The Government’s most ambitious and complex privatisation - the sale of the electricity industry in England and Wales - was finally completed last month when dealings commenced on the London Stock Exchange in the shares of National Power PLC and PowerGen plc, both generating companies. In November of last year the twelve regional electricity companies (RECs), which distribute electricity to customers in their twelve regions (or “authorised areas”), were floated.

Many of the most prominent names in corporate and commercial law were involved in the privatisation; they included Slaughter and May, with the central role of advising the Government; Herbert Smith, advising the twelve RECs; Linklaters & Paines and Freshfields advising National Power and Powergen respectively; and McKenna & Co advising the National Grid Company. Hundreds of individual lawyers were engaged on the project, some for over three years.

Restructuring

The reason why so many lawyers were needed was that the privatisation required a massive restructuring of the industry designed to encourage competition where feasible but to regulate prices where natural monopolies existed. It involved the old local electricity distributors, the Area Electricity Boards, being superceded by the RECs and the splitting up of the Central Electricity Generating Board, which had owned the major power stations and transmission systems, into four new companies: National Power, which inherited the major part of the CEGB’s fossil fuel (currently coal and oil) fired power stations; PowerGen, the smaller fossil fuel generator; Nuclear Electric PLC, the successor to the CEGB’s nuclear business which was to remain in the public sector; and the National Grid Company plc, the owner and operator of the national electricity transmission grid, which was to be collectively owned by the RECs through an intermediate holding company.

Legislation

The first task of the lawyers was to work on the legislation necessary to turn the CEGB and Area Boards from their old legal form as statutory corporations into public limited companies suitable for flotation.

The Electricity Act 1989 contained provisions for the reorganisation of the industry including the transfer of the property, rights and liabilities of the Area Boards and the CEGB to chosen successor companies (known as “vesting”). There were also consequential provisions enabling the Government to set the capital structure of the companies by subscribing for shares, debentures or other securities, or requiring that these be issued to it for no payment in return. Using these provisions, the Government took some £3.5 billion in debt out of the electricity companies, believing that the market would not give equivalent value for the companies with less debt. The Government also required the companies to issue complex and unique property clawback debentures under which a share of future property profits accrues to Government. Tax provisions were also needed to give these newly created companies a “tax history” and to cope with the tax consequences of vesting and the adjustments to their capital structures.
The splitting up of the CEGB in particular was a massive undertaking requiring the detailed allocation of the assets and liabilities of this multi-billion pound organisation among its successor companies. The Electricity Act left the task to be carried out in a “transfer scheme” to be made by the CEGB and approved by the Secretary of State. The transfer scheme in turn required the successor companies to enter into the hundreds of agreements, leases and licences required to implement the splitting up of the CEGB.

Regulation
The other major part of the Electricity Act concerned the regulation of the industry in its new form. This involved not only the updating of a century of electricity legislation on matters ranging from planning and compulsory purchase to the power to dig up streets to lay cables, but also the introduction of a new system of regulation through licensing. Electricity generation, transmission and supply now generally require licences under the Act, although there are a number of exemptions. Licences are granted by the Secretary of State or by the Director-General of Electricity Supply (DGES), the new industry regulator established by the Electricity Act. Licences can be lengthy and complex: in the case of the RECs and NGC, they contain regulations on pricing and other provisions such as the requirement that the licensee make its electricity transmission or distribution system available for use by third parties. The licences of the generators, whose prices are not regulated, are simpler and contain requirements to provide the DGES with information as well as regulations conferring compulsory purchase powers. The drafting of these licences was the lawyers’ next task.

Commercial arrangements
The really radical aspect of the electricity privatisation lay in fundamental changes to the industry’s commercial arrangements. Previously electricity had been generated by the CEGB as the monopoly producer, transmitted through the national grid owned and operated by the CEGB, purchased by the Area Boards on the basis of a “bulk supply tariff” (a statutory tariff set by the CEGB), and then distributed and sold to the ultimate customer by the Area Boards, who themselves charged a statutory tariff for electricity they supplied.

All this has changed. Although the RECs still have local monopolies for all except the largest customers and charge these end-users on the basis of a tariff, the generators compete with each other and they and the RECs now trade electricity through a complex spot market administered by NGC known as the pool. Prices in the pool are set half-hour by half-hour, according to supply and demand. The massive pooling and settlement agreement, which establishes the rules of this market and the procedures for the settlement of its transactions, was another major task for the privatisation lawyers. And because most pool members did not want to be left fully exposed to the uncertainties of this spot market, numerous financial hedging contracts (“contracts for differences” requiring the parties to obtain permissions under the Financial Services Act 1986) had to be negotiated.

Flotation
Only when vesting had been achieved and hundreds of commercial contracts had been signed could the new commercial regime start to operate, and the lawyers turn to the more conventional problems of flotation. Here the problems were mainly logistical - 14 newly established companies operating in a novel regime having to be simultaneously prepared for flotation, involving preparation of the prospectuses and underwriting documentation for the largest series of share offers the UK has
ever seen, with offerings in the US, Canada, Japan and Europe. As in most recent privatisations, a major marketing campaign was involved and the television, poster and press advertising will have been seen by most of the population of the country. A share information office collected the names of members of the public wishing to take part in the sales, sending them information and eventually a mini-prospectus. There were the usual incentives for qualifying applicants and there were special offers to employees and pensioners of the industry. All the marketing material and all the employee and pensioner communication had, of course, to be checked by the lawyers.

The final phase of the flotation of National Power and PowerGen was unconventional; it was achieved without the involvement of a “primary underwriter” (the merchant bank or banks normally taking the risk that an offer will not be fully sub-underwritten by City institutions). Instead, the Government’s brokers went direct to the institutions to obtain underwriting commitments, after rounds of contacts between the brokers and the institutions concerned to establish the levels of commitment that each institution would be prepared to accept. The risk that the sub-underwriting would not be completed during the course of the impact day for the offer, normally taken on by the merchant banks, was taken by the Government itself in the sense that the offer would have been aborted if appropriate legal commitments had not been obtained from the institutions during the course of impact day.

What next?

The privatisation of electricity in the UK is not yet over. The two Scottish electricity companies, Scottish Power PLC and Scottish Hydro-Electric plc, are due to be floated in May or June of this year, although this timetable would be jeopardised by a general election. Scottish Power and Hydro-Electric are vertically integrated regional monopolies in Scotland, both generating electricity and distributing it to the consumer, and are therefore very different from any of the English companies.

The privatisation of the industry in Northern Ireland is still at a relatively early stage, although the Government has announced that it proposes to separate distribution from generation and to introduce competition into the latter.

A final stage is also still to come in England and Wales. In the uncertain conditions of the early part of this year, the Government decided to retain 40 per cent. of the shares of National Power and PowerGen and has said that it will sell these shares as soon after 31st March, 1993 as circumstances permit. The Government has not ruled out a sale to a single buyer.