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Prime Minister

BRITISH ALUMINIUM COMPANY LTD: INVERGORDON SMELTER

I have seen the Secretary of State for Industry's minute to you of 10 December reporting on the outcome of the E(EA) meeting on 9 December. He has noted my view that we will need to defend any decision to close the smelter against what it would cost to provide an additional subsidy to keep it going. I am therefore setting out the relative costs of the options for closure and continuation for consideration by colleagues.

Continuation

2. The Parliamentary Under-Secretary of State for Industry and I had a meeting this morning with Lord Plowden and Mr Utiger of British Aluminium Company Limited (BACo) during which they set out the requirements which would enable the company to continue its operations in Invergordon, these are attached at Annex A. In summary this would involve writing off the disputed charges from BACo's books, reducing their price for electricity to something nearer to what they originally expected, agreeing a basis for cost escalation in the future, and safeguarding the future of the company by putting the smelter into a separate subsidiary.

As Annex B shows continuation would cost us some £59m to write off the accumulated disputed charges plus a total of £14m or so annually to bring the cost of electricity down to a price the company could afford. The actual cost might be more or less than this depending on how the cost escalation provision worked out. If we were to consider an arrangement such as this I consider that BACo should surrender to us their claim on the residual value of Hunterston B power station currently estimated by the electricity boards at £70m, and a break clause would be necessary so that the arrangements could be reviewed on a mutually agreed basis in three years' time.

3. Closure

I accept that on economic grounds it is difficult to justify an operating subsidy of this kind. Nevertheless this is an exceptional case. The catastrophic effect in the Highlands will give rise to extremely severe political problems. Moral obligations to the company, the need to safeguard the company's other activities, the scale of remedial measures

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required and the knock-on effects to NCB through reduction in demand for coal together mean that the cost of closure is very large. As the table shows the total for the three years is at least £50m and if BACo are to get a net payment of £30m the total becomes £80m.

If closure is decided on, an aspect which is particularly difficult for me is the continuation of much larger subsidies from CEGB to the Anglesey smelter. Because Dungeness B is still not in operation this smelter gets its electricity at about a third of the cost at Invergordon with CEGB meeting the deficit. Invergordon would of course be viable at this price also.

Assistance to the Highlands

I made it clear at E(EA) that if closure takes place special measures would be required at Invergordon to try to reduce the political and economic impact. Unemployment in the immediate area would rise to 25 per cent and there would be very wide repercussions. The local economy is fragile and there would be no prospect that early new development could make good the loss of one of the largest industrial projects in the Highlands.

I propose that the Highlands and Islands Development Board (HIDB) should be given the task of co-ordinating remedial measures and should have its budget increased by up to £5m in each of the next three years. This should make it possible for them to redevelop the Invergordon site, make a particular effort to attract new industry to the area by providing funds for investment if necessary, and assist retraining by providing further funds for Inverness Technical College. In addition, in view of the scale of the disaster and the difficulty of the remedial task we face I would wish to see the area accorded Special Development Area status.

Recommendation

As will be seen from the table the costs of closure exceed those of continuation over the first three years. I therefore recommend strongly that we offer arrangements to the company which will enable the plant to continue.

I am sending copies of this minute to members of E and E(EA); the Secretary of State for Wales, the Lord Advocate, the Parliamentary Under Secretary of State, Department of Industry, Robin Ibbs and Sir Robert Armstrong.

A.Y.

4 December 1981

Strictly Confidential

14 December 1981

A BASIS TO ENABLE BRITISH ALUMINIUM TO CONTINUE OPERATING
INVERGORDON

The following actions will be necessary for Invergordon to be a competitive plant in the future.

- 1 NSHEB to withdraw the present legal action and to give up any claim in respect of the disputed items at 31 December 1981.
- 2 NSHEB to give firm undertakings that it will not attempt to charge BA in the future for costs within the categories of the present disputed items.
- 3 BA to receive a guarantee that future escalation under the terms of the contract shall not exceed the general rate of inflation in any year.
- 4 BA to pay charges to NSHEB in direct proportion to the number of kWh actually taken.
- 5 BA to be given an undertaking that in the event of a termination of the power contract at any future date the smelter deficit account cannot be included as a deduction against BA's rights in termination.
- 6 BA would wish to put the Invergordon smelter into a separate wholly owned subsidiary company, together with all agreements and contracts pertaining to the smelter, so that there could be no future risk of problems arising from the power contract destroying the financial viability of the whole Group.

BA would almost certainly need to reduce load at Invergordon to about half until the market improves, and this would presumably qualify for short-time working compensation.

R E Utiger
Chairman

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COMPARISON OF COSTS OF CLOSURE AND CONTINUATION

The complicated arrangements which would be necessary to either effect the closure of the Invergordon smelter or to provide assistance to allow continuation would give rise to various transactions. Some of these would be self-cancelling in Government accounting terms and therefore the following table concentrates on those transactions which would have an effect on cash flows.

A. CLOSURE	<u>£m (1981/82 Prices)</u>			
	<u>1981/82</u> <u>January-March</u>	<u>1982/83</u>	<u>1983/84</u>	<u>1984/85</u>
Net Cash to BACo	<u>£30</u> Note 1	-	-	-
Loss of Revenue to NCB by coal displaced by Hunterston	2 Note 2	8	5	2
Loss of capital repayments on loan by BACo	0	2	2	2
Extra expenditure by HIDB	1	5	5	5
Unemployment Pay)	1	3	2	1
Loss of tax revenue)				
		2	1	1
TOTAL	<u>£34</u> or 4	20	15	11
				<u>GRAND TOTAL</u> <u>£80m</u> or £50m
B. CONTINUATION				
NSHEB loss on supply to BACo	4 Note 4 Note 5	14	14	13
				<u>GRAND TOTAL for 3½ YEARS = £45m</u>
SAVINGS ON CLOSURE	<u>£-30</u> or 0	-6	-1	+2
A - B				

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1. Opposed by Treasury.
2. Assuming that NCB cannot find alternative markets or rundown production in late years.
3. Provisional figures subject to examination by officials of remedial measures for which expenditure may be required.
4. In addition to other costs it will be necessary to place an Order before Parliament in 1982 to reimburse the disputed charges to NSHEB. These would amount to a total of approximately £59m. In exchange for this write off the Government will take a charge on the tranche of Hunterston B previously held by BACo.
5. Financial support for deficit payments would be necessary until the end of the contract.