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PRIME MINISTER

BSC Strategy
E(A)(85)45

BACKGROUND

Provisional figures suggest BSC will make a notional profit - after allowing for the cost of the miners' strike - of £40 million after interest for 1984-85 - a better performance than their target for 1984-85 of break-even before interest. But external finance from Government in 1984-85 (which reflected the circumstances of the strike) amounted to £523 million and BSC is still far from full commercial viability; it will need bigger profits (around £300 million a year, suggests Mr Tebbit) if it is to be fully commercially viable and ripe for privatisation. The Secretary of State for Trade and Industry's Memorandum (E(A)(85)45) suggests a future strategy for BSC towards this goal.

FLAG C. —

Proposals

2. Mr Tebbit proposes:

£100m

(a) that BSC should acquire and close in 1985 the (Greek owned) Alphasteel strip mill at Newport, subject to assurances from the EC Commission;

(b) that Alphasteel's two casters be installed at BSC's Llanwern steelworks and that a second reheat furnace be installed at Port Talbot at a cost of about £15 million to enhance the capacity of the strip mill currently being modernised there;

(c) that BSC close the Gartcosh cold rolling mill near Ravenscraig, with the loss of about 700 jobs;

(d) to agree in principle that BSC and GKN undertake the Phoenix II joint venture in engineering steels, subject to further appraisal of the costs and terms of the deal.

MAIN ISSUES

3. The main issues now are:

(a) Alphasteel;

You discussed this with Mr Tebbit and Chancellor on 13/6. BSC were authorised to negotiate up to limit of £150 million. Policy Unit – see note – continue to argue that this is a poor deal and that you should reopen, particularly as Mr Tebbit is bidding for £74 million more in 1986-87. But PU approach loses 750 jobs at Ravenscraig, in addition to the 700 at Gartcosh which will close in all scenarios.

(b) Gartcosh;

(c) the Phoenix II joint venture with GKN;

(d) European Community considerations;

(e) Financial Considerations;

(f) Presentation of Decisions.

Alphasteel

4. BSC still wish to close Ravenscraig in the longer run; but the acquisition and closure of Alphasteel would be sufficient to meet EC quota restrictions, thus permitting Ravenscraig to remain in operation for the time being. Alphasteel is a Greek-owned steel company (strip products), operating in Newport employing 300. Alphasteel has never produced at even ½ capacity, has made losses, and is dependent upon the collaboration agreement with BSC to market its products. With your agreement and that of the Chancellor of the Exchequer, Mr Tebbit authorised BSC to negotiate the purchase of the company within a limit of £150 million. BSC has agreed on a purchase price of £130 million plus £2 million a year for eight years. Agreement is required from the BSC Board, the Government and the EC Commission by 2 August if the deal is not to lapse.

5. BSC have set three preconditions to the deal. These are:

(a) installation at Llanwern of the Alphasteel slab casters, so as to give Llanwern a secure basis as a supplier of concast steel;

(b) installation of a second new reheat furnace at Port Talbot in order to make full use of the hot strip mill currently being modernised there; and

(c) closure of the cold rolling mill at Gartcosh in Scotland at a cost of about 700 jobs.

6. The case for this further investment in South Wales is that it is needed to assure the efficiency and competitiveness of the two Welsh steelworks, and to ensure that they have the capacity needed to service Ravenscraig's customers when and if that works closes. Without the investment, closure of Ravenscraig would result in a loss of business and future profitability for BSC. Meanwhile the Alphasteel deal does not close off any longer-term options about the future of Ravenscraig; and the new investment in South Wales would enable Ravenscraig to be closed quite quickly in 1988 without damage to BSC's business.

Gartcosh

7. BSC wish to close Gartcosh in 1985 or early in 1986. It is not part of Ravenscraig, and is so outdated that the Ravenscraig workforce is said not to object to its closure. If Gartcosh is closed, Ravenscraig's output would go to modern mills such as Shotton or South Wales for cold-rolling, thus producing a better product. On the other hand, the closure could be seen as a first step towards the closure of Ravenscraig. The Secretary of State for Scotland may therefore have doubts about this proposal.

8. The Iron and Steel Trades Confederation is pressing for investment of £90 million in new coke ovens at Ravenscraig. Because of their doubts about the works' long term future BSC do not propose to undertake this investment. They intend to use present coke ovens for as long as possible, even bringing in coke from elsewhere if necessary.

Phoenix II

9. The proposed Phoenix II joint venture between BSC and GKN in engineering steels would bring together all BSC's special steel activities in the Sheffield and Rotherham area into an independent company, with BSC and GKN each having 50 per cent of the voting equity. The company would have an annual turnover of £575 million, 12,000 employees; its strength would be a boost to the area, and with luck the companay could be ripe for privatisation in the early 1990s.

10. BSC's wish to go ahead with Phoenix II presupposes the acquisition and closure of Alphasteel. Failing that, they would wish to switch some engineering steel production from Rotherham to the spare capacity they would have at Scunthorpe and Teesside. The proposals have now been under consideration for two years, and GKN are pressing for an early decision. Phoenix II as now presented would involve early new capital investment in a continuous concaster at BSC's Aldwarke mill at a cost of £67 million. The estimated cash required for Phoenix II is £55 million over the two years 1986/87 and 1987/88. Because BSC would require about £25 million for their engineering steels business over these years if Phoenix II did not go ahead, the net increase in BSC's external financing requirement is £30 million.

11. Mr Tebbit argues that Phoenix II could represent a significant 'privatisation' of BSC's steel activities against the 'nationalisation' of the Alphasteel acquisition. The Treasury, however, are concerned about the additional bid for external finance, given the difficult overall position set out in the IFR; and they consider that if the Government refused to provide the £55 million sought for the joint venture, BSC and GKN could devise an alternative arrangement, with private sector finance being secured to cover the costs of a rather smaller new investment in continuous casting facilities. The DTI consider that the proposed joint venture represents the best prospect for maintaining an internationally competitive engineering steels business in the UK, and that it would be

cheaper for the Government in the longer run than the alternatives of developing BSC's capacity separately or running the BSC business down. If the joint venture went ahead, it would clearly be important that it should only do so on the basis of a satisfactory financial appraisal, in the light of the latest assessments of market prospects and the detailed plans for investment, production and financing.

European Community Considerations

12. BSC has to satisfy the EC Commission that it has a plan for viability without subsidy as from the beginning of 1986. The criteria are rigorous and few European steel producers will be able to meet them. In practice, therefore, the Commission will be pressing for the most stringent improvements it can negotiate. The DTI are confident that it would accept a BSC plan including the acquisition and closure of Alphasteel. If Alphasteel were not acquired and closed, matters would be more difficult. The UK would have to point to favourable steel demand and optimistic price assumptions, but BSC would not regard five integrated steelworks without the closure of Alphasteel as a sensible way forward.

Financial Considerations

13. A table showing BSC's profit projects and cash requirements until 1989-1990 under the various projections (including a Ravenscraig closure) is attached to Mr Tebbit's memorandum. If Alphasteel is purchased and the first instalment of £65 million paid, BSC would require £395 million. Mr Tebbit and the Chancellor have agreed to defer any adjustment until later in the year because BSC's current financial performance is better than expected. For 1986/87, the second instalment of £65 million plus the requirements of Phoenix II would take BSC to an EFL of £245 million, some £74 million above baseline. Treasury officials are briefing their Ministers to press for offsetting savings to be found. Beyond 1986/87, there should be savings - £40 million below baseline in 1987/88 and larger savings afterwards.

Presentation of Decisions

14. BSC wish the Government to avoid issuing a statement about BSC strategy before the Summer Recess, even though there is pressure on the Government to do so. Instead BSC would like to make a full statement early in August covering the Alphasteel deal and the framework of their future Plan. This statement would be agreed in advance with Mr Tebbit, who would then make a statement in support of the BSC announcement. This would avoid immediate awkward questions in the House about Ravenscraig; but it invites the accusation that the Government is depriving Parliament of the opportunity to discuss matters of concern to Members. BSC, the DTI and the Treasury are all agreed on the need to ensure that the terms of the announcement avoid any long-term commitment to the continued operation of Ravenscraig; that would be said to be dependent on the future evolution of the market.

Lord Privy Seal should advise on this.

HANDLING

15. You will wish to invite the Secretary of State for Trade and Industry to present his paper. The Chancellor of the Exchequer and the Chief Secretary, Treasury may wish to respond on public expenditure implications. The Secretaries of State for Scotland and Wales will wish to comment on the implications of the proposals for steel communities in their areas.

CONCLUSIONS

16. You will wish to reach conclusions on:

(i) whether or not BSC should acquire and close in 1985 the Greek-owned Alphasteel strip steel mill subject to necessary assurances from the Commission on the acceptability of a Corporate Plan providing for retention of all BSC's present integrated steelworks.

(ii) Whether the two Alphasteel casters should be installed at BSC's Llanwern steelworks, and a second reheat furnace be installed at Port Talbot.

(iii) Whether BSC should close the Gartcosh cold rolling mill.

(iv) Whether or not to agree in principle that BSC and GKN should undertake the Phoenix II joint venture in engineering steels, subject to satisfactory further appraisal of the costs and the terms of the deal, and the prospects for the proposed new company.

J B UNWIN
Cabinet Office.
16 July, 1985