



File
PM

B/c A. Duguid

10 DOWNING STREET

From the Private Secretary

22 December, 1981

I attach a copy of a note of a meeting held here on Friday, 18 December at 0900 hrs to discuss the note by officials on the British Aluminium Company, attached to Mr Ibbs' minute of 17 December.

I am copying this letter to Peter Jenkins (HM Treasury), John Craig (Welsh Office), Terry Mathews (Chief Secretary's Office), Anthony Willis (Department of Industry), Ian Ellison (Department of Industry), Julian West (Department of Energy), Gerry Spence (CPRS) and David Wright (Cabinet Office)

M. C. SCHOLAR

A M Russell, Esq
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✓ cc. monitor set

SUBJECT.

NOTE OF A MEETING HELD AT 10 DOWNING STREET ON FRIDAY 18 DECEMBER 1981
AT 9.00 am TO DISCUSS THE BRITISH ALUMINIUM COMPANY (BACo)

Present

The Prime Minister

Chancellor of the Exchequer

Secretary of State for
Scotland

Secretary of State for
Wales

Secretary of State for
Industry

Chief Secretary,
Treasury

Secretary of State for
Energy

Parliamentary Under Secretary of
State, Department of Industry
(Mr MacGregor)

Mr J R Ibbs (Central Policy
Review Staff)

Sir Robert Armstrong

Mr D J Bostock

The meeting considered the [redacted] note by officials on the British Aluminium Company's smelter at Invergordon attached to Mr Ibbs's minute of 17 December to the Prime Minister's Private Secretary.

Mr Ibbs said that, as the Ministerial Committee on Economic Strategy had asked (E(81)39th Meeting, Item 1), a group of officials under his chairmanship had considered the comparative costs of closing the smelter and keeping it open. Taking into account the loss of interest and capital repayments on the Department of Industry's loan, the extra expenditure which the Secretary of State for Scotland had proposed for the Highlands and Islands Development Board, unemployment pay, loss of tax revenue and the effects of closure on the finances of the National Coal Board and the Scottish Electricity Boards, the cost of closure to the PSBR was likely to be £2 million in 1981-82, £11½ million in 1982-83, £6½ million in 1983-84 and £2½ million in 1984-85, ie a cumulative cost of £22½ million up to the end of 1984-85. Thereafter there should be a net gain to the PSBR, reflecting the fact that the Scottish Boards would no longer have to supply electricity to Invergordon at a non-commercial rate. These calculations assumed that BACo's contract with the North of Scotland Hydro Electric Board (NSHEB) would be ended on terms which involved no cash payment

from the Board to the company. Any such payment would increase the cost of closure by the same amount. Officials had discussed with BACo the terms on which the smelter could be kept open. The company had assumed that the smelter would have to close. The least generous terms which it was likely to accept for keeping Invergordon open would involve the Government's and the Scottish Electricity Boards' effectively cancelling all claims on the company (in return for BACo's dropping its own claims on the North of Scotland Hydro Electric Board); an electricity price of 1.0p per unit, as compared with about 2.5p for other large industrial users and the present price of about 1.4p at Invergordon, this price to increase from 1 April 1982 in line with costs at Hunterston but with an upper limit set in any year by the rate of increase of published electricity tariffs for industrial customers in Great Britain; and an agreement that BACo would not be liable for any charges arising from a major accident at Hunterston B. BACo would not agree to a break clause and a review after three years on the grounds that it could again put the ^{company} in a position where the smelter ceased to be viable; would make it impossible for the company to authorise the investment necessary to improve the smelter's use of energy or to make definite provision for raw material; would require the company to depreciate the smelter more rapidly, worsening its profit and loss account; and would damage the company's effective borrowing power. As a substitute for a review clause BACo would undertake that if it made very high profits in future years it should contribute towards the subsidy on its electricity prices. A formula [redacted] would be agreed whereby BACo and the NSHEB shared equally the excess of pre tax profits above an agreed ceiling representing a fair rate of return on assets employed. These arrangements would be embodied in a revision of BACo's contract with the NSHEB and, like it, would run until the year 2000. The costs to the PSBR would be about £16 million a year and would increase if actual costs relating to Hunterston in any year increased faster than electricity prices generally; but [redacted] would be less if Hunterston B's availability or costs were better than expected. These arrangements would have to be explained to Parliament and defended in terms of the legal and moral obligations arising from the existing arrangements between BACo, the Scottish Electricity Boards and the Government. The presentation would have to be carefully judged to minimise problems with the European Commission. Whether the smelter closed or continued in operation, BACo would be in a weak financial position and could collapse. In either case, therefore, Ministers would need to consider whether BACo should

receive a net payment from the NSHEB as part of the settlement of the matters in dispute between them. A payment of £30 million, which the company had proposed, would probably be unnecessarily generous and would leave the company with a favourable capital gearing ratio of about 20 per cent. A payment of about £15 million might be more appropriate.

The Prime Minister, summing up the discussion, said that the meeting agreed that the Government should not accept BACo's terms for keeping Invergordon open, involving as they did a commitment to pay a subsidy of at least £16 million per annum until the end of the century to a company whose own preference was to close the smelter. If a subsidy were paid to keep open Invergordon it would be very difficult to avoid giving similar support to Alcan and Anglesey Aluminium, both of whose fuel costs were likely to rise sharply within the next year or two. Subsidising BACo's electricity would also make it much more difficult for the Government to resist demands from /^{other} industries for compensation for allegedly high United Kingdom energy prices. The Invergordon smelter should therefore be allowed to close. The Government must however try to ensure that BACo neither went into liquidation, with the loss of its other operations in Scotland and elsewhere in the United Kingdom, nor closed its rolling mills at Falkirk to try and avoid liquidation. The Government ought also to do its best to ensure that BACo generously compensated its ex employees at Invergordon, who would have little prospect of alternative employment. The company would not be able to bind itself to keep open Falkirk or any other particular plant; they might become unviable. But the company could be told that the Government would agree to its receiving a net cash payment from the NSHEB, in final settlement of the matters in dispute between them, to enable the company to re-establish a sound balance sheet on the basis of the continuation of all its existing activities other than Invergordon; and to enable BACo to make reasonable redundancy payments to its employees at Invergordon. The size of the net payment would have to be worked out in negotiations with BACo. £30 million seemed excessive; the Government should aim for a payment of nearer £15 million. The Secretary of State for Scotland should announce that, to help in mitigating the grave effects on the Highlands of Invergordon's closure, the Highlands and Islands Development Board would be permitted to spend an extra £10 million over three years in ways to be agreed with the Government: it would be necessary to see that the extra money was spent on worthwhile projects. In defending the decision to let

Invergordon close, Ministers should emphasise that it could only have been kept open at an unacceptable cost; and that its closure resulted in part from BACo's weak financial position. If unfavourable comparisons were drawn with Anglesey Aluminium, which paid only 0.5p per unit for electricity until Dungeness B power station came on stream, the defence must be that Anglesey was paying according to its contract with the Central Electricity Generating Board. The Secretary of State for Energy would consider and discuss with the Chief Secretary, Treasury, the effects on the finances of the National Coal Board of closing Invergordon. Officials would need to agree urgently on the handling of the closure vis-a-vis the European Community: the settlement between BACo and the NSHEB would involve writing off a Department of Industry loan; on the other hand since the smelter was being closed there ought not to be any serious difficulty with the Community.

The Meeting -

1. Agreed that the Government should not attempt to prevent the British Aluminium Company from closing its smelter at Invergordon.
2. Agreed that the company's contract with the North of Scotland Hydro Electric Board should be ended on terms which included a payment to BACo of not more than £30 million.
3. Invited the Secretary of State for Scotland to arrange for his officials, in consultation as necessary with those of other Departments and with the Central Policy Review Staff, to negotiate with the company and, as necessary, the Scottish Electricity Boards, a payment as far below £30 million as necessary, taking account of the points made in the Prime Minister's summing up.
4. Agreed that the Secretary of State for Scotland should announce that the Highlands and Islands Development Board would be permitted to spend an extra £10 million over three years in ways to be agreed with the Government; and invited him to agree the precise terms of the extra expenditure and of his announcement with the Chief Secretary, Treasury.



5. Invited the Secretary of State for Scotland to arrange for his officials to agree with those of the Foreign and Commonwealth Office and as necessary other Departments how the terms of the settlement between BACo and the NSHEB and the writing off of the Department of Industry's loan to the company should be handled vis-a-vis the European Community.

18 December 1981