

CONFIDENTIAL



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Michael Scholar Esq
Private Secretary
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12 March 1982

Dear Michael,

INVERGORDON

In preparation for the Prime Minister's meeting with the local authority deputation on Monday you asked me for a note on developments since last Monday's E Committee discussion, and in particular on the hydro option. Scottish Office officials are preparing a paper on the hydro option for discussion at E committee which I now understand has been arranged for Tuesday 23 March. The paper will examine the possibility of concessionary charges based on hydro generation costs either for the smelter alone or for the smelter and other large users in the Highlands. An outline of the form a concession scheme might take was included in the Annex to my Secretary of State's E Committee paper considered last Monday (E(82) 19).

The hydro option is certain to be mentioned by the deputation; Mr Finlayson, the Convener of Ross and Cromarty District Council, is a former employee of the North of Scotland Hydro-Electric Board. We suggest that the Prime Minister should respond by acknowledging that hydro power is a unique resource and that one of the objectives of the original Hydro Board was to develop it for the economic development and social improvement of the North of Scotland district. To set it aside now for the smelter or for industry in the Highlands would require legislation (to remove the "undue preference" provisions in the Board's statutes) and would increase the cost of electricity for other Scottish consumers, but the Government are examining this option carefully along with other ways of providing competitive power for the smelter.

Three other developments have occurred since 8 March. Firstly, the British Aluminium Company have published their annual accounts for 1981 and they confirm that the companies position was precarious prior to the closure of the smelter. Secondly, officials of the Scottish Office have met a delegation from the Church of Scotland, including local Invergordon ministers, and were impressed by their fears of the social effects of a permanent closure. Thirdly, the attached Scotsman article suggests that Scottish Office ministers received a pointed warning about the future of the Invergordon smelter in February 1980. We stand by our earlier statements that the meeting in February

1980 discussed the dispute between the company and the North of Scotland Hydro-Electric Board but that at no time did the company suggest there was a doubt about the future of Invergordon. A note was tabled which covered issues with which the Company was concerned including their serious concern about the escalation of electricity costs but this did not mention the possibility of closure. The first informal indication of potential closure was relayed to a Scottish Office official in early September 1981 and the first indication from the company came in their meeting with the Department of Industry on 5 October 1981.

X | The Prime Minister should also be aware of the attached paper forwarded to the Secretary of State by the local authorities at the end of last week. It sets out their views on the smelter issue, but I do not think it contains any points which will be unfamiliar to the Prime Minister.

Yours sincerely,

John Wilson

JOHN WILSON
Private Secretary

PS. No need to send you the paper referred to at X1. I have just seen your letter of 11 March to the Chief Executive of Highland Regional Council and note that the Prime Minister already has a copy of the local authorities' joint statement.

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Two-year warning 'given on smelter'

By CHRIS BAUR

New evidence has come to light which suggests that the Scottish Office were warned almost two years before the closure of the Invergordon aluminium smelter last Christmas, that rising electricity costs were "undermining the whole basis of the operation."

This specific warning was given by senior executives of British Aluminium when they met the Secretary of State for Scotland, Mr George Younger, in February 1980.

It was later reinforced, with added urgency, in June last year when officials of the Highlands and Islands Development Board told the Scottish Office several times that "the company's balance sheet was in jeopardy."

The evidence that Scottish Office officials and Ministers had substantial foreknowledge of a developing crisis at Invergordon is confirmed both by the company and the board. It contrasts with the department's own account, which suggests that the Government were not aware of the seriousness of the company's position until October last year.

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According to Mr Younger, the February 1980 meeting with the company was held to discuss the dispute between them and the North of Scotland Hydro Electric Board about charges for electricity supplies to the smelter — a dispute which eventually crippled the smelter and involved an outstanding sum of about £47 million at the time of the plant closure.

"The company made a number of points to me about the terms of their contract with the board and about the issues in dispute," Mr Younger told the House of Commons in January.

"But at no time during the meeting did they suggest that there was an underlying doubt about the future of the company as a whole or the Invergordon smelter in particular.

"The first indication the Government received from the company of the seriousness of their position and of the possibility of closing the smelter came during a meeting in October 1981 between officials of the Department of Industry and representatives of the company.

WARNING

"The Government immediately instituted an intensive series of discussions with the company involving both Ministers and officials in an effort to find a solution."

The company acknowledge that the possibility of "liquidation" was not raised at that meeting. But they insist that a pointed warning was issued — the words actually used and munitied were that "the extent of the escalation in power prices undermines the whole basis of the operation at Invergordon."

Just over a year later this warning came home to roost. The company's half-yearly financial results published last June showed that the previous year's £9.3 million profit before tax had been transformed into a £8.8 million loss, with the company having to set aside more than £37 million in accumulated provisions for power charges that were under dispute with the Hydro Board.

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'Cold sweat' on smelter

The Highlands and Islands Development Board, apparently, read these results "in a cold sweat" according to one source. "It was like a funeral oration."

A statement by the board's then chairman, Rear-Admiral David Dunbar-Nasmith, at the end of December placed on record the fact that the board had "altered the Government to the very serious situation which we have seen developing over recent months."

What actually happened, it appears, is that in June last year the board warned the Scottish Office of the precariousness of Invergordon's position twice in writing and several times in face-to-face representations. "They had at least six months warning," I was told.

For their part, the company suggest that the Scottish Office had less reason to be surprised by the eventual closure decision than the Department of Industry, who were not brought into discussions about the smelter's future until October last year.

It appears, however, that the danger signals were not displayed with sufficient vigour or were simply misread. The Scottish Office say there was no question of their being forewarned about the possibility of closure.

It was not until October 6 last year, they say, that "British Aluminium came to us in dire straits, although we did have indications in early September that the company were encountering difficulties."

The company agree that it was in October that they initiated a final round of negotiations with the Government and

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told Ministers that they were confronted with three choices

ONE — To continue with the existing power contract, negotiated originally in 1968, in which case the entire company would go into liquidation;

TWO — To negotiate a power contract from now until the end of the century;

THREE — To close the Invergordon smelter.

By December 17, according to the company, negotiations with government officials had reached a point where the company believed a new power

contract was possible. Directors were asked to approve the terms in the expectation that a final offer would be made by the Government on the following day.

However, as the record now shows, Ministers overruled the proposed deal which according to Mr Younger, would have involved the Government in raising their annual deficit payment to the Hydro Board smelter account from £8 million to £16 million a year until the year 2000. "Such a commitment was unacceptable", he said.

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