CONFIDENTIAL

Ind Pol

c JV

Prime Minister (2)

MS 21/10

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Patrick Jenkin
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
London
SW1E 6RB

MT

20 October 1982

Dear Patrick,

ALCAN ALUMINIUM (UK) LIMITED

I have seen a copy of your letter of 13 October to Nigel Lawson, Nigel's reply of 18 October and Nicholas Edwards' and John Sparrow's comments in their letters of 15 October.

2. I agree that we should accept officials' conclusion that there is no case for the Government to intervene in the normal commercial negotiations between NCB and its customers. As you recognise, any course of action other than straight commercial negotiations between the Board and Alcan has very obvious dangers. I therefore agree with Nigel Lawson that the Board must take their decision within existing financial constraints and policy objectives. As John Sparrow comments, the sort of contract which Alcan seeks would be doubtfully consistent with the medium-term profitability objective which we set the Board earlier this year.

3. I am sending a copy of this letter to the Prime Minister, members of E Committee, the Secretary of State for Scotland, the Secretary of State for Wales, Sir Robert Armstrong and John Sparrow.

Yours ever

John

JOHN WAKEHAM

CONFIDENTIAL

IND POL : Alcan Aluminium (UK) Ltd
July '82

Ind Pol
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2 Apps

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Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

The Rt Hon Patrick Jenkin
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
LONDON
SW1E 6RB

19 October 1982

D Patrick,

ALCAN ALUMINIUM (UK) LTD

You sent me a copy of your letter of 13 October to Nigel Lawson about the difficulties currently facing Alcan Aluminium.

I agree that Alcan and the NCB should be left to try to reach a settlement by normal commercial negotiations. If these fail the Government should not be committed to intervene as we were prepared to do in the case of Invergordon, but it would be wise for Ministers to review the matter before the irrevocable decision was taken.

If it proves impossible to renegotiate the coal contract it will be difficult for the NCB to explain why it is against the interests of the coal industry for some of its immense stocks to be sold, even at a reduced price. What is more Ministers will find it even more embarrassing when they are asked to explain why they will not do for Northern England (Lynemouth) and South Wales (Rogerstone) what we were prepared to do so recently for Scotland. I do not believe, as paragraph 20 of the official paper seems to expect, that those affected by closures in England and Wales entailing nearly three times as many redundancies as Invergordon will be prepared to agree that the problems of the Highlands are "unique". Rather would I expect all the cries for a Minister for the North (ie another territorial spending machine) to be created.

It follows that in my view some defensive briefing should be prepared without delay so that we can meet the criticisms that will be advanced if Alcan and the NCB are unable to reach a settlement. At that stage it will no longer be possible for us to "decline to give any explanation", as the official paper puts it.

SECRETARY OF STATE FOR EMPLOYMENT

No doubt Nigel Lawson will have a view on the potential effects of a closure announcement upon the miners dispute.

I am copying this letter to the Prime Minister, members of E Committee, George Younger and Nicholas Edwards, and also to Sir Robert Armstrong and John Sparrow.

Yours ever
Norman

2nd Pd Dean Plowman

CONFIDENTIAL

ex JU

MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB

Telephone 01-218 6621 (Direct Dialling)
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3 pps.

Minister of State
for Defence Procurement

D/MIN/TT/1/6

19 October 1982

Prime Minister (2)

Three letters on Alcan. Mr Tebbit's is particularly apt.
MES 19/10

Dear Patrick

ALCAN ALUMINIUM (UK) LIMITED

In your letter of 13th October to the Secretary of State for Energy, copied to John, you asked for our comments on your proposals on the future of Alcan.

From the defence point of view, we would not dissent from your judgement that there are no compelling industrial or defence reasons for the Government to intervene. I should, however, draw to your attention the strategic significance, to British Aerospace in particular, of the quality assured plate plant at Kitts Green, Birmingham. The Study Group report concludes that, whatever the future of Alcan, this plant is likely to survive. I hope this is so. If closure of Kitts Green was likely, then we would like an opportunity to reconsider the position.

B.T.P.

I am sending copies of this letter to the Prime Minister, members of 'E' Committee, the Secretaries of State for Scotland and Wales and to Sir Robert Armstrong and John Sparrow.

Yours
Tom.

Trenchard

The Rt Hon Patrick Jenkin MP

CONFIDENTIAL

Alcan Aluminium :- Ltd Pd

cc

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01-211-6402

The Rt Hon Patrick Jenkin MP
Secretary of State for Industry
Ashdown House
London SW1

18 October 1982

Dear Secretary of State,

ALCAN ALUMINIUM (UK) LTD

Thank you for your letter of 13 October.

Like you, I accept officials' conclusion that there is no case for the Government to intervene and that Alcan and NCB should negotiate as a normal commercial matter over future coal supplies to the smelter at Lynemouth. We must, of course, accept the possibility that negotiations will fail to bridge the gap between the two sides.

I shall certainly write or speak to Norman Siddall. The NCB will indeed have to balance many factors and I am sure that they will not want to lose a major customer. But I shall make it clear to him that the Board must take their decision within existing financial constraints and policy objectives.

I am sending copies of this letter to the other recipients of yours.

Yours sincerely

J.P. Carr

pp NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence)

Ind Rel, Alcan, July '82

Ind Pol
Prime Minister (2)

MCS 18/10

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The Rt Hon Nicholas Edwards MP

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From The Secretary of State for Wales

CONFIDENTIAL

15 October 1982

Dear Nigel

NT

ALCAN ALUMINIUM (UK) LTD

I have seen a copy of Patrick Jenkin's letter to you of 13 October. attached

I agree that it is right the Government should stand back and allow Alcan and the NCB to try to settle their dispute through normal commercial negotiations. But I also very much share the concern expressed by Patrick about the political implications of what would be very large scale closures indeed. As you may know I visited the headquarters of Alcan Aluminium Ltd in Montreal on 1 October and I had a very full and frank exchange of views with senior management there. I am circulating with this letter a copy of the record of that meeting which you and colleagues will wish to see.

I was left in no doubt in my discussions about the seriousness with which the Canadian parent company views the position of Alcan in the UK. And I have no reason whatsoever to believe that there is any element of bluff in the threat to close the Lynemouth smelter if the negotiations between the company and the NCB cannot be satisfactorily concluded. In addition to the 1140 employed at the Lynemouth smelter this would of course have obvious implications for employment at the NCB's Lynemouth colliery as well as for Alcan's downstream operations in UK and particularly for the 1400 employed at the sheet mill at Rogerstone, Gwent, the closure of which seems virtually certain to follow if the Lynemouth smelter closes. As Patrick says, the consequences of shutdowns on this scale in areas where unemployment is already running at very high levels are considerable.

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1

/...

Incidentally, although I do not wish to labour the point about Invergordon, I simply want to note that we ought to recognise that that is an argument which will cut no ice at all at Lynemouth, Rogerstone and other communities which would be affected by large scale redundancies if the Lynemouth smelter were to close.

I do urge you to speak to the Chairman of the NCB along the lines proposed by Patrick.

I am sending copies of this letter to the recipients of Patrick's.

Yours ever

Nick

F

Record of the Secretary of State for Wales' visit to Alcan Aluminium Ltd, Montreal October 1 1982

Those present:

Secretary of State	Mr Harold Corrigan,	Vice President of Corporate Relations of Alcan Aluminium Ltd
Mr Lintorn Simmons Consul General Montreal		
PS/SofS		
	Mr David M Morton	President and Chief Executive Officer o Aluminium Company o Canada
	(Former Head of Alcan's UK Plant)	
	Mr John Purkis	Assistant to Senior Vice-President of Alcan Aluminium Ltd
	Mr Ihor Suchoversky	Vice President, Research and Operations Technology of Alcan International Ltd
	(Former Head of Alcan's European Operations)	

At Mr Corrigan's request, the Secretary of State opened up the meeting. He was aware of Alcan's current difficulties with their UK operations. He had visited the Rogerstone mill last year, and had recently had a visit from Mr George Russell and Mr John Peyton MP. He was thoroughly familiar with the broad issues and difficulties confronting the aluminium industry in the UK today. His particular aim in the current meeting was to hear Alcan's thinking on the contract with the NCB and on the interrelation between the Lynemouth smelter and the Rogerstone mill.

Mr Morton said that it was extremely difficult to forecast demand and therefore levels of profitability in the aluminium industry. This made it the more important that Alcan's essential cost base should be fully competitive with other producers. Provided that was so, he was completely confident of Alcan's ability to ride the waves and be profitable in the long term, even though the effect of the current recession on the world aluminium industry had been cataclysmic. It had resulted in the virtual demise of aluminium smelting in Japan, which had had an annual capacity of 1.6m tons per annum. It looked as though Japanese plants in regular production would henceforth produce no more than 400 k tons per annum - based on hydro-electric power. World demand had fallen from a peak of 13+m tons to only 10m tons last year from primary producers in the western world. The price per lb for ingots in the first quarter of 1981 had been upwards of 70¢ per lb; this had now fallen to 48 ¢. As a result, the industry, which had been operating at 95% capacity was now down to an average of 74%. However, supply was now coming more into line with demand, and surplus inventories should begin to fall soon. The good news was that despite new plants

/coming ...

coming on stream (such as Alcan's Grand Baie in Quebec) net capacity for smelting worldwide was forecast to remain static or decrease slightly over the next few years. The hurdle which newcomers to the industry would have to overcome was now extremely high: the minimum viable size of a new smelter was 200 k tons per annum, which on a greenfield site would require a capital investment of $0.75 billion. The bad news however concerned the likely level of demand for aluminium. The remarkable growth in demand in recent years had been largely fuelled by the use of aluminium in substitution for other metals eg in cans. Now there was a counterwave and plastics in particular were beginning to fight back. For example, in Germany 5 years ago window-frame production had been 100% aluminium: now it was 40% plastic. The growth of demand generally was therefore likely to be at best sluggish compared with the recent past. Alcan in particular were now heavily dependent on cans for the North American market (they reckoned however to have won the war so far as the prospective renaissance of tinplate was concerned).

Mr Suchoversky pointed out that a number of Governments were now supporting aluminium smelting directly or indirectly. Even Japan, with 80% of its power production based on imported oil, had retained some 400 k r.p.a of capacity, equivalent to some 30-40% of domestic demand. Smelting capacity in Britain was already down to that sort of level. He assumed the UK Government would want to retain some smelting capacity.

The Secretary of State said that that was clearly a strategic decision which the UK Government had to take. Energy pricing policy had to accord with economic reality. The zero option could not therefore be ruled out in advance.

Returning to the Secretary of State's query about the relationship between the smelter and downstream capacity, Mr Suchoversky pointed out that nowadays major mill operations were universally integrated with smelting. There were no independents left in the rolling business in the UK, Europe or North America, save of course for small volume specialist applications.

The Secretary of State said that the need for Rogerstone to be fed from Lynemouth had been put to him by Mr George Russell primarily in terms of a technical requirement for ingot quality, shape, and size. He wondered whether this were really determining factors which would make it impossible for a modern rolling mill to operate by buying its feedstock on the open market.

Mr Suchoversky pointed out that a rolling mill in Britain buying ingots from the continent would find its feedstock prices fluctuating markedly because of the fluctuating exchange rate for the DM and the Franc. This would make it difficult to plan operations and pricing policy. Moreover the rolling industry in Britain was already in a less than healthy state. In the 1960s rolling-mills had had a capacity of 30-50 k tons p.a. A modern mill had a capacity of 120-150 tons p.a. The bulk of the product went to sophisticated applications such as can stock where fine tolerances were required. It had to be said that by and large the modernisation of rolling mills in the UK had been done poorly. In his view, 2 mills in the UK were "already dead but don't know it". Alcoa had tried hard but had committed technical blunders. The generally poor restructuring of the UK rolling industry left it vulnerable vis-a-vis fierce competition from France

/and ...

and Germany. Alcan had done their best to update Rogerstone and had succeeded at a cost of some £20 million to the extent of making it the 3rd or 4th best mill in Europe. It was now the only competitive mill in the United Kingdom. However physical limitations made it impossible to modernise Rogerstone to the standards of a new greenfield plant.

Mr Morton confirmed Mr Russell's point that there was a technical competitive advantage in close liaison between mill and smelter: it was obviously easier to obtain feedstock meeting the mill's optimum technical requirements.

Reverting to the viability of smelting operations in the UK, Mr Suchoversky said that obviously the UK could not compete with say Korean energy prices. But it was a minimum requirement for the UK aluminium industry that UK energy costs should compete with European rates.

Mr Morton reiterated that Alcan UK could not stay in business unless it had a competitive cost basis. Alcan had invested relatively heavily in Lynemouth, Rogerstone and Kitts Green: the smelter and mills were competitive insofar as it lay in Alcan's power to make them so. But to compete in the European market, Lynemouth had to have reasonable energy costs. Alcan could not possibly go to £33 per ton for coal, said to be NCB's production cost at the Lynemouth pit. Alcan's total UK employment of 3200 stood at risk as did 1000 jobs in the Lynemouth pit, since he did not believe the coal could be sold elsewhere.

The Secretary of State pressed Mr Morton for a clear indication of what Alcan saw as the maximum coal price which would secure viability, but Mr Morton declined to quote a figure, saying that it was George Russell's responsibility as Managing Director of Alcan UK to decide on the crunch point.

Summing up, Mr Suchoversky said that any increase in the coal price right now was bad news in the short term since Alcan UK was losing money. However, a modest increase in the coal price was sustainable in the longer term when demand for aluminium picked up. But a coal price anywhere near the NCB's "opening gambit" would simply result in the closure of Alcan UK on a short or long-term view. Even though Rogerstone was the only fully competitive rolling mill in the UK and was now in the black, Alcan did not need Rogerstone on its own. It had hitherto been Alcan's preferred policy to have a rolling mill in each major EEC country but that might have to be revised. The output of the German mill could be expanded to make up for the loss of Rogerstone.

The Secretary of State said that he was grateful for a frank and informative discussion. Clearly there were difficult issues which would require collective Ministerial discussion and Alcan would understand that he could give no indication of what the Government's decisions might be.

A E PEAT
Private Secretary

7.10.82

Ind Pol, July '82, Alcan Aluminium

✓ JV

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765

Qa 06092

From: John Sparrow

CONFIDENTIAL

The Rt Hon Patrick Jenkin MP
Department of Industry
Ashdown House
SW1

15 October 1982

Dear Patrick,

Alcan Aluminium (UK) Ltd

Thank you for sending me a copy of your letter of ~~13~~ October 1982 to Nigel Lawson.

I am sure you are absolutely right to emphasise that the NCB must decide about the renegotiation of the Alcan contract on the basis of its own commercial advantage, within the framework of the objectives which the Government has set for it. I recognise the political implications of the possible closure of Alcan facilities. But I regard it as of paramount importance that nothing is said or done in this context which could deflect the NCB from the very difficult objectives for profitability and supply/demand balance, as well as for cash, which it has now been set. It may be that in the short term a continuation of the Alcan contract at a low price of coal could help the NCB with its cash objectives, but it seems to me doubtful whether a contract for as long as 5 years ahead would be consistent with the medium term profitability objective.

Provided that Nigel is satisfied that NCB is interpreting its objectives correctly, it seems to me that the actual decision on the terms on which NCB would be willing to provide coal after December 1983 should be left with the Board itself, without any guidance which it might interpret as pressure from the Government to be more lenient to Alcan than its own commercial judgement would suggest.

I am sending copies of this letter to the Prime Minister, members of E Committee the Secretaries of State for Scotland and Wales, and to Sir Robert Armstrong.

Yours sincerely,

John

John Sparrow

CONFIDENTIAL

cc Mr. Mount
Mr. Vereker

MR. SCHOLAR

PA

ALCAN ALUMINIUM UK LIMITED

The letter of 13 October from Secretary of State for Industry to Energy is, I believe, quite satisfactory and does not need the Prime Minister to intervene. Essentially, Industry argue that it is best to leave the National Coal Board and Alcan to negotiate the price of coal. NCB knows it needs the market, and of course also know that Alcan will only pay a certain price.

However, I can well see that at the negotiated price there will still be the threat of closure of Linemouth. This will then undoubtedly come to E Committee.

The main consideration is employment. Alcan accounts for 7,000 or more jobs.

Yet, in the Report by the interdepartmental study group there is no mention at all of wage rates. (Yet these must amount to a wage cost of approximately £70 million a year. Not a trivial item.) Whereas coal costs only account for 12% of Linemouth's smelter production costs, or about £13 million a year.

no action req'd - we are not intervening

I think this is a case where typically we should insist on Alcan putting its own house in order. They can do that by negotiating much lower pay rates or pay increases. Ideally they should negotiate no increases at all until the business becomes profitable again.

This consideration doesn't seem to have entered the discussions at all of the interdepartmental committee. You might think it is worth while reminding them that there are costs other than those of coal. At least this aspect of it should be covered before it eventually finds its way, as it must, to E Committee.

14 October 1982

ALAN WALTERS

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DEPARTMENT OF INDUSTRY
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Secretary of State for Industry

13 October 1982

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank SW1

Prime Minister (2)

Mr Jenkin is not proposing any intervention

MCS 15/10

Dear Nigel,

ALCAN ALUMINIUM (UK) LTD

Following representations by Alcan Aluminium (UK) Ltd in July, you and other colleagues agreed with my proposal that the time had come for the Government to take stock of the difficulties the company is facing.

2 I attach a report by officials. The main points are:-

a Alcan is weak financially. It forecasts losses of around £30 million this year following losses of £26 million in 1981.

b Its problems stem from weak demand and low prices for aluminium and aluminium products, with no immediate prospect of a strong recovery; with the UK company's borrowing capability largely exhausted, the Canadian parent company, also weak for the same reasons, will have to decide whether it can continue to sustain UK operations until recovery takes place.

c A major factor in the decision is that Alcan's Lynemouth smelter, an important source of investment cash and metal for down-stream operations, faces the prospect of higher coal prices under a contract with the NCB, which could make it uneconomic compared with European primary aluminium smelters.

d Alcan have proposed a new 5-year "rolling contract" for coal supplies to be renewed annually as long as NCB coal stocks stay high. The price would start at £15 per tonne (compared with the £10.77 a tonne they pay at present). Alcan claim that this is near to the NCB's lowest export price, after adjustment for quality and would save the cost of stockpiling.

e Based on the NCB's average export prices (£30 per tonne) adjusted for quality and making an allowance for the cost of stocking, it seems unlikely that the NCB could regard a figure near Alcan's offer as an acceptable commercial proposition or one which is compatible with the objectives set for it by the Government, without direct financial assistance. There are legal constraints on the NCB's powers to offer preferential or non-commercial tariffs.

f If Lynemouth were to close, the Rogerstone sheet rolling mill in Gwent is also likely to close because it could not afford to pay premia for the grades of metal it needs for some uses. But alternative UK or imported sheet could be obtained. However the strategically important plate plant at Kitts Green, Birmingham seems likely to survive.

g Closures would raise significantly the already high unemployment around both Lynemouth and Rogerstone.

3 Officials have concluded that there are no compelling industrial or defence reasons for the Government intervention, that intervention on regional and employment grounds would not be consistent with Government policies and that Alcan and the NCB should be left to negotiate commercially, as is happening between Anglesey Aluminium and the CEGB. Only the parties can assess fully where their interest lies.

4 I agree that there are no grounds for us to repeat the exceptional offers of assistance made earlier this year by the Scottish Office to try to keep the Invergordon Smelter open. However, none of us can ignore the political implications of closures of important industrial capacity in areas of high unemployment, although I recognise that any course of action other than straight commercial negotiation between the NCB and Alcan has very obvious dangers. But it will be difficult for anyone, most of all the NCB, to explain satisfactorily, either to its employees or to the public generally, why a coal contract cannot be renegotiated, when the Board is known to be cash constrained, and has large stocks of coal it cannot sell, and indeed has no hope of reducing for several years. In telling the Chairman of the NCB that it is for the Board to resolve their contractual difficulties with Alcan, and that the Government will not take any overt action by way of subsidy, you may think it right to identify with him privately the complex of factors, including those mentioned above, which he will have to balance in deciding the commercial advantage of the NCB.

5 Because of the urgency of the problem I should be grateful for any comments by 18 October.

6 I am sending copies of this letter and enclosures to the Prime Minister, members of E Committee, the Secretary of State for Scotland, the Secretary of State for Wales, Sir Robert Armstrong and John Sparrow.

Yours ever

Patrick

ALCAN ALUMINIUM (UK) LIMITED

REPORT BY AN INTER-DEPARTMENTAL STUDY GROUP

Issue

Alcan faces a serious situation. Because of reduced demand and the prolonged slump in prices for aluminium products brought about by the recession, its financial situation has deteriorated rapidly (Annex A). The company lost £26m in 1981, forecasts losses of some £30m in 1982, and is approaching the limits of its borrowing capability. It is taking steps to reduce the rate of losses but, until there is a strong and sustained increase in the prices of its products, losses will continue. Its prospects for a return to profitability are clouded by the threat, under a break clause in its contract with the NCB at 31 December 1983, of a large increase in the price of coal used in generating electricity for its Lynemouth (Northumberland) smelter. Lynemouth is the main source of metal for Alcan's other UK operations and, with the benefit of cheap coal, has until recently provided most of the company's profits and investment funds. Alcan's Canadian parent, which is itself in a weakened financial position because of the depressed market, will have to decide shortly whether to inject funds to sustain UK operation on their present scale (7,000 jobs), or to close all or part of the UK operations to stem the cash drain. With the prospect of higher coal prices, Lynemouth (1,140 jobs) and the Rogerstone (Gwent) sheet rolling mill (1,400 jobs) - Lynemouth's main customer - are particularly at risk. In response to representations from the UK company, the Secretary of State for Industry agreed to discuss the situation with colleagues after officials had studied the problem.

Background

2 Alcan is a vertically integrated business, with smelting capacity at Lynemouth designed to produce 120,000 tonnes of aluminium per annum, and with downstream operations producing semi-finished aluminium products. Its financial performance depends on the competitiveness of the Lynemouth smelter, which in turn is largely related to the cost of electricity used in smelting. At the currently favourable price of coal for its power station, Lynemouth's electricity costs are approximately average for a Western European smelter. If the price were to double, Lynemouth would cease to be competitive.

3 Lynemouth was built in the late 1960's, when total UK primary aluminium capacity was considerably enlarged. In using electricity from its own coal-fired power station, Lynemouth differs from the other two smelters built at about the same time (Anglesey and Invergordon) which were designed to use electricity from the grid at prices linked to the expected costs of particular nuclear power stations. Alcan received no "comfort letter" from the Government of the day, nor does it have rights to a capital payment on premature termination of the NCB contract. Invergordon closed in December 1981 with the loss of 890 jobs despite offers of Government assistance,

because it could not survive in the depressed aluminium market in the face of mounting electricity costs and a legal dispute with NSHEB. Discussions about a possible renegotiation of Anglesey's contract with the CEGB, which provides cheap electricity, are about to begin.

Alcan/NCB Contract

4 The contract was drawn up in 1968 and amended in 1970 and 1976. The Government is not a party. It is an agreement under which the NCB has undertaken to supply coal for 25 years to Lynemouth from the colliery next door. A summary is at Annex B. The contract provides for coal supplies up to 1.3 million tonnes per annum. The NCB gave notice on 7 January 1980, in accordance with termination provisions, of their intention to cease supplying coal for Stage I (0.9m tonnes) with effect from 31 December 1983.

Coal Costs

5 Coal currently accounts for 12% of the Lynemouth smelter's production costs or about £13m a year. This cost is increased by £1.2m for every £1 increase in the price per tonne. The current price paid by Alcan to the NCB is £10.77 per tonne compared with the present national average NCB production costs of £41.50 per tonne and the NCB's average pithead realisation from exports from the North East coal-field of approxmately £30 per tonne. Taking into account lower calorific value and ash content, the NCB says £27-28 is the corresponding figure for coal now supplied to Alcan.

Alcan's Proposal

6 Alcan have proposed in opening discussions that in place of the 13 year remaining period under the present contract, there should be a rolling 5 years contract, to start on 1 January 1984 and to be renewed yearly for as long as the NCB's undistributed coal stocks do not fall by 2½m tonnes in a year. Even if the NCB's stocks fell to their target level Alcan suggest they should not pay more than the NCB lowest pithead realisation for exports, (details in Annex C). Alcan say they need at least 5 years notice of termination of the contract to justify the regular capital expenditure required at a smelter to maintain operations. They say that, provided there is some recovery in aluminium prices, £15 per tonne is the maximum coal price at which the smelter could break even and remain reasonably competitive with other European smelters. Against the background that the NCB cannot sell on the domestic and export markets as much coal as they are producing and that current pithead stocks are high (22m tonnes), Alcan argue that it is to the NCB's and Government advantage (as financier of the NCB's losses) to have an assured market in Alcan rather than to hold coal in stock with an eventual prospect of world market prices at best. They argue that the NCB could not, even in 1984, sell the additional 1m tonnes a year for a return greater than Alcan can pay; they believe that to obtain an export market without stocking, the NCB would have to cut its price very severely and that if the NCB stock the coal until they can secure a higher price, they incur substantial stocking and capital charges and deterioration costs.

7 The key issues for Alcan seem to be the assurance of price stability for 5 years ahead and the starting price. We do not know

what negotiating latitude Alcan has in these figures; our own assessment is that the costs of holding stock even for long periods, eg up to 7 years, would go nowhere near closing the gap between Alcan's opening figure of £15 a tonne and the NCB's present average export realisation adjusted for quality. The proposal that the price should in no circumstances rise higher than the NCB's export realisations presupposes continuing excess production by the NCB to the end of the century. It is clear that in putting forward this proposal, Alcan recognise that importing alternative supplies of coal is not an economic option.

Legal and Financial Implications for NCB

8 At Annex D we identify potential legal implications for the NCB of giving undue preference to Alcan and of supplying coal at non-commercial prices.

9 Ministers' firm policy for the NCB is that it should return to financial viability as soon as possible, and should bring its productive capacity into line with its long-term, profitable, share of the market. Current coal demand prospects suggest that, if the supply to Alcan continued for 1-2 years beyond 1983, NCB could make sales which they would not otherwise achieve in those years. In the very short term, in 1984, to 1985, there might therefore be a PSBR saving, though NCB's losses, and claims for deficit grant, would be increased. If the NCB fulfil their objectives, they would thereafter, and on Alcan's proposal until 1999, make heavy losses on the supply with additional cost to the PSBR. The provision of coal at preferential prices to Alcan under new arrangements would increase the NCB's vulnerability to pressure from other industrial customers also seeking supplies at advantageous prices.

Industrial Effects of Closure of Lynemouth

10 Alcan have repeatedly stressed the financial and metal supply relationship between Lynemouth and their semi-fabricating plants, particularly Rogerstone (Annex E). It seems likely that if Lynemouth were to close, alternative metal supplies for some uses could be obtained without difficulty, but because of the technical constraints others would only be available at premium prices. Rogerstone historically has been a poor performer and despite recent considerable productivity improvements may not be able to afford to pay premia for some of its metal. The other plant which would be affected particularly is Alcan Plate, Kitts Green, Birmingham; its closure could have serious strategic implications for BAe, for whom there is no immediate alternative supplier of quality assured plate for aerospace purposes. Plate for military vehicles could be purchased in France. On balance however it seems that Kitts Green would survive, because it is a unique facility in Alcan's worldwide operations, although considerable capital investment would be needed in order to process metal bought from alternative suppliers.

11 It is difficult to predict the effects of closure of Alcan plants on competitors and on imports. In theory BACO's Falkirk rolling mill, as the only UK competitor for Rogerstone's high added

value sheet should benefit but it too has been a poor performer and might not be able to take advantage of Rogerstone's closure. Alcan might simply withdraw from the market, or more likely might supply from their European sheet and extrusion plants, where there is currently overcapacity, without losing customers. Experience suggests that Alcan's UK competitors would not take full advantage of the situation unless they were very efficient, and that business would be lost to imports (Annex F).

Employment Implications of Closure of Lynemouth and Rogerstone

12 Lynemouth (1,140 employees) is in the Travel-to-Work Area (TTWA) of Morpeth which has Development Area status and a current unemployment rate of 16.8%. If the smelter were to close, but not the Lynemouth colliery, the total TTWA unemployment could rise to about 19.6%. If the Lynemouth colliery also closed, the total unemployment for the area could rise to about 20.9%. These unemployment rates compare with current average for Special Development Areas of 19.4%.

13 Rogerstone currently has 1,750 employees (although it has been announced that 350 workers will become redundant on 1 November this year) and is in the Newport TTWA which has Development Area status. Closure would also affect the Bargoed TTWA (Special Development Area). It is likely that the unemployment rate for Newport would rise from 15.9% to about 17% and for Bargoed from 22.9% to around 24%.

Assessment

14 Alcan's immediate problem is to persuade its parent company to finance continuing losses until the price of aluminium and aluminium products recovers sufficiently to restore profitability and reverse the cash drain. With operating losses running at the rate of £25m per annum on turnover of little more than £300m, it will take a very substantial increase in the price of primary aluminium and in processing margins to restore profitability to acceptable levels. Alcan, Canada will have to take a view on the timing and extent of recovery in prices and decide whether it can afford to sustain UK operations on the present scale until that recovery takes place. There is as yet no indication of any general recovery in the international aluminium industry. The Canadian company's view will also be strongly influenced by the prospect of an increase in the price of coal to Lynemouth, which will reduce the profit potential of aluminium smelting, historically the most profitable activity within Alcan.

15 Alcan believe the lowest current pithead export price for coal to be £23-25 a tonne and that there would be an adjustment downwards of some £6 a tonne to reflect the low quality of the Lynemouth coal. There would be further costs if the coal were stockpiled. In Alcan's view the viable price to the NCB is close to Alcan's offer.

16 On the other hand the average NCB export price during the last year of £30 a tonne suggests, according to the NCB, a value for this

coal, after adjustment for quality of £27-28 a tonne, at least in the medium-term, though currently export prices are falling below this. There is a wide gap between this figure and the £15 a tonne proposed by Alcan. The NCB's stocks of coal are high and may even increase in the short-term. However our calculations (discussed at Annex G) suggest that the economic cost of holding stocks could not by itself justify a reduction of more than about £4 a tonne. Further the NCB's present export realisations reflect a depressed world coal market and world prices are expected to rise somewhat in real terms after 1984. If they did so the economic cost of deferring sales would be reduced. Although we have not examined the NCB's commercial position in detail, our general assessment is that they are not likely to be willing or able to move close to Alcan's figure of £15 a tonne unless they are assured of additional Government support for the purpose. There might also be legal difficulties for the Board.

17 There is much uncertainty about the NCB's future market. Ministers' firm policy is set out in para 9 above. It is not yet clear how quickly the objectives can be achieved but it would be against Ministers' policy for the NCB's present surplus of coal to last indefinitely.

18 Alcan appear to have scope for increasing the price they pay per tonne of coal through capital investment, reduced manning and further sales of electricity to the North Eastern Electricity Board. At £19 a tonne for example, Alcan would still have power costs lower than one third of the European aluminium industry; some of the remainder is thought to be subsidised although details are not usually available. As an indication of the limit of Alcan's possible flexibility it has recently been announced that they are to close their Ludwigshafen smelter in Germany; they have told us in confidence they could not accept the electricity price offered equivalent to about £23 per tonne of Lynemouth coal, compared with a previous price equivalent to rather less than £15 per tonne.

19 There are pressures on both Alcan and the NCB to settle the issue. There are no compelling industrial or defence reasons for the Government to intervene. Similarly, although the regional and employment implications of closure would be serious, in the light of the Government's policies these are not grounds for intervention. In a commercial situation nobody except the contesting parties can make a full assessment of his own interests. If the Government implied to either party that it might be prepared to offer financial assistance, the outcome of the negotiations would be prejudiced.

20 If there are serious negotiations between Alcan and the NCB, both sides will lobby the Government and in public in their own interests. There has already been public discussion of the issue in the press. If the Government declines to become involved, it will be pressed to explain why its decision on Lynemouth differs from its decision on Invergordon, where subsidies were offered towards reopening the plant. The circumstances are not the same. The offer of Government assistance for Invergordon (Annex H) was wholly exceptional and was made because of the unique importance

of the smelter for the local economy and the rest of the Highlands. However the Government will not wish to say that Lynemouth is of inferior importance and should publicly decline to intervene or to give any explanations, even though heavy pressure, including from local interests, can be expected. To get involved in any way would prejudice commercial negotiations between Alcan and the NCB.

21 A decision not to intervene would be consistent with the stance adopted by the Secretary of State for Energy towards forthcoming negotiations between Anglesey Aluminium and the CEGB, which the parties are to be left to negotiate commercially and where heavy pressure to intervene can also be expected.

Recommendation

22 Officials recommend that Ministers should not intervene in the dispute between Alcan and the NCB, and leave it for settlement between the parties by normal commercial negotiations.

7 October 1982

ANNEX A

ALCAN ALUMINIUM (UK) LIMITED: FINANCIAL POSITION

Alcan Aluminium (UK) Ltd is a wholly-owned subsidiary of Alcan Aluminium Limited of Canada.

2 In 1981 Alcan (UK) reported a pre-tax loss of £25.7m on a turnover of £307m. The figures for the first half of 1982 were a pre-tax loss of £13.2m on a turnover of £156m. Before 1981 profits roughly halved each year from a peak of £24.8m (pre-tax) in 1977 as prices of aluminium products, though rising, failed to keep pace with costs. The heavy losses of 1981 were brought about by a 4% reduction in realised value per tonne of aluminium sold by Alcan due to the effects of the recession.

3 1981 and 1982 losses to date have raised the company's "gearing" (debt/equity ratio) to 134% compared with 83% at end of 1977, despite additional equity of £11.8m provided by the parent company in 1981. Falling interest rates will ease the interest burden, but the level of debt is far beyond what an independent company could sustain.

4 Alcan, Canada is experiencing similar problems of declining profitability and increasing debt. Net income attributable to shareholders fell from a peak of $542m in 1980 to $264m in 1981 and $17m in the first half of 1982. Borrowings increased by 66% in 1981, and gearing rose from 43% to 69%, which is at the normal limit of acceptability to North American banks.

5 Alcan, Lynemouth has been the mainstay of the UK company's profitability but it is now only breaking even. Despite armslength trading between its operating companies, of the £69.4m pre-tax profits reported for the Lynemouth smelting operation since 1977, all but £2.3m have been lost on down-stream plants. The major loss contributor with £39.3m losses since 1979 has been the Alcan Sheet plant at Rogerstone; only Alcan Plate, Kitts Green and the Luxfer gas cylinder plants (based in Nottingham and the USA) have been successful on the past 5 years' performance.

6 Alcan, Lynemouth's profitable performance has been largely due to a favourable coal price under the contract with the NCB, and to sales of surplus electricity to the North Eastern Electricity Board.

ANNEX B

ALCAN/NCB COAL CONTRACT

This note summarises the main provisions of the contract between Alcan Aluminium (UK) Limited and the National Coal Board (NCB) for supplies of coal to the Alcan power station at Lynemouth. It is a summary, not a legal interpretation.

2 The original heads of agreement were drawn up in April 1968 and were subsequently revised in 1970 and 1976. This summary describes the existing state of the contract taking account of these revisions. The provisions described appear in the original heads of agreement unless otherwise stated.

Purpose of the Agreement

3 For Alcan to build and operate an aluminium smelter at Lynemouth with the capacity of 120,000 tonnes per annum using electricity generated at their own power station from coal supplied by the NCB from the Lynemouth colliery.

4 If Alcan wish to extend the smelter by up to 120,000 tonnes per annum capacity, they must give priority to NCB coal for generating additional electricity requirements, provided that the cost is less than that of alternative sources of electricity. NCB are to supply the additional coal necessary, at the same price as that supplied under the original contract, subject to availability and to the requirements of existing customers. Alcan must give three years notice to NCB of an increase in their requirements due to extension of the smelter.

5 In addition to using power generated in their own power station, Alcan may supply power to and draw from the North Eastern Electricity Board (NEEB) under an agreement between Alcan and NEEB, (provision inserted 1970).

Quantity of Coal

6 Up to 1.3 million tonnes per annum of coal from 1 January 1975 (revised in 1970). (Note this supply covers the requirements of both Stage I of the smelter, which was commissioned in 1971, and of Stage II, commissioned three years later. The smelter has not been extended as envisaged in paragraph 4 above.)

Price

7 3.5p/therm from 1 January 1978, indexed equally to movements in the Wholesale Price Index (WPI) and the Aluminium Virgin Ingot Price Index (AVI). The price is never to exceed 68.3% of the average pithead price paid by the CEGB in any calendar year (revised 1976).

Duration

8 The contract runs 25 years from the commissioning of Stage I of the smelter but may be extended by agreement.

Assignment

9 Neither party may assign all or part of the agreement nor may Alcan re-sell coal supplied without NCB's consent.

Force-Majeure

10 Both NCB and Alcan may withdraw from the contract in the event of unforeseen disaster, although both parties are obliged to take all possible steps to remedy such a situation.

Revision and Modification

11 The contract may be revised, by agreement of the parties, in the event of any material change of circumstances, including changes in prices, costs, market considerations (but excluding normal inflation).

Termination

12 Either party may terminate the contract by giving at least 3 years notice to take effect for:-

i Stage I, not earlier than 31 December 1983, or, thereafter, at the end of a calendar year;

ii Stage II, not earlier than 31 December 1987, and thereafter at the end of a calendar year;

iii in the event of the extension envisaged under paragraph 4 above, not less than 13 years from the commencement of supply.

Both parties are to share equally:-

iv additional costs incurred by Alcan if NCB terminate the contract under this clause and Alcan are compelled to take a direct supply of power or to use fuels other than coal produced by the Board for the generation of electricity;

v any financial advantage accruing to Alcan if they terminate the contract under this clause and turn to alternative supplies, as in iv above.

13 NCB may terminate the contract if Alcan go into receivership or liquidation.

Disputes

14 Any disputes under the agreement should be referred to an arbitrator.

ANNEX C

ALCAN'S PROPOSALS FOR CONTINUING LYNEMOUTH COAL SUPPLIES

Alcan has proposed a "rolling contract" formula intended by the company to provide some assurance that Lynemouth power costs will be controlled within limits competitive with European aluminium smelters over a 5 year period, and which would allow continuing capital investment to maintain operations.

2 The principle is that the contract is extended each year for 5 years as long as the NCB's stocks (at present 22m tonnes) do not decline at an agreed rate. Alcan suggest that a desirable level may be about 10m tonnes. The details are:-

a Alcan would pay an increased price for Stage I supplies for a 5 year period from 1 January 1984, subject to the existing contractual escalation mechanism. The price for Stage II supplies would be calculated in the same way as for Stage I supplies, from January 1988;

b For each year in which the stocks fail to decline to a required level, continuity of coal supplies to Alcan priced by this mechanism, would be extended by 1 year beyond the end of 1988;

c If year-end undistributed stocks reach the required level, the NCB may, subject to D/Energy and Department of Industry agreement, give 5 years' notice of termination;

d If during the 5 year notice period, the year-end level of undistributed stocks again rises, the termination notice would be cancelled, and supplies to Alcan guaranteed for a new 5 year period, subject to continued operation of the existing price escalation mechanism. In addition a new figure for rate of decline would be established;

e The initial price for coal would be £15 per tonne;

f Even after expiry of the period of termination, Alcan would be entitled to take NCB coal at the lowest price being obtained by NCB for exports of coal, until 1999.

ANNEX D

LEGAL IMPLICATIONS FOR NCB

The Coal Industry Nationalisation Act 1946

The CIN Act 1946, S1(1)(c) states that the NCB has a duty to make supplies of coal available, at such prices as may seem to further the public interest in all respects, including the avoidance of any undue or unreasonable preference or advantage.

2 The appropriate interpretation of the Act in relation to the supply of coal to Lynemouth is uncertain. If, however, low priced supplies to Alcan under a new contract are made from 1984, it seems likely that the legal position would need to be carefully considered.

NCB Deficit Grant

3 The Joint Opinion of the Law Officers, 3 December 1981, concerning industrial electricity pricing, implied that if the supply of coal to Alcan at a lower than commercial price was an undue preference, it would be ultra vires for the Secretary of State for Energy to provide deficit grant to fund the Board's losses arising in respect of that supply.

ECSC Requirement

4 The ECSC Treaty and Commission Decision 528/76 on assistance to the coal-mining industry would probably allow the alignment of prices paid by Alcan with the latest price at which imports were obtainable or exports made. There is a wide disparity between Alcan's suggested price of £15/tonne and the NCB's average export price (adjusted for quality) for the NE of £27-28 per tonne.

ANNEX E

THE LYNEMOUTH/SEMI-FABRICATING PLANTS RELATIONSHIP

Constraints on Alternative Sourcing

Alcan contend that their semi-fabricating plants, particularly Rogerstone, are technically and commercially dependent on metal produced by Lynemouth.

2 The main technical constraints are metal purity (freedom from dissolved metals such as iron) which depends on raw material selection, on close control of the smelting process, and metal cleanness (freedom from undissolved non-metallic inclusions) which depends on close control in the handling, treatment and casting of the molten metal. Another constraint lies in the technical know-how necessary to achieve sound metal with uniform properties which also requires close control of the casting process. These constraints are not absolute as the major international producers generally use the same technology and trade metal to some extent. Semi-fabricators are able by remelting pure aluminium (at a cost of £50-£100 per tonne) to produce their own alloy ingots for subsequent fabrication.

3 Commercial constraints lie in the premium prices commanded by particular grades and the ability and will of international competitors to supply material on long-term contracts. Imports of metal from Alcan's Canadian plants or other dutiable sources would cost about £100 per tonne in duty and transport charges.

4 The Rogerstone sheet mill which absorbs about 50-60% of Lynemouth production could use remelting ingot for more than half its 70,000 tonnes per annum out-put although remelt material would have to be available at competitive prices. It would, however, be unlikely to be able to secure an alternative supplier for the 25,000 tonnes per annum of high grade lithographic plate material which provides a substantial contribution to profits. The Kitts Green plate mill (approx 15% of Lynemouth production but growing) was manufacturing high quality plate before Lynemouth material was available although standards have risen in recent years. It would need considerable capital investment in remelt facilities to become self reliant, but unlike Rogerstone it owes its place in the market to its own technology and efficiency rather than that of its suppliers. The Banbury extrusion plant (approx 10% of Lynemouth production) could readily use alternative sources for most of its requirements but this would also require remelt investment.

Assessment

5 Alcan's claims about the difficulties of alternative sourcing are generally realistic. Under suitable market conditions half of the metal at present supplied by Lynemouth for downstream operations could be obtained at little additional cost from other sources, and a quarter could be obtained at premium prices. Alternative sourcing of the remainder would be commercially impracticable. The main burden of additional costs and supply constraints would fall on

Rogerstone which is already a substantial loss maker but which currently provides a valuable outlet for Lynemouth material.

6 Closure of Rogerstone would be likely to follow that of Lynemouth but closure of Banbury would not be likely given some improvement in the market. Kitts Green seems likely to continue if Lynemouth closes, either under Alcan, who have no other plate plants, or under another company, because of its importance in the market (see Annex F).

ANNEX F

INDUSTRIAL IMPLICATIONS OF CLOSURE OF ALCAN'S UK PLANTS

Alcan is an integrated aluminium company (7,000 employees) with a smelter supplying metal for plate, sheet, foil and extrusion operations. A breakdown of subsidiary companies' employment at main sites is at Appendix 1 to this Annex. Alcan's shares in 1981 of UK despatches and consumption for primary metal, rolled products, and extrusion and tube products are shown in Appendix 2.

2 Probable effects of closure of Alcan's main plants are:-

Primary aluminium - If Lynemouth were to close, remaining UK capacity for primary aluminium would be some 160,000 tonnes, (Anglesey Aluminium 112,000 tonnes, BACO Lochaber/Kinlochleven 48,000 tonnes), approximately 50% of 1981 consumption, further increasing UK (and EEC) dependence on imports of primary metal. Although there is currently surplus world production, there could be short-term difficulties in obtaining top quality metal; in the longer-term low-grade metal would probably still be available, but higher grades might be scarce.

Sheet and foil - Rogerstone accounts for over half the UK capacity with British Aluminium, Falkirk, accounting for the bulk of the remainder. British Aluminium could probably increase output by about 20-25,000 tonnes per annum but this could require some investment in remelting facilities. The remaining 50,000 tonnes per annum could fall to imports which already account for about 50% of the UK market particularly if Alcan were to switch production of their more profitable Rogerstone products to Alunorf, the largest rolling mill in Europe with cold rolling capacity of 450,000 tonnes per annum, which they operate jointly with VAW, the major German producer.

Plate - Alcan Plate Ltd, Kitts Green, is a facility unique in the UK and in Alcan's world-wide operations. The only EEC competitors are Kaiser, West Germany and Pechiney, France. Alcan Plate's main customers are British Aerospace and Alvis (armour for fighting vehicles), who together take almost half of production; much of the remainder is exported. BAe, who buy 75-80% of their aircraft plate requirement from Alcan, regard the Kitts Green plate as strategically important. They could possibly, in the present depressed aerospace market, obtain light-alloy plate materials from overseas sources, but probably not in the longer-term when demand for aerospace products rises again. Even if Alcan Plate did not close, particular problems could arise in the late 1980's, when some 40% of air-frame structural design will require materials based on super-purity aluminium. BAe say it would be commercially unrealistic to rely on imported material, with risks to security of supply and price instability. Furthermore, even if other aluminium manufacturers were willing to invest in aerospace plate production the capital cost would be high and it would be a considerable time - probably well over a year following establishment of the plant - before quality could be properly assessed and full production achieved.

3 There are no current alternative UK sources of supply to Kitts Green for armour plate. An alternative approved source for armour plate up to 76mm thick is Pechiney of France; approval for thicker plate (up to 120mm) is still under assessment and it will take some months before full approval will be obtained. Approval from scratch of a second UK-based source for armour plate could take at least 12 months and possibly longer.

4 Finally, it should also be noted that Kitts Green are collaborating with MoD R&D establishments in the development and evolution of some new aluminium alloys. Closure of the plant could mean the premature termination of this important work.

5 <u>Extrusions</u> - Alcan are less dominant in this market having a number of UK competitors who could absorb the bulk of their output but some alternative sourcing from Alcan's German interests is possible.

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ALCAN ALUMINIUM (UK) LIMITED

EMPLOYEES AT MAIN SITES
(*Assisted Areas)
(End March 1982)

COMPANY TITLE	MAIN LOCATIONS	PRODUCTS	
Alcan Lynemouth Ltd	Ashington*	Primary aluminium	1139
Alcan Sheet Ltd	Rogerstone*(2)	Sheet, Coil, Circles, Extrusions & Foil	1755
Alcan Plate Ltd	Kitts Green	Plate, Sheet, Painted Sheet & Foil	993
Alcan Extrusions Ltd	Banbury Skelmersdale(1)*	Extrusions (plain, anodised & painted	951
Alcan Foils Ltd	Wembley	Foil and Laminates	297
Alcan Polyfoil Ltd	Amersham	Household & Catering Foil, dishes, plastic films and bags	129
Alcan Metal Centres Ltd	Tipton	Metal Stockists	391
Alcan Transport Products Ltd	Norwich Lancing	Vehicle Bodies	245
Luxfer UK Ltd	Nottingham	Gas Cylinders	211
Alcan Building Materials Ltd	Worcester	Roofing & Building Products	79
Alcan Design Products Ltd	Weston-Super-Mare	Domestic replacement windows, double glazing & patio doors	186
Alcan Windows Ltd	Leeds	Commercial & domestic doors, windows, shopfronts & screens	183
Alcan Wire Ltd	London	Wire	53
Serco-Ryan Ltd	London (3)	Engineering Stockist	74
Alcan Safety Glass Ltd	Leeds	Glass Products	106
Administration, R & D etc			502
UK GROUP TOTAL			7294

(1) Due to close November 1982 (202 employees)
(2) 350 Redundancies announced 14 September 1982.
(3) Sale of company announced on 4 October 1982.

Data supplied by Alcan

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PRODUCT	(000 TONNES) ALCAN UK		UK INDUSTRY		UK IMPORTS	UK CONSUMPTION[1]	ALCAN (UK) SHARE (%) UK CONSUMPTION	UK INDUSTRY DESPATCHES	
	DOMESTIC	EXPORT	DOMESTIC	EXPORT				DOMESTIC	EXPORT
PRIMARY[2] INGOT	91.2	33.4	213.9	119.5	116.8	330.7	27.6	42.6	27.9
ROLLED PRODUCTS	64.2	20.5	129.2	41.0	104.2	233.4	27.5	49.7	50.0
EXTRUSION AND TUBE PRODUCTS	23.9	2.2	121.0	7.1	19.5	140.5	17.0	19.7	31.6

(1) UK domestic despatches derived from consumption minus imports.

(2) Invergordon smelter (BACO) closed at end December, 1981.

Data supplied by Alcan from European Aluminium Association statistics and Lynemouth production data.

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ANNEX G

THE VALUATION OF COAL SOLD TO ALCAN

Alcan have argued that in the short-term the only alternative to selling the Lynemouth coal to the smelter is for the NCB to stockpile this coal. Alcan's assumption is that the colliery will continue for the foreseeable future to produce this coal, and that the NCB are likely to have to stockpile for some years before they can export. On this basis it is possible to calculate what increased price to Alcan would be equivalent (in net present value terms), to the alternative of initially stockpiling the coal and then exporting it.

2 A number of key factors have to be decided before calculations of this sort are possible:-

a because costs and revenues occur over a number of years it is necessary to discount everything back to present day value; the Nationalised Industries Required Rate of Return (5%) has been used for this purpose;

b a key consideration is the export price which it would be reasonable to assume the NCB could achieve for the low-quality coal which Lynemouth uses. Whatever price is chosen must be adjusted back to a pithead price to take account of transport and other costs involved in exporting. If Lynemouth coal produced the same pithead realisations, adjusted for lower quality as the average of the NCB's present exports of power station coal from the NE, it would be valued at £27-28 per tonne. In view of the lower figures suggested by Alcan and by way of sensitivity the figures equivalent to a range of other coal values have also been calculated;

c it is unlikely that the NCB would be able to export the extra quantity of coal immediately after termination in 1984, and there is uncertainty about the period before export sales occur. A 2 year initial stockpiling period before exports begin has also been assumed throughout the calculations and provision has been made for normal levels of stockpiling costs and small losses of value due to reduction of calorific content during storage.

3 A shorter basic appraisal period than 5 years would be inconsistent with the operational requirements of aluminium smelting and a much longer period would add considerably to the uncertainties in the calculations. If disposal to exports on a straight-line basis over 5 years after the initial two is assumed, the following combinations of netted-back export prices and equivalent Alcan prices are obtained:-

Notional Export and Alcan Prices of Equal Value to NCB

(Exports in years 3-7)

Export Price (Netted-back to pithead) (£ per tonne)	Alcan Price (£ per tonne)
21	17.67

Export Price (Netted-back to pithead) (£ per tonne)	Alcan Price (£ per tonne)
23	19.45
25	21.23
27	23.00

4 An alternative assumption is that the total quantity of coal could be exported over three years after the initial two. This means that Alcan would have to pay slightly more to equal the present value of exports:-

Notional Export and Alcan Prices of Equal Value to NCB

(Exports in years 3-5)

Export Prices (Netted-back to pithead) (£ per tonne)	Alcan Price (£ per tonne)
21	18.95
23	20.83
25	22.71
27	24.60

ANNEX H

ASSISTANCE OFFERED TO INVERGORDON (BACO)

During negotiations with BACO, to enable the Invergordon smelter to continue in operation the Government were prepared to offer the company an annual subsidy towards power costs of £16m for 3 years only and with no assurances about escalation in power costs. BACO felt unable to continue operations on this basis and the smelter closed in December 1981. Under the terms of the settlement reached between BACO and NSHEB, the company's rights under the contract to purchase electricity from Hunterston B to the year 2000 were valued at £79.328m. From this sum the Board deducted £47.049m in settlement of disputed charges. Of the remaining £32.279m, the company paid £4.488m to the Board in respect of current debts for electricity supplies and £12.279m to the Secretary of State for Industry in part payment of loans made in 1968 and 1975. To reduce the threat to the company's other activities, the remainder of the loans, totalling £21.248m was waived with the approval of the Treasury.

2 BACO agreed to maintain the smelter in a usable condition for 6 months while the Scottish Office, in conjunction with the "Locate in Scotland" Office and the Highlands and Islands Development Board made efforts to find a purchaser. Prospective operators were offered an annual subsidy up to £20m a year on average for 5 years. Despite this offer of assitance and a number of enquiries, no firm purchaser came forward. The Government therefore made available a special extra allocation of funds of £10m over the next 3 years to the Highlands and Islands Development Board to undertake special measures to provide new employment opportunities. In addition, it was decided to locate a new Enterprise Zone in the Invergordon area.

Ind Pol, July '82, Alcan Aluminium