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Prime Minister

No decision sought – this is designed just to update you. It seems to me no more than a variation on the original proposal.

MLS 8/1

Sohio / Kennecott won't keep Kaiser. Why? The mills are too good?! Further for S/K to buy merely to extract [illegible] and then to have no further responsibility is extraordinary. MT.

(2) 16

PRIME MINISTER

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 Baldridge, 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 Baldridge'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 must also be concerned about the capacity in the rest of the EEC which is far greater, no

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.

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.

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

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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

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 deicision 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

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Note Suggested to Mr Young that he put something in writing to the PM in week beginning 4 Jan. No need to B/F MCS 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?

MCS.

* or on Thursday morning.

22 December, 1981

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