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SWEB PRIVATISATION

By Richard Paine

Richard was SWEB's Financial Director until privatization was mooted by the Board and it was thought to be prudent to engage someone with the experience of private business accounting and he was redesignated as Corporate Development Director. However he was actively involved in the privatization process and has been kind enough to detail this complex process for us.

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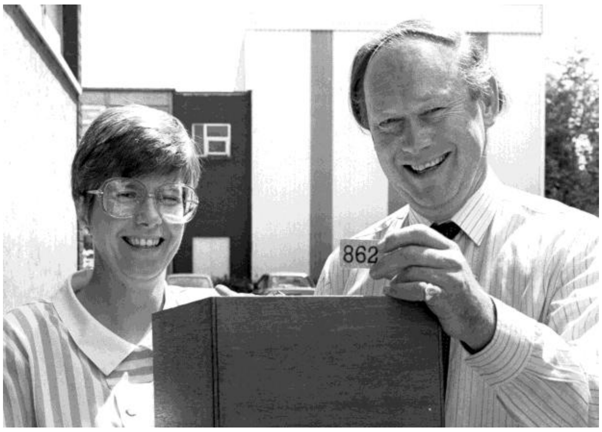
In 1985 the Directors of SWEB, led by Ken Whittle, Chairman and his deputy Brian Townsend probably thought along the lines that "Privatisation will not happen to Electricity – we give a good service to consumers and keep the lights on, we make a profit and return money to the Treasury".

SWEB Area Management (e.g. Frank Morris, Bruce Merrick, George Ashwood and John Bee) generally may have considered that Privatisation should only apply to loss-making industries. This seemed to be borne out by the Govt.'s policy in the recent past. BT had been privatised in December 1984, Gas was planned for December 1986 and Water for December 1989. Surely, it was said, the Conservative Government had enough detailed work on their hands and would have no appetite for the complicated structure of the Electricity Industry?

But we were wrong, the Prime Minister (Margaret Thatcher) was determined to get rid of Nationalised industries and develop a share-owning electorate.

In 1987 Cecil Parkinson on behalf of the Conservative Government gave a clear commitment to privatise the electricity supply industry, which led to major changes in the organisation of SWEB. With Ken Whittle's retirement and Brian Townsend's move as Chairman of Midlands, SWEB was now led by Bill Nicol (ex- LEB) and John Seed (ex- Eastern). These changes included increased control of Operations from Head Office in Bristol, and the restructure of the Shops and Contracting side of the Commercial Function.

Finally in Feb. 1988 a White Paper was published setting out the Govt.'s intentions. In contrast to BT and Gas, which were sold as single entities, Electricity was to be re-structured prior to the issue of shares and sold as several entities. It was claimed that this was to prevent a public monopoly, with the central power residing in the CEGB, becoming a private monopoly. It was further claimed that "the main beneficiaries would be the consumers"!



1. Bill Nicol with his Secretary Christine

With all these changes imminent, the new management team persuaded the Board that Electricity House was tired and old fashioned and needed refurbishment. A cost analysis was undertaken comparing a new build as against a total refurbishment of Electricity House. Eventually it was decided to build new premises at Aztec West near the M5 Motorway, and the Head Office moved there in 1989.

2. SWEB New Offices Aztec West

In the financial year 1988/89 the Electricity Bill passed through Parliament, and SWEB became

South Western Electricity plc, in preparation for flotation. There appeared the new term "PES" (Public Electricity Suppliers) and to become one, a company had to be granted two licences to be able to a) Distribute and b) Supply electricity to premises in the plc's authorised area.

In preparation for flotation, the Directors of SWE plc were involved in (almost weekly) sessions at hotels and country houses reorganising the management structure and deciding on policy and aims, advised by Merchant Bankers . For instance papers were presented by the then Finance Director, Richard Paine, on the meaning of the jargon used on the Stock Exchange and by Merchant Bankers – such as P/E Ratios, Dividend Yield, Gearing and Dividend Cover. We were advised by Rothschilds and Schroders that the dividends for future electricity companies should be covered by Historic Cost earnings by up to 2.5 times, and the P/E should be around 8 to 9, to make the shares attractive to Investors. Corporate Services under David Mutton took over the routine Accounts activity at the Plymouth office.

3. **John Seed, Deputy Chairman and later Chief Executive**

In some senses the industry was moving from an Engineering concern to a financial concern, with the emphasis on profits to keep up the Share Price and avoid take-overs. Of course the Engineering /Operations Function, with Malcolm Carson and John Spiller to the fore, was still very important. Indeed Customer Services was placed under Operations with Derek Lickorish in charge. The Commercial Function was re-structured and SWEB Retail Ltd., was formed to look after all the Shops, (without any subsidy from the Electricity business) with leading lights in the change being, Randoll Meadows, Graham Brown and Martin Jarvis. Within three years they had expanded their remit by establishing electricity superstores including 6 outside the South West area. The contracting arm of the Commercial activities became South Western Electricity (Connect) Ltd and was later sold off in a management buy-out and much later still sold to Southern Electric.

In March 1990 the Area Boards of England & Wales were changed into independent Regional Electricity Companies (RECs), the Electricity Council was mostly abolished, being temporarily replaced by the Electricity Association, and the CEGB was split into four companies. One of these was the National Grid Company, which was placed under the joint ownership of the RECs. The Government had decided ,however, that one part of CEGB – the Nuclear Power Plants – would not be privatised because of the uncertainty of selling the shares to Investors with the unknown costs of decommissioning and dealing with nuclear waste.

Many working parties were set up in the Industry to ease the transition to a limited company environment, and to deal with a potential tug-of-war between independent companies while needing to act in some areas with co-operation on agreed standards. There was also another potential conflict between the views of the RECs and those companies arising from the break-up of CEGB - Power Gen, National Power and National Grid.

On these working parties there were representatives of the Govt. (Dept. of Energy) and all the Electricity companies. All sides had their legal, accounting, engineering and financial advisers – expensive consultants! Areas covered included Pensions, Prospectus, Regional tariffs, Regulation and Ownership of Property. Also with the abolition of the Bulk Supply Tariff, a new mechanism was developed for setting wholesale Electricity prices. This included the setting up of "the electricity pool" and the complex equations of "Contracts for Differences". Nobody was given the responsibility for being "the Supplier of the Last Resort" and keeping the lights on – the Govt's. Merchant Bank advisers declared this could be left to the operation of the competitive free market in electricity! SWE itself entered the Generation field when John Bonner, the Commercial Director, negotiated a minority share in the new Gas fired Power Station on Teesside.

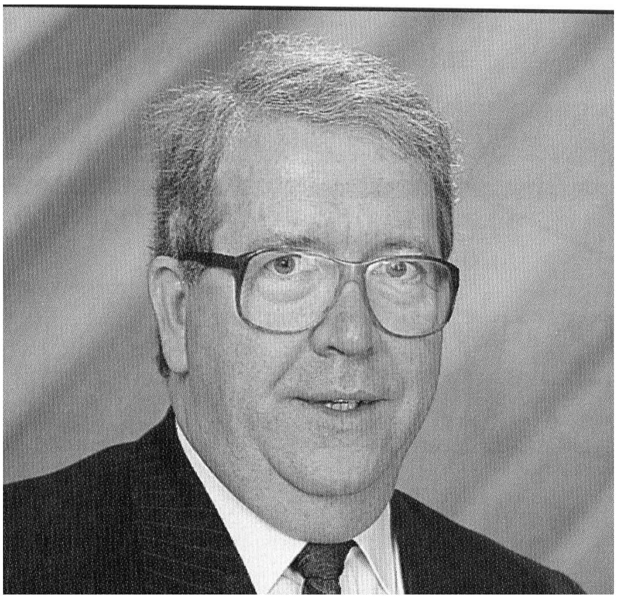
One large area of national deliberation was the Pension arrangements for the new structure of the Industry. Changes had to be made from a single Superannuation Scheme for the whole Industry to individual Pension Schemes for each REC and Generator. This change, however, had to still be within the framework of a National Scheme, mainly for the Inland Revenue purposes and to obtain tax advantages. Assets and Liabilities had to be allocated by the Actuaries, who had to estimate the Pension Fund value for each company. The Generators tended to have different aims and views to those of the RECs – so it was a tricky time. Richard Paine, by now SWEB's Corporate Development Director (CDD), represented all the RECs in these discussions.

Long discussions were held with the Unions over Pensions and their fears that private companies would in the future reduce pension benefits. In the end, the Govt., in order to avoid the possibility of a Strike upsetting the Flotation process, gave a pledge of "no detriment" to pension benefits for existing staff in the Electricity Industry – unless a majority of members in a scheme voted for change. This was a pledge the Government had not given to any other privatised industry – not even Gas or Water.

Within SWE plc there was set up early in 1990 a task force (headed by the CDD), and including members from all functions such as David Peacock and John Stanton, to produce the company's Prospectus for Sale of Shares. Valuable input was on tariffs was given by John Bonner and his Commercial staff. This work linked in with the National Committee on producing a Prospectus for all RECs and Generating companies that would use common terms and definitions, and agreed projections for future sales and earnings. This National Committee started work in May 1990 and included many expensive advisers – merchant bankers, lawyers, statisticians, etc.

Privatisation also required a change from Historic Cost Accounting (HCA) to Current Cost accounting (CCA), because it was deemed necessary to make allowance for the impact of price changes on the industry's fixed assets which had long lives and so replacement cost exceeded original costs. To judge the significance of this change, one can look at the profit figures, before taxation, for 1990/91 quoted in SWE's prospectus. Under HCA the profit was £44.9m, but under CCA it was only £18.5m – a lot more depreciation had to be charged to the Accounts. Similarly the assets were shown as £722m under HCA, and £249.6 m under CCA. The Board decided that a new Finance Director was required to handle a privatised organisation so they looked for a suitable candidate in private industry; and John Sellers was found from Range Rover. Also Chris Ecker was appointed to the new post of Treasurer within the Finance Dept.

To bring the Prospectus to "Perfection", there took place what was called "Successive Versions of the Verification Process" - in other words a hard slog going round the same items and queries time and time again. The process had to ensure that no one could question or disagree with the words and facts stated in the final Prospectus – which made for rather dull and bland reading with little to differentiate the RECs, apart from size.



4. New Finance Director John Sellers

Aspects tackled included the "exciting" ones :-

a) Should a REC be called a Group if it had subsidiaries?

b) Was a 10 year picture of past sales sufficient to give the Investor the information he required?

c) Should exceptional items be excluded from the statistics on Rate of Return?

d) How to standardise the various definitions of Switchgear and Sub- stations that different RECs used?

e) Should 8 meters on one premise be counted as 1 customer or 8?

f) By how much would Energy Efficiency reduce sales, and thus affect estimates of future profits?

g) How could SWEB's unique Load Curve and its low cover for night-load, be explained to satisfy the Investor?

h) Should SWEB strongly emphasise the seasonality of profits so that there were no surprises to Investors with the first 6months results after flotation?

Eventually it was agreed that for issues covering the Industry as a whole, the Industry Prospectus would start with a General Section. This included topics such as :-

a) An explanation of "Contracts for Differences"
b) The Regulation of Prices through the RPI +/- X +Y formula (SWE set up a section to deal with the Regulator , under the Regulation Manager Bob Westlake, within Commercial Division.)
c) The position of the National Grid Company
d) The basis of Profit Forecasts.

In the end 162 pages were required to explain these common topics. In contrast the SWE plc Prospectus only required 52 pages. The SWE board initialled their final proof on Oct.23rd 1990 and the combined Prospectus, forming the Offer for Sale of the 12 RECs, was signed off 3 days later and was ready for printing and distribution to possible Investors on Nov 21st 1990!

Application for shares had to be in by 11th Dec. The same share price 240p was set by the Govt. and its Merchant Banker advisers for all the RECs. 34.4% of the ordinary share capital was made available to the General Public (of which 4% was reserved for employees under the Free and Matching Offer). Most of the remaining shares were sold to the Financial Institutions in the UK and abroad. SWE plc issued 123.1 million shares giving an initial market capitalisation of £295.4m. Only Manweb and South Wales had less shares and hence a lower capitalisation. The shares of all RECs were heavily over-subscribed and capital gains were made by many individuals (including employees) and the financial institutions. However allotments under the Share-Save Scheme had to be significantly cut back.

5. Chairman Maurice Warren making a presentation, but he was only in the post for two years

The sale of Nat. Power and Power Gen shares was held in February 1991. The NGC, initially owned by all the RECs was also floated on the Stock Market in December 1995 as an independent company. The Government held a special share in each REC to be redeemed by 31st March 1995. By this time Bill Nicol had retired and Maurice Warren, from private Industry**,** had become Chairman with John Seed as his Chief Executive. Maurice Warren had been educated in Bristol at St. Brendan's College and trained as an accountant and had just retired as Chief Executive of Dalgety PLC. He was seen as a "local boy" and actually lived at Clevedon.

The golden share prevented any person or organisation having an interest of 15% or more of the voting share capital of a REC - thus preventing take-overs for almost 5 years. So one change was delayed, but other changes happened quite soon after Privatisation, for instance diversification into Gas (Ron Whiley) and Telecommunications (Stephen Jaggard) and buying a share in electricity generation with Teesside Power.

After the expiry of the "Golden Share", there was a flurry of take-over activity – more need for expensive Merchant Bankers and Lawyers! This led to a big reduction in the number of companies and so in 1996 South Western Electricity plc was bought by the American company, Southern Electric, described as one of the largest electric utility groups in the USA based at Atlanta, Georgia, in an uncontested take-over (despite plans having been carefully prepared on how to resist potential bidders). The existing SWE directors retired/resigned and were replaced by Americans from Southern Electric, including Gale Klapper as Chief Executive, with Mike Harreld as Finance Director and two other Americans. Three senior staff members were included on the Board of Directors, and they were Derek Lickorish, Maurice Fletcher and David Mutton, although David was to leave within a year.

6. The American Chief Executive Gale Klappa

However within three years the Americans had sold off the Billing, Retail and Contracting activities and renamed the company Western Power Distribution with Senior Engineer Robert Symons elevated to the Board as Executive Director (Ops). Robert had learnt his expertise in SWEB's Engineering Departments over many years. Later another American company Pensylvannia Power & Light (PPL), which had previously had a minority stake, acquired WPD in 2003. To their credit they agreed later to finance the large deficit in the Pension Fund.

The two licences (PES) held by each REC had become, under the Utilities Act 1999/2000, two separate businesses -- Distribution and Supply. Distribution was deemed to remain a monopoly and thus needed to be covered by Regulation in the form of RPI -X. The Supply side, however, ceased to be price regulated in this way because of the Government's view that competition would lead to lower prices or at least a restriction on increased prices. After the second American take-over the Chief Executive appointed was another American, Paul Bowers, who only stayed for one year and handed over the baton to Robert Symons. Currently there seems little or no signs of American managers, so PPL rely on home grown talent, which is good.

The SWE Supply side had been sold to London Electricity in the year 2000, which itself had become a subsidiary of Electricité de France (EDF) and this of course included the major billing establishment at Plymouth previously known as CAO. It says something for the past management of SWEB that the CAO building became the centre of billing for all the EDF enterprises in the UK.

It was decided by PPL to concentrate on the Distribution business and so give up Gas and Communications. The sale to London Electricity included the title SWEB, so a new name was given to the organisation as Western Power Distribution (WPD). However subsequently WPD bought Infralee – the South Wales distribution company, and later still took over the East and West Midlands businesses, and therefore became a major player on this side of the Electricity Industry, currently distributing to nearly 8 million customers, a considerable achievement.

Now, in 2014, the Electricity Industry – Distribution, Supply and Generation- seems to be owned more by foreign companies (French, German and American) than by British companies.

Conclusion

Have the objectives of Privatisation been achieved and are Consumers better off? It is a moot point:
a) Prices have increased.
b) There is less competition than initially because the majority of supplies are in the hands of the "Big Six" operators.
c) There are real fears of a shortage of generating plant.
d) There have been long delays in agreeing to build any new Nuclear Power stations.
e) Customers now probably have less trust in Electricity Companies than they had in nationalised Boards.
f) A significant part of the ESI is now in foreign hands allowing profits to be siphoned off abroad.

On the other hand :-
a) Privatisation of the ESI encouraged share ownership.
b) There have been significant cost and staff savings in operating the equipment and computer systems.
c) Customer services, especially in Distribution, are now more contactable quickly both on-line and by phone.
d) WPD has been acknowledged by the Regulator as the most efficient Distribution Company.

The House of Commons on Public Accounts concluded that :-
"Whilst some customers have benefited from the introduction of competition, others were worse off overall, and that OFGEM needed to ensure that the competitive market was operating in the interests of customers and that all customers were adequately informed about the choices available". Let us see whether Ofgem's referral of the "Big Six" companies to the Competition & Markets Authority (CMA) produces any action or just talk again.

The future may hold even further surprises and disappointments! ***Richard Paine***