PRIME MINISTER

TIN

You are holding a meeting tomorrow afternoon to discuss tin.

The ITC met yesterday and again today. I have not had an authoritative account of what has happened, but DTI say that this week may well be the crucial week. We have been told that before, but it really does seem that a crunch is close.

I suggest you start the meeting by asking Mr Brittan to describe the position so far reached. The meeting then falls into two parts: what would happen if the negotiations collapse and whether the Government should be prepared to go beyond the £50 million loan guarantee already offered.

On the options if there is a collapse, the essence is in paragraphs 4 and 5 of the DTI note. In effect there is for practical purposes little difference between the fall-back options which have been identified and the likely cost to HMG if there is an uncontrolled collapse. The fall-back options the DTI put at £200 million and uncontrolled collapse they say might cost £250 million. Expenditure on fall-back options would arise immediately; expenditure after an uncontrolled collapse would only become payable after a long legal action which we lost.

The essential questions to be answered about the fall-back options are:

(i) would it be worthwhile financially to adopt a fall-back option;

(ii) can the Government politically afford to participate in a rescue as the only Government involved?

The second area for discussion is whether the Government should be prepared to offer more than the £50 million loan guarantee. This is mentioned but not discussed in detail in paragraph 7 of the DTI note. Should the Government be prepared to offer more support within the package? Where would the negotiators be able to draw the line once they agreed to put up more cash than the UK share?

(Duty Clerk)

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DAVID NORGROVE

15 January 1986

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~~cc~~ BG
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Secretary of State for Trade and Industry

15 January 1986

COVERING CONFIDENTIAL

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear David

TIN: MEETING AT 16.00 - 16 JANUARY

I enclose a copy of a paper on possible fallback options which may be useful background information for this meeting tomorrow.

I should emphasise that my Secretary of State has not seen or authorised this paper, but I think it is helpful to circulate it at this stage rather than later.

I am copying this letter to Colin Budd (Foreign & Commonwealth Office), Philip Wynn-Owen (Chancellor of the Exchequer's Office), Paul Pegler (Chief Secretary's Office), Henry Steele (Law Officers Dept), and to the Office of the Governor of the Bank of England. I am also attaching a copy to Ruth Rawling (MAFF) for information.

Yours sincerely,

C Bradley

CATHERINE BRADLEY
Private Secretary

FALLBACK OPTIONS

We have now considered in more detail the costs which might fall to HMG in the event of a failure to resolve the tin crisis, resulting in a collapse in the price of tin and legal action being taken by the banks and brokers against HMG.

2 The results of this analysis are set out in the first part of the attached paper, together with a fuller description of three alternative fallback options which HMG might possibly consider, in order to stabilise tin prices and reduce the potential exchequer costs if the crisis cannot be resolved.

3 The best estimate that we can make of the likely cost to HMG if there is an uncontrolled collapse is that it would be about £250m. Such a sum would only become payable some years in the future, as a result of successful legal action. This estimated net cost is much lower than the £500m gross costs estimated earlier, because we believe that there is a good chance of recovering, from other ITC member countries, at least half of the costs awarded against HMG on a joint and several basis by the Courts.

4 We have been unable to identify any fallback option which is likely to cost HMG significantly less than £200m. Such expenditure would arise immediately. A table summarising the costs of various options is at Annex 1.

5 The reason why there is such a small disparity between the estimated net costs to HMG of an uncontrolled collapse on the one hand, and the costs of controlled fallback options on the other, is that we consider that the likelihood of recovery of any contribution to HMG's costs in a fallback option from other ITC member countries is very slight.

6 The conclusion to be drawn from this analysis is that it would be difficult to recommend any of the fallback options we have identified purely as a means of reducing exchequer costs. It may be, however, that if it became clear that the ITC member countries were not prepared to agree to any reasonable proposals to resolve the crisis, a cheaper solution might conceivably be negotiable with the brokers in the very short period which might remain before the tin market reopened.

7 A further conclusion from this analysis is that, if a negotiated solution to the ITC crisis is close to being reached, and all that would be required to clinch would be an extra contribution from HMG, then it would make sense to consider moving from our present position under which we are prepared to make a contribution of a £50 million guarantee of loan finance to the new company proposed to acquire and dispose of the ITC's tin stocks. There have been several suggestions made by other delegates to the ITC that the UK Government should be prepared to put up £50 million in cash to facilitate a settlement, rather than simply a guarantee. These suggestions are of course firmly rejected by UK delegates to the ITC.

ANNEX 1

	Cost to HMG £ millions	
Uncontrolled Collapse	Worst Case	Estimate of Most Likely Outturn
Average selling price of tin		
- £4,500/tonne	409	225
- £3,500/tonne	516	
Option I		
Newco sells tin at:		
- £6,000/tonne	175	200
- £5,000/tonne	225	
Option II		
HMG sells tin at:		
- £6,000/tonne	120	220
- £5,000/tonne	220	
Option III		
HMG sells tin at:		
- £6,000/tonne	328	209
- £5,000/tonne	368	

D17b/RR5

Uncontrolled Collapse

1 **Assumptions**

a The price of tin falls to £3,500/tonne and the bank and broker losses crystalise as follows:

- banks (including broker loans) sell 44,000 tonnes held as security against loans of £281 million at an average price of £3,500 realising £154 million leaving a deficit of — £127m

- brokers sell 61,000 tonnes of tin purchased for delivery to BSM at £8,9000mt a £3,500 realising £213.5m leaving a deficit of — £329m

- Loss on provisionally priced sales (6,810 tonnes) — £40m

- Banks' interest — £20m

TOTAL — £516m

b Banks and brokers are successful in suing HMG for the full amount of their losses.

c No other ITC member government contributes voluntarily to the financial settlement of the action.

2 **Comment**

All the assumptions listed above are open to possible modification:

a In an uncontrolled collapse, the price of tin is expected to fall dramatically but it is not certain that the average price realised by banks and brokers would be as low as £3,500 per tonne. An increase of £1,000 per tonne in the average price would reduce the potential costs to HMG by a £105m. (In this connection it is worth noting that since average production costs of tin are believed to be in excess of £6,000 per tonne some holders of tin might consider it worth hanging on to their metal in the expectation that prices would rise significantly after the initial sharp fall). It is also possible that at least in the case of tin held in the UK, the banks would be under an obligation to act prudently in realising their security if they were to receive judgment for the difference between the value of the security and the value of the loan.

The calculation of the broker losses assumes that the Courts would award damages based on the Buffer Stock Manager's total purchase commitment of 61,000 tonnes. Although it is believed that the brokers would only be able to present some 40,000 tonnes of physical tin, almost all those concerned would sustain a loss if their contracts were not honoured and we believe would have a case for legal action. We do not therefore believe that there is much scope for saving here.

b Our lawyers have advised that an action against HMG would probably succeed, however, this is by no means certain as some of the legal issues which would arise are in uncharted territories. In any event, a successful legal action against HMG would not, necessarily, result in an award of damages equal to the creditors' losses if for example some had not taken adequate action to mitigate their losses or if the courts found they had not acted sufficiently prudently in their dealings with the ITC.

c The assumption that no other member governments would pay up if a legal action against HMG succeeded is particularly questionable. The FRG has said that it would regard it as self-evident that it would meets its legal obligations and, in practice, other consumers and Australia would probably do likewise. If these countries contributed in proportion to their contributions to the ITA, the cost of any settlement would be reduced by more than half. It might, although this is less likely, also be possible to persuade them to share the burden imposed by any defaulters. The possibility of taking sequestration action against the assets of defaulting countries would be available in the event of a judgment against those countries, but the amounts available from such action are likely to be insignificant.

d Countries which decline to pay in the face of a clear obligation imposed by a court decision could find themselves disadvantaged in the international money markets, particularly if the judgment against them related to the failure to meet an obligation arising out of an ITC loan. This could be a significant factor in the US, where lending to sovereign borrowers tends to be on terms which contain cross default clauses. Regardless of the formal legal position however, market perceptions there are likely to be adversely influenced against countries which refused to recognise clear obligations and could be manifest in the interest rates and other conditions imposed on those countries.

3 An uncontrolled collapse of the ITA would pose a grave but unquantifiable threat to the future of the LME. The costs of the demise of the LME are not known, but it is likely that a certain amount of tax revenue both from companies and from individuals would be foregone, although in relation to the total sums involved the amount is unlikely to be significant. No allowance has been made for Cornish job losses and the exchequer costs of these, as it is thought that most are likely to disappear anyway in the event of the various options involving a price of around £6,000 per tonne.

Conclusion

4 In a situation of uncontrolled collapse, the maximum sum which might fall to HMG could be around £500m. This sum has not been discounted even though it would probably be some years before it had to be paid, because as a counter-balance to discounting, the courts are likely to award interest to the successful litigants. However given the possibility of recovery of at least part of the sum awarded in the courts it seems unlikely that the eventual costs to the UK of a settlement determined by the courts would exceed £250m. It also needs to be borne in mind that the lawyers have estimated that the chances of litigation succeeding is roughly 6:4 in favour of the potential litigants. One further benefit in public expenditure terms of this course compared to any of the possible rescue options, is that the sums of money due would only be called for after several years, which would be easier to handle from the public expenditure standpoint.

D17b/RR1

OPTION I

"Newco" with no initial participation from other ITC member countries. Broadly the same as the bank and broker proposals but slightly modified.

A new company would be formed to take up the ITC tin purchase contracts with LME brokers and to take over from the banks their existing loans to the ITC together with the tin held as security. The new company would be financed as follows:-

	£m
Equity capital, subscribed by banks and brokers	80
Contribution by HMG	175
Bank loan guarantee by HMG	50
*Banks' existing loans	271
*New bank loan facility	up to 150

*(It is estimated that financing costs would be £70m over the three year period.)

Assumptions

a The new company would hold 85,000 tonnes of tin at 31 January 1986.

b The tin would be sold over a 3 year period and would realise an average price of £6,000/tonne.

c There would be no legal actions by banks or brokers against HMG and they would assign their legal rights to Newco.

d No other ITC members join.

Comment

This proposal would result in immediate additional expenditure by HMG of £175m. The maximum total cost to the UK (£225m if the average price of tin sales fell below £5,200/tonne and the full £50m guarantee was called) would be limited and would be known from the outset. The arrangements for Newco would have to be in place on the day on which the tin market re-opened; a great deal of preparatory work would, therefore, be necessary.

Newco would require the support of all interested parties and this cannot be taken for granted, particularly in the case of the ITC's existing bank creditors.

It would be open to HMG to pursue contributions towards the cost of Newco from other ITC members through diplomatic and political channels but the likelihood of any sum being forthcoming would not be strong, and would depend on it being clearly demonstrated that member countries had a legal liability.

Conclusion

The immediate costs of this option would be £175m. It is probable that at least part of HMG's guarantee would be called although this might not happen for 3 years (£50m discounted at 10% = £41.5). These costs would be offset by whatever sum we were able to extract from other countries but the prospects of any significant contribution would be much less than in the case of uncontrolled collapse where a clear legal liability was established.

As regards equity contributions of banks or brokers we could require them to pay amounts from successful court action into Newco. But the chances of recovery would be problematical.

D17b/RR2

OPTION II

HMG to buy 61,000 tonnes brokers' tin at a price which would ensure agreement not to take legal action, estimated at £7,500 tonne. It would simultaneiously sell the 21,000 tonnes required to make tin available at £7,500.

Under this proposal the brokers would be required to waive their rights to legal action against HMG, and the banks would be offered a deal that HMG would hold or partially hold tin off the market whilst the banks sold some of their tin, if the banks undertook not to, take legal action in return.

<u>Assumptions</u>

a A purchase by HMG of the brokers' tin at £7,500/tonne would be sufficient to secure an undertaking that no legal action would be taken.

b HMG would realise an average price of £5,000/tonne when selling the tin, except (see above) for its first 21,000 tonnes of sales).

<u>Comments</u>

Since some of the brokers have indicated that they would be willing to contribute to a settlement under the Newco proposals, it seems likely that they would be prepared to agree to a settlement which involved HMG in buying their tin below the contract price of £8,900 per tonne; the exact figure would be a matter for negotiation but, since a price of £7,500/tonne would imply a "contribution" of £85 million by them, as opposed to some £60m in the Newco proposal, it is unlikely that any lower figure would prove acceptable.

<u>Costs</u>

Purchase of net 40,000 tonnes at £7,500 gross cost of £300m. Financing cost, on basis of sales 2-3 years @ £6,000 mt:	£60m
Loss on sales of 40,000 if sold at £6,000 per tonne:	£60m
	£120m

<u>Conclusion</u>

Under this option the total cost would be less than under the other options, but there would be virtually no prospects of recovering anything from other ITC members. The prospects of selling at £6,000 mt over 2-3 years might not be good, bearing in mind the banks would also be selling 44,000 tonnes. Nor might the banks agree to forego legal action. If they were not prepared to forego legal action against the UK it could cost about £16m at a price of £6,000 or £60m at a price of £5,000 mt.

OPTION III

Purchase by HMG of 40,000 tonnes of brokers' tin at £6,000/tonne.

The Government would offer to purchase, at £6,000/tonne, the tin which brokers had contracted to sell to the Buffer Stock Manager. The purchases would be undertaken either directly or through a new company. The resulting tin stock would be held off the market for up to one year to allow the banks to dispose of the tin which they hold as security for their loans to the ITC, or possibly sold pari passu with the banks, if the latter were prepared in return to forego legal action against the UK.

Assumptions

a The Government would purchase the 40,000 tonnes of tin; which were physically available; the maximum finance required would be £240m. [It is assumed the brokers would have no incentive at £6,000 mt to find immediately the 21,000 tonnes of tin not physically available.]

b The purchases would be financed mainly by borrowing, using the tin as security.

c The Government would sell the tin, at an average price of £5,000/tonne, over a 3 year period and borrowing would be reduced proportionately. Total financing costs would be in the region of £35 million.

Comment

The principal objective of this option would be to reduce market disruption. HMG's agreement to withhold its tin from the market would be conditional on the banks undertaking not to take legal action in respect of any losses incurred following the sale of their tin. If the banks were unwilling to give such an undertaking, financing costs might be reduced but the chances of the tin price falling below £5,000/tonne would be increased if both the banks and HMG were selling at the same time. If this option were pursued, the brokers would still take legal action against HMG (and possibly others). Subject to the qualifications set out above (see uncontrolled collapse), the maximum possible award against HMG would appear to be some £238 million representing a loss of £3,900/tonne on 61,000 tonnes of tin (£156m if 40,000 tonnes of tin is assumed instead). The net costs would depend on whatever is recovered from the member states. The threat of legal action, might encourage other ITC members to reach a settlement with the brokers, in conditions of greater market stability than in the case of an uncontrolled collapse.

Conclusion

The cost of financing this option would be in the region of £35m. The additional risks can be quantified as follows.

a Successful legal action by banks if their tin sold at £5,000 (assuming they would not agree to refrain from legal action in return for the UK holding or partially holding tin off the market):	£60m
b Successful legal action by brokers depending on tonnage for which legal action succeeds:	£178-238m
c HMG's tin sells at £5,000/tonne	£40m
TOTAL	£343m
If 50% of legal costs were recovered, total costs would be:	£209m

(The same assumption as in uncontrolled collapse has been made, namely that any discounting of future payments would be cancelled out by award of interest in legal actions.)

D17b/RR3