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PRIME MINISTER

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SPECIAL SHARES IN ELECTRICITY GENERATORS

It is unfortunate that timetable constraints are forcing the privatisation of fossil fuelled generation as a duopoly. The original justification for the duopoly was that we had to build a big enough cage to hold the nuclear generators. Without that requirement, the logical form for privatisation would have been 4 or 5 generating companies, probably grouped according to the coal fields that supply them. This would have been a natural step towards the ultimate privatisation of coal.

Just as the nuclear red herring led us into the generation duopoly - the cage with no bear in it - so it is leading John Wakeham, led on by Malcolm Rifkind, into a false conclusion about special shares. It is perfectly reasonable for any newly privatised organisation to have a special share for a limited period. Management experiences a real jolt when its business goes private because alien and unfamiliar issues suddenly appear on all sides. It is therefore perfectly reasonable to allow management a breathing space of, say 5 years, to adjust to such new elements without worrying about threats from its share register. However, to make such takeover protection permanent is a totally different matter.

With the current duopoly structure, there will be many cosy anti-competitive practices carried over from the present CEGB. The newly appointed Regulator, Stephen Littlechild, will be hardput to flush them out. He will also have to be ever on his metal to dissuade new ones from coming into being. Ultimately, the competitive situation should right itself as the supply companies develop other sources of electricity,

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including power stations which they may build themselves. This natural process of evolving from a duopoly into a regime of proper competition will be totally frustrated if the big generating companies are given permanent protection from takeover.

If there is to be limited competition in the consumer market, at least let it prevail in the share market! At the end of 5 years the special share should evaporate, just as it will in the distribution companies. The risk of not setting a time limit, and leaving it to the initiative of the Secretary of State, is that it will never be the right time to lift the special share. Remember the build up of pressure over Jaguar. Because the special share had only one year left to run, it was possible to build the case that an unreal market was developing. If there had been no automatic expiry deadline, Ford and GM would not have put their energy into building up takeover proposals of the kind which ultimately prevailed.

Permanent takeover protection is bound to sustain inefficiencies. The companies will operate as though they were still state owned. There will be no automatic market discipline to examine performance or the level of their price earnings ratio. Dividends will be miserly and vast sums will be spent indulging their engineers in new power station designs. There will be a continuation of the kind of hopelessly uncommercial thinking which led to those assets, both nuclear and fossil fuelled, which it is proving so difficult to privatise.

To protect a management from its shareholders is ultimately to protect it from its customers. There is no commercial or national case for maintaining a golden share in the generating companies and the producer led arguments from Rifkind and Wakeham should be soundly trounced. The Treasury

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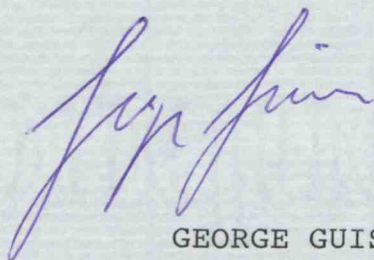
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is right to reopen the issue and the arguments in the DTI letter are excellent.

The national security case, raised in particular by Rifkind, is weak. Under emergency conditions government can take control of any strategic asset. Furthermore, the MMC is obliged to consider the national interest in assessing takeovers. It is not merely competition which it must address. A future takeover of an electricity generator would be referred to the MMC who would be obliged to consider every factor in concluding whether the bid should proceed. There are therefore adequate safeguards and the Rifkind argument is both hyperbolic and bogus.

CONCLUSION AND RECOMMENDATION

Support the retention of a special share against takeover for a period of 5 years and no longer.



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