CF.
PM has seen. Pl pa.
MCS 18/5

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

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PRIME MINISTER

INVERGORDON SMELTER: ASSISTANCE FOR A POTENTIAL NEW OPERATOR

1. At its meeting on 4 May (E(82) meeting) E Committee invited me to arrange for the details of possible assistance for a new operator to be worked out. I now attach an outline plan for our proposed negotiations, the line of which has been agreed by other interested departments at official level.

2. You will see that under the plan the power supply to the smelter would be based on coal supplied at the normal power station price, and that the gap between the power supply price and the price an operator would need would be met entirely through an annual subsidy from the Highlands and Islands Development Board (HIDB). E Committee concluded that this arrangement would be preferable to that put forward in my memorandum (an HIDB annual subsidy of around £10m linked to a supply of coal at a price below the normal power station price), provided that it was no more expensive in public expenditure terms and created no greater difficulties for international acceptance. The arrangements now proposed are indeed no more expensive: the HIDB subsidy would be £20m instead of £10m but NCB's revenue will benefit by £10m from the extra sales at the power station price rather than the export price. FCO advice is that an operating subsidy of £20m per annum will be no more difficult to clear with the Commission than one of £10m per annum linked to an arrangement on coal.

3. I recognise that it may help to minimise the possibility of other claims for comparable assistance if the support for Invergordon is not based on a coal deal and relies entirely on a subsidy from the HIDB. I should however draw attention to the considerable presentational disadvantages I see in the arrangement now proposed. Firstly, it will result in a "headline" figure of £20m for the proposed subsidy. The

proposal I put to E Committee involved a "headline" figure of only £10m, because the terms of NCB's coal supply would be confidential and no extra subsidy would be involved in substituting sales to the smelter for sales in the export market. The £20m figure will I think attract some additional degree of public comment and, with it, some increased chance of difficulty with the Commission. Secondly, the level of subsidy we are known to have been prepared to accept in December was £16m per annum over three years and it will appear that we have increased the total offer in order to find a new operator and that we should never have allowed the smelter to close in the first place. This view is not soundly based but it will be difficult to rebut without detailed explanation. Thirdly, it can be argued that half of the subsidy simply will be devoted to enabling NCB to sell coal at a higher price than it would otherwise be able to obtain in the open market.

4. BACo has made it clear that it intends to break up the plant at the end of June when the Company's undertaking to keep the plant in usable condition expires. It is therefore a matter of urgent priority to establish the level of interest among potential operators and I am therefore proceeding to put into effect the negotiating plan attached to this minute. The first step in this plan will be very early contact by letter with interested companies. It will be some time before any of these negotiations can reach a critical stage and before then I should be very glad to have your views on the presentational difficulties which I have outlined in the preceding paragraph.

5. I am copying this letter to other members of E Committee, to Nicholas Edwards, John Sparrow and Robert Armstrong.

G.Y.

G.Y.

Scottish Office
17 May 1982

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PROPOSED PLAN FOR NEGOTIATION OF NEW POWER ARRANGEMENTS FOR INVERGORDON

1. Scottish Office officials will write to the companies who have already expressed an interest in acquiring the smelter and to any others who may be interested. The letter will indicate that the Government are prepared to discuss special financial assistance covering a period of no more than 5 years and will invite them to further discussions. The same information will be conveyed to the British Aluminium Company (BACo) in a separate letter, which will also invite the company to discussions about the price at which they would be prepared to sell the plant to a new operator.

2. Scottish Office officials will then hold preliminary discussions with any companies who respond positively to the letter, in which they will outline the basis of the proposed assistance in more detail, but without disclosing the maximum amount of assistance which the Government can offer. The proposed arrangement is that power will be supplied by the Scottish Electricity Boards at the lowest price which would enable them to cover the costs of providing the supply. The marginal generating capacity from which the supply will come would in practice nearly always be coal-fired. The price in the current year will be likely to be around 2.3-2.4 pence per unit. In future years it might be escalated in line with actual costs or power station coal prices; this will be for negotiation but against a background that public finances would not be expected to cover the costs of fluctuations in the power supply. The price to the operator will be lower than tariffs for other industrial consumers but as the new operator will also be the largest consumer in Scotland the costs of generating his electricity will be correspondingly much lower and we consider that this is a defence against claims of undue preference.

3. It will be explained that the Government accepted in principle that at such a power price, aluminium smelting would not be economic and that in the exceptional circumstances of Invergordon, the Government will be prepared to consider an annual subsidy over a 5-year period. It will be made clear that the subsidy will be an annual one, will not subsequently be adjusted in line with power costs or any other variable and will have either to be fixed in money terms or to decline over the period. The companies would then be expected to have discussions with BACo about the price at which they could acquire the smelter.

4. If any of the companies who have expressed an interest respond positively to this proposal, subsequent more detailed negotiations will be undertaken by a team led by Scottish Office officials but including representatives of the Scottish Electricity Boards, HIDB and, if they wish, other interested departments. The aim will be to establish from each of the companies the level of assistance they would consider essential to operate the smelter successfully and the basis on which they would operate the plant, including in particular the numbers they would employ and the various operating costs assumed including the wage bill they would intend to pay. Any eventual offer of HIDB assistance would be varied according to the level of output achieved in each of the years in question.

5. In parallel with these discussions, consideration must be given to the problem of clearance of the proposed assistance with the Commission. A draft notification will therefore be prepared in consultation between the Scottish Office, FCO and UKREP. It it becomes clear that a potential new operator could be found, UKREP will first show the notification on an informal basis to the Commission and then in the light of their comments formally submit a notification for the Commission's approval. Sufficient time should be allowed to enable the Commission to complete its examination of the notification.

6. The Secretary of State for Scotland will consult his colleagues before making a final decision between any competing candidates for assistance. If no company is prepared to reopen the smelter on the basis of a subsidy of less than the £20m approved by the Committee, he will report to his colleagues, before terminating negotiations, the level of subsidy which those companies expressing interest consider would be necessary.

Scottish Office
17 May 1982

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Qa 05932 25 May 1982

To: PRIME MINISTER

From: JOHN SPARROW

Invergordon Smelter

1. I have seen the correspondence on this, and I believe Leon Brittan's latest minute is hard to refute. We must minimise the problems which a subsidy is bound to cause. A power contract based on a coal price below the normal power station price would create major new problems for our energy pricing policy. Large electricity users such as ICI are already pushing hard for special schemes, possibly based on cheap coal; other users such as BOC are believed to be watching like hawks for evidence of undue preference; as we know from our work on Electricity Prices the issue is smouldering dangerously and it only needs a spark to bring new and powerful pressures to bear.

2. I therefore believe that a 'straight' subsidy through the HIDB represents much the safest method of implementing any subsidy.

3. I am sending a copy of this minute to Sir Robert Armstrong.

JS.

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cc IV

PRIME MINISTER

INVERGORDON

- TPM

I have seen George Younger's minute of 20 May.

2. I agree with him that there would be presentational advantages in providing assistance to a new smelter operator by a combination of a direct operating subsidy from the HIDB and a concealed subsidy on the price of coal, provided that the concealed element of the subsidy remained concealed. But I see little prospect of our achieving this. Any agreement we reach with a new operator is bound to be scrutinised very closely by the European Commission and probably by the PAC as well (they have already shown an interest in the subject). The fact that subsidised coal is being provided for the smelter, in addition to a very large direct subsidy from the HIDB, will quickly become public knowledge. I believe that an unsuccessful attempt to conceal the full extent of the subsidy provided would be extremely embarrassing.

3. We would inevitably come under considerable pressure from other energy intensive industries to provide them, too, with subsidised coal, It will be much more difficult to resist this pressure than it would be if the whole of the subsidy were provided via the HIDB, which would give the subsidy a more limited 'Highland dimension'. I do not imagine that it will be possible, however we tackle the problem, to 'ring-fence' Invergordon completely, but we need to make it as difficult as possible to maintain that our rescue of Invergordon has set a general precedent.

4. I hope, therefore, that you can agree that the balance of advantage lies in providing the whole of the subsidy via the HIDB. I am grateful for the opportunity of a discussion on Wednesday.

5. I am copying this minute to members of E Committee, Nicholas Edwards, John Sparrow and Sir Robert Armstrong.

L.B.

LEON BRITTAN

Prime Minister (2)

Another dissentient from George Younger's line. I have pencilled in a small meeting after E on Wednesday (although I have not entirely lost hope that Energy Treasury and Industry will give up their objections by then).

CC. J.V.

MCS 24/5

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PRIME MINISTER

INVERGORDON SMELTER : ASSISTANCE FOR A POTENTIAL NEW OPERATOR

In his minute of 17 May George Younger argued that the negotiating plan agreed between officials has considerable presentational disadvantages. Since then both Leon Brittan and Nigel Lawson, in their minutes of 19 and 20 May have expressed strong doubts about George's proposal to reconsider the mixed HIDB subsidy/coal price deal. I have also just seen George's response of 20 May.

LWN MCS

2 This is just to let you know that I strongly endorse the points made by Leon and Nigel. I question George's argument for a mixed deal because I do not believe the terms on which coal was being supplied could be kept confidential. I strongly suspect that the Press would quickly put £10m and £10m together to make a headline figure of £20m.

3 But in any case I think the other advantages of providing the subsidy entirely through HIDB far outweigh any presentational problems. This route will underline that the subsidy is not being offered for industrial reasons but for reasons unique to

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the Highlands. As George Younger concedes it will minimise the risk of other claims for comparable treatment, an aspect which in my view could cause us early and serious embarrassment.

4 It would also avoid the complicated negotiations that would otherwise be necessary between the NCB, the Scottish Electricity Boards and any prospective new operator.

5 At 'E' Committee on 4 May we reached the conclusion that it would be better to provide support entirely by means of a direct subsidy to the operator via HIDB provided it was no more expensive in terms of public expenditure and would not be more difficult to clear with the EEC. Since these conditions appear to be met, I think we should stick to that decision.

6 Copies of this minute go to the recipients of earlier correspondence.

PJ

P J

24 May 1982

Department of Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

10 DOWNING STREET

(1)

Prime Minister

Invergordon

Both Leon Brittan (flag A) and Nigel Lawson (flag B) are unhappy with the decision reached during your brief talk with George Younger (recorded in my letter at flag C). George Younger (flag D) comments on their objections but, clearly, is determined to press on regardless.

Do you wish to intervene

(i) confirming George Younger's preferred

course – i.e. £10m to HIDB plus a low coal price?

(ii) siding with Leon Brittan and Nigel Lawson – i.e. £20m to HIDB with no cheap coal scheme?

(iii) bringing the matter back to E once more on Wednesday?

Or do you prefer to take no further action, allowing George Younger to press ahead as he wishes?

MCS 21/5

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

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PRIME MINISTER

INVERGORDON SMELTER: ASSISTANCE FOR A POTENTIAL NEW OPERATOR

I have seen the minutes of 19 and 20 May from Leon Brittan and Nigel Lawson about the agreement we reached when we met on 18 May to discuss my minute of 17 May. They are concerned about the wider implications of a package which includes the supply of coal at around the export price, with a correspondingly lower subsidy payable through the HIDB.

Both minutes draw attention to the risk of challenge to the proposed arrangements on the grounds that they constitute "undue preference". There may be some risk of this whether we adopt the mixed HIDB subsidy/coal price arrangement or channel the entire subsidy through the HIDB: the latter course, which Leon and Nigel favour, would not rule out the risk of challenge. My advice from the Lord Advocate is that provided the South of Scotland Electricity Board is acting in a way which is commercially sound - and supplying low-price electricity from low-price coal is one of the possibilities which, naturally, he considered - the risk of a successful challenge on the basis of the "undue preference" provision is very slight. If we thought it significant I believe we could consider averting it by leasing to the operator the coal-fired plant involved. The Lord Advocate's earlier advice on this option was that it would involve no undue preference. An added advantage of it is that it would strengthen the "ring fence" round the deal although of course it could put up the unit price of electricity to the operator.

Otherwise, both minutes deal with the very matters of judgement and presentation which I canvassed in my minute of 17 May and which we considered when we met. I still feel that the course we agreed I should adopt has decisive presentational advantages but, during the course of the negotiations, I will keep in mind the points which Leon and Nigel have made and if some middle way can be found which partly meets their concerns I will naturally seek to do so. As negotiations proceed I will ask my officials to keep in touch with theirs.

I am copying this minute to the Members of E Committee, Nicholas Edwards, John Sparrow and Sir Robert Armstrong.

Gy.

G.Y.

Scottish Office
20 May 1982

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cc JV

PRIME MINISTER

INVERGORDON SMELTER

I have just seen Leon Brittan's minute to you of yesterday, following George Younger's of 17 May and your Private Secretary's letter of 18 May.

I agree strongly with the points Leon makes. It has now been established that assisting a potential new operator for the smelter by a £20 million subsidy to the HIDB, as E preferred, is no more difficult to clear with the Commission than doing so by a £10 million subsidy and a cheap coal scheme costing another £10 million. On the other hand, the presentational arguments in paragraph 3 of George's minute in favour of the £10 million subsidy depend on the assumption that the cheap coal scheme would remain confidential. I do not believe that it would.

I was content, in our discussion at E on 4 May, to offer the cheap coal scheme because it then appeared to be the only means of saving the smelter. This is no longer the case and, in addition, the scheme as set out by George now includes an element of cheap electricity as well. I have consistently made clear that I cannot accept this because its repercussions, particularly if there were any question of altering the SSEB's obligations on undue preference, would be incalculable. Like Leon, therefore, I hope that you can reconsider the possibility of channelling the whole of the subsidy through the HIDB.

I am copying this minute to the other recipients of the earlier correspondence.

NL

Secretary of State for Energy
20 May 1982

I have just been asked by Britnell to give to you at yesterday's following Prime Minister's or [illegible] and your Private Secretary's letter of 11th.

I agree strongly with the points Lord [illegible] makes. It has now been established that including a potential contribution for the smelter by a £20 million subsidy to the FIDC, as I preferred, is no more difficult to clear with the Commission than doing so by a £40 million subsidy and a cheap coal scheme costing another £40 million. On the other hand, the presentational arrangements in Prime Minister's minute in favour of the £40 million subsidy depend on the assumption that the cheap coal scheme would remain confidential. I do not believe that it would.

I was convinced, in my discussion with a CCN, so far, the cheap coal scheme became it then appeared to be the only means of saving the smelter. This is no longer the case and, in addition, the scheme is not work by Thorpe not includes an element of cheap hydroelectricity as well. I have consistently made clear that I cannot accept this because its repercussions, particularly if there were any question of allowing the CCN's obligations on undue preference, would be incalculable. Mike Pope, therefore, I hope that you can reconsider the possibility of cancelling the whole of the subsidy through the FIDC.

I am copying this minute to the other recipients of the earlier Thorpe minute.

Chancellor of the Exchequer
20 July 1982

PRIME MINISTER

£20m (gross) is psychologically bad when we returned to keep the smelter operating for £16m gross. £10m net is much better. I understand that NCB does not have a fixed price for coal.

INVERGORDON SMELTER: ASSISTANCE FOR A POTENTIAL NEW OPERATOR

I have seen your Private Secretary's letter of 18 May to George Younger's Private Secretary which records your agreement that the assistance for a potential new operator for the smelter should be given by way of an HIDB subsidy and a power contract based on a coal price below the normal power station price, rather than through a £20 million subsidy to the Highlands and Islands Development Board.

further disincentive

2. I must confess to doubts about the mixed HIDB subsidy/coal price deal which George has suggested. We did agree at E that there were attractions in channelling the whole of the subsidy through the HIDB, if that could be arranged, rather than have the NCB supply coal at export prices: but any arrangement to achieve this end should not be pursued if they had the effect of increasing the cost to the public sector, or of tipping the scale against international acceptance of the subsidy. George's minute records the FCO advice that an operating subsidy of £20 million per annum would be no more difficult to clear with the Commission than one of £10 million per annum and an arrangement on coal. And as he says, the arrangements now proposed ought to be no more expensive. So the conditions envisaged by E do appear to be capable of being met and I hope that therefore you can reconsider the possibility of channelling the whole of the subsidy through the HIDB. This route would have the real advantage of making it much easier to "ringfence" the arrangement to prevent other heavy electricity users, whether aluminum smelters or in the rest of industry, seeking comparable treatment.

If they made such a request, our reply would be that support was being given through the HIDB because of the unique circumstances of the Highlands.

3. That reply would not be available if the mixed HIDB grant/coal arrangement was adopted. Other large users could well demand similar favourable coal contracts as a basis for their cheap power supplies. In that case it would hardly be open to us to defend the deal by invoking the particular circumstances of the Highlands, particularly as the coal would be burned in the power stations of the South of Scotland Electricity Board, not the stations of the North of Scotland Hydro-Electric Board which would actually provide the power to the smelter.

We should have to defend both sets.

4. I also understand that the South of Scotland Board believe the proposed mixed arrangement is quite likely to be challenged by British Oxygen or another industrial customer as "undue preference". I do not know whether George has taken Law Officers' advice on this risk, but we clearly ought not to put ourselves into a position where the arrangement is open to legal challenge, which if successful could have far-reaching and costly repercussions. Nor do I think that we should give the Scottish Boards any assurance that in the event of such challenge the Government would take steps to amend the statute.

Has he?

5. I am sending a copy of this minute to the members of E Committee, Nicholas Edwards, John Sparrow and Sir Robert Armstrong.

L.B.

LEON BRITTAN
19 May 1982