudent to put it out to a sub-underwriter. The Prime Minister suspects that this would be very costly, and so would give us a clear indication of the risks of the operation. On the question of risk, the Prime Minister has expressed puzzlement at BSC's recognition (paragraph 7 of your Secretary of State's letter) that they must not enter an arrangement with Kaiser which exposes them to any risk of the guarantee being called within 90 days. Mrs. Thatcher has suggested that if there is no risk during this period, then there is surely no need for guarantee.

Finally, the Prime Minister has expressed a willingness to take a meeting on this subject if, notwithstanding these points, together with those raised by the Chancellor of the Exchequer and the Foreign and Commonwealth Secretary, it is thought advantageous to go ahead with this deal.

I am sending a copy of this letter to Brian Fall (Foreign and Commonwealth Office), Muir Russell (Scottish Office), Adam Peat (Welsh Office), Julian West (Department of Energy), John Rhodes (Department of Trade), Gerry Spence (CPRS) and Richard Hatfield (Cabinet Office).

Yours sincerely,

Michael Scholar

Jonathan Spencer, Esq.,
Department of Industry.



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

The Rt Hon Patrick Jenkin MP
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
London SW1

3 November 1982

Patrick

BSC AND KAISER STEEL CORPORATION INC

Thank you for your letter of 2nd November. I had some forewarning of the possibility of a proposal on the lines you describe, but there are still a number of questions which need to be answered.

Foremost is the likely attitude of the US Government. I note that advice from the Embassy at Washington is expected. We surely need to know whether the Administration would look favourably on BSC's support for the purchase of Kaiser by its employees, perhaps on the grounds that it would help to preserve jobs in the West Coast steel industry, or whether, perhaps under renewed pressure from steel producers, it would be antagonistic.

Second, there seems to be the real possibility of successful action by the US steel companies against BSC exports of slab.

The complexity of the deal itself may give rise to a certain risk of unfavourable publicity, and perhaps financial cost to BSC, if it breaks down. It would be helpful to know how essential it is for BSC's name to be lent to the operation from the outset. If the guarantee could be provided through the intermediation of a third party such as a UK bank, and BSC's formal involvement thereby minimised, this would be preferable.

We would, of course, have to make the existence of a guarantee to a US company known to Parliament. I assume you would justify the guarantee by reference to the need for BSC to assure itself of outlets for exports, but there must be a risk that the Corporation would then come under pressure to take similar action in the UK in those cases (such as the Phoenix III proposals for Sheffield Forgemasters) where it is being urged to provide some form of financial assistance to the private sector steel industry.



Finally, useful though a contribution of £12 million is to BSC's overheads, this needs to be kept in the perspective of their own need for fixed cost savings of up to £350 million. Unless you can satisfy yourself on the attitudes of the US Government and steel producers, I do not myself think that the scheme is likely to be a runner.

You may also wish to satisfy yourself about the likely reactions of our European partners.

I am sending a copy of this letter to the Prime Minister, Francis Pym, George Younger, Nick Edwards, Nigel Lawson, Norman Tebbit, Arthur Cockfield, Sir Robert Armstrong and John Sparrow.

A handwritten signature in black ink, appearing to be "Geoffrey Howe", written in a cursive style.

GEOFFREY HOWE

Nat Ind, Dec '81, Kaiser Steel



NOV 11 1982



A

MR. SCHOLAR

BRITISH STEEL AND KAISER

The essence of this proposal is that BSC wants the Government to be underwriters for a take-over deal of Kaiser Steel Corporation by a new company owned by Kaiser's employees. In return for underwriting, British Steel will get what they imagine is a contract for 300,000 tons for three years, together with other goodies.

x | Put in these terms, the proposition sounds quite bizarre. And I think it is. I cannot see how we can justify the use of public money in such a strange underwriting operation. But if we did wish to go ahead, then since we know so little about it, we should put it out to a sub-underwriter (I suspect that this would easily and quickly show that it is prohibitively expensive!).

There are many unknowns and risks in the proposition. For example, under A.2(d) we are told that 51% of Kaiser stock would be acquired at a cost per share of \$22 each plus about \$7 million for expenses. If they are picking up stock on the market from a wide share ownership it is by no means certain that they can acquire it for as little as \$22. Monday's closing market price was \$18½ (asked) and it has been as high as \$50 in the last calendar year. I am also suspicious about \$7 million being the expenses for this acquisition; I know merchant bankers charge high fees, but this has the appearance of being a rip-off. *[There is also the possibility of insider trading on such a take-over - and although illegal it does occur.]*

y | The guarantee in A.2(e), seems to say that the guarantee is conditional upon BSC getting its money back! The only missing link is a requirement that NEWCO actually pays off its debt. This is echoed in the Secretary of State's letter, in para 7, where he argues that BSC must ensure that there must be no risk at all of the guarantee being called within 90 days. But if there is no risk at all, there is no need for a guarantee, at least for the \$37 million. The remaining \$8 million which it is thought will be outstanding for a year or so, presumably will just about cover the advisers' fees.

I do not think that BSC should be encouraged to proceed further until we are less uncertain about the nature of the risks involved.

Aw

3 November 1982

ALAN WALTERS



CABINET OFFICE
Central Policy Review Staff

With the compliments of
John Sparrow

70 Whitehall, London SW1A 2AS
Telephone 01-233 7765



CV

CABINET OFFICE
Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

Qa 06125

From: John Sparrow

CONFIDENTIAL

COMMERCIAL-IN-CONFIDENCE

3 November 1982

The Rt Hon Sir Geoffrey Howe QC MP
HM TREASURY
S W 1

Dear Geoffrey,

BSC and Kaiser Steel Corporation Inc.

The Secretary of State for Industry has written to you seeking approval in principle for a proposal by BSC to guarantee the borrowings of a trust formed to finance the purchase by Kaiser Steel employees of 51 per cent of the Kaiser Steel equity. This proposal raises a number of questions which I think you will need to consider.

First, support of the Kaiser employees' buy-out would set an awkward precedent. BSC are bankrupt, so a guarantee of borrowings by BSC is effectively a guarantee by HM Government. So far as I know, this Government has not so far guaranteed the financing of either a public sector or private sector management buy-out. The lenders to, for example, the employee consortium which purchased National Freight Corporation were, quite rightly, obliged to bear the normal commercial risk. If BSC, and hence the Government, are seen to be supporting a buy-out by employees of a foreign corporation through a loan guarantee, it will be difficult to resist demands for similar support of employee buy-outs in the United Kingdom. It is not clear whether attempts have been made to obtain a private sector guarantee for the Kaiser transaction.

Secondly, the proposal to supply slab to Kaiser can only arise because supplies of semi-finished steel are currently exempt from the US import quota arrangements. I understand that BSC are also negotiating for the supply of 500,000 tons of slab per year to the Houston Steel Works of Armco. It seems quite likely that their European and Japanese

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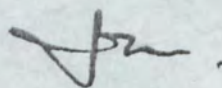
competitors are negotiating similar deals. There must be a risk that, if imports of semi-finished steel into the US rise too rapidly, quota arrangements will be imposed on these products. This might leave BSC with the balance of their loan guarantee outstanding and no outlet for their slab.

Thirdly, as regards the commercial aspects, the slab supply contract as presently proposed by Kaiser seems less than satisfactory. It guarantees minimum purchases only for 1983 at a time when Kaiser are already cutting back on existing contracts to buy slab, and merely provides opportunity for supply of 50 per cent of Kaiser's requirements in 1984 and 1985 providing price and quality are competitive. Given BSC's high cost structure and tenuous supply route through the Panama Canal, there appears considerable risk that the low cost Japanese producers, supplying directly across the Pacific, will pre-empt the bulk of the Kaiser slab supply.

I appreciate BSC's wish to secure as many outlets for its products as it can, but the present proposal seems hard to justify either politically or commercially. If, nonetheless, BSC are permitted to give a guarantee, it should only be on the basis of a slab supply contract, in terms at least as good as those set out in paragraph 8 of the paper by officials.

I am sending copies of this letter to the recipients of Patrick Jenkin's letter of 2 November.

Yours sincerely,



John Sparrow

West Ind, Dec 81, BSC Acquisition of Kaiser Steel.



ce J.V

FCS/82/181SECRETARY OF STATE FOR INDUSTRYBSC and Kaiser Steel Corporation

1. In your letter of 2 November to Geoffrey Howe you sought comments by close of play today about a possible deal between BSC and the Kaiser Steel Corporation.
2. The aspects that concern me are the possible repercussions within the European Community, and the possible implications for EC/US relations more generally. If the Kaiser scheme goes through, the US steel industry, in its present mood, may well petition for countervailing (ie anti-subsidy) action on steel slab. This would trigger the consultation provisions of the EC/US steel agreement on which so much effort has been spent in recent months, and could lead to the re-opening of the whole package.
3. I do not wish to strike an unnecessarily pessimistic note. But experience shows that if the US industry does decide to petition, the US Government are not likely to override them.
4. I recognise that there are very real attractions in the deal from BSC's point of view in terms of plant loading, providing the financial details are right, but they might prove to be short term only. If there were adverse repercussions for our steel interests, both within the Community and in our relations with the US generally, they could do the Corporation more harm than good.
5. I think that it would be a useful first step, if you have not already done so, for you and/or Ian MacGregor to have a word with Davignon and Baldrige personally.

/We



We could then reach a final view on the degree of risk involved in the light of what they have to say.

6. I am copying this minute to the recipients of your letter.

A handwritten signature in dark ink, appearing to be 'FP', written in a cursive style.

(FRANCIS PYM)

Foreign and Commonwealth Office
3 November 1982

Wrat. Ind: #3 12/87
Proposed takeover by
Kaiser Steel BSC of

cf. JV.



Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

*We have been round a
circle some before,
and turned it down*

*I agree with Alan -
but on this proposal
to have a
meeting to discuss
out the details.
mb*

2 November 1982

①

The Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Prime Minister

As I read this I felt grave
misgivings about this proposal.

Dear Geoffrey,

BSC AND KAISER STEEL CORPORATION INC

So I asked Alan and John Sparrow
to let you have advice; and held up the
deadline. Shall I say you have
strong doubts

As you know, in the face of deteriorating commercial and
financial prospects BSC are reviewing their future plant
configuration. Mr MacGregor is at present preparing a range of
options to achieve significant cost reductions, including the
possibility of major plant closures. I expect to circulate a
report on this shortly.

- particularly
given X or Y

2 In the meantime, the Corporation have been discussing two
possible deals with US companies under which BSC would improve
plant loading by supplying semi-finished slab steel from the UK
for finishing in the USA. Discussions with Armco, which would
involve slab exports of about 500,000 tonnes a year, are still at
an early stage. BSC have, however, put firm proposals to the
Government for another deal which would provide them with an
outlet for 300,000 tonnes a year of slab to the Kaiser Steel
Corporation for a period of up to three years, with the
possibility of supplying more than that quantity each year and
with the prospect of negotiating a long-term supply contract to
follow. The proposition stands independently of the review of
plant configuration. This minute seeks your agreement and that
of colleagues to BSC being authorised to negotiate such a deal
with Kaiser, subject to certain conditions.

in Alan's
note?
(Play A)

ML 3/11

3 The terms of the proposed deal are set out in the attached
paper by officials. The main features are:

- (a) BSC would guarantee a bank loan of \$45 million (about
£28 million at current exchange rates) to a trust to be
formed on behalf of Kaiser Steel employees. The purpose of
the trust is to finance the purchase by Kaiser employees of
51 per cent of Kaiser steel equity, under US legislation
which provides tax advantages for employee share purchase.



(b) In return for the loan guarantee, BSC would be given a contract for 300,000 tonnes a year of slab to be supplied to Kaiser, for up to 3 years.

(c) \$37 million of the loan guaranteed by BSC would be repaid within 90 days of the acquisition of control of Kaiser by its employees.

4 The advantages would be as follows:

a) Out of total losses of £138 million in the half year to end September, BSC estimate that almost all were attributable to inadequate plant loading. Weekly production at present is two-thirds the level necessary to achieve break-even. A contribution to fixed costs of £12 million a year, while far from retrieving the position, would be helpful.

b) Unlike the earlier attempts to form a link between BSC and Kaiser, which we considered at the end of last year but which came to nothing, BSC would hold no stake in Kaiser. Nor would they have to meet any of Kaiser's liabilities (apart from any commercial liabilities under the slab contract) if the venture failed. You will remember that last time around we were particularly concerned about the potential costs of Kaiser's pension and health insurance schemes if BSC took a stake in the company.

5 With the recent settlement of the EEC/US steel dispute, there is no longer any risk of negotiations being upset by the conclusion of such a deal. However, there may be some danger that the US steel companies might take action against BSC exports of steel slab to the USA, which are not covered by the EC/US steel settlement, and our Embassy in Washington has been asked to advise on this urgently.

6 The proposal needs also to be considered against the recent decline in Kaiser Steel's recent performance. Early in October the company announced that it was suspending raw steelmaking for a minimum of three weeks because of large stocks of slabs and a "severely depressed" market described as "the worst since the 1930s". Slab purchases under existing contracts, having been already cut from 500,000 to 350,000 tons this year, were reported to be "very much in question" for next year. However, Kaiser Steel remains a cash rich company, with about \$300 million of reserves, and can be expected to continue operating for at least 3 years even if its fortunes do not improve. The danger of an early collapse of the company, after the proposed acquisition of control by its employees, is therefore remote.

300 - reserves

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE



But why guarantee if there is no
risk (at least for \$7m!)?

Are they going to use this guarantee to gear
up their capital structure?

7 BSC recognise that they must not enter into an arrangement with Kaiser which exposes them to any risk of the guarantee being called within the 90 days, and have instructed their US lawyers to ensure that the guarantee arrangements meet this objective. After 90 days, the amount remaining outstanding under the guarantee should therefore not exceed \$8 million, and the duration of this risk is expected to be just over 1 year. In the worst case, BSC would expect to gain sufficient financial benefit from the slab export contract to recover this \$8 million within 5 months.

8 BSC have asked for a quick response in principle by Government, and I am therefore consulting colleagues before soundings in Washington are completed and before details of the proposed guarantee can be finalised. Subject to my being satisfied on both these points, however, and subject also to the approval of the proposal by the BSC Board, I recommend that BSC be authorised to give the guarantee of \$45 million as proposed in paragraph 3 above.

9 I should be grateful for your agreement that I should proceed in this way by close of play on Wednesday 3 November.

10 I am sending copies of this letter to the Prime Minister, Francis Pym, George Younger, Nick Edwards, Nigel Lawson, Norman Tebbit, Arthur Cockfield, Sir Robert Armstrong and John Sparrow.

Your ever
Patel



KAISER STEEL CORPORATION INC. - BSC PROPOSAL

The proposal is that BSC guarantee a loan to a trust company formed to enable the employees of Kaiser Steel Corporation to buy a 51 per cent controlling share in Kaiser Steel. In return BSC will be granted a contract for up to 3 years to supply steel slabs to Kaiser Steel.

A. STRUCTURE OF THE TRANSACTION

2. The transaction rests on the acquisition of a controlling stake in the Kaiser Steel Corporation by a new company (NEWCO) owned by Kaiser employees under US legislation governing Employees' Stock Ownership Plans (ESOP). The acquisition would be made as follows:

- (a) Formation of NEWCO to acquire 51 per cent of Kaiser stock.
- (b) Formation of a NEWCO ESOP to acquire, but not pay for, 100 per cent of the outstanding common shares of NEWCO in exchange for a note.
- (c) Capitalisation of NEWCO by an equity investment of \$45 million in preferred and convertible preferred stock and by \$45 million (£28 million at current exchange rates) of bank borrowings guaranteed by BSC.
- (d) Purchase of 51 per cent of Kaiser stock by NEWCO using its cash resources of \$90 million (3.8 million shares at \$22 each, plus about \$7 million for expenses).
- (e) BSC will guarantee a note of \$45 million payable by NEWCO to a bank, in return for which BSC will receive a commitment fee of 1 per cent payable immediately. The provision of the guarantee will be conditional on (i) the injection of \$45 million as equity into NEWCO, (ii), the acquisition of 51 per cent of Kaiser, (iii) enforceable agreements to ensure that cash is received from Kaiser to pay off the NEWCO debt, and (iv) the provision of appropriate financial information on a monthly basis to BSC while the guarantee is outstanding.

4. About \$37 million of this debt will be repaid by NEWCO within 90 days leaving a balance of about \$8 million outstanding. This will be repaid within a further year and during that time BSC will receive a 5 per cent a year guarantee fee.

\$90 no explanation
Buy on market?
Then \$7 m are going to some
But not on labor cost reduction

with interest?



5. The mechanics of repayment, as envisaged at present, would be as follows:

- (a) Kaiser will make the "maximum permissible contribution" from its cash reserves to the NEWCO ESOP in exchange for agreed reductions in labour costs. The "maximum permissible contribution" is fixed under ESOP legislation at 25 per cent of the taxable emoluments ("compensation") received by the ESOP participants. Professional advisers on the scheme have estimated the number of participants as at least 2,950 and their taxable emoluments as \$85 million in 1983 and \$93 million in 1984 giving a "maximum permissible contribution" of \$21 million and \$23 million in each year. These figures will be confirmed by Kaiser within 90 days of the transaction being agreed, and payments totalling \$44 million in respect of both years can then be made simultaneously. Payment in respect of 1985 will be made in the first 90 days of 1984.
- (b) The NEWCO ESOP will repay its outstanding debt to NEWCO, thereby paying for its shares in NEWCO.
- (c) NEWCO will repay its bank debt subject to its obligations on its preferred stock.

But what if they do not get that money? Will our guarantee be called?

6. The professional advisers consider that they have taken a conservative view of the number of participants in the ESOP. The figure of 2,950 includes all non-union employees of Kaiser and all union employees at the Fontana plant. But it excludes 1,400 employees comprising union members at Napa, the fabricating division, the coal mines and clerical staff at Fontana. The total workforce stood at 9,632 on 1 January 1982, is currently 5,158, and is projected to average 4,350 in 1983. A reduction of 20 per cent in total labour costs has been pledged by the workforce, so reducing hourly wage costs by about \$5½ to \$21.

irrelevant no equity interest

B. SLAB SUPPLY CONTRACT

7. In return for BSC providing a guarantee, Kaiser will offer a three year slab supply contract on the following terms:



- 1983 - A guaranteed purchase of a minimum of 300,000 tons of slabs in addition to any existing contracts between BSC and KSC.
- The pricing formula would be a minimum of the prices in the existing BSC/KSC contract escalated upwards for exchange rate movements and changes in UK and USA inflation. *at what price or what*
- 1984 and 1985 - The opportunity to supply 50% of KSC's outside slab purchases providing price and quality are fully competitive.

8. BSC have made a counter proposal to this suggesting three changes:

- (a) Minimum tonnages of 300,000 tons for 1983, 1984 and 1985, with BSC being given the option to supply up to 70 per cent of KSC's outside slab requirements to the extent that these exceed 300,000 tonnes a year. *at what price?*
- (b) A more favourable pricing formula which should include a price index for Kaiser finished products.
- (c) A general statement of intent that, over the three year period, BSC and KSC should try to work out a long term supply agreement.

C. IMPLICATIONS OF SLAB CONTRACT FOR BSC PLANT LOADING

9. Under the present arrangements for supplying 130,000 tonnes of slab a year to Kaiser, BSC provide ingot-based slab from Port Talbot. However, under the new contract Kaiser are specifying higher quality concast steel. This cannot be provided from Port Talbot because such concast as is now produced there from the recently-installed machines is already committed to other customers. BSC therefore envisage that the new contract would be met from Scunthorpe and Teesside.

10. At the liquid steel stage of production, Scunthorpe can produce 3.1 MT a year and Teesside 3.3 MT. In current depressed market conditions, BSC were planning an annual load of 2.7 MT at Scunthorpe and 2.1MT at Teesside. There is thus substantial spare capacity.



11. At the concast slab stage, this plan assumes output of 1 MT at both Scunthorpe and Teesside compared with capacity of, respectively, 1.5 MT and 1.7 MT. Spare capacity at both plants thus totals about 1.2 MT. If a further slab supply contract for 0.5 MT, currently being pursued separately, were concluded, this would leave spare slab capacity of 0.7 MT. If, in addition, Ravenscraig were to be closed with the consequent transfer of about 0.4 MT of slab load to Scunthorpe and Teesside, there would be only about 0.3 MT of capacity available for Kaiser. Depending on the outlook for home demand, some further capacity might be found. If Ravenscraig were not to be closed, then some or all the concast slab requirements could be met from there.

D. IMPLICATIONS FOR BSC'S PROFIT AND LOSS POSITION

12. The pricing formula to be agreed between BSC and Kaiser takes the existing slab prices for 1 January 1983 as the basis. The formula proposed by BSC will enable these prices to be escalated upwards to reflect changes in relative inflation rates, exchange rates and in the price of KSC's finished products.

13. Existing prices are as follows:-

| | | |
|---------------------|---|--------------------------------|
| Slab for Plate | : | £134 per metric tonne ex works |
| Slab for Tinplate | : | £130 per metric tonne ex works |
| Slab for Galvanised | : | £135 per metric tonne ex works |

14. At these prices, the full costs of concast slab produced from Teesside and Scunthorpe would be approximately covered, giving a contribution of about £40 per tonne. The position would be the same if the slab were provided from Ravenscraig operating on two blast furnaces, but costs would increase by about £10 a tonne if this were reduced to a one-furnace operation. Assuming that the base prices remain in a constant relationship to BSC costs (which is conservative), the Corporation estimate that a minimum supply of 300,000 tonnes per annum would provide a contribution to BSC of about £12 million per annum or breakeven at near full costs.

Why not simply slash the price



SECRET
FILE

Not Ind

DS
17

BC A. Duguid

10 DOWNING STREET

From the Private Secretary

11 January 1982

Dear Jonathan,

The Prime Minister was grateful for your Secretary of State's up-date on developments in relation to the Kaiser Steel Corporation.

She has commented as follows:

"Sohio/Kennecott won't keep Kaiser. Why? The risks are too great? Further, for Sohio/Kennecott to buy merely to asset strip and then to have no further responsibility would be extraordinary."

Against the last sentence of paragraph 8, which describes the European Commission's concern about the amount of excess potential steel capacity at BSC, the Prime Minister has commented:

"Then they must also be concerned about the capacity in the rest of the EEC which is far greater."

I am sending copies of this letter to John Kerr (HM Treasury), John Rhodes (Department of Trade), Muir Russell (Scottish Office), John Craig (Welsh Office), Keith Long (Paymaster General's Office), Stephen Lamport (Mr. Hurd's Office, FCO), Gerry Spence (CPRS) and David Wright (Cabinet Office).

Yours sincerely,

Michael Scholar

Jonathan Spencer, Esq.,
Department of Industry.

SECRET



PRIME MINISTER

Sohio/Kennecott
 word-keep Kenick. SECRET
 why? The mills are
 too good?
 Further for S/K to buy
 to add ships have no
 further. newly designed just to update you. It seems to
 me no more than a variation on
 the original proposal.
 MLS 8/1
 in excess delivery.

Prime Minister

No decision sought - this is
 just to update you. It seems to
 me no more than a variation on
 the original proposal.
 MLS 8/1
 in excess delivery.

I am writing to bring you and other colleagues up to date on recent developments in relation to the Kaiser Steel Corporation.

2. Ian MacGregor remains firmly of the view that a link between BSC and KSC, under which BSC will have an assured contract to supply KSC with steel slabs, offers incomparably the most hopeful prospect for securing the future of the 3 BSC strip mills, of which the most vulnerable is at Ravenscraig.

3. Exploratory talks were held last week by Ian MacGregor in the USA with Sohio (which as you know is controlled by BP) and Kennecott, a large minerals subsidiary of Sohio. Kennecott are interested in purchasing KSC's coal properties, some of which adjoin their own. BSC suggested that Sohio/Kennecott should make a bid for KSC in order to acquire the coal properties, together with some of the cash in KSC, then give BSC a long-term management contract to run KSC, possibly as a joint venture, with BSC supplying steel slabs to KSC from the UK.

4. Sohio and Kennecott have, however, made it clear that, while they are willing to consider in more detail the proposal that they should acquire KSC, they are not prepared to buy KSC if the end result is to give them a stake in the steel business. Ian MacGregor has returned this week to the US to discuss with Sohio/Kennecott a modified proposal, under which Sohio/Kennecott would make a bid for KSC, transfer out of KSC the coal properties and a sufficient proportion of the cash in the company to recoup the balance of the purchase price, and sell the residual steel business to BSC for a nominal sum (perhaps \$1). Under this proposal, BSC would manage the KSC steel business from the date of acquisition by Kennecott, and the sale of the steel business to BSC would be completed within a relatively short period thereafter, probably not longer than 6 months.



5. This new proposal has a number of advantages over BSC's earlier proposal to make a bid itself for KSC. First, there should be little or no cash outlay by BSC to acquire the KSC steel business. Second, the bid for BSC would be made not by a subsidised British nationalised industry, but by a US company (albeit one controlled by BP).

6. There remain a number of difficulties which were discussed at your meeting on 17 December, most notably the likely reaction of the US Administration and the US steel industry. Informal soundings of Mr Baldrige, the US Commerce Secretary, both by Mr John Morgan and by Ian MacGregor, have indicated that the main concern is likely to be over the timing and handling of any announcement, given the current delicate stage of US/EEC relations on steel. Mr Baldrige's reaction was not hostile, nor was that of Mr Roderick, of US Steel, to whom Ian MacGregor has also spoken on the possibility of a "friendly European" takeover of KSC.

7. In discussing this new proposal with me, Ian MacGregor has stressed that, when he presented his Plan for 1982/85 to me on 1 December, he did so on the basis that the 3 BSC strip mills should remain in operation. He was not at that time in favour of the option of closing Ravenscraig, even though the costs of producing steel there are significantly higher than at Port Talbot and Llanwern, and projections showed that BSC's profits might increase by £147 million a year by 1984/85 if Ravenscraig were closed, as against the cash costs of closure of £53 million. However, he now regards it as a much stronger possibility that, in about a year's time, he may have to recommend closure, despite the internal disruption to BSC and the external social consequences. I attach a paper outlining more fully the current BSC assessment of the position at Ravenscraig.

8. I do not regard it as politically possible for the Government to allow BSC to close Ravenscraig. But we would have



great difficulty in providing BSC with a continuing subsidy to keep it open. The European Commission, which have strong powers to control steel subsidies under the Treaty of Paris and a recently agreed Decision on State Aids for Steel, are already concerned about the amount of excess potential steel capacity at BSC, especially in the 3 strip mills.

*Then they
numbers*

be concerned about

9. Until Ian MacGregor has completed his current round of discussions with Sohio/Kennecott, it is not possible to present a detailed financial appraisal of the proposed new deal. But we do know that the initial outlay by BSC should now be nominal and that BSC would build up extra steel exports to KSC to a value of about £200 million a year by 1983 if the deal were to go ahead, giving rise to at least 1,000 more jobs and profits of at least £20 million a year within BSC. We would also be spared the social and political costs of closing Ravenscraig, or a tough battle with the Commission to subsidise BSC to keep it open. This latter course is contrary to all we have said recently about subsidies in general, and in particular about the need to phase out subsidies to steel in Europe. Against these advantages must be set the possibility that Ian MacGregor's commercial judgement may turn out to be wrong and KSC has to be liquidated, at considerable cost in medical and other social expenses.

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the BSC
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10. If Ian MacGregor can reach agreement in principle with Sohio/Kennecott, they we may need to meet next week to consider this new proposal in detail. David Young is standing by to go to New York to take urgent independent advice from John Morgan on this new deal as he did before. Fortunately, no hint of these proposals has leaked to the press, but you should be aware that Ian MacGregor told the full BSC Board what he had in mind at the regular monthly meeting on Wednesday 6 January.



SECRET

4.

11. I am sending copies of this letter to the Chancellor of the Exchequer, the Secretaries of State for Trade, for Scotland and for Wales, the Paymaster General, the Minister of State Foreign & Commonwealth Office (Mr Hurd), Mr Robin Ibbs and Sir Robert Armstrong.

PJ

P J

8 January 1982



FUTURE OF RAVENSCRAIG

BSC have 3 major steel plants producing bulk steel for strip products, at Port Talbot, Llanwern and Ravenscraig. Each of these 3 plants is manned and operated at well below its original design capacity, and at current levels of output it is unlikely that the BSC strip mills group will return to profit in 1982/83, even after the significant price increases, already in train as a result of the ECSC steel measures, have worked through fully into sales revenue.

2 There would be significant cost savings from concentrating strip production in 2 mills, provided that strip could be produced at these remaining 2 mills in the range of qualities required by the market. The highest cost production of the 3 strip mills is at Ravenscraig, and BSC consider that, even if they can get manning levels and other plant costs at Ravenscraig down to the levels in S. Wales, there will still be a significant cost penalty from producing strip at Ravenscraig since:

(i) its port handling facilities are too large and expensive for current or foreseeable throughput;

(ii) freight costs from the port to the plant are high.

Only a very small proportion of steel produced at Ravenscraig is



used by Scottish manufacturers.

3 However, it would not make economic or commercial sense to close Ravenscraig at present. The Ravenscraig plant is the only source within BSC of the continuously cast steel necessary for the production of higher grade strip products, such as tinplate. A continuous caster is being installed at Port Talbot which is expected to be commissioned in May 1982 and which should be in full operation by November 1982. When steel from this new concast plant is regularly available in the right amounts and qualities at Port Talbot, the case for retaining Ravenscraig as a bulk steel strip producer will need to be critically assessed. Unless there is a significant increase in demand for strip products in the UK (there is significant excess capacity in strip mills elsewhere in the ECSC), or unless there are unexpected production or quality problems at Port Talbot, the medium term future of Ravenscraig as a major strip mill must be in serious doubt.

4 The transfer of most or all of Ravenscraig's strip production to S. Wales need not necessarily lead to the complete closure of steelmaking at Ravenscraig. At present Ravenscraig is the major source of slabs for making plates. The BSC Plates business consists of 2 distinctive parts; lower quality heavy plates, particularly for shipbuilding, and higher quality plates for offshore pipelines and process plant fabrication. There is not enough business in plates to keep Ravenscraig going economically,



and BSC have begun to consider whether a new plant to make seamless tubes, which would require a considerable quantity of higher grade steel, might be sited at Ravenscraig.

5 The economic and technical feasibility of siting the new tube works at Ravenscraig, and running Ravenscraig largely as a specialised steel producer feeding the plates business and the new tube works, has not yet been fully assessed. But BSC are becoming increasingly doubtful about whether the combined raw steel demand from these 2 outlets will be sufficient to make it economic to continue to produce steel at Ravenscraig. In particular the outlook for the plates business has deteriorated, partly due to the abandonment of the gas-gathering pipeline and partly due to intense competition (especially from the Japanese) in overseas markets for offshore pipelines.

6 It looks increasingly likely therefore that, towards the end of 1982 or early in 1983, BSC will face a decision to move, in a gradual and orderly fashion, the production of strip steel from Ravenscraig to S. Wales, in order to restore the strip products business to profitability. The future of Ravenscraig will then need to be decided in the light of the following factors:

(i) the outlook for demand for strip products in UK markets and the extent to which any of these markets might still be economically supplied from Ravenscraig;

(ii) the outlook for the plates business;



(iii) the siting and sourcing of the new seamless tube mill;

(iv) other significant new steel demand which could be supplied economically from Ravenscraig.

7 The BSC Chairman's current assessment is that consideration of the factors in (i) to (iii) above will be likely to lead to a decision to close Ravenscraig and with it Gartcosh cold mill and the Clydebridge plate mill, unless significant new demand can be found as indicated in (iv) above. This is the impetus behind the negotiations for supplying slab to Kaiser Steel.

8 If the contract were secured to supply 1.5 million tons/year of slab to Kaiser Steel, this would not, however, all be produced at Ravenscraig. It would be more economic to spread this extra production among the 3 strip mills, in varying proportions depending on the demand for other strip products and for plate from Ravenscraig.

7 January 1982

SECRET

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15

Note Suspended to
Mr Young that he put
something in writing to
me for in week

beginning 4 Jan.
No need to B/F

MUS 23/12

PRIME MINISTER

BSC/Kaiser

David Young asks whether he could come in and talk to you for half an hour about his idea for a private sector solution to the BSC/Kaiser problem. He makes this request with Patrick Jenkin's blessing and I have ascertained that Mr. Jenkin is quite willing that David should come to see you on his own on this matter.

**
and, I understand
at the
suggestion
of Keith
Joseph

David has, apparently, been putting a good deal of effort since Thursday night's meeting into devising a scheme whereby a truly independent private sector entity, but with a substantial BSC shareholding, would acquire Kaiser and purchase BSC's output for on sale to Kaiser. The scheme would be designed so as to involve no liability to BSC or to the Government if anything went wrong either with Kaiser or with the arrangement to purchase BSC output of slabs. The purpose of David's talk with you would be to ascertain whether there is, or whether there is not, point in putting further effort into attempting to reach a solution on these lines.

||

||

It seems to me that, if you are willing to see David Young, it would be best if he came in at some point tomorrow - say after you have finished with Sir Edward Youde.*

Shall I say that you are ready to see him tomorrow?

MUS.

* or on Thursday morning.

22 December, 1981

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SECRET AND PERSONAL



meeting record
Filed under 17/12/81
10.15 pm meeting

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14

10 DOWNING STREET

From the Private Secretary

21 December, 1981

I attach a record of the Prime Minister's second meeting on Thursday, 17 December about BSC's proposed merger with Kaiser Steel.

As you know, the Prime Minister is anxious to restrict the circulation of these papers to the minimum and I would accordingly be grateful if you would ensure that this note is neither copied nor goes outside your office.

M. C. SCHOLAR

Ian Ellison, Esq.,
Department of Industry

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SECRET AND PERSONAL

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Submitted to 13
PM 20/12
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FM WASHINGTON 201620Z DEC 81

TO IMMEDIATE F C O

TELEGRAM NUMBER 3872 OF 20 DECEMBER 1981.

MY TELNO 3862: BSC/KAISER.

1. LLOYD CUTLER (SENIOR PARTNER IN THE LAW FIRM WILMER, CUTLER AND PICKERING AND FORMER COUNSEL TO PRESIDENT CARTER) TELEPHONED MINISTER YESTERDAY MORNING, AS KAISER'S COUNSEL, TO DISCUSS BSC'S POSSIBLE ACQUISITION OF KAISER. CUTLER HAD EARLIER IN THE DAY DISCUSSED IT AT LENGTH WITH SECRETARY BALDRIGE. CUTLER SUBSEQUENTLY CALLED AT THE EMBASSY AT HIS OWN SUGGESTION. I SAW HIM BRIEFLY AND HE THEN GAVE THOMAS AN ACCOUNT BOTH OF HOW THE DEAL WOULD LOOK FROM KAISER'S POINT OF VIEW AND OF HIS TALK WITH BALDRIGE.

2. CUTLER CONFIRMED THAT KAISER HAD DEFINITELY DECIDED TO SHUT DOWN THEIR LIQUID STEEL CAPACITY, SITUATED AT OAKLAND, CALIFORNIA, 40 MILES INLAND AND SUBJECT TO STRINGENT ENVIRONMENTAL REGULATIONS, THEY WERE NO LONGER ABLE TO PRODUCE SLAB STEEL COMPETITIVELY. NOR WOULD IT BE WORTH MAKING THE HEAVY INVESTMENT THAT MIGHT ENABLE THEM TO DO SO. THEY WOULD THEREFORE NEED TO BUY IN BASIC STEEL SLAB TO KEEP THEIR FINISHED STEEL OPERATIONS GOING. THIS THEY FULLY INTENDED TO DO. CUTLER ASSERTED (AS MORGAN HAD DONE YESTERDAY WITH BALDRIGE) THAT NO U.S.-PRODUCED SLAB COULD COMPETE ON THE WEST COAST WITH IMPORTED SLAB, GIVEN THE HIGH COST BOTH OF BASIC STEEL PRODUCTION HERE AND OF INLAND OR INSHORE TRANSPORT. KAISER WOULD THEREFORE HAVE NO CHOICE BUT TO IMPORT IT. THE MAIN COMPETITIVE SOURCES AT PRESENT WERE THE FAR EAST (JAPAN OR KOREA) OR EUROPE (UK OR SWEDEN). THIS WAS WHY KAISER HAD APPROACHED BSC IN THE FIRST INSTANCE.

3. CUTLER SAID THAT THE KAISER MANAGEMENT WOULD WELCOME BSC'S BID TO TAKE THEM OVER. WITHOUT A LINK OF THIS KIND, THEIR FUTURE WOULD BE UNCERTAIN. FROM THE INDUSTRIAL AND MANAGEMENT POINT OF VIEW BSC'S BID WOULD BE GREATLY PREFERABLE TO THE ONLY ALTERNATIVE BID THAT WAS ON OFFER. (HE MENTIONED HILLER, WHO HAD ORIGINALLY OFFERED DOLLARS 50 PER SHARE AND MOVED UP TO DOLLARS 54. THE KAISER BOARD, HE SAID, WERE LOOKING FOR A BID "SOMEWHERE NORTH OF DOLLARS 60".) CUTLER BELIEVED THAT THE TRADE UNION INVOLVED, AS WELL AS LOCAL INTERESTS IN CALIFORNIA, WOULD ALSO REACT FAVOURABLY TO A TAKEOVER BY BSC SINCE THIS WOULD OFFER THE BEST PROSPECTS FOR THE PRESERVATION OF JOBS.

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4. FROM BSC'S POINT OF VIEW, CUTLER SAW THAT THE ACQUISITION OF KAISER REPRESENTED A GREAT OPPORTUNITY FOR BSC. THOMAS ASKED HOW CUTLER WOULD RATE THE LONG TERM VIABILITY OF A BSC/KAISER PARTNERSHIP IN THE U.S. MARKET. CUTLER PREDICTABLY THOUGHT THAT ON PRESENT PRICE AND PERFORMANCE FORECASTS IT WOULD BE EXCELLENT. BUT EVEN IF THESE FORECASTS PROVED WRONG OVER THE MEDIUM TO LONG TERM, THE SHORT TERM PROSPECTS WERE SO GOOD THAT BSC WOULD HAVE GOT ITS MONEY OUT. THE CASH POSITION OF KAISER AND ITS DISPOSABLE COAL ASSETS WOULD HELP TO ENSURE THIS.

5. CUTLER HAD FOUND THAT BALDRIGE'S MAIN CONCERN WAS THE REACTION OF U.S. INDUSTRY. IF THE STEEL INDUSTRY WAS DISPOSED TO ACCEPT THE DEAL, BALDRIGE DID NOT THINK THE U.S. GOVERNMENT WOULD OPPOSE IT. CUTLER RECOGNISED THAT THERE WAS A RISK THAT OFFICIALS MIGHT RECOMMEND AGAINST ANOTHER TAKEOVER BY A FOREIGN NATIONALISED CORPORATION. BUT IN ADDITION TO ELF/AQUITAINE, THE GOVERNMENT HAD RECENTLY LET THROUGH THE ACQUISITION OF SANTA FE BY THE GOVERNMENT OF KUWAIT. UNLESS THE U.S. STEEL INDUSTRY CREATED AN UNHOLY ROW, BALDRIGE'S VIEW, AS RELAYED BY CUTLER, WAS NOW THAT THE U.S. GOVERNMENT SHOULD NOT BE A PROBLEM.

6. THE KEY PROBLEM WILL BE THE U.S. STEEL INDUSTRY. CUTLER SHARED BALDRIGE'S VIEW THAT BSC SHOULD NOW TAKE SOUNDINGS WITH THE TOP PEOPLE IN THE U.S. STEEL INDUSTRY. CUTLER WOULD BE IN TOUCH TODAY WITH GERARD (CHIEF EXECUTIVE OF KAISER) AND MCGREGOR TO ADVISE THAT THEY SHOULD GO EARLY NEXT WEEK TO SEE RODERICK (U.S. STEEL) AND ONE OR TWO OTHERS TO EXPLAIN THE PROJECT AND SEEK A REACTION.

7. IN CUTLER'S VIEW THE WAY TO PRESENT IT WOULD BE TO SHOW THAT THE ACQUISITION OF KAISER WOULD SERVE AS A KIND OF PERFORMANCE BOND FOR BSC, OR A GUARANTEE OF "GOOD BEHAVIOUR". WITH A STAKE OF THIS SIZE IN THE U.S., BSC COULD SIMPLY NOT AFFORD TO RUN THE RISK OF INCURRING ANTI-DUMPING OR COUNTERVAILING ACTION. ACCORDING TO CUTLER, BOTH BALDRIGE AND MCGREGOR THOUGHT THIS APPROACH WOULD BE PERSUASIVE.

8. THOMAS ASKED WHETHER THERE WAS NOT SOME RISK THAT IF BSC'S PRICES FOR SLAB, ALBEIT INTERNAL TO THE MERGED COMPANY, WERE THOUGHT BY U.S. STEEL PRODUCERS TO REFLECT A SIGNIFICANT ELEMENT OF SUBSIDY, THEY MIGHT ATTRACT COUNTERVAILING ACTION. CUTLER POINTED OUT THAT IT WOULD NOT BE NECESSARY TO RUN THIS RISK. BSC COULD RAISE THEIR SLAB PRICES (FOR INSTANCE IN THE EVENT OF A TRIGGER PRICE FOR SLAB BEING INTRODUCED) AND IF NECESSARY RUN KAISER AT A LOSS, BUT STILL MAKE A PROFIT OVERALL. IN ANY CASE, HE ARGUED THAT ONCE BSC'S UK PLANT WAS OPERATING AT A HIGHER LEVEL OF CAPACITY UTILIZATION ITS PRICES SHOULD BE HIGHLY COMPETITIVE WITHOUT BEING SUBSIDIZED.

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9. CUTLER SUGGESTED THAT GIVEN THE UNCERTAINTIES FOR HMG, A PRUDENT WAY TO PROCEED MIGHT BE TO AUTHORIZE BSC TO ENTER INTO NEGOTIATIONS FOR A MERGER AGREEMENT WITH KAISER. UNDER U.S. PRACTICE SUCH AN AGREEMENT WOULD CONTAIN A VARIETY OF WARRANTIES AND "OUTS", FOR EXAMPLE IN THE EVENT THAT THE U.S. GOVERNMENT RAISED OBJECTIONS TO THE MERGER. THE MAIN CONDITION ON KAISER'S SIDE WOULD BE THAT THE DEAL SHOULD BE APPROVED BY A MAJORITY OF SHARE HOLDERS. THIS KIND OF AGREEMENT WAS MORE THAN A LETTER OF INTENT. IF NONE OF THE CONTINGENCIES PROVIDED FOR AROSE, THE AGREEMENT WOULD BE BINDING. BUT IT PROVIDED BOTH SIDES WITH AN ELEGANT AVENUE FOR WITHDRAWAL IN THE EVENT OF THEIR CONDITIONS NOT BEING MET.

10. CUTLER WAS OF COURSE SPEAKING IN THE INTERESTS OF KAISER WHOSE BOARD WOULD LIKE THE TAKEOVER TO TAKE PLACE. HE IS A SKILLFUL AND EXPERIENCED ADVOCATE, WELL KNOWN TO MCGREGOR AS WELL AS TO THE OTHERS CONCERNED.

11. ADVANCES TO BRIDGES (DESKBY 201800Z VIA RESIDENT CLERK) AND SIR P CAREY, MANZIE AND MURRAY (DOI) (DESKBY 210900Z).

HENDERSON

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MR J R IBBS CPRS CABINET OFFICE
SIR D WASS H M TREASURY

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S E C R E T

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ZZ WASHINGTON
GRS 444
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FM FCO 181300Z DEC 81
TO FLASH WASHINGTON
TELEGRAM NUMBER 1959 OF 18 DECEMBER

YOUR TELEGRAMS NOS 3826 AND 3847: BSC/KAISER

1. THIS QUESTION WAS CONSIDERED FURTHER AT A MEETING OF MINISTERS LAST NIGHT. SAMUEL C BUTLER OF CRAVATH SWAINE AND MOORE (ATTORNEYS IN NEW YORK) AND JOHN A MORGAN (SMITH BARNEY) WHO HAVE BEEN CALLED IN TO ADVISE THE DEPARTMENT OF INDUSTRY, WERE PRESENT FOR PART OF THE TIME.
2. IT WAS AGREED THAT, WITHOUT PREJUDICE TO HMG'S FINAL DECISION, AN ENQUIRY SHOULD BE MADE OF THE US SECRETARY OF COMMERCE PERSONALLY TO ASCERTAIN HIS VIEWS ABOUT THE PROPOSED ACQUISITION. AS MORGAN IS WELL-KNOWN TO SECRETARY BALDRIDGE IT WAS DECIDED THAT HE WOULD BE THE BEST PERSON TO APPROACH THE SECRETARY. BUT MINISTERS ALSO CONSIDERED THAT THE MINISTER (COMMERCIAL) SHOULD ACCOMPANY HIM.
3. MORGAN IS RETURNING TO THE USA TODAY AND WILL BE INFORMED OF THIS DECISION ON ARRIVAL. HE WILL BE ASKED TO CONTACT THOMAS AND TO MAKE THE APPROACH TO SECRETARY BALDRIDGE AS SOON AS POSSIBLE.
4. THE POINTS ON WHICH WE PARTICULARLY NEED BALDRIDGE'S VIEWS ARE THOSE IN A, C AND D OF YOUR TEL NO 3826. SPECIFIC QUESTIONS WHICH SHOULD BE COVERED IN THE CONVERSATION INCLUDE :
 - (A) WHAT WOULD BE THE EFFECT OF AN ACQUISITION OF THIS SIZE (INITIAL COMMITMENT OF DOLLARS 200 MILLION BY BSC, AND LOAN OF SAME AMOUNT RAISED BY BSC IN USA) ON US VIEWS OF THE STANDING OF THE TWO CORPORATIONS IN THE US STEEL MARKET?
 - (B) WHAT WOULD BE THE PROSPECT OF ANNUAL IMPORTS OF L.5 MILLION TONNES OF SLABS DO TO THE EXISTING STEEL IMPORT REGIME?
 - (C) WHAT IS THE RISK THAT NEWS OF THE MERGER WILL CAUSE ANTI-DUMPING SUITS AGAINST BSC, DESIGNED TO PREVENT THE

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CORPORATION FROM STRENGTHENING ITS POSITION IN THE MARKET?
(D) WOULD THE DEAL RENDER BSC MORE VULNERABLE TO COUNTERVAILING
ACTION, FOR THE SAME REASONS?

AGAINST THE BACKGROUND OF THESE SPECIFIC QUESTIONS WE ALSO WANT
TO KNOW BALDRIDGE'S OVERALL JUDGEMENT ON

(I) HOW THE ACQUISITION WOULD BE VIEWED BY THE US INDUSTRY, AND
(II) WHAT WOULD BE THE LIKELY ATTITUDE OF THE US ADMINISTRATION -
POSITIVE, ADVERSE, OR NEUTRAL?

5. THE COMMENTS IN YOUR TELEGRAMS HAVE BEEN HELPFUL IN
CONSIDERING THE QUESTION HERE. MINISTERS ACCEPTED THAT THE
VIEWS OF BSC'S OWN ATTORNEYS IN WASHINGTON WOULD BE VERY RELEVANT,
AND THE DEPARTMENT OF INDUSTRY HAVE SUGGESTED TO BSC THAT THEY
INSTRUCT CUNNINGHAM ACCORDINGLY. BUT THEY ALSO THOUGHT THAT,
GIVEN SECRETARY BALDRIDGE'S RESPONSIBILITY FOR THE TPM AND HIS
FREQUENT CONTACT WITH LEADERS OF THE US STEEL INDUSTRY, HIS VIEW
OF THE LIKELY EFFECT OF THE PURCHASE WOULD BE VALUABLE. BUT
THERE IS LITTLE TIME TO SPARE AND THE MEETING SHOULD TAKE

PLACE IN THE VERY NEAR FUTURE

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S E C R E T

Pass on
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Mr Jenkins's
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FM WASHINGTON 190105Z DEC 81
TO IMMEDIATE FCO
TELEGRAM NUMBER 3862 OF 18 DECEMBER

*I think they
confirms the
wisdom of our
decision
MS*

SECRET

Prime Minister

12

(2)

Even if Mr MacGregor got a
green light now (last para), could
we be sure the arrangements would be
unchallenged over the years during which
they'd have to run if employment at
Ravenscroft
Blawieon
were to be
safeguarded?

YOUR TELNO 1959: BSC/KAISER

1. JOHN MORGAN (SMITH BARNEY) AND MINISTER CALLED ON SECRETARY
BALDRIGE THIS AFTERNOON AND SPENT AN HOUR AND A HALF WITH HIM.
BALDRIGE LISTENED INTENTLY WHILE MORGAN EXPLAINED THE BASIS OF
THE PROPOSED ACQUISITION AND SUMMARISED THE QUESTIONS WHICH THE
PRIME MINISTER HAS ASKED HIM TO TRY TO CLARIFY (ESSENTIALLY THOSE
SET OUT IN YOUR TELEGRAM UNDER REFERENCE).

MS 19/12

2. BALDRIGE'S ATTITUDE WAS SYMPATHETIC BUT CAUTIOUS. HE IDENTIFIED
THREE MAIN PROBLEMS IN THE COURSE OF THE DISCUSSION. FIRST, THE
TIMING COULD NOT BE WORSE. HE WAS HAVING GREAT DIFFICULTY AT PRESENT
HOLDING THE US STEEL INDUSTRY BACK FROM FILING 90 OR SO ANTI-
DUMPING AND COUNTERVAILING ACTIONS AGAINST EUROPEAN STEEL PRODUCERS.
BSC WERE CERTAINLY AMONG THE TARGETS. BALDRIGE HIMSELF HAD IMMENSE
RESPECT FOR THE STEPS WHICH THE BRITISH GOVERNMENT AND BSC WERE TAK-
ING TO RESTORE THEIR POSITION. BUT BSC'S OUTPUT WAS GENERALLY
REGARDED HERE AS AMONGST THE MOST HIGHLY SUBSIDISED OF ALL. THIS
APART, THE US STEEL INDUSTRY FELT THAT THEY HAD ALREADY BEEN TAKEN
FOR A RIDE TWICE ON THE TRIGGER PRICE MECHANISM (AND BALDRIGE
HIMSELF CLEARLY HAD SOME SYMPATHY WITH THIS VIEW). THEY WOULD NOW
BE CLOSELY WATCHING THE OUTCOME OF THE US GOVERNMENT'S CURRENT DISCU-
SSIONS WITH THE EUROPEAN COMMISSION TO SEE WHAT KIND OF UNDERTAKINGS
WOULD BE FORTHCOMING ABOUT RESPECT FOR THE QUOTE INTEGRITY UNQUOTE
OF THE TRIGGER PRICE MECHANISM. IF THESE WERE NOT SATISFACTORY, THE
US INDUSTRY WOULD UNQUESTIONABLY GO AHEAD WITH A SERIES OF ANTI-
DUMPING AND COUNTERVAILING ACTIONS. BALDRIGE CLEARLY FELT THAT IF A
DEAL INVOLVING THE ACQUISITION OF KAISER BY BSC WERE ANNOUNCED IN
THIS ATMOSPHERE, IT WOULD BE ANYTHING BUT HELPFUL.

3. SECOND, BSC WAS A NATIONALISED COMPANY. THE FACT THAT IT WAS ALSO
WIDELY BELIEVED TO BE SUBSIDISED MADE MATTERS WORSE. FOREIGN
TAKEOVERS WERE NOW SUBJECT TO EXAMINATION IN A SUBCABINET COMMITTEE.
IF IT WAS A QUESTION OF A PRIVATE SECTOR COMPANY
TAKING OVER KAISER, HE DID NOT THINK THERE WOULD BE ANY PROBLEM.
BUT THERE HAD BEEN INCREASING CONCERN ABOUT THE TAKEOVER OF US
NATIONAL RESOURCES BY FOREIGN NATIONALISED ENTERPRISES. HE MENTIONED
PARTICULARLY ELF/AQUITAINE'S TAKEOVER OF TEXAS GULF LAST SUMMER,
WHICH HAD CAUSED A CONSIDERABLE ROW. BALDRIGE SAID THAT THE ADMINIS-
TRATION WERE PROBABLY WORKING TOWARDS A POLICY WHICH WOULD AS A
GENERAL RULE EXCLUDE TAKEOVERS OF US COMPANIES BY FOREIGN NATIONAL-
ISED ENTERPRISES. A PROPOSAL NOW BY BSC TO TAKEOVER KAISER MIGHT
PRECIPITATE A DECISION. PRIVATE SECTOR COMPANIES IN THE US INCREASIN-
GLY FELT THAT IT WAS UNFAIR IF THEY WERE TRYING TO COMPETE IN THE
MARKET PLACE WITH COMPANIES BACKED BY THE FULL WEIGHT OF FOREIGN

SECRET

GOVERNMENT RESOURCES. BALDRIGE WAS NOT CERTAIN HOW THE ADMINISTRATION WOULD RESPOND TO THIS MOOD. NOR WAS HE SURE THAT IF IT DID IT WOULD NECESSARILY EXCLUDE THE DEAL ENVISAGED BY BSC. BUT HE CLEARLY SENSED SOME DANGER OF THIS.

4 THIRD, THE VOLUME OF STEEL INVOLVED WOULD MEAN A SIGNIFICANT INCREASE IN THE LEVEL OF IMPORTS IN THE US FROM BSC. AT PRESENT IMPORTS OF SLAB WERE RELATIVELY SMALL AND CAME MAINLY FROM CANADA. THEY WERE NOT SUBJECT TO THE TRIGGER PRICE MECHANISM BUT IF QUANTITIES WERE TO INCREASE, THIS COULD BE CHANGED. IN ANY CASE, IF THE MAJOR STEEL PRODUCERS FOUND THAT THEIR INTERESTS WERE BEING DAMAGED BY AN INFLUX OF SLAB FROM BSC, IT WOULD BE OPEN TO THEM TO LOOK AT THE CASE FOR INSTITUTING AN ANTI-DUMPING OR COUNTERVAILING PETITION. WITHOUT GOING INTO THE CASE IN GREATER DETAIL, HE COULD NOT BE SURE WHAT THE REACTION OF THE INDUSTRY MIGHT BE.

5. AFTER MORE THAN AN HOUR OF MORGAN'S PERSUASIVE ARGUMENTS AND THOMAS'S QUESTIONS, BALDRIGE, THOUGH MUCH INTRIGUED, STILL SEEMED TO FEEL IN HIS BONES THAT THE US INDUSTRY WOULD NOT MUCH LIKE THE DEAL. HE DID NOT THINK THE US GOVERNMENT, WHICH WAS STRONGLY SYMPATHETIC TO MRS THATCHER'S POLICIES AND OBJECTIVES, WOULD NECESSARILY WANT TO BLOCK IT, AT LEAST IN THE ABSENCE OF A CLEAR POLICY AGAINST TAKEOVERS BY FOREIGN NATIONALISED COMPANIES. BUT THE PROPOSAL WOULD HAVE TO BE CAREFULLY EXAMINED AND BALDRIGE WAS NOT PREPARED TO FORECAST HOW A DECISION MIGHT GO. HE THOUGHT MUCH WOULD DEPEND ON THE REACTION OF THE INDUSTRY. HIS ADVICE THEREFORE WAS THE MACGREGOR, WHO WAS WIDELY KNOWN AND RESPECTED AMONG THE CHIEF EXECUTIVES OF THE MAJOR US STEEL CORPORATIONS, SHOULD TAKE DISCREET SOUNDINGS OF ONE OR TWO OF THEM. THE MOST IMPORTANT IN HIS VIEW WOULD BE RODERICK (US STEEL) AND DELANCY (REPUBLIC, AND CHAIRMAN OF THE AMERICAN IRON AND STEEL INSTITUTE). IF MACGREGOR COULD GET A GREEN LIGHT FROM THEM, BALDRIGE THOUGHT HE WOULD FEEL REASONABLY CONFIDENT THAT NOT MUCH DAMAGE WOULD BE DONE. WITHOUT THAT HE CLEARLY THOUGHT THAT FOR ALL ITS ATTRACTIONS, THE SCHEME WHICH HAD BEEN OUTLINED TO HIM WAS FROUGHT WITH A GOOD DEAL OF RISK.

6 ADVANCE TO BRIDGES (FC), SIR P CAREY (DOI),
MANZIE (DOI), MURRAY (DOI).

[ADVANCED AS REQUESTED]

HENDERSON

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MR J R IBBS } CPRS CABINET OFFICE
SIR D WASS } H M TREASURY
DUTY OFFICER } DOT

SECRET

Prime Minister

11



Mr MacGregor

will, clearly,

be returning to

the charge.

MUS 18/12

WELSH OFFICE
GWYDYR HOUSE

WHITEHALL LONDON SW1A 2ER

Tel. 01-233 3000 (Switchboard)
01-233 8545 (Direct Line)

FROM THE PRIVATE SECRETARY
TO THE SECRETARY OF STATE
FOR WALES

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 8545 (Llinell Union)

ODDI WRTH YSGRIFENYDD
PREIFAT YSGRIFENYDD
GWLADOL CYMRU

SECRET

18 December 1981

Dear Michael

BSC: KAISER

My Secretary of State saw Mr Ian MacGregor this morning. Mr David Prior and Mr R A Lloyd Jones (Welsh Office) were also present.

My Secretary of State told Mr MacGregor the outcome of yesterday's Ministerial discussions. He made it clear to Mr MacGregor that there were two major stumbling blocks to the proposed deal. One was the possible attitude of the US administration and the US steel industry; and the second was the nature of the option and the Government's commitment at every point as it seemed that the merger route implied that if none of the conditions which would allow withdrawal arose then BSC would be expected to complete the deal.

My Secretary of State also referred to anxiety about countervailing suits which might be made after the deal was completed. He also told Mr MacGregor that soundings of the Secretary of Commerce would be taken urgently by Mr John Morgan and Mr Derek Thomas (from the Embassy).

Mr MacGregor said that he was incensed: he was insulted by the implications that such obvious points had been overlooked, and particularly by the point about suits being made after the deal was completed. He said that the deal was totally conditional until signed. Cash ^{merger} tender deals took place all the time. He had great experience of them. If anything came up that was not contemplated and not written in then the deal would not go through.

He said that he had already arranged for soundings to be taken from the US administration by one of his senior partners and the feedback was wholly reassuring. He strongly disagreed with the FCO assessment and

/as for

Michael Scholar Esq
Private Secretary
10 Downing Street
LONDON



as for the proposed method of sounding he said that he hated to have his case pleaded with his friends by others. He was in a position to speak to Mr Al Haig, Mr Donald Reagan and Mr Baldrige and was willing to do so over the weekend. My Secretary of State made it clear that even if he did so the Government would want to take independent soundings.

Mr MacGregor said that in his view NKK would step in and buy Kaiser if the BSC deal did not go through. He said that the US steel industry would be very well aware of this and would very much prefer to deal with BSC.

At the end of the discussion Mr MacGregor said that the UK Government should be in no doubt that without this deal BSC would be looking into a very big black hole indeed before the end of the year, having regard to the state of demand for steel.

Yours ever
J F Craig
J F CRAIG
Private Secretary



10
Next Gen

10 DOWNING STREET

From the Private Secretary

18 December 1981

BSC/Kaiser

I attach a Secret and Personal note of yesterday morning's meeting on BSC/Kaiser.

The Prime Minister has given instructions that this note should not be circulated, and I would accordingly be grateful if you would ensure that it does not leave your office and is not copied.

M. C. SCHOLAR

Ian Ellison, Esq.,
Department of Industry.

NW



010

Subject

meeting record filed under
7/12/81 10.15 pm meeting

MR SCHOLAR

cc Sir Robert Armstrong
Mr Ibbs

BSC/KAISER

I attach a record of the Prime Minister's meeting on BSC/Kaiser on Thursday night. I am assuming that, following the Prime Minister's instructions, you will prefer not to distribute the note. You may however wish to have it for your records, and to assist in dealing with any queries.

A handwritten signature in blue ink, appearing to read 'P L Gregson', is centered on the page.

P L GREGSON

21 December 1981

Subject

SECRET AND PERSONAL

9a

COPY No. 1

NOT TO BE COPIED

MLS



NOTE OF A MEETING HELD AT 10 DOWNING STREET AT 10.15PM ON THURSDAY 17 DECEMBER 1981
TO DISCUSS BSC'S PROPOSAL TO ACQUIRE KAISER STEEL

Present

| | |
|--|--------------------------|
| The Prime Minister | |
| Chancellor of the Exchequer | |
| Secretary of State for Scotland | |
| Secretary of State for Wales | |
| Secretary of State for Industry | |
| Secretary of State for Trade | |
| Paymaster General | |
| Attorney General | |
| Minister of State, Foreign and Commonwealth Office (Mr Hurd) | |
| Mr J R Ibbs | CPRS |
| Sir Douglas Wass | Treasury |
| Lord Bridges | FCO |
| Mr R A Lloyd-Jones | Welsh Office |
| Mr A G Manzie | } Department of Industry |
| Mr David Young | |
| Mr J F Laing | Scottish Office |
| Mr L Oates | Law Officers' Department |
| | |
| Sir Robert Armstrong | |
| Mr P L Gregson | |

The meeting had been convened to consider further the proposed acquisition by the British Steel Corporation (BSC) of the Kaiser Steel Corporation (KSC), in the light of expert advice from a US lawyer, Mr Sam Butler of Cravath, Swaine & Moore and a US merchant banker Mr John A Morgan of Smith Barney, Harris Upham & Co Inc.

The Secretary of State for Industry said that, at a meeting which he, together with certain Ministers and Mr Ibbs, had held earlier with the two US experts, he had sought clarification in particular on three questions ie:

- i. the risk of anti-trust action after BSC had been committed to purchasing KSC's shares;
- ii. the risk of litigation against BSC on other grounds, eg because BSC was proposing to secure 100 per cent of KSC's shares by taking an option on only 40 per cent of them in the first instance; and
- iii. the risk of action by the US Administration in response to protectionist pressures from US steel makers.



On i. the advice was that BSC, in addition to taking an option on a minority interest in KSC, should enter into an agreement for a merger, which would then take effect some 90 days later. As soon as the initial action had been taken BSC would approach the Federal Trade Commission and the Department of Justice. There was said to be a 95 per cent chance of complete clearance of the merger. There could be no guarantee that, after the shares had been purchased and the merger effected, some private interest would not instigate an anti-trust suit. If, however, clearance had been given by the Federal Trade Commission and the Department of Justice, any such suit was unlikely to succeed and could be regarded as frivolous.

On ii. the advice was that there was nothing unusual, from the point of view of US law, in the proposed method of acquisition. It was possible under California law as well as Nevada law to secure 100 per cent of the shares of a company after exercising an option to purchase only a minority interest. The possibility of vexatious law suits could not be ruled out but it would be possible, and would not be regarded as exceptional, to draft the merger agreement so as to provide a let out where litigation or legislation was initiated or threatened.

On iii. the advice was that an approach should be made to the US Administration before any steps were taken, including the taking of an option on a minority of the shares. Mr Morgan had himself offered to approach the US Secretary of Commerce, Mr Baldrige, informally. Mr Baldrige could then consult President Reagan. If the US Administration had provided reassurance at the initial stage, it would be easier for BSC to withstand any protectionist pressures from the US steel makers.

At this point Mr Morgan and Mr Butler joined the meeting. In answer to questions they made the following points:

- a. Under their recommended method of a merger agreement, which was to take effect after 90 days, BSC would be committed to going ahead with the takeover unless they were able to take advantage of one of the escape clauses in the agreement; this could be widely drawn and could include actual or threatened litigation and legislation.
- b. It would be possible to draw up a merger agreement which did not bind BSC at all. This would be unusual, and might invite deterrent activity by US steel



makers, but it might be negotiable with KSC; this would depend on how keen KSC was to find a partner which would maintain the downstream activities.

c. It was difficult to assess the risks of anti-dumping or countervailing action and the consequences for the trigger price mechanism; such action was more likely to arise if the merger had been put into effect and substantial BSC imports were being made.

d. Protectionist pressures ought to be lessened by the fact that the East Coast steel makers were not in general interested in supplying the Californian market because of US shipping costs; moreover KSC had already announced that it was ceasing the production of steel slab and it was widely accepted that this production would be displaced by imports from some source.

e. It was right to assess carefully the economic viability of the project; the prospects for the gas pipeline market seemed favourable and KSC ought to be well placed to get a share of this business but success could not be guaranteed.

f. There was much to be gained by an approach to the US Administration; this increased the possibility of a leak, but a leak might not be too serious; the existing share price already reflected the possibility of a bid but a leak could make it harder to negotiate with the group of 10-15 institutional shareholders.

After the US experts had left the following were the main points made in discussion:

a. Although the method by which BSC was to acquire KSC and take advantage of its cash and other assets might well be legal and defensible in the United States, there were many aspects which would be contrary to UK company law; if the venture failed at some stage, this would substantially increase the embarrassment to the Government.

b. Although BSC might have no legal obligation, in the event of liquidation, to meet the pensions and medical insurance liabilities, there would be a moral obligation on BSC and in turn on the Government; it would be difficult to defend the exposure of UK taxpayers' money to such risks.



- c. US opinion was exceptionally sensitive about steel imports; hitherto protectionist pressures had not been directed towards imports from the UK, but these had been small, it was now proposed that BSC, which was known to receive substantial support from the British Government; would take over a major US steel company and increase its supplies to the US market to five times the present level; an adverse reaction could threaten even BSC's existing business.
- d. There was a reasonable chance that the proposal would be welcomed, at least by union interests in California, especially since no other bidder had so far come forward.
- e. Although the anti-trust position should be reasonably clear at an early stage, many of the other risks could not be assessed until BSC had made its investment; there was a danger that BSC would be locked into a venture which would not in the event yield the benefits which had been assumed.
- f. It would in any case be difficult politically in the UK, especially in Scotland and South Wales, to draw back from the proposal once it had been announced and the expected benefits for Ravenscraig, Llanwern and Port Talbot had been explained.

The Prime Minister, summing up the discussion, said that the balance of argument appeared to be against going ahead with the proposal. The political, financial and legal risks appeared to be too great and it was unlikely that enough of these risks could be adequately assessed before BSC was irrevocably committed to the deal. The benefits would take some time to work through and were dependent on several unknown factors - the development of the US economy generally, the attitude of US steel makers to imports, the prospects for gas pipeline construction and KSC's ability to win a good share of this market. The question remained whether it was desirable to sound out the attitude of the US Administration. It seemed unlikely that firm assurances would be provided and that the political uncertainties would be greatly clarified, but it would be wrong to forgo the opportunity of an informal sounding. If the informal reaction was unfavourable, the matter would not be pursued further. If it was favourable, it would need to be followed up by a more formal approach by



H M Ambassador in Washington. It was therefore agreed that Mr Morgan's suggestion of an informal talk with the US Secretary of Commerce Mr Baldrige, whom he knew personally, should be taken up; Mr Morgan should however be accompanied by the Minister (Commercial) in Washington. Ministers would consider the matter further in the light of this approach.

The meeting -

1. Took note of the Prime Minister's summing up.
2. Invited the Minister of State, Foreign and Commonwealth Office to arrange for the Minister (Commercial) in Washington to accompany Mr John A Morgan of Smith Barney, Harris Upham & Co Inc at an informal discussion with the US Secretary of Commerce to seek an indication of the US Administration's own attitude to the possibility that BSC might acquire Kaiser Steel, and an assessment of the US steel industry's likely reaction to such a development.

18 December 1981

COVERING SECRET



9

~~SUBJECT~~

MR SCHOLAR

cc Sir Robert Armstrong
Mr Ibbs

cc Mr. Scholard

I attach the note of this morning's meeting on BSC/Kaiser. I am leaving it to you to arrange distribution in the light of the Prime Minister's wishes.

PLG

P L GREGSON

17 December 1981

COVERING SECRET

NOT TO BE COPIED

MLS

NOTE OF A MEETING HELD AT 10 DOWNING STREET AT 9.45AM ON THURSDAY 17 DECEMBER 1981
TO DISCUSS BSC'S PROPOSAL TO ACQUIRE KAISER STEEL

Present

The Prime Minister
Chancellor of the Exchequer
Secretary of State for Scotland
Secretary of State for Wales
Secretary of State for Industry
Secretary of State for Trade
Paymaster General
Mr J R Ibbs

Sir Douglas Wass
Mr R A Lloyd-Jones
Mr A G Manzie
Mr J F Laing

Treasury
Welsh Office
Department of Industry
Scottish Office

Sir Robert Armstrong
Mr P L Gregson

The meeting had before it a paper prepared jointly by the Department of Industry, the Treasury and the CPRS on the proposed acquisition by the British Steel Corporation (BSC) of the Kaiser Steel Corporation (KSC).

The Secretary of State for Industry said that the latest paper contained new proposals about the method by which KSC could be acquired. One method was to obtain options on at least 51 per cent of the issued shares; the alternative was to make a bid for at least 51 per cent of the shares. The former method was preferred because it provided a longer period (probably of about 60 days) in which to verify the assumptions on which the bid was based and it removed the risk of the price being forced up by other bidders. It was not yet certain however whether the necessary options could be acquired. If and when the options were acquired a public announcement would have to be made. Since the paper was circulated his Special Adviser Mr David Young, had reported some of the results of his consultation with the US merchant bank and US law firm. The advice was that the bid would not be vulnerable to anti-trust action since BSC and KSC overlapped in only one small area of production (carbon plate). There was unlikely to be a contested bid since no other potential bidder was likely to want to maintain KSC's downstream operations. Under Nevada law, which would be



applicable in this case, BSC would be able, having acquired 51 per cent of the shares, to secure the remainder. It was not possible to estimate accurately the contingent liabilities which would arise, on liquidation, in respect of pensions and medical insurance but these were unlikely to be more than \$500 million.

The following were the main points made in discussion:

- a. The US political reaction might be hostile. It might appear, for example to the US steel industry, that a loss making corporation owned by the British Government was exploiting Nevada law to strip the cash from a US company and secure a guaranteed outlet for unprofitable UK steel in the American market. President Reagan would be particularly interested in developments in his home state of California. On the other hand the move might be seen as benefiting US interests because it would enable KSC's downstream operations to be continued.
- b. The political reaction in the United Kingdom might also be adverse. Labour Party supporters might argue that public money was being used to maintain jobs in California, while some of the Government's supporters would object to the apparent extension of the public sector. Against this it could be argued that the proposal would bring benefits to employment in South Wales and Scotland and might make the eventual privatisation of BSC's strip products group more attainable.
- c. Although there might be no legal obligation on BSC, in the event of liquidation, to meet the pension and medical insurance liabilities, there would be a moral and political obligation; this might be held to offset the benefits of the cash which BSC could extract from KSC.
- d. The prospects for the venture were sensitive to the outlook for the US economy. The latest figures showed that US output in November had dropped for the fourth month running. On the other hand the new legislation enabling US gas utilities to cover the financing of new investment in their purchases opened up the prospect of major new gas pipeline construction and the new venture would be well placed to take a substantial share in this business.



e. Although there might be no serious risk of the acquisitions being blocked on anti-trust grounds, the Federal Trade Commission and the Department of Justice would have the right to obtain extensive documentation from BSC over a period of 30 days. The provision of this information could cause embarrassment both to BSC and to the Government.

f. It was important to judge how far it would be possible to assess the political and other risks during the 60-day period when the option was open. It seemed however that the Federal Trade Commission and Department of Justice would not begin their work until after the option was exercised. From that point on BSC would have committed itself to the purchase of 51 per cent of the shares.

The Prime Minister, summing up the discussion, said that final decisions could not be taken until advice had been sought directly from the US merchant bank and law firm on the financial and legal issues which had been identified. A further meeting would be arranged as soon as the advisers could be brought over from the United States.

The meeting -

took note of the Prime Minister's summing up.

17 December 1981

Paper circulated (and then withdrawn)
at 945 meeting 17/12/81
MCS

8A

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SECRET

BRITISH STEEL CORPORATION: PROPOSED ACQUISITION OF KAISER STEEL CORPORATION

Note by the Department of Industry, Treasury and the CPRS

THE PROPOSAL

1. Kaiser Steel Corporation (KSC) is located in California and has the capacity to finish about 2 million tons of steel slabs per annum. The Company has a significant market share on the US West Coast, where there are no major local competitors. Following recent asset sales KSC is cash rich (about \$420 million). It also owns substantial coal reserves which it has estimated could be sold for at least \$300 million. BSC believe that the company has a good management which is well-disposed to them.
2. The purpose of acquiring KSC would be to obtain an outlet for about 1.5 million tons of steel slabs a year by 1984 from the three BSC integrated steel strip mills at Port Talbot, Llanwern and Ravenscraig. The 1.5 million tons would be additional output; would help secure, although not guarantee, the future of all three mills; would reduce the scale of currently planned redundancies; and would make a significant contribution to the return to profitability of the BSC Strip Products Group.
3. The cost of the purchase would be about \$400 million and it would be financed as follows: At least \$200 million would be borrowed in the US through a "Grantor Trust" without recourse to BSC, and outside the PSBR and BSC's EFL. A further sum of about \$200 million would need to be provided initially by BSC; this would be raised in the US through a subsidiary incorporated there (thus falling outside the PSBR and BSC's EFL). This loan would require a letter of comfort from BSC. At least half this sum (\$100 million) would be repaid to BSC shortly after the acquisition from KSC's own cash resources. The outstanding loans (\$500 million) would be repaid from the sale of KSC's coal reserves and other assets, probably in 1983. The transaction would therefore be self-financing, as shown in Annex A.

SECRET

4. There are two possible methods of acquisition:
- (i) to obtain options on at least 51 per cent of the issued shares. This would be achieved by purchase of options for a substantial minority interest together with an option on an issue of new shares.
- or
- (ii) a public bid for at least 51 per cent of the shares.

In both instances it would be possible under the relevant State law to force the sale to BSC of the outstanding shares.

The former method is preferred because (a) it provides a longer period in which to verify the assumptions on which the bid is based (probably about 60 days compared with one week); and (b) it removes the risk of the price being forced up by other bidders. Whether this method can be pursued will depend on if it proves possible for BSC to acquire the necessary options, and this cannot be assured. If the options cannot be obtained it would be necessary either to make an immediate public bid or to abandon the project.

THE BENEFITS

5. The benefits of the acquisition would be:
- (i) it would allow three major BSC plants to operate at higher and more economical loadings;
 - (ii) it would improve the prospects of retaining all three mills in production;
 - (iii) it would safeguard 1,000 jobs in areas of high unemployment;
 - (iv) it would improve the profits of the Strip Group by at least £20 million per annum by 1984;
 - (v) the projected earnings of KSC would enhance BSC's overall profitability by about \$250 million before tax in 1984;
 - (vi) it would in time provide BSC with a readily saleable asset either on its own or as part of a more general scheme for privatising all or part of the BSC Strip Group (a combined profit projection of KSC and the existing Strip Group is at Annex B).

SECRET

(vii) it would entail no increase in the BSC's EFL or the PSBR, and would be self-financing within about two years.

THE RISKS

6. The main risks are:

(i) whether the US economy and steel market will recover in 1983 as forecast in the KSC projections;

(ii) whether KSC will recover its market share, which depends on (a) the accuracy of the cost structure forecasts for the new BSC/KSC process route, and (b) that this level of forecast costs remains below prevailing prices. In recent years these have normally been determined by a "Trigger Price Mechanism" related to the landed costs of imports from Japan;

(iii) whether the coal reserves are correctly valued at a minimum of \$300 million and whether they can in fact be realised by about 1983;

(iv) in the extreme case that KSC cannot be turned round and lapses back into losses to the extent of forcing a closure, the costs of liquidation may be substantial but there would be no legal recourse for those against BSC;

(v) a possible adverse political reaction in the US (probably stimulated by US steel-makers);

(vi) any possibility that imports of semi-finished steel into the US might be restricted as part of a move towards more general protectionism there.

7. BSC, having taken professional advice in the US, do not believe that point 6(vi) above is a real risk. Officials from the Department of Industry are at present in the USA checking this, and other aspects, with US bankers and lawyers and with the Washington Embassy.

SECRET

8. Announcement of the bid would be bound to attract considerable attention in this country. If a bid were made but for some reason proved unsuccessful this would prove politically embarrassing. The situation would be even worse if the bid succeeded but the enterprise itself ran into serious trouble.

DECISION REQUIRED

9. BSC seek authority from Ministers to acquire KSC, preferably by the option route (paragraph 4(i)), but if this proves unattainable then by a public bid (paragraph 4(ii)).

17 December 1981

SECRET

PHASING OF INVESTMENTS AND REPAYMENTS\$ MILLION

| | <u>1981</u> | <u>1982</u> | <u>1983</u> |
|--|-------------|-------------|--------------|
| Borrowing by BSC Subsidiary - | 200 | | |
| Repaid out of KSC cash assets - | (100) | | |
| Loan raised by Grantor Trust in US - | <u>200</u> | | |
| Carried forward - | 300 | 300 | 300 |
| Sale of KSC's coal assets, applied to: | | | |
| (i) repaying loan raised by Grantor Trust - | | | (200) |
| (ii) repaying balance of BSC's initial investment - | | | <u>(100)</u> |
| NET INVESTMENTS | <u>300</u> | <u>300</u> | <u>-</u> |

SECRET

SECRET

Combined Profit Projection for KSC and
BSC Strip Products Group

| <u>Pre-tax Profits (Losses)</u> | <u>£ Million</u> | | | |
|---|------------------|----------------|----------------|----------------|
| | <u>1981/82</u> | <u>1982/83</u> | <u>1983/84</u> | <u>1984/85</u> |
| Strip Products Group in present Corporate Plan | (150.3) | (37.0) | (2.6) | 61.0 |
| Additional profit from New Investment | (9.0) | 2.0 | 76.0 | 133.0 |
| | | | | |
| Combined | (159.5) | (35.0) | 73.4 | 194.0 |
| | | | | |

SECRET



k-a.

AD 17/2

With the compliments of

THE PRIVATE SECRETARY

Mr GWS

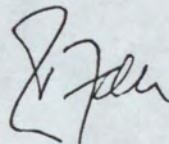
We opdn. I have imperted
on all concerned the need
for discretion. E. J. 17/12

FOREIGN AND COMMONWEALTH OFFICE
SW1A 2AH

Mr Lamport (PS/Mr Hurd)

I passed you earlier today some papers about a proposal by the British Steel Corporation. I now attach further relevant papers which have been sent to me by No. 10.

The Prime Minister has indicated that she would be happy for Mr Hurd to be accompanied by one FCO official, and she is particularly concerned that the FCO team should be able to advise on the likely impact on Anglo-American relations of BSC's proposal. I have spoken in your absence to Lord Bridges, who has advised on the earlier papers which were passed to us; he would be glad to accompany Mr Hurd. I am sending him copies of the most recent papers, but I shall be grateful if you will ensure that he has a chance to see the limited circulation annex of the discussion in 'E' committee.



(B J P Fall)
Private Secretary

17 December 1981

cc: Lord Bridges

bcc: A J Coles Esq
10 Downing St

SECRET



10 DOWNING STREET

From the Private Secretary

17 December 1981

Dear Brian,

As I explained on the telephone, the Prime Minister would be grateful if an FCO Minister could attend a Ministerial meeting in her room in the House of Commons at 9.00 p.m. this evening. She is particularly concerned that the Minister in question should be able to advise on the likely impact on Anglo-American relations of BSC's proposal to acquire Kaiser Steel Inc.

You should know that knowledge of this matter is being very carefully restricted in Whitehall. The Prime Minister therefore hopes that whoever attends her meeting (and we should be grateful to know who it will be) will not tell others of it and will arrive at her room as discreetly as possible.

I enclose copies of certain papers which will indicate the stage reached in the discussions so far. Would you please note that the paper by the Department of Industry, Treasury and the CPRS, dated 17 December, now has no status. It was withdrawn following an earlier meeting. I enclose it now because it sets out the background usefully.

*Yours ever
Joh*

P.S. One official may also accompany the F./C.O. Minister if necessary.

Brian Fall, Esq.,
Foreign and Commonwealth Office.

SECRET

MR WHITMORE *km*

MR SCHOLAR

DUTY CLERK

The following will be attending the meeting with the Prime Minister at 21~~05~~ hrs this evening - Thursday, 17 December:-

- ✓ Secretary of State for Trade - No official
- ✓ ✓ Secretary of State for Industry - Mr Gordon Manzie, Mr David Young, 2 Americans - Lawyer Mr Samuel Butler, senior partner Cravath Swain & Moore; Mr John A Morgan, Vice-Chairman, Smith Barney Harris Upham & Company.
- ✓ Secretary of State for Scotland - Mr Hamish Laing
- ✓ Secretary of State for Wales - Mr R Lloyd-Jones
- ✓ Chief Secretary - ✓ Sir Douglas Wass
- ✓ *Mr D. Hurd* ✓ Mr Robin Ibbs
✓ Sir Robert Armstrong
Lord Bridges

All the officials have either been told how to get to the Prime Minister's room or will be coming with their Secretary of State.

ES.

*I have told them
all it is 9.15.*

17 December, 1981

~~MR.~~ WHITMORE
MR. SCHOLAR
DUTY CLERK

You asked me to find out where everyone could be contacted from 0915 onwards.

The numbers are as follows:

| | |
|-----------------------------|---|
| Patrick Jenkin | Room at the House |
| Nicholas Edwardes | 219 5181 |
| Mr. Lloyd-Jones | " |
| Chief Secretary | 219 4500 |
| Sir Douglas Wass | 233 3620 P. Jenkin Room at the House. |
| Robin Ibbs | Federal 1460 |
| Sir Robert Armstrong | 722 6393 call 930-945, then 233 7609 * or 233 8319. |
| Trade | 219 4540 |
| George Younger | 219 5161 (up to 7.30 and after 8.45) |
| Hamish Laing | " |
| Douglas Hurd | Room at House or Chamber |
| Lord Bridges | 233 5923 |
| Chancellor of the Exchequer | Strangers Dining Room, House |
| Cecil Parkinson | |

Ian Gan

(3)

MCS - Chancellor's Office

17 December 1981

Chancellor
Peter Grogan
Mr. Hurd
+ Havers (Att. Gen.)
IG

② via Mr. Austin Gov. Whys office. or Mr. Gavis
① OR in at the

SW



File cc #10
HMT
50
WD
TRADE
PGO
W
CPS

10 DOWNING STREET

~~SUBJECT~~

cc Master Set

From the Private Secretary

16 December, 1981

Dear Ian,

Your Secretary of State, accompanied by Mr. Ian MacGregor and Mr. Robin Ibbs, discussed with the Prime Minister this evening BSC's proposal to acquire Kaiser Steel, Inc.

Mr. MacGregor explained that the purpose of the acquisition would be to obtain an outlet for about 1.5 million tonnes of steel a year from the three BSC steel strip mills at Port Talbot, Llanwern and Ravenscraig. This would help to secure the future of all three of these steel mills and would reduce the scale of currently planned redundancies. On the current prospects for the take up of the output of these three mills in the UK, and given the European quota system, closure of at least one of these sites seemed to be very likely: this would be expensive in social and political, as well as economic terms. The management of Kaiser Steel had decided to cease their production of liquid steel, partly because their existing blast furnaces and coke ovens needed refurbishing, and partly because the environmental control regulations in California had imposed very heavy costs on basic steel production. The Kaiser Steel management had decided, in this situation, that it would be more economic to buy in steel slabs, and BSC were already supplying trial quantities of slabs for evaluation by Kaiser. Recent events in the US meant that it was likely that there would be a substantial requirement of steel to construct a gas pipeline from Alaska South. Kaiser also had a good local market, in supplying California's canning needs.

The Prime Minister said that her immediate reaction was that there was a strong political reason for not proceeding with this acquisition. It was an extension of nationalisation. She was very concerned about a proposal which increased the liabilities of a nationalised industry, particularly when these were overseas liabilities. Mr. MacGregor said that, on the arrangement he was proposing, the acquisition would be self-financing. The whole transaction would be off-balance sheet so far as BSC was

/concerned.

- 2 -

concerned. A BSC subsidiary company would be formed in the United States through which half of the necessary finance would be raised in the United States against the security of Kaiser's assets, which included substantial cash resources (some £50 million worth appeared to be free cash resources). BSC themselves would need to put in £100 million immediately, but some £50 million of this would be repaid immediately after the acquisition from Kaiser's cash resources. BSC believed that they could find the remaining £50 million from within their agreed EFL for 1981/82. Mr. MacGregor sought authority to make an offer, during the course of next week, to purchase, at \$55 per share, 51 per cent of the shares in Kaiser Steel. The deal would be subject to Nevada law, under which it would be permissible to use the assets of the company in arranging the finance to purchase it; and under which there would be no problem about proceeding immediately to a 100 per cent share holding.

The Prime Minister said she was doubtful about the soundness of the position so far as US law was concerned. Would not the deal be open to challenge insofar as the purchaser would be a UK nationalised industry; would there not be accusations of unfair competition in view of the UK Government subsidy to BSC? Further, on the assumption that there were no current US regulations prohibiting the import of steel slabs, was there a risk that the US authorities, no doubt at the prompting of some US steel makers, would impose some such restriction, either now or at some time during the period in which the arrangements were running? Your Secretary of State explained that the US concern was at present with finished steel products and not the kind of semi-finished products which BSC would be exporting. Mr. MacGregor said he knew of no legal obstacle to the purchase by a subsidiary of Kaiser Steel. He could not see that the deal could be attacked on anti-trust grounds. On the contrary, it could well be presented as increasing competition. The Prime Minister enquired why, if this was so attractive a deal, Kaiser were not being killed in the rush of potential purchasers. Mr. MacGregor said that Kaiser's wish was to continue as a going steel-making concern, and that they were looking for an arrangement with a supplier of steel slabs; they would not be prepared to contemplate a purchaser with asset-stripping intentions. This criterion ruled out most potential purchasers. Furthermore, the Japanese, for reasons of their own, were unlikely to wish to purchase, and the South Koreans, who might be glad to do so, were not regarded as a secure source of supply by Kaiser.

The Prime Minister enquired about the liabilities of Kaiser Steel. There were, presumably, pension as well as medical and redundancy liabilities. What was the scale of these? Mr. MacGregor said that these liabilities were a first charge on the assets of the company. It would, nevertheless, be legitimate for some of these assets to be sold off - as was implied in his financing scheme - so that it might be that the total value of the liabilities exceeded the reduced value of the assets against which they were secured.

/Mr. MacGregor

- 3 -

Mr. MacGregor said that their present information about the financial position of Kaiser was based on their balance sheet published in May this year, as up-dated in respect of two quarters since then. They would have further information only when the deal was closed but it would be established that if, on revelation of this information, the position appeared materially different from what they at present believed it to be, the whole deal would be off. The Prime Minister asked why it would not be possible for a third party to purchase Kaiser and for there to be contractual arrangements between Kaiser and BSC for the supply of steel? Mr. MacGregor said that, without BSC ownership, there could be no certainty that the arrangements to purchase steel from BSC would continue in being. BSC would not be in control.

Mr. Ibbs identified three risks: first that the deal would, for one reason or another, not be closed - perhaps because BSC were outbid by another potential purchaser. In this situation, BSC and the Government would face political criticism without any useful end result. Second, it was assumed that the US economy would begin to come out of the recession in 1982. If this did not come about the forecast profits accruing from the arrangements would be deferred. Third, there was the risk that Kaiser might get into serious difficulty, either through mismanagement, or through a deterioration in their economic circumstances. In this situation, its liabilities, including those to which the Prime Minister had referred, would become a further drain on BSC's resources. Mr. MacGregor said that the US legal position would preclude recourse being made to the parent of a failed subsidiary. He believed that the chances of failure between now and the closure of the deal would be small. He saw this as an opportunity to create a viable enterprise (Celtic Steel, comprising Kaiser and the Welsh and Scottish plants) which would ultimately be saleable.

The Prime Minister said she had considerable doubts about this proposal. She remained concerned about the US legal position, and feared that there might be damage to Anglo/American relations at some stage. The uncertainties about the US economic prospect meant that there must be doubt about profitability of Kaiser and about the prospects for early and satisfactory sales of its assets. She foresaw considerable political difficulties: this would be seen as an extension of nationalisation, and at the same time as the export of capital from the UK. She saw, however, the attractions of providing extra work for the three BSC steel strip mills. She was ready to authorise a highly confidential consultation with an independent New York merchant banker; and she would wish to have further advice on the US legal position. Ministers would further consider the matter at a meeting to be convened on Thursday morning, 17 December.

I am sending copies of this letter to John Halliday (Home Office), John Kerr (HM Treasury), Muir Russell (Scottish Office), John Craig (Welsh Office), John Rhodes (Department of Trade),

/Keith Long

Keith Long (Paymaster General's Office), Gerry Spence (Central Policy Review Staff) and David Wright (Cabinet Office).

Yours sincerely,

Michael Scholar

Ian Ellison, Esq.,
Department of Industry.

(Name redacted)
This arrived
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TELEGRAM NUMBER 3826 OF 16 DECEMBER
INFO NEW YORK (PERSONAL FOR DONKIN)

FOR SIR P CAREY, DOI.

YOUR TELNOS INDUS U/M OF 11 AND 16 DECEMBER: BSC/KAISER.

1. WE HAVE BEEN IN TOUCH WITH MURRAY AND WILL BE PLEASED TO SEE HIM AND YOUNG TOMORROW IN WASHINGTON IF THEY ARE STILL ABLE TO COME. DEPENDING ON AVAILABILITY, WE COULD ARRANGE DISCUSSION WITH OFFICIALS AT THE DEPARTMENT OF COMMERCE AND POSSIBLY THE US TRADE REPRESENTATIVE'S OFFICE.

2. IT WOULD ALSO BE USEFUL TO BE ABLE TO DISCUSS THE QUESTION IN CONFIDENCE WITH BSC'S LAWYERS HERE (IN PARTICULAR CUNNINGHAM OF STEPTOE AND JOHNSON). GRATEFUL TO KNOW IF THEY ARE AWARE OF WHAT IS AFOOT.

3. MEANWHILE THE FOLLOWING IS OUR PRELIMINARY ASSESSMENT OF THE FOUR POINTS IN PARAGRAPH 4 OF YOUR TELEGRAM OF 16 DECEMBER.

(A) IN NORMAL CIRCUMSTANCES, THE ACQUISITION OF KAISER (ABOUT TENTH IN SIZE AMONG US STEEL MAKERS) BY A FOREIGN STEEL CORPORATION WOULD BE UNLIKELY TO CAUSE SERIOUS ADVERSE REACTION. INDEED, IF KAISER IS IN DIFFICULTIES, LOCAL REACTIONS IN CALIFORNIA WOULD BE LIKELY TO BE STRONGLY POSITIVE. BUT THE QUESTION IS COMPLICATED BY BSC'S STATUS AS A NATIONALISED CORPORATION AND BY THE PRESENT STATE OF THE STEEL MARKET. THE FACT THAT BSC IS UNDER PUBLIC OWNERSHIP HAS BEEN HEAVILY SUPPORTED OVER THE YEARS, AND ONLY RECENTLY OBTAINED A FURTHER SUBSTANTIAL INJECTION OF PUBLIC MONEY WOULD BE BOUND TO PROVOKE QUESTIONS ABOUT WHETHER SUCH AN ACQUISITION WAS IN EFFECT SUBSIDIZED. SUCH A REACTION WOULD BE STRENGTHENED IF IT APPEARED THAT BSC'S AIM WAS TO SECURE A CAPTIVE MARKET FOR ITS SEMI-FINISHED STEEL. THE BACKGROUND, AS YOU KNOW, IS ONE IN WHICH FEELINGS IN THE US STEEL INDUSTRY AND IN THE CONGRESSIONAL STEEL CAUCUS HAVE BEEN RUNNING HIGH OVER THE LEVEL OF STEEL IMPORTS FROM EUROPE. THESE CONSIDERATIONS MIGHT INFLUENCE THE NORMALLY OPEN AMERICAN ATTITUDE TOWARDS FOREIGN INVESTMENT WHICH IN THE PAST HAS ENABLED A NUMBER OF ACQUISITIONS BY FOREIGN NATIONALISED ENTERPRISES TO TAKE PLACE WITHOUT TOO MUCH DIFFICULTY ALBEIT IN RATHER DIFFERENT CONTEXTS, (BP/SOHIO AND RENAULT/AMERICAN MOTORS). TAKING ALL THIS TOGETHER, BSC MIGHT FIND THEY WERE IN FOR A ROUGH RIDE.

*cc SAs Trade
SAs Sect
SAs Wales
Paymaster Gen.
Sir Robert Armstrong*

SECRET

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SECRET

(B) IN VIEW OF KAISER'S APPARENTLY MODEST SIZE, THERE WOULD SEEM TO BE NO PRIMA FACIE REASON FOR THE DEPT OF JUSTICE TO BLOCK THE ACQUISITION. MUCH WOULD DEPEND, HOWEVER, ON THE PRECISE PRODUCTS AND GEOGRAPHICAL MARKET. WHILST THE BLOCKING OF A BID SEEMS UNLIKELY, THE POSSIBILITY OF CONDITIONS BEING ATTACHED TO IT REQUIRES CAREFUL ATTENTION. FULL LEGAL ADVICE WOULD BE ESSENTIAL ON THIS ASPECT.

(C) THE FUTURE OF ALL US STEEL IMPORTS IS IN THE BALANCE. IF THE US INDUSTRY CARRIES OUT ITS THREAT TO FILE A LARGE NUMBER OF SUITS, WHICH IT MIGHT STILL DO AT ANY TIME, THE RESULT WOULD PROBABLY BE TO INHIBIT IMPORTS FROM EUROPE, CAUSING A SHARP REDUCTION OVER THE MEDIUM TERM. IF FURTHER SUITS ARE NOT FILED, AND PROVIDED BSC'S EXPORTS, AFTER ITS ACQUISITION OF KAISER DO NOT BECOME SO LARGE AS TO CONSTITUTE A NEW THREAT TO U.S. STEEL PRODUCERS THERE WOULD BE LITTLE FEAR OF ACTION LEADING TO A RESTRICTION ON BSC THIS ASSUMES THAT THEY WOULD CONTINUE TO RESPECT TRIGGER PRICES.

(D) IF THE U S INDUSTRY'S SUITS ARE FILED, IT IS ALMOST CERTAIN THAT THE TRIGGER PRICE MECHANISM WILL COLLAPSE. PRICES WOULD THEN FALL IN THE PRODUCT AREAS AFFECTED BY THE SUITS UNLESS SOME MODUS VIVENDI COULD BE WORKED OUT BETWEEN U S AND FOREIGN PRODUCERS. NOTWITHSTANDING THIS, THE MEDIUM TERM OUTLOOK FOR THE U S STEEL MARKET IS OBVIOUSLY LINKED TO THE PERFORMANCE OF THE U.S. ECONOMY. THE PRESENT OUTLOOK IS FOR AN UPSWING IN THE MIDDLE OF 1982.

4. A FURTHER REPORT WILL FOLLOW THE VISIT OF YOUNG AND MURRAY.

5. PLEASE ADVANCE TO BRIDGES, FITZHERBERT (ECD(E)), BINNING (ISD, DOI), IBBS (CPRS).

HENDERSON

[ADVANCED AS REQUESTED
BUT NOT PASSED BY
COD TO IBBS (CPRS)]

LIMITED
ECD (E)
NA D
MR BULLARD
LORD BRIDGES
MR HANNAY

COPIES TO:
SIR P. CAREY DOI
MR BINNING ISD, DOI

2
SECRET

Natasha
Standish
R
PRIME MINISTER

Mr Ian MacGregor is asking if he could come in for a brief talk with you this afternoon.

I have said that your diary is crowded, but left it open that it may prove possible for you to see him provided you are back in time.

It would in fact be possible for you to see him at, say, 1645 before your meeting with the Chancellor. Do you wish to see him, or shall we plead the diary difficulties for which I have already laid the ground?

Michael Scholar

16 December 1981

I will see him - but we
must have time to talk, $\frac{1}{4}$ hour
isn't enough. We need 40-45 mins.

Lillian

pl. tell Michael that the P.R. agrees to
1645 provided they have at least 45 minutes.

A.F.C. - $\frac{16}{12}$

~~SECRET~~
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TELEGRAM NUMBER 3826 OF 16 DECEMBER
INFO NEW YORK (PERSONAL FOR DONKIN)

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SECRET

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SECRET

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HENDERSON

LIMITED
ECD (E)
NA D
MR BULLARD
LORD BRIDGES
MR HANNAY

[ADVANCED AS REQUESTED
BUT NOT PASSED BY
COD TO IBBS (CPRS)]

COPIES TO:

SIR P. CAREY DOI
MR BINNING ISD, DOI

2
SECRET

PERSONAL AND CONFIDENTIAL

MR. WHITMORE

BSC and Kaiser

This morning's meeting agreed that no final decisions could be taken on this until advice had been sought directly from the representatives of the United States bankers and lawyers who have been consulted on the matter. I understand that a meeting has been arranged for 9.00 pm this evening.

2. I think that we should give some thought to the tactics of this. The Prime Minister will naturally be minded to see the American advisers herself and put her questions direct to them. But I think that she might be better advised to keep herself, and perhaps the Chancellor, in reserve. In a situation of this kind it is often as well if those conducting the negotiation or discussion are not plenipotentiary, but are under a duty to report back to principals. This means that they cannot settle but must reserve the position. This gives an unforced opportunity for reflection, and for final private discussion without the advisers, before a decision has to be made.

3. Applying this to the present case, I believe that the best course might be for the American banker and lawyer to be seen in the first instance either by officials only (Sir Peter Carey, supported by Sir Douglas Wass, Mr. Ibbs, Mr. Manzie and Mr. David Young (with representatives from the Scottish and Welsh Offices if necessary)), or by the Secretary of State for Industry, supported by those officials. This morning's meeting made clear the questions to which the Prime Minister would need to have answers; it would be the business of those concerned at this first meeting to ask these questions, and all the necessary follow-up questions, and get answers. They should then report the answers to the Prime Minister and the Chancellor of the Exchequer at a meeting without the American advisers present, either later this evening or first thing tomorrow (there is a possible slot at 9.00 am, if we could postpone the business for which that meeting has been called). What happened hereafter could go one of two ways:

PERSONAL AND CONFIDENTIAL



PERSONAL AND CONFIDENTIAL

- (i) If the Prime Minister's meeting identified further questions to be answered, the American advisers could be invited to a further meeting, this time perhaps with the Prime Minister herself.
- (ii) If the Prime Minister's meeting reached a decision, unconditional or subject to conditions, the Secretary of State for Industry would have a further meeting with the American advisers to tell them the decision and consult as necessary on any conditions proposed.

4. I know that this procedure would be more time-consuming; but I believe that it might in the end produce a better result.

RA

Robert Armstrong

16th December 1981



PRIME MINISTER

BSC/KAISER STEEL

In his minute of 14 December the Secretary of State for Industry recommends that we allow BSC to go ahead today with an offer to purchase 17% of Kaiser shares held by the Kaiser Foundation, and to take an option on a further 22%. He also recommends that we should meet later this week to discuss the whole issue: I would welcome this.

From my own point of view, I see no overriding reason to object and am content that BSC should go ahead. The proposed acquisition might raise a few eyebrows in the US Administration, Congress and the US steel industry because of their sensitivities to what they see as BSC's subsidised status (the US industry are threatening anti-dumping and countervailing suits against most European producers). But in my view the acquisition itself does not appear to fall foul of any of our international trading obligations. It is true that under BSC's proposals the steel slabs for the Kaiser plant would be imported from the UK, but Kaiser are anyway phasing out their own steel production facilities.

I ought to point out that BSC might have some problems if the proposed acquisition is scrutinised by the US Federal Trade Commission, or the Justice Department, under US antitrust law. These bodies would demand a wide range of documents from BSC. This might cause embarrassment, depending on the information on internal application by BSC of Government aid which might have to be provided. And I also think it would be advisable to warn the US Administration very soon of what is afoot, so that BCS's

SECRET



(and our) actions can be presented clearly and are not misunderstood.

Copies of this minute go to Members of E Committee, and to Nicholas Edwards, George Younger, Robin Ibbs and Sir Robert Armstrong.

W J B

W.J.B.

Department of Trade
16 December 1981

SECRET



Steel shares held by the Kaiser Foundation, at \$55 a share (with freedom to increase this to \$60 to clinch the deal) and to take an option on 22 per cent of Kaiser Steel shares held by institutions as proposed in Mr Colin Barker's letter. I understand the cost of the option will be about \$3 million.

4 I also recommend that we should meet this week to discuss the whole issue. Unless we act this week there is a clear risk that the whole project might fail. We cannot in my view wait until E Committee meets on 22 December.

5 Copies of this minute go to recipients of my minute to you of 11 December.

I. Ellison

P J

(Approved by the Secretary
of State and signed
in his absence)

14 December 1981

3255.

MARKER
MANAGING DIRECTOR
FINANCE

BRITISH STEEL CORPORATION

PO BOX 403
33 GROSVENOR PLACE
LONDON SW1X 7JG

01-235 1212

14th December, 1981

PRIVATE AND CONFIDENTIAL

Sir Peter Carey, KCB,
Permanent Secretary,
Department of Industry,
Ashdown House,
123 Victoria Street,
London SW1.

Dear Sir Peter,

Since the meeting last Friday, 11th December, 1981, Mr. MacGregor has visited the Chairman of Kaiser Steel, Mr. Stephen A. Girard, and has indicated the British Steel position. The opportunity for the total bid is retained.

On Saturday, Edgar Kaiser Snr., died. This results in the Kaiser Trust having a high priority for the disposal of their 17% interest in Kaiser Steel. This priority centres upon the US rules for retaining the charity status of the Trust of which this 17% holding forms a small part.

Effectively this 17% will now be sold most urgently. Should it fall into hands unfriendly to the British Steel Corporation's aspirations this could thwart the plan presented last Friday.

Mr. MacGregor has therefore instructed me to request:-

- (1) That urgent attention continue to be given to the proposals to acquire 100%. The earlier that the Government decision is available the more likely that the proposals can be brought to fruition.
- (2) Pending the decision on the total plan, Mr. MacGregor desires immediate approval for BSC to offer \$55 per share for the 17% held by the Kaiser Foundation. He wishes to make this offer (using funds borrowed offshore) on Wednesday.

Should you sanction action under (2) above, successful completion of this purchase will not pre-empt a separate decision under (1) above. If the 17% is acquired and, later, the main proposal is not approved, BSC would then dispose of the 17% holding either:-

/...

PRIVATE AND CONFIDENTIAL

Sir Peter Carey

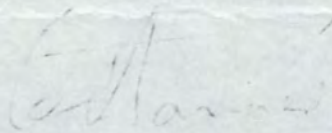
14th December, 1981

- (a) To the city institutions already considering the purchase
- or (b) To Kaiser Steel itself as part of its stated plan to retire some of its own stock - an undertaking by Kaiser Steel is being sought
- or (c) To third party bidders who will by then have materialised.

If, on the basis of this letter, you authorise action under (2) above, I also recommend that you similarly authorise BSC taking an available option on a further 22% held by major institutions in Wall Street. Such an option would very much strengthen the likelihood of success of the final offer. Current estimates are that the cost of such an option would be of the order of \$3 million.

Your very urgent decision both on the 17% and the option would be appreciated.

Yours sincerely,



Colin Barker



Tsy
swt
wchh
PJ
N.J.



SECRET

✓ 3

Qa 05747

To: MR SCHOLAR

From: J R IBBS

1. I understand that the Secretary of State for Industry will be putting a minute to the Prime Minister this weekend about a proposal that BSC should acquire a US steel company. You may like to know that the CPRS is involved in discussions on this matter at the Department of Industry; our aim is to be able to offer a view on it at an appropriate time.

2. I am sending a copy of this minute to Sir Robert Armstrong.

11 December 1981

SECRET



11 12 1 2 3 4 5 6 7 8 9 10

11-1 DEC 1981

SECRET



Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 - 3301
SWITCHBOARD 01-212 7676

2 ✓
Friday, Dec 11

Dear Margaret,

I attach a minute which will perhaps stable you.

In my view, this project is one which we would be right to treat seriously. If it comes off, I think we would reap considerable political dividends. George Young and Nick Edwards are as enthusiastic as I am. We believe that it is the kind of project which only a man with Ian MacGregor's unique experience could bring home. He probably knows more

about the American steel industry than
anyone else this side of the Atlantic.

I strongly recommend that we should
allow him to explore the project further.

Yours ever

Patrol

We will discuss in party
but: —



PRIME MINISTER

SECRET

- ① This is an extension of nationalisation.
- ② Why can't Kaiser take over BSC - or a
third company take over both
- ③ What would happen after Macgregor.
- ④ U.S. Law? Would it allow such a takeover.

Ian MacGregor has put to me a proposal that BSC should acquire a US steel company, Kaiser Steel Inc. He has also discussed this proposal with Nicholas Edwards and George Younger.

2 The purpose of this bold move is to obtain an outlet for about 1.5 million tons of steel a year by 1984 from the three BSC integrated steel strip mills at Port Talbot, Llanwern and Ravenscraig. The 1.5 million tons would largely be additional output, it would help secure the future of all three of these steel mills, reduce the scale of currently planned redundancies and make a significant contribution to the return to profitability of the BSC Strip Products Group. The Strip Products Group includes all three strip mills and, despite the considerable improvements in productivity which have taken place over the past year, particularly at Port Talbot and Llanwern, the Group is still making losses and is not expected to become profitable during 1982/83 even following the steel price rises due on 1 January.

3 Kaiser Steel Inc is situated 45 miles East of Los Angeles. It is an integrated steelworks of about 2.2 million tons per year liquid steel capacity. Its main products are very similar to those of the BSC Strip Products Group: hot rolled coil, tinplate, galvanised sheet and welded tubes. At 31 December 1980 Kaiser had about 11,000 employees. The company reported operating losses in each of the 3 years 1978 to 1980 but made an operating profit of \$30 million in the first half of 1981. Taking into account revenues from its considerable cash reserves, Kaiser Steel is expected to report over \$100 million profit in 1981.

SECRET



4. The management of Kaiser Steel announced several months ago that they intended to phase out gradually their production of liquid steel. Instead they propose to buy in semi-finished steel slabs for further processing. The reasons for this decision are twofold: first that Kaiser's existing blast furnaces and coke ovens are old and would need a lot of money spent on them; second and more significantly the environmental control regulations in California impose increasing capital and running costs on basic steel production, to such an extent that it will be more economic to buy in steel slabs rather than to continue to make steel in the blast furnace/basic oxygen route.

5. BSC are already supplying trial quantities of slabs for evaluation by Kaiser and are sufficiently confident that they will obtain a share of the business to include in their Corporate Plan for 1982/83 the production of 130,000 tonnes of steel slab for Kaiser.

6. Ian MacGregor is confident that far greater benefits would accrue if BSC were to own Kaiser Steel. Not only would BSC have the advantage of being the assured supplier of slabs; he considers that Kaiser would be a very profitable business and that the purchase would be self financing within a very short period.

7. The estimated cost of buying Kaiser Steel Inc is about £200 million (\$400 million). BSC propose to raise half this sum through an intermediary body handling the steel slabs, which would be outside the PSBR and BSC's EFL. The remaining £100 million would need to be provided or guaranteed by the Government to BSC, but Ian MacGregor expects that at least £50 million of this could be repaid immediately after the acquisition, from Kaiser Steel's own cash resources, (a device permitted in US law but not in the UK). BSC believe that they could find most of the remaining £50 million from within their £730 million EFL agreed for 1981/82. →

Guatemala July

- Proj. costs now

1 1/2 - 2 m. dets.

Piping for
Natural Gas.

3,000
↙
↗

{ Counterbalancing duties }
{ Anti-dumping duties }

- Duts -

R' cap. 50-60%

Ms.

Bum

Bum

17%

512

Opto.



8. Clearly, much more detailed work needs to be done to evaluate this proposal, both by BSC and by the Government. But in order to obtain the further information required for a full assessment, it will be necessary to have detailed discussions with the Kaiser Steel management. And once this process starts, under Securities and Exchange Commission rules, BSC's interest in acquiring Kaiser must be made public.

9. Others are known to be interested in Kaiser Steel and Ian MacGregor needs to move quickly. He has arranged to have lunch tomorrow (12 December) in California with Mr Kaiser of the Kaiser Foundation which owns about 17 per cent of the shares in Kaiser Steel and which is known to be keen to sell them. I have advised him that at this stage he should not take any steps which would lead to a public announcement, and that we would let him have a more considered view before the end of next week.

10. I expect to circulate a further note, covering a rather fuller report by officials, by Tuesday evening, (15 December). This report will need to present some alternatives to the Kaiser deal, including the closure of Ravenscraig or finding an alternative use for it. If in the meantime news of BSC's interest in Kaiser does leak out, we will need to acknowledge that we know of the proposal and that Ian MacGregor is exploring it further, without commitment.

11. I am sending copies of this letter to the members of E Committee and to Nicholas Edwards, George Younger, Robin Ibbs and Sir Robert Armstrong.

P.J.

P J

// December 1981

Ashdown House
123 Victoria Street

60 days. = Anti-dumping =
Trigger.

3 matters
 - Commercially - good deal. Revenue
 - Anti-trust
 - Validity of Proceeds of law → Control.
 - Admin.

Start trigger.

① B.S.C. vulnerable to attack.
 - Admin with confidence =

Stability of Trigger Price Mechanism

(i) - Anti-dumping } be up.
(ii) - Countervailing duties }

B.S.C.'s own lawyers
Stephen Johnson

How competitive - stable

Start industry.

① Must
with Co. first.
② Shareholder.
③ Fed's back
corner
Type of Policy.
Anti-trust.
95+
Clearance.

MSU option,
↓
Stu.

Merchant Banker.

"Out" legislation

{ Will to spread
admin. blocked }

+ plus.

John D. ... R. Miller

Celtic Kaiser Steel

Profits (Losses)

£ Million

| | <u>1981/82</u> | <u>1982/83</u> | <u>1983/84</u> | <u>1984/85</u> |
|----------------------------|----------------|----------------|----------------|----------------|
| Strip Products as per plan | (150.3) | (37.0) | (2.6) | 61.0 |
| New Investment | (9.0) | 2.0 | 76.0 | 133.0 |
| Combined | (159.3) | (35.0) | 73.4 | 194.0 |

PRO FORMA KAISER/BSC

| <u>Investments</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> | <u>£ Million</u> |
|----------------------------------|-------------|-------------|-------------|-------------|------------------|
| Initially from BSC | 100 | | | |) |
| Kaiser Returns Equity | (50) | | | |) 8.2 |
| Grantor Trust | <u>100</u> | | | |) 8.5 |
| C/F | 150 | B/F 150 | B/F 150 | | |
| Sale of Coal Deposits | | | | | |
| (i) Applied to Grantor Trust | | | (100) | | 8.6 |
| (ii) Returned to BSC | — | — | (50) | — | |
| <u>Net Investments</u> | <u>150</u> | <u>150</u> | <u>Zero</u> | <u>Zero</u> | |
| | | | | | |
| <u>Return on Investments</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> | |
| 1) BSC incremental | - | 6 | 13 | 21 | 3 ii |
| 2) Kaiser | - | 14 | 73 | 114 | 3 iii |
| Sub Total | | 20 | 86 | 135 | |
| | | | | | |
| Margin for Grantor Trust | | | | | |
| £100 m @ 16% | (8) | (16) | (8) | - | 8.5 |
| Extra 2% on Kaiser Borrowings | | | | | |
| 2% on £100 m | (1) | (2) | (2) | (2) | 8.7 |
| | | | | | |
| <u>Net Results of Investment</u> | (9) | 2 | 76 | 133 | |

Attachment 11

(Profit & Loss) after interest

£ Million

| | 1982/3 | 1983/4 | 1984/5 |
|---|--------|--------|--------|
| 1. Objective - Operating result | (150) | Nil | 150 |
| 2. <u>Option 1</u> - Close Ravenscraig | | | |
| - Effect on operating result | - | 74 | 147 |
| - Extra ordinary items | | | |
| Closure Costs | (53) | - | - |
| Asset write off | (170) | - | - |
| | (223) | 74 | 147 |
| 3. <u>Option 2</u> - Close Teesside | | | |
| - Effect on operating result | - | 55 | 110 |
| - Extra ordinary items | | | |
| Closure Costs | (115) | - | - |
| Asset write off | (300) | - | - |
| | (415) | 55 | 110 |
| 4. <u>Consolidated P&L after interest</u> | | | |
| - <u>Option 1</u> | | | |
| Operating result | (150) | 74 | 297 |
| Extra ordinary items | (223) | - | - |
| | (373) | 74 | 297 |
| - <u>Option 2</u> | | | |
| Operating result | (150) | 55 | 260 |
| Extra ordinary items | (415) | - | - |
| | (565) | 55 | 260 |

