10 DOWNING STREET

THE PRIME MINISTER

8 October 1980

Thank you for your letter of 1 October 1980. I welcome your support towards the basic aims of the Government to reduce inflation.

Your letter acknowledges savings of £2 million per annum in raw material and energy costs but does not acknowledge the possibility of further assistance with coal prices which could amount to £1.8 million per annum. I understand that, in addition, the workforce's attitude towards future wage increases could have saved the company up to a further £1 million per annum.

I am sorry that you feel obliged to talk of "the long term decision of investing £36 million" when grants of £14.4 million towards it could be expected, coupled with a soft loan for a further £18 million. This is apart from the tax relief that would be available to be set off against group UK profits.

We have not failed to recognise that any closure decision must be your own; but Bowater requested assistance from the Government to enable the mill to survive. Not only do the improvements in timber and energy costs and the potential grants and loans, based on your own figures, offer the prospect of mill profitability in all but the most adverse circumstances, but they also show no cashflow penalty when compared with closure. The details of the profit figures under the investment plan supplied by your company were attached to Lord Trenchard's letter to you of 6 August. At his subsequent meeting with Mr. Popham, your Chief Executive,

/ they

they were, I understand, broadly accepted. If even more adverse assumptions are now to be taken, then the improved offers on energy should also be taken into account.

The case has been put in the media that the solution of the problem turns only on wood and energy costs. I find this unfortunate as it is investment in improved production methods which holds the key to long term viability. It is our belief that the package of assistance towards major investment at the mill and the substantial reductions indicated for raw material and energy costs do offer a real prospect for long term viability.

Like yourself, we deeply regret your decision to close the mill and would still hope that you might reconsider it. I trust that this letter clarifies the Government's view.

(SGD) MARGARET THATCHER

The Right Honourable Lord Erroll of Hale.

3

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212
SWITCHBOARD 01-212 7676

From the
Minister of State

Prime Minister

Draft letter at Flag A for you to send to Lord Erroll.

[initials] 7/10

The Rt Hon Mrs Margaret Thatcher MP
Prime Minister
10 Downing Street
LONDON SW1

6 October 1980

Dear Prime Minister

BOWATER

First, my apologies for the inadequate publicity on Friday. Both ITV and BBC recorded nearly all the points, which I put strongly, but it was cut to a small fraction to make room, I imagine, for the Paris synagogue bombing. However, enough is out for the debate to continue and the unions are clearly going to have a go at Bowater as well as us, so we will try to do better next time.

Secondly, I attach a draft letter for your reply to Lord Erroll. Since Lenton categorically told you that they did not agree that they could make a profit, we have spelt it out. I had deliberately confirmed everything in writing (for instance in my letter of 6 August, attached), as it has been clear for some time, I fear, that they have not been playing quite straight.

Third, I am sure our rightful indignation with Bowater will not take our minds off the fact that a large proportion of the paper and board industry is losing money due to the combination of pressures of which you are well aware. The same, I fear, applies to other industries.

Only a minority of an industrial nation's production will ever lie in the security of "up market", fairly invulnerable added value fields. The current combination of factors, including particularly the accumulated swing in cost and price competitiveness against our manufacturers, is more than the majority of companies can or will be able to cope with when the full pressures reach them. At the moment, with falling volume, productivity has actually worsened, but even a 5% per annum improvement would take 7 or 8 years to offset the 40% swing in competitiveness since 1978. That is of course at present exchange rates. Energy prices are also important.

yours

Tom T.

LORD TRENCHARD

DRAFT LETTER FOR THE PRIME MINISTER TO SEND

The Rt Hon Lord Erroll of Hale
Chairman
Bowater Corporation
Bowater House
Knightsbridge
LONDON SW1X 7LR

Thank you for your letter dated 1 October 1980. I welcome your support towards the basic aims of the Government to reduce inflation.

Your letter acknowledges savings of £2m per annum in raw material and energy costs but does not acknowledge the possibility of further assistance with coal prices which could amount to £1.8m per annum. I understand that, in addition, the workforce's attitude towards future wage increases could have saved the company up to a further £1m per annum.

I am sorry that you feel obliged to talk of "the long term decision of investing £36m" when grants of £14.4m towards it could be expected, coupled with a soft loan for a further £18m. This is apart from the tax relief that would be available to be set off against group UK profits.

We have not failed to recognise that any closure decision must be your own; but Bowater requested assistance from the Government to enable the mill to survive. Not only do the improvements in timber and energy costs and the potential grants and loans, based on your own figures, offer the prospect of mill profitability in all but the most adverse circumstances, but they also show no cashflow penalty when compared with closure. The details of the profit figures under the investment plan supplied by your company were attached to Lord Trenchard's letter to you of 6 August. At his subsequent meeting with Mr Popham, your Chief Executive, they were, I understand, broadly accepted. If even more adverse assumptions are now to be taken, then the improved offers on energy should also be taken into account.

The case has been put in the media that the solution of the problem turns only on wood and energy costs. I find this unfortunate as it is investment in improved production methods which holds the key to long term viability. It is our belief that the package of assistance towards major investment at the mill and the substantial reductions indicated for raw material and energy costs do offer a real prospect for long term viability.

Like yourself, we deeply regret your decision to close the mill and would still hope that you might reconsider it. I ~~hope~~ trust that this letter clarifies the Government's view.

Bowater

cc Mr Avery
PS/SofS
PS/Mr Mitchell
PS/Secretary
Mr Ridley
Mr Mannie
Miss Mueller
Mr Binning
Mr Smoutha
Mr Lodge
Mr Owen

From the
Minister of State

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212
SWITCHBOARD 01-212 7676

Lord Erroll of Hale
The Bowater Corporation Limited
Bowater House
Knightsbridge
London SW1

6 August 1980

PERSONAL AND CONFIDENTIAL

Dear Lord Erroll

I have today met Dr Lenton for a further discussion on Bowater's problems at its Ellesmere Port Mill and its request for help to overcome these.

I think I should make the Government's position and understanding of the situation entirely clear.

Your company has asked for assistance in relation to wood prices, energy prices and trade matters. When I saw Dr Lenton on 3 July I made clear that if there was a chance of arriving at a situation where Bowater might feel able to continue its Mersey Mill operation it must include ensuring that the company became fully competitive in terms of investment and productivity. The problem was such that no one action alone was likely to overcome it.

Your own management at the Mill has developed an investment plan involving expenditure of some £36 m and including the provision of a new sulphite pulp mill offering genuine prospects of a return to reasonable profitability were the investment to be made. The implications of the investment are set out in the attached memorandum from which you will see that a direct Government contribution of some £6½ m under Section 7 of the Industry Act as well as Regional Development Grants of some £7.9 m could be anticipated. In addition, within this investment framework, further significant contributions have been offered by the Forestry Commission and the NCB whilst the publishers had indicated that they would take all the output from the Mill if it is produced to an acceptable quality.

As I told Dr Lenton, against this background my colleagues and I frankly find difficulty in understanding the company's reluctance to endorse this Government-assisted investment proposal. It would involve the company in expenditure but not any additional cash outflow above those it would incur in the alternative event of closure. (See paragraph 10 of the memorandum.) Even as it stands therefore the investment option would seem merit-worthy.

Looking at the situation more widely Dr Lenton gave me the impression that Bowater regarded the UK as a second rate location for such manufacture on a long-term basis. When you kindly asked me to lunch last summer we speculated on the future of energy prices and the exchange rate. The current discussion of the energy situation will have shown you that there is a widespread debate with the Government in relation to industry's energy prices. You may recall my private opinion on this subject. Again, for what would essentially be a view of the long-term prospects I would think that the particular advantages/disadvantages of present and future North American/UK exchange rates would repay your further consideration.

You will readily appreciate that beyond the help already proffered we cannot recommend any major change of Government policy for your company or your industry alone, but I believe that it must be clear to all of us that notwithstanding present effects on UK manufacturing industry of our possession of North Sea oil, this country will be a reasonable base for efficient manufacturing industry in the future. We rely partly on large British companies to help the country through the inevitably tough short-term period. If heavy losses appeared to be unavoidable, I could not ask you to consider the matter any further, but this does not seem to be the case.

I am available and would welcome a meeting next week (Thursday or Friday) to discuss further this letter and the attached memorandum if it would be at all helpful.

Copies of this letter go to Mr Popham and Dr Lenton.

Yours sincerely

Trenchard

LORD TRENCHARD

BOWATERS - ELLESMERE PORT

MEMORANDUM FOR LORD TRENCHARD'S DISCUSSIONS

1 Forestry Commission have proposed a reduction in timber costs as set out in their letter of 1 August which would give the following reduction in costs (@ $2.30):

£K	1981	1982	1983	1984
	810	1080	1410	1410

and would ensure that there is an availability of timber for enlarged requirements.

2. The National Coal Board have offered a reduction in coal prices of approximately £1.50 p.t., giving a saving of up to £300 K pa on a year by year basis.

3. The Department of Industry would consider Selective Financial Assistance of £6.5 m. towards a project securing 1300 jobs with capital expenditure of £36m. The capital expenditure would also quality for Regional Development Grants of £7.9m giving a total assistance of £14.4m.

4. An EIB loan of £18m. would be sought for the £36m. investment programme. The current rate of interest on such loans is approximately 10%.

5. The publishers have indicated that they would take all output from the mill if it is produced to an acceptable quality.

6. The cash flow projection for closure shows a need for borrowings of £12.5m. in addition to the £13.5m. already shown as borrowings of the mill, and for the investment programme under discussion shows a lesser need for cash.

The cash flows can be summarised as follows: (for the purposes of comparability interest has been assumed on the closure option - alternatively the £26m. write-off could be deducted from the investment option).

Total borrowings (including EIB loan)

	1981	1982	1983	1984	1985	1986
Closure option £M	(26)	(30)	(34)	(39)	(45)	(51)
Investment option £M	(19)	(14)	(25)	(15)	(5)	4

7. After the capital investment and at $2.30 the projected profitability (before interest) of the mill would be £10m. per annum.

Bowaters have drawn attention to the following sensitivities:

(a)	Currency risks	£2m.	$2.30 to $2.40 (a further £2m. if it goes to $2.5).
(b)	Volume risks	1	Inability to obtain UK market for increased capacity (maximum risk £2m)
(c)	Quality risks	1	Reluctance of users to wholly convert to 45 gram weight paper.
		4	

If the balance of qualities of newsprint were brought into line with the requests of the publishers (see 5 above), the volume risks would be avoided.

The profit before interest has been used as:

i) interest on £13.5m already borrowed is academic as this will not be repaid

ii) interest on the additional closure costs will be incurred anyway.

All figures are in 1980 £s. The projections therefore do not reflect the effect of inflation on profitability.

8. Bowaters have principally requested assistance for the current trading. The cash flow forecasts include the projected losses until the investment comes on stream and assistance is being provided as set out in 1 to 4 above.

9. If the investment programme were to fail prior to 1983 Bowaters would have further cash costs in excess of those of an immediate closure in the range £5m to £15m. (For this calculation it has been assumed that the exchange rate will be $2.50 and other worst situations have been taken.) The cost would reduce thereafter to the extent that if reasonable trading had taken place for a couple of years there would effectively be no penalty by 1986.

10. Conclsuion

The assistance being discussed would have the effect of putting the plant in a position to earn profits from 1984 onwards of £10m. pa and positive cash flow of £10m pa (profits £6m and cash flow £6m. with worst assumptions). All this at no additional cash cost to that of closure but with a maximum further exposure of £15m (see 9 above).

Bowaters are confident that the investment option would bring the mill up to a level as efficient as any other than the top 25% in the world. At some stage between, perhaps before 1990 and maybe as early as 1986, it would be necessary to invest in a larger newsprint machine (150K t.p.a.) at a substantial cost to retain the profitability of the mill.

Given the confidence which Bowaters have in their technical ability, the offers suggested by HMG and the costs of closure reduce their exposure to such a level that the potential benefits make the investment a not unreasonable commercial venture (based on Bowater's own projections).

JH

DEPARTMENT OF INDUSTRY
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PS/ Secretary of State for Industry

T Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

2 October 1980

Dear Tim,

BOWATER ELLESMERE PORT

The main points in Lord Erroll's letter of 1 October to the Prime Minister are the familiar ones that due to the constraints on raising selling prices, the high cost of wood and energy and the company's views on the strength of sterling and of future markets the risks of making the Ellesmere Port investment are too great for the company to undertake. Only a guarantee, quantified as £7m/annum, that operating losses will be met and the certainty of a full order book would induce Bowater to keep the Ellesmere Port operation open.

2 These points have already been covered in the briefing provided for tomorrow's meeting. It has always been for Bowater to decide whether or not it is prepared to keep open the Ellesmere Port plant. But on the basis of the figures agreed with Bowater the investment proposal, allied to the reductions in wood and energy costs that could have been available could on the company's own figures have produced profits at the mill from 1984 onwards though these were subject to certain sensitivities. Bowater was assured of an offtake for its newsprint at competitive prices. By contrast an operating subsidy with no commitment to investment could not ensure a viable future for the mill.

3 Additionally, Lord Erroll suggests that the problems of the mill are not due to newsprint alone but also to problems on the smaller packaging paper side. It is true that those operations are also experiencing difficulties, though less severe than in the case of newsprint but if, through investment, the newsprint operations were made viable then the major problems at Ellesmere Port would be overcome. The profit figures discussed with Bowater were for the Ellesmere Port operations as a whole.

4 A substantive draft reply to Lord Erroll's letter will be forwarded in the light of the outcome of tomorrow's meeting.

Yours ever,
Pete
PETER STREDDER
Private Secretary

22 OCT 1980

RH

NB: Lord Trenchard's Office (DOI) have already received a copy of this letter and will be letting us have a draft reply within 10 days.

1 October, 1980

I am writing to acknowledge your letter of 1 October, which I will place before the Prime Minister in advance of her meeting with the delegation from the British Paper and Board Industry on Friday. A reply will be sent to you as soon as possible.

T. P. LANKESTER

The Right Honourable
Lord Erroll of Hale

RH

From the Chairman
The Rt. Hon. Lord Erroll of Hale

THE
BOWATER
CORPORATION
LIMITED
England 191285

Bowater House Knightsbridge London SW1X 7LR
Telephone 01-584 7070
Telex London 22191 Nuseprint London SW1

1 October 1980

The Rt Hon Margaret Thatcher M. P.
No. 10 Downing Street,
LONDON SW1.

Dear Prime Minister,

At Lord Trenchard's request, I went to see him on Wednesday last, 24th September, accompanied by Mr C. F. Popham, Bowater's Deputy Chairman and Chief Executive, and heard your views on the impending closure of our Ellesmere Port Mill.

As you are receiving a delegation from the British Paper and Board Industry on Friday, and time is short, I thought it best to write to you direct, with a copy to Lord Trenchard.

My colleagues and I firmly believe in, and support, the basic aim of your Government to reduce inflation.

Our planning must assume that you will succeed, and we believe that the pound will continue to be strong, both as the rate of inflation comes down and pay settlements are realistic, and as Britain continues to be self-sufficient in energy. To this extent the Bowater new investment in the U.K. of £75 million over the last three years demonstrates our confidence.

The losses at our Ellesmere Port plant are now running at the rate of approximately £7 million per annum, based on current market conditions. The cash outflow for 1980 will be some £8.5 million, and this in a year of relatively modest capital expenditure, and a full newsprint order book. Additionally, I cannot emphasise too strongl y the very real improvement in productivity which has been achieved at the mill during the last two years, as a result of the efforts of the total workforce. This mill has an annual capacity of 90,000 tonnes of packaging papers in addition to 190,000 tonnes of newsprint and consequently, contrary to popular belief, its future is not solely dependent on a solution to the newsprint problem.

This present situation has arisen due to the very low selling prices of both packaging papers and newsprint, which in sterling terms are still at 1977 levels. Newsprint selling prices in the U.K. are linked to the U.S. dollar (a factor dictated by the domination of the Canadian producers in this market). Additionally, on two of the major items of variable cost, namely energy and wood, U.K. prices are very substantially higher than those enjoyed by our overseas competitors.

In the very frank and open discussions which we have had with the Department of Industry, every possibility of reducing costs has been examined, including the building of a new pulp mill with Government support. This new mill would supply the newsprint machines only, and not benefit the production of packaging papers.

Recent discussions with the appropriate Government Agencies have succeeded in achieving possible reductions in raw material and energy costs of some £2 million at the Ellesmere Port Mill, although the continuity of such offers remains uncertain. This does not overcome the problem, and it cannot be commercially correct for this Corporation to take the long-term decision of investing £36 million, primarily in the aforementioned new pulp mill, until the problem of manufacturing costs is resolved.

Furthermore, the change to a worldwide over-capacity for both packaging papers and newsprint in 1981 is now certain, and several other facets of the investment option are not only at risk in the weak market ahead, but also are at best achievable only over a period of years.

The Corporation is therefore faced with a range of exposures:

(a) The effect of the strength of sterling on selling prices of dollar-based products.

(b) The prospect of weak markets for the next few years.

(c) Uncompetitive wood and energy costs.

In the absence of any indications that these problems will be resolved, it is our judgement that the risks of continuation are too high. However much we may regret it, therefore, the only sensible course open to us is to close down an operation which is losing, and could continue to lose, up to £7 million a year, and so draining off money generated by our other activities within the United Kingdom. These operations are also under strain because of the strength of the pound, and high energy costs. I do not need to tell you that this in turn could jeopardise the jobs of other employees.

We deeply regret the necessity of making so many hard-working employees redundant. The only way, however, in which we would feel justified in keeping the mill running, and so saving these 1,600 jobs, would be if we were to receive a reduction in costs, or a cash injection, of £7 million per annum for three years, and if we were certain of a full order book for newsprint. We would still, of course, continue to be exposed to considerable risks on world prices, and on the market for packaging papers.

Yours Sincerely,

Freddy Erroll

PS/SofS
PS/Mr Mitchell
PS/Secretary
Mr Steele
Mr Mangie
Mr Wright
Mr Smouha
Mr Avery
PS/Prime Minister.

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
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From the
Minister of State

Lord Trenchard

The Rt Hon Lord Erroll of Hale
Chairman
The Bowater Corporation
Bowater House
Knightsbridge
London SW1X 7LR

1 October 1980

R 2/10

Dear Lord Erroll with regrets

As agreed, I asked Brian Smouha to contact Mr Pomeroy, and I learn from their discussions that there are no new figures subsequent to those attached to my letter of 6 August. Mr Pomeroy made it clear that your company was worried about the assumptions and sensitivities involved, in particular regarding the exchange rate and the savings offered by the sulphite pulp mill, but the figures still, I understand, suggest profits of up to £10m, though more probably around half that amount.

We shall, of course, take care in any response to the media, MP's and other enquirers to state the company's right to make its own commercial decisions, but if it is suggested, as it has been in some press reports, that the majority of the problem is due to energy prices, we shall have to make it clear that they are not the whole story and that it appeared possible on your company's plan, with present exchange rates and quoted energy prices, to see the operation in profit in 1984. This would of course be after further investment towards which we were willing to offer aid and for which we would also arrange EIB loans. If asked, we shall also have to make it clear that reductions in wood and other prices were in prospect, on a commercial basis, and in a full year following the investment these could have been very substantial. Indeed, I understand suggestions of further concessions on coal prices have been made since we met. We shall therefore have to say that we are disappointed by Bowater's decision, particularly in view of the Government's determination to see improved efficiency in our energy producing industries in the longer term.

I must also make it plain to you that checking the figures again indicates clearly that Bowater's closure costs would be approximately the same in relation to cash flow as the aided investment plan. You asked whether we would be prepared to guarantee you a balanced cash flow for three years if the Mersey Mill were kept open. I am afraid this would involve a very considerable subsidy for unimproved production methods which would not necessarily lead to long term viability, and it would not be proper for the Government to support your company alone in this way.

I can only say that I am sorry that you and your colleagues have felt unable to see out the next few years, which will undoubtedly be tough for all of manufacturing industry.

Yours sincerely

P C Mu...

pp Lord Trenchard

(Dictated by the Minister
and signed in his absence)