

f. JV.



Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
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*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

*to let you have advice; and held up the
deadline. Shall I say you have*

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.

*strong doubts
- 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

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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.

Useless

?

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

at what price?

- (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.
- (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



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 notes:
Kle Mb
or Asbelow
+ 12 Verker
Nait Ind

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 read "Geoffrey Howe".

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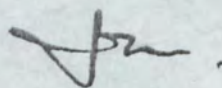
competitors are negotiating similar deals. There must be a risk that, if imports of semi-finished steel into the US rise too rapidly, quota arrangements will be imposed on these products. This might leave BSC with the balance of their loan guarantee outstanding and no outlet for their slab.

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', with a horizontal line underneath.

(FRANCIS PYM)

Foreign and Commonwealth Office
3 November 1982

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