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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

IRON AND STEEL BILL 1981

Note By the Secretary of State for Industry

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1 The Legislative Programme includes provision for a Bill to provide for a capital reconstruction of the British Steel Corporation (BSC). BSC's Corporate Plan makes it essential to include in the proposed Bill provision for liquidating BSC.

Background

2 As colleagues will know, BSC has incurred massive financial losses in each year since 1975/76 as the table below shows:

	1975/76 £m	1976/77 £m	1977/78 £m	1978/79 £m	1979/80 £m
Turnover	2,357	3,059	3,154	3,288	3,105
Loss	(255)	(95)	(443)	(309)	(545)

3 The prospects for BSC remain poor. Little improvement in the present depressed market can be expected before 1982 at the earliest, as I made clear in my paper "Prospects for the Steel Industry" (E(80)139). In November BSC was forecasting a loss on ordinary activities of over £500m for the financial year to 31 March 1981. The Corporation's revenue deficit will be about £4,000 million by 31 March 1981 but this may be increased if the value of fixed assets has to be written down further. Further losses on ordinary activities and further extraordinary closure costs can be expected in the 1981/82 financial year, and these will be described in the BSC Corporate Plan which I shall have received before we discuss this paper.

4 Because of BSC's continuing losses, I had to tell the House on 22 May this year that it would no longer be possible to require that all the new capital subscribed since April 1978 would be remunerated by dividends after the capital reconstruction (Hansard 22 May 1980 cols 298-299).

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Increase in borrowing powers

5 BSC will exceed their present limit of £5.5 billion around the end of February 1981 and therefore new statutory cover is necessary before then. I am fully aware of the pressures on the Parliamentary timetable this year and that some of my colleagues have had to postpone desirable legislation. I have therefore sought to avoid proposing two Bills. There is a device by which this can be circumvented. This is to include in a single Bill a clause giving me an entirely new power separate from section 18 of the Iron and Steel Act 1975 (by which we presently finance BSC) to advance monies to the BSC. The advantage of this course is that it would leave unaffected the existing borrowing limit (which applies only to the sum of the Corporation's borrowings under section 16 and advances under section 18) and BSC could continue to use their existing short term borrowings facilities.

6 There are unfortunately two drawbacks to any new form of financing the Corporation. The first is that it would be necessary to distinguish it in an arbitrary manner from section 18 finance. It would therefore be quite clear that we were introducing this new power as a device and consequently we would have trouble in Parliament.

7 The second drawback is that any advances to BSC under a new power, before legislation was enacted, would need to be made from the Contingencies Fund. The problem here is the quantity of money required; if legislation were enacted by end June, on present estimates £400m will be needed, rising to £600m to £800m by the end of November. There is a statutory limit on the Contingencies Fund of two per cent of the previous year's supply, and the 1981/82 limit will be about £1,250m. But if this device fails, two Bills are inevitable, one short bill to increase the borrowing powers enacted by the end of February 1981, the second, and longer - but nevertheless urgent - Bill to give effect to the Corporate Plan enacted by the end of June.

Capital reconstruction and future financing of BSC

8 We have now received BSC's Corporate Plan and we need time to consider it carefully. Until we have done that we cannot take a definitive view of the Corporation's long term capital structure and thus what sort of provision is needed. We certainly need to write off large sums of debt and other capital immediately to recognise that the Corporation has already lost the money through its trading results. We shall also need to take powers to write off capital in respect of future costs. (Annex A sets out the sort of write offs required, which may involve as much as £4.5 billion).

9 Provision is also necessary for the financing of the Corporation after the reconstruction, especially as it seems likely that future capital issues may not be wholly

remunerated. We need general not specific powers in the Bill because the appropriate shape of the Corporation's financial structure will not be clear until after July when we shall be able to see the extent to which Mr MacGregor has succeeded.

Removal of statutory duty to supply

10 I told colleagues earlier this month (E(80)138) that negotiations were in progress between BSC and the private sector steelmakers with the aim of rationalising their operations in the billet, bar and rod area into one or more joint companies in which BSC would be a minority shareholder. I am continuing to explore with the Chairman the possibility of privatising other areas of BSC's operations. The existing statutory duty in section 2(1)(a) of the Iron and Steel Act 1975 does not constitute an obstacle to disposal of steelmaking assets on a moderate scale. But the present statutory formulation does not sit easily with my proposals for privatisation - if I am able to achieve them. I propose therefore to modify the BSC's statutory duty.

Liquidation

11 No power currently exists in any statute to enable the Government to wind up a statutory corporation. I propose to provide for liquidation of BSC. BSC is intended to be a commercial undertaking but it requires a great deal of Government finance to sustain its business. It is only right that the Government should take powers similar to those of a shareholder or a bank towards a private sector company in which it had invested to protect its money when things go badly wrong. The Government is effectively liable to pay BSC's creditors and it now seems essential that there must be a power for the Government to say "stop". Unless we take such powers we stand the risk of sustaining continuing massive public expenditure with consequent damage to our medium term financial strategy. Any power to liquidate the Corporation ought not, however, to be exercised in an arbitrary manner. I therefore propose that the BSC ought to have a duty to recommend to the Secretary of State that the Corporation be wound up in circumstances where it considers that there is no prospect within a reasonable period of meeting its financial duties to break even. If the Secretary of State agreed with the BSC that liquidation was necessary he would have to inform Parliament when the procedure for winding up commenced. The legislative provision to achieve this objective will be complex; further details are at Annex B.

CONCLUSION

12 It is essential that the Government is seen to support Mr MacGregor fully, and legislation should therefore be enacted by the end of June 1981. Without this backing he cannot give effect to his announced intention "progressively

to liquidate the business" which would become an empty threat.

13 I therefore invite my colleagues to agree to the introduction of a single Bill to be enacted by the end of June 1981 to provide for:

(i) an increase in BSC's borrowing limit from £5.5 billion to £6.5 billion;

(ii) a capital reconstruction of BSC;

(iii) modification of BSC's duty to supply so as to permit privatisation and a reorganisation of the boundary between the public and private sectors of the steel industry; and

(iv) the introduction of provisions to enable the BSC to be liquidated.

K J

Department of Industry
15 December 1980

CAPITAL RECONSTRUCTION

(i) Write off of accumulated losses

BSC accounts record a loss of ordinary activity of £1.647m in the five years to March 1980 (see paragraph 3). On current estimates the results for the present financial year are likely to show a loss from ordinary activities of £700m making a total loss from ordinary activities over the six years to March 1981 of some £2.35 billion. These losses and the Government money used to finance them cannot be recovered from future earnings and I propose that they should be written off. Because BSC will not be in a position to know the final loss figure for 1980/81 until June or July 1981 I would propose to provide in the Bill a close estimate of trading losses which can be adjusted during the Bill's passage through Parliament.

(ii) Restructuring costs

Before the financial year ending March 1980 the Corporation had met the cost of redundancy and works closure from a general reserve under section 15 of the Iron and Steel Act 1975. This reserve ran out in 1979 and consequently BSC's 1979/80 Accounts showed restructuring costs of some £400m of which some £390m was for costs identified for 1980/81 but not yet incurred which were added as an extraordinary item to the revenue deficit. I would propose that this sum should be written off. In addition it will be necessary to take powers to write off restructuring costs for the year 1980/81 (estimated at £500m) and for 1981/82 (which BSC estimate might be in the region of £300m). I would therefore propose to provide for a maximum of £800m to be written off by means of an order subject to affirmative resolution possibly in two tranches when the sums for each year become known.

(iii) Write off of capital to take account of write down of assets

The Corporation came to the view in 1979 that its manned capacity of 21.5 million tonnes should be quickly reduced to 15 million tonnes of liquid steel. As a result of this decision it began an assessment of the amount to be written off its fixed asset values to take account of capacity which would not be needed to produce this level of output. The amount written down was £1.1 billion which was charged as an extraordinary item in the profit and loss account. The fixed assets relifing reserve of £300m created in 1977/78 was applied to the write down making the amount finally charged to the revenue deficit £841 million. I would propose that this sum should be written off on Royal

Assent. We know that the Corporate Plan will postulate a level of production lower than 15 million tonnes and a further write off may be necessary. Indeed, in commenting upon the write down, the Corporation's auditors could not confirm that the value of the remaining fixed assets would be recoverable out of future earnings and considered that a further write-down beyond the present level might be necessary. I would therefore also wish to take powers to write off assets not required to produce whatever level of production is included in the Corporate Plan but would not wish to exercise this power unless and until the trading results of the restructured corporation confirm that this is necessary.

(iv) The total amount to be written off would therefore be as follows:

(a) To be written off as soon as Bill receives Royal Assent

	£ million
Losses from ordinary operations to March 1980	1,647
Losses from ordinary operations to March 1981 (estimated)	700
Restructuring costs identified and accounted to March 1980	398
Asset write down	841
	£3,586 *

(b) To be written off by order when amounts become known

	£ million
Restructuring costs to March 1981	500 (est)
Restructuring costs to March 1982	300 (est)
To take account of further write down	X
	£800 + X

* These figures will have to be finally agreed with BSC.

ANNEX B

LIQUIDATION OF BSC

Objective

1 The objective of the legislation is to provide enabling powers to the Secretary of State to require the Corporation to dispose of its assets and for the Corporation to be wound up. Where possible the consequences of the legislation would be to enable the activities of the Corporation to be terminated on the analogy of a Companies Act company, but there are considerable difficulties.

Method

2 In the case of a limited liability company, the objectives at paragraph 1 above are met by the provisions of the Companies Acts for the appointment of liquidators. But a statutory corporation is radically different from a Companies Act company particularly since there is no legislative provision for dissolution and because the Government accepts that it stands behind its debts, so that the appointment of a compulsory liquidator who has specific duties towards creditors is not appropriate.

3 It would also be inappropriate for the Government to legislate to transform the Corporation into a Companies Act company since the Corporation would be insolvent without further injections of capital. It would not be proper to form a company solely for the purposes of closing it down again.

4 Powers to liquidate the BSC could however be taken covering the following steps:

(i) defining the circumstances in which liquidation is triggered

(ii) the replacement of the existing Corporation board by members charged with the duty to bring about the termination of the BSC's activities within a defined period (perhaps 2 years)

(iii) at the end of the period, to dissolve the Corporation and transfer its residual property to the Secretary of State.

Triggering off the procedure for terminating the Corporation

5 Since the responsibility for managing the Corporation

rests with the Members, it seems right that, by analogy with private sector directors where a company becomes insolvent, the Corporation should be required to inform the Secretary of State if they believed that the Corporation would not be able to meet, within a reasonable period, agreed financial objectives (such as a return to profitability on trading activities after allowing for depreciation).

6 On receipt of such a report from the Corporation, the Secretary of State would then have the power to decide whether to liquidate the Corporation. He would report his decision, and the reasons for it, to Parliament.

7 To guard against the possibility of the Board failing to act the legislation could also give the Secretary of State the power (to be exercised only with the consent of the Treasury) to begin the liquidation of the Corporation if he considers that there is no prospect of the BSC becoming financially viable.

New Board and its Powers

8 This would be the main section of the legislation. The liquidation board might well operate under a different name (e.g Steel Disposal Board), and would need to exercise most of the current powers of the Corporation, but be relieved of many of the duties, the latter to be replaced by a duty to sell as much as is practicable of the BSC's activities, and to close down the remainder.

Finance for the Board after liquidation proceedings have begun

9 The legislation would have to provide that the provision of capital under section 18 would cease immediately the termination proceedings commence because such capital no longer has any chance of being remunerated. Thereafter grants would have to be made from a separate Vote with Parliamentary authority being sought in the normal way. The legislation will need to provide for an advance to be made to the liquidator immediately on his appointment.

Employees

10 On the commencement of the liquidation, it will be the aim to put the employees of the British Steel Corporation as nearly as possible into the same position as the employees of a private sector company which is wound up voluntarily. The existing legislation in this area is complex and special provisions will probably be needed.