The sale of AEA Technology : sixtieth report, together with the proceedings of the Committee relating to the report, the minutes of evidence, and an appendix / Committee of Public Accounts.

HOUSE OF COMMONS SESSION 1997–98

COMMITTEE OF PUBLIC ACCOUNTS

Sixtieth Report

THE SALE OF AEA TECHNOLOGY

Together with the Proceedings of the Committee relating to the Report, the Minutes of Evidence, and an Appendix

Ordered by The House of Commons *to be printed*
15 July 1998

LONDON: THE STATIONERY OFFICE

£8·00

749

HOUSE OF COMMONS SESSION 1997–98

COMMITTEE OF PUBLIC ACCOUNTS

Sixtieth Report

THE SALE OF AEA TECHNOLOGY

Together with the Proceedings of the Committee relating to the Report, the Minutes of Evidence, and an Appendix

Ordered by The House of Commons *to be printed*
15 July 1998

LONDON: THE STATIONERY OFFICE
£8·00

The Committee of Public Accounts is appointed under Standing Order No. 148 viz:

Committee of Public Accounts

148.– (1) There shall be a select committee to be called the Committee of Public Accounts for the examination of the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit, to consist of not more than fifteen Members, of whom four shall be a quorum. The Committee shall have the power to send for persons, papers and records, to report from time to time, and to adjourn from place to place.

(2) Unless the House otherwise orders, each Member nominated to the committee shall continue to be a member of it for the remainder of the Parliament.

(3) The committee shall have power to communicate to any committee appointed under Standing Order No. 152 (Select committees related to government departments) such evidence as it may have received from the National Audit Office (having been agreed between the Office and the government department or departments concerned) but which has not been reported to the House.

28th October 1997

Ordered, That Standing Order No. 148 (Committee of Public Accounts) be amended, in line 7 [line 4 of this text], by leaving out the word "fifteen" and inserting the word "sixteen".

The following is a list of Members of the Committee at its nomination on 25 July 1997. The date of any later nomination, discharge or other change is shown in brackets.

Rt Hon David Davis (elected Chairman 30 July 1997)
Mr Alan Campbell
Mr Geoffrey Clifton-Brown
Mr Ian Davidson
Mr Geraint Davies
Ms Maria Eagle
Ms Jane Griffiths
Mr Phil Hope
Mr Christopher Leslie
Mr Andrew Love
Rt Hon Robert Maclennan
Ms Dawn Primarolo (added 30.10.97)
Mr Richard Page
Mr Charles Wardle
Mr Dafydd Wigley (discharged 16.12.97)
Rt Hon Alan Williams

The cost of preparing for publication the Minutes of Evidence published with this Report was £903·61.
The cost of printing and publishing this Report is estimated by The Stationery Office Limited at £2,210.

TABLE OF CONTENTS

SIXTIETH REPORT

The Committee of Public Accounts has agreed to the following Report:—

THE SALE OF AEA TECHNOLOGY

INTRODUCTION AND SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

1. In September 1996, the Department of Trade and Industry (the Department) sold their shares in AEA Technology by flotation for 280p each, raising £224 million. In addition they received £3.75 million from the company in the form of a dividend soon after the sale. On the first day of trading, the stock market valued the shares at 323.5p each, a premium of 43.5p,[1] compared with the Department's anticipated premium of 20p. Since the sale the share price has risen substantially, standing at 777.5p on 29 May 1998.[2] Advisers' costs totalled £8.1 million (excluding VAT). The Department's principal advisers were Schroders (financial adviser) and Cazenove (broker). Before the sale AEA Technology were restructured at a cost of some £121 million.[3]

2. In May 1998 the Committee took evidence from the Department on the conduct and outcome of the sale on the basis of a report by the Comptroller and Auditor General.

3. Three main points emerged from that examination:

- The Committee questions the Department's view that the sale can be regarded as a success. The larger than anticipated rise in share price on the day after the sale, and the subsequent substantial increases over and above the increase in share prices of companies in the same sector, suggest that the Department could have obtained more value for the business they sold.

- It is regrettable that the Department did not give explicit consideration to the possibility of phasing the sale. Experience, not least in previous sales handled by the Department, demonstrates that phasing can result in higher proceeds overall and our predecessors have repeatedly recommended that phasing should always be carefully considered.

- The Committee is concerned that the Department did not oversee the allocation of shares by Cazenove to institutions particularly since the institutions included three other Cazenove companies. As such allocations may result in considerable profit for those who receive the shares, it is important for vendor departments to ensure that objective criteria for allocation are published in advance of the sale and that the allocations are made in accordance with those criteria. We urge departments to exercise greater oversight of the share allocation process in future sales.

4. We look to departments to have regard to these points and to ensure that sales teams and steering groups overseeing sales include individuals with relevant and up to date sales experience.

5. Our more specific conclusions and recommendations are:

on the proceeds from the sale

(i) We note the increase in share price from 280p to 323.5p on the first day of trading and the very substantial increase since. We are not convinced by the Department's explanation that this increase was unforeseeable and attributable either to a general increase in share prices or the unforeseeable market reaction to eight acquisitions made

---

[1] C&AG's Report HC 618, 1997–98, paragraph 1.20
[2] Financial Times
[3] C&AG's Report paragraphs 1–3, Figure 7

between December 1996 and February 1998. We note that a significant rise in share price (see Figure 1, p6), above general market increases, took place before any acquisitions were made (paragraph 24).

(ii) We are surprised at the Department's conclusion that the rise in share price before acquisitions was attributable to the care with which the management of the privatised company explained their plans to the market following the sale. We also note that the first acquisition was made within three months following the sale. We would have expected the Department's advisers to have identified these business opportunities and to have used them as a selling point in marketing the company (paragraph 25).

(iii) We note that a retained holding of 40 per cent of shares would at 29 May have been valued by the market at around £250 million compared with £90 million at the sale price. This demonstrates the significant potential value for money advantages of phasing (paragraph 26).

(iv) In view of the repeated recommendations of this Committee that departments should give careful consideration to phasing, especially where shares are difficult to price, we are surprised that the Department did not, in this case, give explicit consideration to phasing (paragraph 27).

(v) We consider that the Department should have put the option of phasing to Ministers and we do not consider it relevant for the Department to pray in aid ministerial statements made during the passage of the Atomic Energy Bill in May and July 1995 against retaining a majority shareholding on a long term basis. There is a clear distinction between such a policy and an announced policy of retaining a proportion of shares to sell later when their value is established in the market. Nor are we convinced that such a statement would have posed insuperable difficulties in the market in the run up to the Election (paragraph 28).

(vi) We also find unconvincing the Department's contention that they did not give explicit consideration to phasing because they saw no value for money case for it. There is ample evidence from previous sales of the significant value for money benefits of phasing. This underscores that phasing needs to be considered carefully, and makes it all the more surprising that the Department did not consult their advisers or experts in the Treasury about the matter (paragraph 29).

(vii) We note that, in setting the sale price at 280p a share, the Department sought indications from institutions of how many shares they would be prepared to buy over a range of prices (bookbuilding). When bookbuilding is carried out rigorously departments can set the sale price based on a clear picture of demand for shares at various prices and based on evidence of the price at which demand falls away. But in this case, the range over which they sought bids was narrower than average and the top of the range was 280p. They therefore had no clear picture of the extent of demand at prices above 280p, the eventual share price. On the day after the sale shares traded at 323.5p, a premium of 43.5p. If the sale had achieved a price of 323.5p, an additional £35 million of proceeds would have been obtained (paragraph 30).

(viii) We are not convinced by the reasons the Department gave for a narrow price range. We consider that, as the company was difficult to value, a wider range was more likely to capture the market price. Adverse reaction to a very much wider than average range used in the sale of British Energy is a reason for a range narrower than the very wide range used in that sale, not necessarily a range narrower than average (paragraph 31).

(ix) We also note that, at the time the range was set, there was significant evidence of substantial early demand. We note that five institutions declined to bid at 280p but we do not agree with the Department that this was evidence that 280p was the right price. Five was a small number compared to the 148 who did bid at 280p and represented a very modest overall drop in demand (paragraph 32).

(x) Nor are we impressed by the contention that through informal contacts Cazenove assessed that demand would fall off sharply at prices above 280p. This was not tested during bookbuilding. In addition, the share price of 323.5p on the first day of trading indicates to us that demand would not have fallen substantially at prices just above 280p (paragraph 33).

(xi) We consider that the failure to identify the full extent of demand above 280p using the bookbuilding procedure represents a weakness in the way that bookbuilding was applied in this case. We recommend that departments should conduct bookbuilding rigorously so as to give as good an indication of likely demand at different prices as possible and should take care that the top of the indicative price range they give to potential investors should not constrain the eventual price set (paragraph 34).

on the Department's advisers

(xii) We are concerned that, contrary to established good practice, the Department did not play any part in the allocation of shares by Cazenove to institutions which included Cazenove and Schroders companies. As such allocations may result in considerable profit for those who receive the shares, overseeing allocations based on objective criteria published in advance of the sale is good practice (paragraph 41).

(xiii) We note that, as part of their remuneration, Schroders received a success fee based on the extent to which proceeds exceeded a valuation they themselves had made before they were appointed. We consider that when setting the basis of advisers' success fees it is not sufficient to rely on valuations made by advisers themselves before they are appointed and when they do not have a clear idea of the business or its potential. We reiterate our predecessor's recommendation that where valuations are used as a reference point for success fee payments for the body carrying out the valuation, the valuation should be checked by an independent party who is aware of this intention (paragraph 42).

on restructuring costs

(xiv) We note the Department's view that the £121 million that it cost to restructure AEA Technology and separate them from the United Kingdom Atomic Energy Authority before the sale should not be treated as sale costs because restructuring and separation would have been necessary even if AEA Technology had been retained in the public sector (paragraph 50).

(xv) We are not convinced by this argument: without rationalisation the business was unsaleable and additional funding for rationalisation was justified by the Department by reference to the impact they expected rationalisation to have on the sale. It is unacceptable for departments to seek to inflate net sale proceeds by ignoring expenditure related to the sale (paragraph 51).

(xvi) We note that one of the objectives of rationalisation was to put in place a new financial management information system. We are concerned that deficiencies in this system were not discovered until a late stage and that this delayed the sale by six months. We note that this was attributable to AEA Technology not having the finance staff with the necessary expertise. In the future, we look to vendor departments to ensure that finance staff with the required expertise are in place in time to provide the financial data required by the market for privatisation (paragraph 52).

on the experience of the team handling the sale

(xvii) We are surprised at the lack of experience of the Department's team managing this sale and at their failure to seek the Treasury's advice on key issues such as phasing and allocation, particularly in view of the wealth of experience in handling sales that there now is in the public sector and the expertise that resides in the Treasury. We look to departments to ensure that sales teams, as well as steering groups overseeing sales,

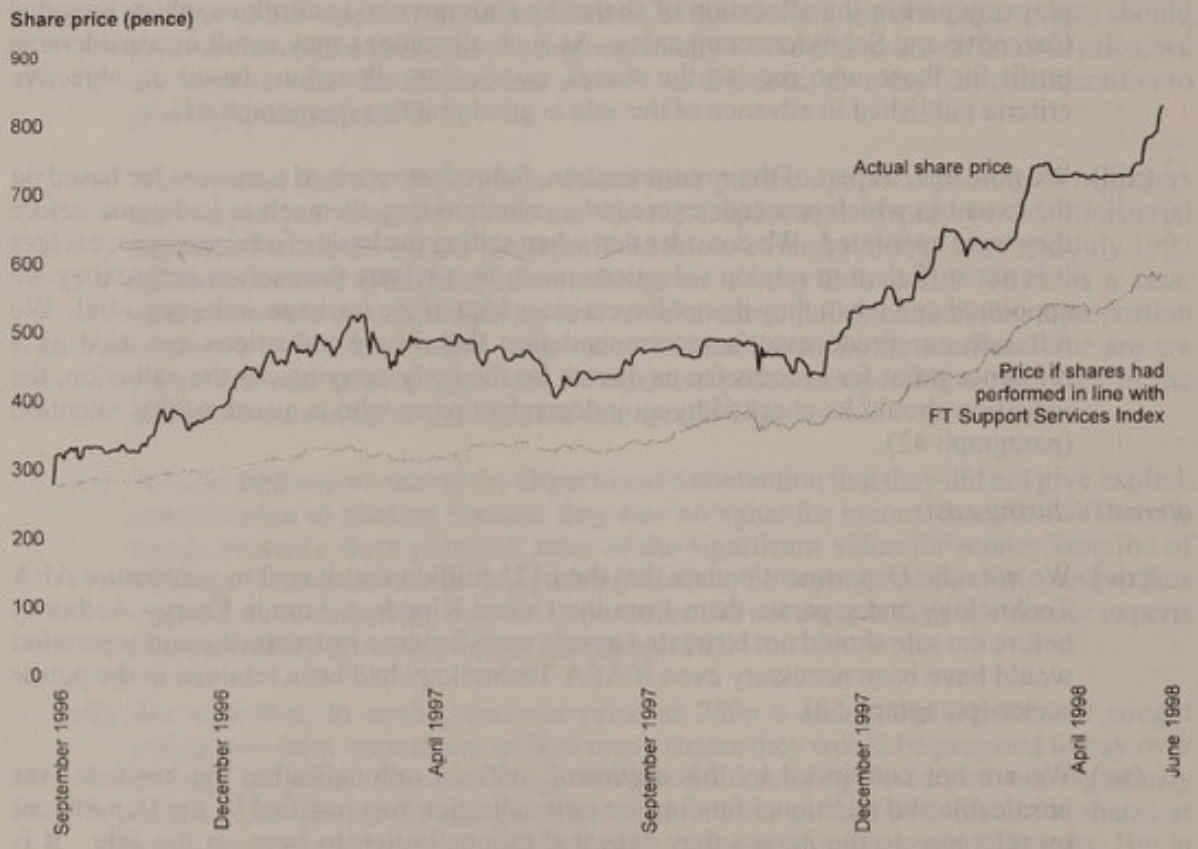
include individuals with relevant and up to date sales experience (paragraph 56).

PROCEEDS

Share Price

6. The Department sold all their shares in AEA Technology for 280p each on 25 September raising £224 million. On the day after the sale, shares traded on the London Stock Exchange at 323.5p, a premium of 43.5p (16 per cent) compared with the Department's anticipated premium of 20p (7 per cent). Since the sale the share price has increased substantially, outperforming by a significant margin the FT Support Services Index (Figure 1).[4] At 29 May, the shares stood at 777.5p, 34 per cent higher than they would have been if they had performed in line with the FT Support Services Index.[5]

Figure 1: AEA Technology's share price compared with the FT Support Services Index



Source: Published stock market prices

7. The Department told us that the sale was a success and that fair value was obtained for the business as it stood.[6] They suggested that the increase in share value since the sale was attributable to two unforeseeable factors, a general increase in share prices in the support services sector and the impact of eight acquisitions made since the sale, the first being BR Research, purchased in December 1996 and the last being Nycomed Amersham Industrial Division in February 1998 (Figure 2) with most of the growth attributable to the acquisitions.[7]

[4] C&AG's Report para 1.20
[5] Financial Times
[6] Qs 135,137
[7] Qs 203–204

Figure 2: Acquisitions/Joint Ventures by AEA Technology

Date	Company acquired
[26 September 1996]	[AEA Technology sold]
December 1996	BR Research
January 1997	Advanced Scientific Computing
January 1997	Safeguard International
March 1997	Joint Venture with Sumitomo Corporation
July 1997	Hyprotech
September 1997	ERG Environmental Resource Group
February 1998	nCode International
February 1998	Nycomed Amersham Industrial Division

Source: Department of Trade and Industry

8. The Department told us that the acquisitions changed the character of the company very substantially. For example, the company now have a substantial software business in North America. The Department told us that none of the increase in share value arising from these acquisitions was predictable. It would have been possible for the acquisitions to be unsuccessful.[8]

9. We therefore asked why, if most of the growth in share price was on account of the acquisitions, AEA Technology's share price had substantially outperformed the FT Support Services Index in the three months after the sale but before the acquisitions were made. For example, by 28 November 1996, before the first acquisition in December 1996, AEA Technology's share price had already risen to 386.5p, 30 per cent higher than if it had increased in line with the FT Support Services Index.[9] The Department told us that, although they had no responsibility for the company after the sale, they believed that in the months following the sale the management was assiduous in talking to their shareholders and explaining to them their plans as they gradually began to develop.[10]

Phasing the sale

10. We have urged on a number of occasions that, especially where shares are difficult to value, departments should consider selling them in phases. For example, retaining 40 per cent of shares in National Power and PowerGen for sale led to increased proceeds of £2,300 million.[11] In response to our predecessors' report on the sale of National Power and PowerGen[12] the Department agreed that consideration should always be given to the possible benefits arising

[8] Qs 16–18, 55–57, 200–204
[9] Published stock market prices
[10] Qs 205–210
[11] C&AG's Report para 3.2
[12] HC 298, 1992–93

from a phased sale.[13]

11. In the case of AEA Technology, the Department sold 100 per cent of their shares even though the shares were difficult to value. They did not investigate the case for phasing and, in particular, whether phasing might generate additional proceeds. Given the increase in the price of shares since the sale and, assuming that a decision to retain the shares in Government hands to sell later would have had no material impact on the development of the company or the attitude of their institutional investors, a retained holding of 40 per cent of shares at 29 May 1998 would have been worth some £250 million[14] compared with £90 million at the 1996 sale price.

12. The Department told us that they did not consider phasing the sale because it was the policy of the Government that AEA Technology should be sold in one go.[15] When the Atomic Energy Authority Bill was being debated in 1995[16] Ministers rejected an amendment proposing that not more than 50 per cent of AEA Technology should be sold.[17]

13. We asked why the Department regarded this long term ownership policy as inconsistent with retaining a minority shareholding with the stated purpose of selling the holding later to obtain best possible proceeds. The Department told us that Ministers had said in debate that full commercial freedom was not consistent with a degree of public ownership. The Department considered that phasing was not consistent with this policy.[18]

14. The Department told us that they understood phasing to require a substantial proportion of shares to be held for some time. If they had kept back a proportion of shares they would have had to explain in the prospectus what the policy was for disposal or holding of the shares. With the imminence of a General Election the Department considered this would have been difficult and might have made a sale impossible.[19]

15. We asked the Treasury what advice they had given to the Department on phasing. The Treasury told us that they saw their role as bringing to bear their experience and giving general advice. They do not seek to double-guess departments and any decision is a matter for departments. In this case the Treasury accepted that it was a policy decision to sell the company.[20]

16. The Accounting Officer told us that he did not seek a Direction from Ministers because the Department saw no value for money implications in the decision to sell 100 per cent of the shares. The Department had not thought that a phased sale would be successful because they regarded the sale prospects for a company with a limited track record, heavily dependent on government work, as fragile. The sale also followed the sale of British Energy which the market had not regarded as a great success. In the view of the Department, a retained holding would have complicated the sale. They believed that it would also have been difficult to write a convincing prospectus saying what would be done with the retained shares given the imminence of a General Election.[21]

17. The Department did not raise the question of phasing with Ministers as they believed it would be academic to do so. They told us, however, that it would have been better if the Department had written a paper setting out the case against phasing.[22]

---

[13] Cm 2279, 1992–93
[14] 32 million shares @ £777.5p each
[15] Q2
[16] Official Report 2 May 1995 col 175–192, 17 July col 82–102
[17] Qs 45–46
[18] Qs 118–119
[19] Qs 120–121
[20] Qs 123–125
[21] Qs 3, 49–50, 106
[22] Q70–72, 105

Setting the share price

18. The Department set the price for shares following a process of obtaining bids from the market (known as bookbuilding). The purpose of bookbuilding is to establish how many shares institutions would purchase at a range of prices. When bookbuilding is applied rigorously the price at which demand falls off is clearly identifiable and the vendor can then judge the price which strikes a balance between obtaining the best possible proceeds and giving investors a reasonable premium in the aftermarket. There is no standard price range over which institutions are asked to bid. Ranges are determined by a number of factors including the particular circumstances of the business for sale.[23]

19. The price range chosen for AEA Technology, 30p, (240p-270p, later revised to 250p to 280p) was, however, narrower than the average of ranges used in flotations from December 1995 to September 1996. The top of the range was initially set at 270p on the advice of Schroders and Cazenove who considered that the objective should be to achieve a final price at the top of the range to indicate to the market that there was strong demand for the shares at that level. They thought that pushing the price range higher than 270p would run the risk of falling short of that objective. In view of the demand indicated during bookbuilding, however, the indicative price range was raised to 250p-280p the day before the close of the offer.[24]

20. Demand surged very considerably at the end of the sale process with 68 of the 148 eventual institutional investors making their bids in the last two days of the bidding process. On the first day of trading, shares were valued by the market at 323.5p compared to the sale price of 280p.[25] If the sale price of 323.5p had been achieved, an additional £35 million proceeds would have been obtained.[26]

21. We asked why the Department only took soundings of demand on prices up to 280p. They told us that they made their decision based on advice from Cazenove and Schroders that they would get better value from the sale if they used an indicative price range of 30p (12½ per cent). British Energy had been sold with a much wider range (55 per cent) and Cazenove's and Schroders' view was that this had not assisted the market's reception of that sale.[27]

22. We also asked whether there had not been indications at an early stage that the Department was underestimating the value of the company. There was substantial demand at 9 September before the prospectus was published and before the price range was set (Figure 3). At that date fifteen bids had already been received, covering one fifth of shares. The Department told us that there was strong resistance in the market to any price above 265p a week before the sale and they understood that a number of potential buyers had capped their bids at 280p.[28]

Figure 3: Demand for shares at 6 September 1996

Price (p)	Amount (£m)	No. of shares	% of 72m shares
240	-		
250	65.79	26,316,000	36.5
260	49.79	19,150,000	26.6
270	39.79	14,737,037	20.5

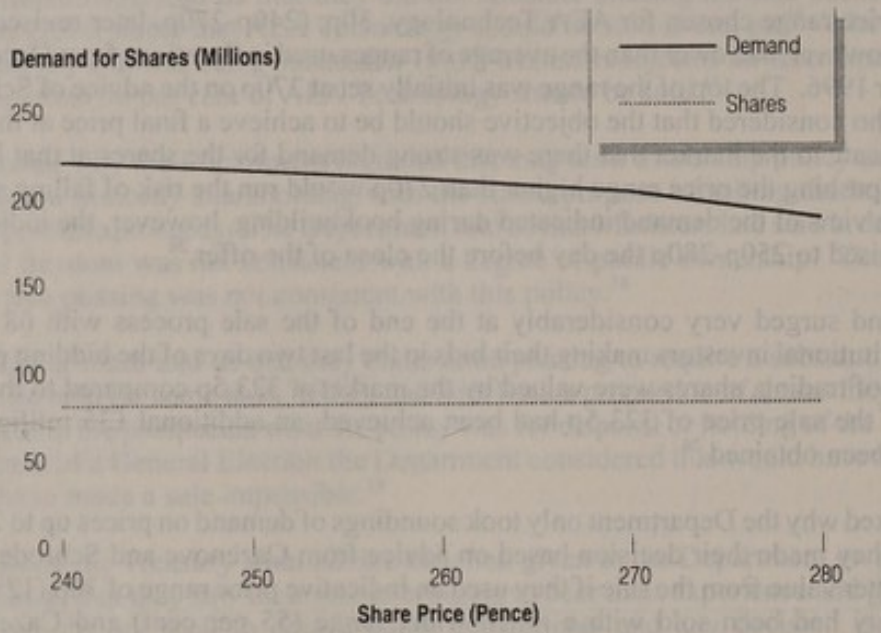
Source: NAO Report

23. Demand at prices of 240p to 280p was substantially greater than the number of shares available and bookbuilding had not indicated the point at which demand for shares fell away (Figure 4). The Department confirmed that there was no formal testing of prices above 280p.

[23] C&AG's Report paras 3.15–13.16, 3.21
[24] ibid paras 3.21–3.22
[25] ibid paras 3.14, 3.28–3.29
[26] 80 million shares @ 43.5p
[27] Qs 4, 109
[28] Qs 115–116

Informal contact by Cazenove indicated to them that institutions were not prepared to pay more than 280p and that there was a precipice beyond 280p where demand would fall away substantially. Five institutions who bid at 270p dropped out at 280p. The Department therefore took the view that they would have obtained lower proceeds if they had adopted a higher indicative price range.[29]

Figure 4: AEA Technology final institutional demand for shares



Source: NAO Report

This shows that the price at which demand would have fallen substantially was not shown by the bookbuilding exercise.

Conclusions

24. We note with concern the increase in share price from 280p to 323.5p on the first day of trading and the very substantial increase since. We are not convinced by the Department's explanation that the increase in share price was unforeseeable and attributable either to a general increase in share prices or the unforeseeable market reaction to eight acquisitions made between December 1996 and February 1998. We note that a significant rise in share price, above general market increases, took place before any acquisitions were made.

25. We are surprised at the Department's unreflecting conclusion that the rise in share price before acquisitions was attributable to the care with which the management of the privatised company explained their plans to the market following the sale. We also note that the first acquisition was made within three months following the sale. We would have expected the Department's advisers to have identified these business opportunities and to have used them as a selling point in marketing the company.

26. We note that a retained holding of 40 per cent of shares would at 29 May have been valued by the market at around £250 million compared with £90 million at the sale price. This demonstrates the significant potential value for money advantages of phasing.

[29] Qs 115–116, 153–160

27. In view of the repeated recommendations of this Committee that departments should give careful consideration to phasing, especially where shares are difficult to price, we are surprised that the Department did not, in this case, give explicit consideration to phasing.

28. We consider that the Department should have put the option of phasing to Ministers and we do not consider it relevant for the Department to pray in aid ministerial statements made during the passage of the Atomic Energy Bill in May and July 1995 against retaining a majority shareholding on a long term basis. There is a clear distinction between such a policy and an announced policy of retaining a proportion of shares to sell later when their value is established in the market. Nor are we convinced that such a statement would have posed insuperable difficulties in the market in the run up to the Election.

29. We also find unconvincing the Department's contention that they did not give explicit consideration to phasing because they saw no value for money case for it. There is ample evidence from previous sales of the significant value for money benefits of phasing. This underscores that phasing needs to be considered carefully, and makes it all the more surprising that the Department did not consult their advisers or experts in the Treasury about the matter.

30. We note that, in setting the sale price at 280p a share, the Department sought indications from institutions of how many shares they would be prepared to buy over a range of prices (bookbuilding). When bookbuilding is carried out rigorously departments can set the sale price based on a clear picture of demand for shares at various prices and based on evidence of the price at which demand falls away. But in this case, the range over which they sought bids was narrower than average and the top of the range was 280p. They therefore had no clear picture of the extent of demand at prices above 280p, the eventual share price. On the day after the sale shares traded at 323.5p, a premium of 43.5p. If the sale had achieved a price of 323.5p, an additional £35 million of proceeds would have been obtained.

31. We are not convinced by the reasons the Department gave for a narrow price range. We consider that, as the company was difficult to value, a wider range was more likely to capture the market price. Adverse reaction to a very much wider than average range used in the sale of British Energy is a reason for a range narrower than the very wide range used in that sale, not necessarily a range narrower than average.

32. We also note that, at the time the range was set, there was significant evidence of substantial early demand. We note that five institutions declined to bid at 280p but we do not agree with the Department that this was evidence that 280p was the right price. Five was a small number compared to the 148 who did bid at 280p and represented a very modest overall drop in demand.

33. Nor are we impressed by the contention that through informal contacts Cazenove assessed that their demand would fall off sharply at prices above 280p. This was not tested during bookbuilding. In addition, the share price of 323.5p on the first day of trading indicates to us that demand would not have fallen substantially at prices just above 280p.

34. We consider that the failure to identify the full extent of demand above 280p using the bookbuilding procedure represents a weakness in the way that bookbuilding was applied in this case. We recommend that departments should conduct bookbuilding rigorously so as to give as good an indication of likely demand at different prices as possible and should take care that the top of the indicative price range they give to potential investors should not constrain the eventual price set.

ADVISERS

Allocation of shares

35. Demand for shares at 280p each greatly exceeded the 80 million shares available (Figure 4) making it likely that there would be a premium in the aftermarket and that there was potential for considerable profits to be made from any shares allocated. Contrary to the usual practice in privatisations, the Department did not monitor the process of allocating shares to institutions by

their broker Cazenove, including allocations made to three Cazenove companies and one to a Schroders company.[30]

36. The allocation used Cazenove's standard allocation criteria, although these were not set out in writing or published in advance. Neither was a specific weighting given to each of the criteria, this made the allocation itself a matter of judgement. By July 1997, companies owned by Schroders and Cazenove (Schroders Investment Management and Cazenove Fund Management) had purchased 13.35 per cent and 4.74 per cent respectively of AEA Technology's shares.[31]

37. Each of the four Executive Directors of AEA Technology also applied for shares at the full price and with no preference or priority. Each was allocated around 36 per cent of the amount they applied for, the average for institutional investors. This was in addition to shares they obtained preferentially on the same basis as other employees of AEA Technology (Figure 5).[32]

Figure 5: Share Allocations to Directors of AEA Technology

Directors	Number of shares applied for	Number of shares allocated	Cost of shares allocated
Sir Anthony Cleaver	35,714	13,020	£36,456
Dr Peter Watson	71,429	26,050	£72,940
Ray Proctor	4,286	1,560	£4,368
Michael Watson	1,429	520	£1,456

Source: Department of Trade and Industry

38. Since the rise in value of the shares owned by Schroders and Cazenove companies far exceeded the fees they received from the Department as advisers, we asked what safeguards there had been to ensure that Schroders' and Cazenove's advice to the Department on pricing the shares was free from conflict of interest. The Department told us that the shares held by Schroders and Cazenove were held by separate companies on behalf of clients such as charities, trust funds and pension funds. Cazenove separated their merchant bank operation from their investment management operation. This was common place in the market and accepted by the regulators. The Department accepted, however, that they should have been involved in the allocation of shares to these companies. The Treasury Officer of Accounts confirmed that this was good practice.[33]

Success fee

39. Part of Schroders' remuneration (£2.55 million), as financial adviser to the Department, was a success fee of £1.99 million. This was based on their own valuation of the company which was not reviewed by an expert third party. The Department agreed with Schroders that the success fee should be a minimum of £1.05 million if proceeds were obtained equal to the mid-point of Schroders' valuation, increasing to a maximum of £2 million if higher proceeds were obtained.[34]

[30] C&AG's Report paras 3.32–3.35, Figure 11
[31] ibid paras 1.20, 3.36
[32] Evidence, Appendix 1, p19
[33] Qs 6, 21–29, 58–61, 161–181
[34] C&AG's Report. Figure 7, paras 2.23–2.28

40. The Department told us that they did not think it necessary to seek an independent view of the valuation on which Schroders' success fee was based. They chose Schroders as advisers at the end of a competition during which each of the competitors suggested a methodology for valuing the company. They compared these methodologies and Schroders' was similar to the others.[35]

Conclusions

41. We are concerned that, contrary to established good practice, the Department did not play any part in the allocation of shares by Cazenove to institutions which included Cazenove and Schroders companies. As such allocations may result in considerable profit for those who receive the shares, overseeing allocations based on objective criteria published in advance of the sale is good practice.

42. We note that, as part of their remuneration, Schroders received a success fee based on the extent to which proceeds exceeded a valuation they themselves had made before they were appointed. We consider that when setting the basis of advisers' success fees it is not sufficient to rely on valuations made by advisers themselves before they are appointed and when they do not have a clear idea of the business or its potential. We reiterate our predecessor's recommendation that where valuations are used as a reference point for success fee payments for the body carrying out the valuation, the valuation should be checked by an independent party who is aware of this intention.

RESTRUCTURING

43. Restructuring AEA Technology between April 1994 and March 1996, and separating them from the United Kingdom Atomic Energy Authority before the sale, cost £121 million. Most of the money was spent on premature retirements and redundancy and on relocation costs. One of the objectives of rationalisation had been to improve accounting systems. In December 1995, however, after the bulk of the restructuring, a report indicated very serious shortcomings in AEA Technology's financial management information. Schroders concluded that the company could not be floated by the then target date of June 1996 because AEA Technology's financial information would not meet the standards required by the London Stock Exchange.[36]

44. In February 1996, AEA Technology's plan to meet these problems, including the secondment of two senior staff from Coopers and Lybrand to improve the finance functions, was implemented and the issues were resolved to a point where the Department felt the flotation could proceed. One lesson to be drawn from AEA Technology's experience is that it can be difficult and time consuming to recruit finance staff with appropriate experience at a time when future ownership of an organisation is uncertain. In AEA Technology's case, this resulted in difficulties in producing robust financial information on a timely basis at a key stage in the sale process.[37]

45. The Department told us that they were aware of the existence of these problems but not of their seriousness until a report was delivered to them in December 1995. They said they had then taken rapid action to remedy the deficiencies and that privatisation had been postponed by only six months as a result.[38]

46. Without rationalisation AEA Technology was unsaleable and in December 1995 the Department justified additional funding for the rationalisation by reference to the impact they expected the rationalisation to have on the sale.[39]

---

[35] Qs 7–8
[36] C&AG's Report paras 2.2–2.3, 2.11–2.12, Figure 5
[37] ibid paras 2.13–2.15
[38] Q10
[39] C&AG's Report paragraph 3

47. We therefore asked why the Department did not regard these rationalisation costs as costs of sale. The Department told us that the costs should not be regarded as sale costs because restructuring would have been necessary even if AEA Technology had remained in the public sector.[40]

48. We asked whether the decision to sell the company precipitated the restructuring. The Department said that the restructuring would have taken place anyway and was part of a longer term programme designed to improve competition for decommissioning services. Competition was likely to reduce decommissioning costs substantially, perhaps by as much as 25 per cent. In 1994, decommissioning costs were expected to total £9 billion and in 1997 they were shown to total £7.2 billion. Although this was not purely attributable to the restructuring of AEA Technology, the Department consider that the restructuring of AEA Technology played a significant part.[41]

49. We asked whether the saving in decommissioning costs would have occurred if AEA Technology had not been privatised. The Department told us that savings would have been smaller under Government ownership because competitors would not believe there was real competition. If the Government was both placing the contract and owning the company with whom the contract was placed, competitors would consider that the competition was fixed.

Conclusions

50. We note the Department's view that the £121 million that it cost to restructure AEA Technology and separate them from the United Kingdom Atomic Energy Authority before the sale should not be treated as sale costs because restructuring and separation would have been necessary even if AEA Technology had been retained in the public sector.

51. We are not convinced by this argument: without rationalisation the business was unsaleable and additional funding for rationalisation was justified by the Department by reference to the impact they expected rationalisation to have on the sale. It is unacceptable for Department's to seek to inflate net sale proceeds by ignoring expenditure related to the sale.

52. We note that one of the objectives of rationalisation was to put in place a new financial management information system. We are concerned that deficiencies in this system were not discovered until a late stage and that this delayed the sale by six months. We note that this was attributable to AEA Technology not having the finance staff with the necessary expertise. In the future, we look to vendor departments to ensure that finance staff with the required expertise are in place in time to provide the financial data required by the market for privatisation.

EXPERIENCE OF THE DEPARTMENT'S TEAM

53. The Department's staff handling the sale were experienced in matters relating to the business of the United Kingdom Atomic Energy Authority and in trade sales. This was important because much of the preparation of the business for sale required a good understanding of the business and because a trade sale was seen initially as the most likely method of sale. The team as a whole, however, had no previous experience of handling a flotation. They had access to advisers from senior management and others in the Department, the Treasury privatisation team and their own advisers.[42]

54. The Department told us that one member of the steering committees overseeing the sale had experience of sales, but Britoil was the only share sale.[43]

55. In response to our 13th Report, Session 1989–90, the Treasury undertook to be involved in all privatisations and offer advice. We asked whether the Treasury official on the sale steering

---

[40] Q127
[41] Qs 13–15, 62–65, 126–129
[42] C&AG's Report paras 1.10–1.11
[43] Q9

committees gave any advice on share allocation and phasing. The Treasury said that their representative on the sale steering committees was in contact with colleagues in the Treasury who had been involved in other privatisations but that the Treasury had not been approached for advice on the procedures to follow in relation to allocations and had not given advice on phasing.[44]

Conclusion

56. We are surprised at the lack of experience of the Department's team in managing this sale and at their failure to seek the Treasury's advice on key issues such as phasing and allocation, particularly in view of the wealth of experience in handling sales that there now is in the public sector and the expertise that resides in the Treasury. We look to departments and the Treasury to ensure that sales teams, as well as steering groups overseeing costs, include individuals with relevant and up to date sales experience.

[44] Qs 123–125, 177–180

PROCEEDINGS OF THE COMMITTEE RELATING TO THE REPORT

Session 1997–98

MONDAY 18 MAY 1998

Members present:

Mr David Davis, in the Chair

Mr Alan Campbell	Mr Christopher Leslie
Mr Geoffrey Clifton-Brown	Mr Andrew Love
Mr Geraint Davies	Mr Robert Maclennan
Ms Maria Eagle	Mr Alan Williams

Sir John Bourn, KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Jamie Mortimer, Treasury Officer of Accounts, was further examined.

The Comptroller and Auditor General's report on the Sale of Atomic Energy Authority Technology (HC 618) was considered.

Mr Michael Scholar, Permanent Secretary, and Mr Neil Hirst, Director, Nuclear Industries Directorate, the Department of Trade and Industry; and Mr Richard Lazarus, Director, J Henry Schroder & Co Ltd (Advisers to DTI on the Sale of AEA Technology) were examined (HC 749-i).

Mr David Clarke, Director, the National Audit Office and Mr Ben Prynn, the Private Finance Unit, HM Treasury, were examined (HC 749-i).

* * * * *

[Adjourned till Wednesday 20 May at half past Four o'clock.

* * * * *

Session 1997–98

WEDNESDAY 15 JULY 1998

Members present:

Mr David Davis, in the Chair

Mr Alan Campbell	Mr Christopher Leslie
Mr Geoffrey Clifton-Brown	Mr Andrew Love
Mr Geraint Davies	Mr Robert Maclennan
Ms Jane Griffiths	Mr Charles Wardle
Mr Phil Hope	Mr Alan Williams

Sir John Bourn, KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

* * * * *

Draft Report (The Sale of AEA Technology), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 4 read and agreed to.

Paragraph 5 postponed.

Paragraphs 6 to 56 read and agreed to.

Postponed paragraph 5 read and agreed to.

Resolved, That the Report, as amended, be the Sixtieth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

* * * * *

[Adjourned till Wednesday 22 July at half past Four o'clock.

MINUTES OF EVIDENCE

TAKEN BEFORE THE COMMITTEE OF PUBLIC ACCOUNTS

MONDAY 18 MAY 1998

Members present:

Mr David Davis, in the Chair

Mr Alan Campbell	Mr Christopher Leslie
Mr Geoffrey Clifton-Brown	Mr Andrew Love
Ms Maria Eagle	Mr Alan Williams

SIR JOHN BOURN, KCB, Comptroller and Auditor General, and MR DAVID CLARKE, National Audit Office, were further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL DEPARTMENT OF TRADE AND INDUSTRY: SALE OF AEA TECHNOLOGY: HC 618

Examination of witnesses

MR MICHAEL SCHOLAR CB, Permanent Secretary, Department of Trade and Industry, and MR NEIL HIRST, Director, Nuclear Industries Directorate, Department of Trade and Industry, and MR RICHARD LAZARUS, Director, J Henry Schroder & Co Ltd, were examined.

MR JAMIE MORTIMER, Treasury Officer of Accounts, and MR BEN PRYNN, Treasury Officer of Accounts, HM Treasury, was further examined.

Chairman

1. This afternoon the Committee is hearing evidence on the C&AG's investigation of the sale of AEA Technology. The Accounting Officer is Michael Scholar from the Department of Trade and Industry. Welcome to the first time in front of this Committee, Mr Scholar. Perhaps you could introduce your two colleagues to us before we start the questions.

(Mr Scholar) Thank you very much, Mr Chairman. On my left is Neil Hirst, who is the Director, Nuclear Industries, DTI, and on my right is Richard Lazarus who is a Director of Schroders, one of our advisers.

2. Thank you. We will go straight into the questions. Paragraph 12 of the Report says that if you held on to 40 per cent of AEA Technology's shares they would now be worth over £100 million more than you sold them for. I think actually in today's money that is something like £130 million. I see from paragraph 3.5 that you did not investigate the case for phasing the sale in July 1996 when you decided to proceed with floatation. Paragraph 3.4 gives some reasons for not selling the shares in stages. Were these not rationalisations after the event?

(Mr Scholar) No, I do not think they were. It was a fixed policy for the Government at the time that we should sell AEA Technology in one go cleanly. It was well understood by officials that that was Ministers' intention and therefore the possibility of phasing was not explicitly considered by the Department.

3. As the Accounting Officer did the Accounting Officer consider the value for money implications of that and seek a direction?

(Mr Scholar) The view at the time was that no value for money implications arose because it was felt that a phased sale would not offer any significant advantages, as the Report makes clear, and, indeed, that a phased sale might be to the disadvantage of the Exchequer.

4. There were a number of Committee of Public Accounts Reports prior to that date saying somewhat different but I think others will pick that up. Paragraphs 3.21 to 3.23 show that even though the company was difficult to value the Department sought indications of demand over a range of prices that were narrower than average. Paragraphs 3.26 to 3.29 show that the market valued the shares at 323.5p on the first day of trading but you only took soundings as to demand at a range of prices up to 280p. Why was that?

(Mr Scholar) The view that we took at the time based on the advice that we had from our advisers was that we would get better value from the sale if we worked on the basis of a 30 pence range which was a 12 and a half per cent range. A number of other issues at that time were sold in roughly that range. Before that British Energy had been sold with a much wider range and the feeling in the market at the time was that that had not assisted in the market reception to that sale, so we decided to operate on the basis of a narrower range. There was, as you said Mr Chairman, a larger premium in the first day's trading than we had expected.

5. Others may well come back on why that does not indicate that selling the shares all at once was

[**Chairman** *Cont*]
a strategic error but I will leave that. Paragraph 14 says that the Department did not monitor the allocation by Cazenove of shares to institutions (including companies owned by Cazenove). Why was that?

(Mr Scholar) The Department discussed with Cazenove before the allocation the criteria for the allocation. Cazenove's practice in the allocation was its normal practice and was best market practice in relation to an offering of this size so the Department did not involve itself in the actual allocation process. Subsequently, we reviewed the process and satisfied ourselves that it had been done fairly. We saw after the sale that there was a Committee of Public Accounts conclusion which was actually published after the sale which recommended that departments should involve themselves in the allocation process so we recognise that in the light of that recommendation we should have been involved in the allocation process and we so said in the Report.

6. Right. What safeguards were there to ensure the advice that you received from Cazenove and Schroders on setting the original share price at 280p was free from any conflict of interest?

(Mr Scholar) Well, we had a steering committee which involved the management of AEAT; it involved our colleagues in the Treasury; it involved people in the DTI who had experience of previous privatisations. They scrutinised the arguments that were advanced very carefully and came to the conclusions to which they came.

7. I will come back to the team in a minute. Paragraphs 2.23 to 2.28 show that Schroders received a success fee of £1.8 million on the extent to which proceeds exceeded a valuation of £176 million made by Schroders themselves. Why did you not obtain an independent check on the reasonableness of Schroders' valuation?

(Mr Scholar) We chose Schroders as our advisers at the end of a competitive process. There were five competitors including Schroders. Each of them suggested a methodology for valuing the company. We compared those methodologies. We compared them in the Committee which I have just described and we did not think it necessary to seek an independent view of that.

8. Even though Schroders were both valuers and potential beneficiaries?

(Mr Scholar) Their valuation was very similar to the valuation of the four other contenders.

9. You talk about the steering committee but nobody on the Department's team managing this sale had any previous experience, as far as I can tell, of handling a flotation. That is paragraph 1.10 in the Report. Do you think that problems such as the failure to consider phasing and oversee the allocation of shares are more likely to be avoided if the team includes experienced people?

(Mr Scholar) I do not accept that there was a failure to consider phasing. As I explained beforehand, it was the set policy of the Government and had in fact been subject to debate on the floor of this House. So I cannot accept that there was a failure there. I do not believe that there were considerable failures at any point in this process. In fact, in my view the sale of AEA Technology was a success so I find the question a difficult one to answer. In fact, Mr Hirst, who was the Chairman of the two committees concerned, had extensive previous experience of privatisations. He had been involved I think in Britoil, British Coal and the National Engineering Laboratory privatisations.

(Mr Hirst) That is correct.

10. Others may well want to come back on that point of experience of the team. Finally before I open questions up, paragraph 2.12 shows that very serious shortcomings in AEA Technology's financial management information delayed the sale. Why did the Department not recognise these problems before December 1995?

(Mr Scholar) The Department was aware of these problems but it was not aware of their seriousness until the Long Form Report was delivered to it in December 1995. It then took rapid action to remedy the deficiencies which had been revealed in that Report and the privatisation was postponed only by six months[1] as a result, but it was postponed.

Chairman: Mr Alan Williams?

Mr Williams

11. Hello again, Mr Scholar. You are an accident-prone man, are you not? You wandered into the Treasury job straight on the trail of Mr Hayden Phillips who left you with forward catering to defend which to be fair was never your job. Then you wandered into the Welsh Office where you were very welcome but again you inherited a government problem which was none of your fault. Now you seem to have one of your own making this time. This is a bit of a mess, is it not?

(Mr Scholar) As I explained to the Chairman Mr Williams, I do not think this was a mess. I think this sale was a success.

12. Let's try and look at it from the poor taxpayers' point of view. You sold this for £224 million and you got a dividend of three and bit million pounds so altogether you got a total of £228 million, let's say, let's round it up. Out of that there was £8 million for the advisers and £121 million for restructuring. That restructuring was not envisaged before the decision for the sale took place. So the taxpayer actually only got £99 million out of this project. That does not sound very good to me.

(Mr Scholar) I do not accept that analysis.

13. Why not?

(Mr Scholar) The restructuring costs were bound to be met in any event even if there had been no privatisation. The Government's policy was to divide the purchasing——

14. No, that came after the decision to sell. The decisions on restructuring came after the decision had

[1] *Note by Witness:* The privatisation was, in fact, postponed by three months, not six months

[**Mr Williams** *Cont*]
been taken that it was to be sold and sold in a hurry so I would argue, and I think many of this Committee would argue, that it was the decision to sell that precipitated the restructuring rather than the other way round.

(Mr Scholar) Perhaps if I can comment on that.

15. Briefly, if you will.

(Mr Scholar) The restructuring you are talking about was the tail end of a very massive restructuring that had taken place over many years. In the 1960s UK AEA had over 40,000 people working in it. In 1993/94 it was down to 8,000 because the whole nature of the enterprise had changed during that time and it was necessary greatly to reduce the size of AEA. This was the end of that process.

16. You also make the point made in the Report that it was intended the company should not have to incur any of the costs of this slim down. Bear with my £99 million which I am afraid I am going to stick by anyhow because I do not accept your interpretation of the restructuring and there is nothing in what the NAO says to endorse your point of view. Having sold it for a nett £99 million, on day one it was worth £34 million more and at the end of April when it was worth 720 pence a share it was worth £682 million. The taxpayer got £99 million, one seventh of the amount that it is now worth. That is why I call it a blunder, Mr Scholar.

(Mr Scholar) I do not think it was a blunder, Mr Williams. The company was quite different. It was a different company at the end of the period you have just described. It had made eight significant acquisitions. Most of the growth of the company's shares arose through those acquisitions not through the business which it had before. The other point to make is if you look at the market analogues to this company they too have increased by roughly the same amount as the company has increased its value.

17. This is dealt with and I have made allowance for the FT 64 per cent increase in its index and I have made allowance for the £58 million acquisition and even then there has been a gain of £144 million, far more than the taxpayer got.

(Mr Scholar) The reference to the FT index is out of date. The 64 per cent in the Report should now be 95 per cent. If you want to compare it with most of the latest valuations, as you did in your observation there, you should compare it with a 95 per cent rise in that index. So there has been a much greater——

18. It still leaves a more than healthy profit.

(Mr Scholar) The company has been a very successful company since it was privatised.

19. Let's look a bit more at what happened when it was sold. I want to look at Schroders and I want to look at Cazenove. What did Schroders initially have as a shareholding? They had a relatively small shareholding, did they not, at the start, just a few per cent?

(Mr Scholar) Just over four per cent I think.

20. That would have come to about £9 million and it is now worth £25 million so they have made a gain of £16 million which is five times the fee they got from you. They did not need a fee, did they?

(Mr Scholar) Those holdings of Schroders are, I understand, holdings they have on behalf of other people. They are held on behalf of charities, pension funds, trust funds.

Mr Clifton-Brown: Directors!

Mr Williams

21. I am sure, I am sure! What do they hold now? They thought it was worth what it was sold at because they got a bonus for getting it right, did they not? So obviously they think it has gone too high in value since. How much have they cut their holdings down to now?

(Mr Scholar) I have no figure for their holdings to date. I know it is in excess of 15 per cent.

22. Oh, you mean having said it was only worth the original price then subsequently they have scrambled to increase their original holding four fold?

(Mr Scholar) That has been true of the majority of the institutional holders who bought the stock in September 1996 because it has been a very successful company.

23. They were not the people who set the guide value, were they?

(Mr Scholar) No, we were the people who set the value, the DTI.

24. They now have a holding, if it is over 15 per cent, in excess of £100 million, a gain 34 times the fees that they got originally. They do not seem to have done at all badly out of this insider-type situation?

(Mr Scholar) I do not think that is a fair comment to make because, as I say, I think that the increase in the value of these holdings does not accrue to Schroders but to other people.

25. I suppose you are going to tell us the same about Cazenove as well. They allocated the shares, did they not?

(Mr Scholar) They did.

26. They allocated them to themselves among others, did they not?

(Mr Scholar) They did.

27. They allocated some 4.7 per cent to Cazenove's Fund Management which would have cost them £10 million and they will have made a profit of £22 million on those already. Not bad. Now it says in the Report that they also allocated to two other of Cazenove's subsidiaries or companies. Which two were they and how much did they get?

(Mr Scholar) They allocated 300,000 shares to Cazenove Unit Trust and 150,000 shares to Cazenove Securities, both in line with the allocations made to other firms in those categories.

28. In that case, that would have also yielded them a further profit over this time of another £2 million, so they made a profit of £24 million on shares they allocated themselves?

(Mr Scholar) There, again, the increase in value does not accrue, as I understand it, to Cazenove

[Mr Williams *Cont*]
themselves but to those on whose behalf they are holding these shares[1].

29. That is twelve times the fees they got. They certainly seem to get far more out of participating in the privatisation than they do from the fees they receive for their advice, do they not? Why did the Department not monitor it? It is customary for the Department to monitor allocations, just to ensure that no one can allege conflict of interest. This to me actually has a strong aroma of conflict of interest. Why did the Department fail to monitor, as is usual for departments to do?

(Mr Scholar) The usual practice takes places when you have a public offer and there has been a statement in the prospectus of the way in which the allocation policy will be followed. In a private offer of this kind, it is not usual market practice to publish such a statement of policy, and Cazenove followed their normal market practice. I gather in the last two or three years they made 20 or so such allocations, and they followed the practice that they normally use in those cases.

30. Yes, but is it not strange that in a time of transparency and the pursuit of transparency in financial affairs, your Department above all allowed a normal practice which leaves no audit trail? The NAO makes it clear that they could not tell whether the allocations had been done fairly or not because Cazenove do not keep the sort of records most people keep.

(Mr Scholar) I am not aware of any allegation that there is not an adequate audit trail. I have some papers from Cazenove which constitute such an audit trail.

31. I wonder if I can ask the C&AG does he consider this to be transparent? Is there an adequate trail for those who try to check on this?

(Mr Clarke) Mr Williams, what we say in the report is that the criteria by which the shares were allocated were not sufficiently weighted like they have been in other sales, so it is difficult to actually re do. The allocations were made as a matter of judgment based on criteria but it is difficult to tell precisely how the allocations were made.

32. So it could just as easily have been done on the old boys' network, could it not? How can you be sure there has not been any insider trading or anything of that sort, if there is not a proper audit trail?

(Mr Scholar) Cazenove are regulated by the Securities and Futures Authority, who received no complaint in relation to this allocation. The market is regulated. I think we have to rely on that.

33. Tell me, who is Dr Peter Watson?

(Mr Scholar) He is the chief executive of AEA Technology.

34. Currently?

(Mr Scholar) Currently.

35. Was he at the time it was being privatised?

(Mr Scholar) Yes.

36. He made a fortune on the rolling stock companies, I understand, he was involved with Porterbrook. Is he making a second fortune on this? Do we know whether he had shares, stock options, shareholdings, anything like that?

(Mr Scholar) He was allowed only to buy shares on the same basis as every other employee in AEA Technology. There was no differentiation between the scheme for directors or for the rest of the employees.

37. So how many were ordinary employees allowed to buy?

(Mr Scholar) They had free shares up to £160-worth——

38. The total, if they took it all up?

(Mr Scholar) They had priority in buying £5,000-worth. They got £500-worth free for the first £250's worth they bought, and £300-worth free for the——

39. So if they took it all up, what would their total holding have been?

(Mr Scholar) Their total holdings would have been, I think, around £6,000 if they exercised their priority; £6,500, something of that sort.

40. Which would have been around about 2,000 shares. How many shares did the chief executive have? He had the same number, did he?

(Mr Scholar) He had the same number[2].

41. Exactly the same number?

(Mr Scholar) I do not know how many he had, he had the option to buy up to that number but no more.

42. The same figure applied to everybody?

(Mr Scholar) The same figure applied to everybody.

43. The Chairman asked about an accounting officer's letter. You have been through a very traumatic experience at this Committee—as I said, none of it your fault—with Forward Catering, so you were alerted to the dangers of the privatisation process, but your predecessor, Sir Peter Gregson, is a veteran of privatisation. There is hardly anyone with greater experience of privatisation than he, I would have thought, as an accounting officer. Why did he ignore the advice of the Committee of Public Accounts on phasing? He knew of the advice. Did you know there was Committee of Public Accounts' advice that there should be phasing?

(Mr Scholar) Yes.

44. Particularly where it is difficult to evaluate?

(Mr Scholar) Yes, I was aware of that advice.

[1] *Note by Witness:* The 3,550,000 shares allocated to Cazenove Fund Management and Cazenove Unit Trust were held by them on behalf of clients. Cazenove Securities were allocated 150,000 which it held on its own account.

[2] *Note by Witness:* The answers to questions 40—42 apply to the executive directors' preferential rights to acquire shares in AEA Technology plc, which were identical in every respect to the rights enjoyed by all eligible employees. In addition to this, it was open to executive directors to subscribe for shares at full price, with no preference or priority, in the same way as it was to any other employee or any member of the public. Each of the four executive directors applied for shares in this way. See also Evidence, Appendix 1, page 000 Q190 (PAC 314).

[Mr Williams *Cont*]

45. But he decided to ignore it?

(Mr Scholar) No. It was the Government's policy to make a clean break and that policy was tested on the floor of the House in 1995 when the Atomic Energy Authority Bill went through the House. There was an amendment put forward by the official opposition seeking to require the Government to hold a significant shareholding in AEA Technology for three years. That was put forward by the front bench. The Government did not see fit to accept that amendment because that was their policy.

46. The point the Chairman has been making is that that is very different from phasing. That was one particular phasing proposition.

(Mr Scholar) It was one type of phasing. It was a requirement to keep back 50 per cent of the stock.

47. When we made the recommendation on phasing, did the Treasury minutes endorse it?

(Mr Mortimer) The position on phasing is that we do recommend that careful consideration is given to phasing. What Mr Scholar is saying is that consideration was given but they did not agree it would be a good idea. But that is our line, that careful consideration should be given to phasing.

48. You never felt a compulsion to reach to your inside pocket, get a pen out and right a famous letter to your minister about it?

(Mr Scholar) I would have done if I believed that there would be great advantage or there would be advantage to the taxpayer in doing so. In fact the whole view at the time was there would be disadvantage for the taxpayer since the stock would be harder to sell if it were phased.

Mr Williams: You really got it wrong, didn't you. Thank you, Chairman.

Mr Maclennan

49. Can I pursue just a little this question of phasing? The summary of the report of the NAO at paragraph 11 indicates that it was the view of the Department that a phased sale would not be successful. You have said it was a matter of ministerial policy, but the question whether or not it would have been successful is presumably susceptible to objective consideration. What were the objective factors which led you to the view it would not be successful?

(Mr Scholar) I think two principal factors. One was that the sale prospects for AEA Technology were fragile. That was what was being said in the market place at the time and in the press. I have a pile of press cuttings here which I could provide to the Committee.

50. What was the substance of the doubt?

(Mr Scholar) The doubt was that AEA Technology had a limited track record. It was heavily dependent on Government purchases from it. The prospectus made it clear that Government purchases would fall. It had no contracts in place with the private or overseas sectors. It had no assets or cash. So it was a doubtful sale. It followed the sale of British Energy, which had been regarded in the market place as not a great success at that time. So it was a sale that was attended with some difficulty. The feeling was that if you held back a substantial proportion of the shares, you would complicate the sale and make it more difficult to get away. That was one argument. The second argument was that against the political background, which I have described—the opposition did not believe it right to privatise the nuclear industry and did not believe it right to privatise AEA Technology in particular, on the grounds of public interest—it would have been difficult to write a convincing prospectus about what would be done with those shares given the imminence of the General Election.

51. Just to flesh out the background of that second point a little, has anything happened since the election that might have given rise to the view that that was not an entirely misplaced consideration? I have in mind the decision not to sell ESG, the Engineering Services Group of the United Kingdom Atomic Energy Authority, which was subsequent to the General Election.

(Mr Scholar) Yes, that was a decision of UKAEA rather than one of AEA Technology.

52. Sorry, we are talking about the UKAEA here, are we not? AEA Technology is an off-shoot of UKAEA.

(Mr Scholar) The recent decision on ESG was one taken by AEA itself, not by the Government. The decision we were thinking about as regards the sale of a rump of shareholding would have been one for the Government.

53. But in line with Government policy. For the avoidance of doubt, because you are not perhaps with me on this, the UKAEA did not dispose of ESG subsequent to the election.

(Mr Scholar) Yes.

54. Though it had been the policy of the then Government, prior to the election, and the UKAEA, that would be disposed of. If that is correct—if not, no doubt you will tell me—then the expectation that AEA Technology would not be sold off subsequent to an election, or whatever part of it was not sold already, must have been quite a realistic prediction?

(Mr Scholar) I think it would have been certainly a thought in many investors' minds, that given that the present Government when in opposition had declared itself wholly opposed to the privatisation of the nuclear industry, if it had retained a substantial shareholding after the election, there must have been some prospect that AEA Technology might be taken back into public ownership.

55. How successful has AEA Technology been? You have several times referred to it. I am not speaking about the *Financial Times* index but are you able to give any indications of other objective yardsticks?

(Mr Scholar) I think it has had a successful time since it was privatised. It has made eight acquisitions which have been well-regarded by the market. In the case of many of them there was a rise in the share price which was sustained afterwards. Its results have pleased the market. It is early days to say more

[**Mr Maclennan** *Cont*]
because we only have the 1996-97 results to go on so far. I think perhaps the half-year results for 1997-98 are imminent.

56. To what do you attribute the difference between the expectations of the market when the price was set and the performance in the market subsequently?
(Mr Scholar) I think two things. One is, as I was saying to Mr Williams, the whole market—this section of the market particularly—has risen very speedily. That is one thing. The other is that it has made these acquisitions and changed its character very substantially as a company. It is now a company with a substantial software element in North America and a good part of its success, I believe, is attributed to that.

57. None of this was predictable, in your view?
(Mr Scholar) It was not at all predictable. It would have been quite possible for AEA Technology to make eight unsuccessful acquisitions.

58. Can we just look again at this question of the Cazenove shares? You said they were not Cazenove shares, but they were Cazenove's client shares?
(Mr Scholar) I believe so.

59. Cazenove's ability to attract clients must, to some extent, depend upon their success in managing these sort of investments?
(Mr Scholar) Yes.

60. So that although there is not privity here, it was certainly very much in their interests to allot shares to those who had entrusted them with the task of allotting shares for the best price possible?
(Mr Scholar) They are not alone in having a merchant bank operation and an investment management operation under the same roof with a Chinese wall between them. That is common place in the market. It is accepted by the regulator. I think there is nothing unique about that.

61. You do not feel in the least bit uncomfortable about that?
(Mr Scholar) No, I do not.
Mr Maclennan: I am surprised. Thank you.

Mr Leslie

62. I have so many notes with so many explanation marks on them, I do not really know where to start. I have a number of different questions and I think I will need to hear some answers because I am absolutely furious, to be honest, reading this report. From start to finish I feel, as a taxpayer, completely ripped off in this matter. First of all, to put it in context, what was your Department's prime objective in the whole of the sale? Was it to maximise proceeds and get value for money, or was it to privatise at any cost?
(Mr Scholar) There were two purposes. One was to privatise and achieve best value for the taxpayer, and the other was to effect a re-structuring of the nuclear decommissioning and re-processing industry which would benefit the Exchequer. That is an enterprise which offers the taxpayer very large potential savings. There is an estimate in AEA's accounts as to the size of the nuclear liability, the cleaning-up liability, which in 1994 was estimated at £9 billion. In 1997 that was estimated at £7.2 billion, a saving of nearly £2 billion. We have a report by a firm of consultants who estimate that the savings which should accrue from the change which has been made to the structure of this industry, should be of the order of 25 per cent, and it is 25 per cent of a very large number. So this was a policy which was designed to protect the taxpayer.

63. So what do you say? I know you have insisted that you feel the whole of this sale or privatisation has been a resounding success, but I just want to try and get a figure on it though, so what do you estimate to have been the benefits to the taxpayer brought about by the sale, the net benefits, taking into account the immediate losses that you quite obviously see in the share prices as they have rocketed since privatisation?
(Mr Scholar) Well, the taxpayer received £228 million from the sale. The sale costs were around 5 per cent of that. I know Mr Williams does not agree with that analysis, but that is what I believe to be the case. So there was a substantial benefit for the taxpayer from the sale itself. I may add that when the sale was first mooted, general reaction in the press and in Parliament was that there was very little value to be got from this company.

64. I am not surprised at all that there was great delight and hand-rubbing going on in the City perhaps that here comes another great privatisation where the taxpayer is going to be fleeced, but I wanted to know just from you, you were talking about the benefits that the transfer of liability from the public sector to the private sector might bring, so have you got a figure for that or not?
(Mr Scholar) Yes, I would say that on present estimates the change of policy in dealing with the decommissioning of nuclear waste is estimated to save the taxpayer £1.8 billion.

65. And that was solely to do with AEA Technology's privatisation, not associated changes?
(Mr Scholar) No, it is associated with the whole restructuring of which this is an important part.

66. It is a part of it, right. Let me just ask you about the phasing of the sale again. You mentioned before to Mr Maclennan that there were various considerations given by your Department to phasing and yet in paragraph 3.5 of this Report, which I presume you have agreed—am I right in that?
(Mr Scholar) Yes.

67. It says that the DTI did not even investigate the case for phasing. Why is there this discrepancy here?
(Mr Scholar) The Report says that the DTI decided against phasing, but did not investigate the case for phasing.

68. Yet you said some minutes ago that you had investigated the case for phasing.
(Mr Scholar) No, I explained to the Chairman and to Mr Williams that the reason why the Department decided against phasing was that it was firm government policy that there should not be phasing

[Mr Leslie *Cont*]
and that there was no value-for-money reason for going ahead with phasing.

69. But you investigated this idea. What I am just trying to find out is whether this was entire incompetence or whether it was a deliberate decision not to go for phasing. We read in the Report that there is very little previous experience, if any, of handling flotations in this Department in the team which actually dealt with this whole AEA Technology sale, so was it that you were unaware and you were operating blind, in the dark about this whole sale, or did you actually investigate it and come to a conscious decision, having looked at all the facts, not to phase, so which was it?

(Mr Scholar) It was a decision in fact of the House of Commons not to phase.

70. No, it was not a decision of the House of Commons. There is a difference between phasing a sale and an Opposition amendment about one particular point in time. What I am trying to find out is did you advise your Ministers that they should phase this or not?

(Mr Scholar) We did not offer advice to Ministers on the point.

71. So you did not advise Ministers at all——

(Mr Scholar) We did not.

72. —— that there might be potential losses if phasing did not take place?

(Mr Scholar) No, there was no paper, there was no advice given to Ministers on the point.

73. Was this contrary to Schroders' advice?

(Mr Scholar) No, Schroders and Cazenove offered no advice that phasing would be beneficial.

74. So let us just ask you on this point, are you on performance-related pay?

(Mr Scholar) Yes.

75. You are, and were the other officers involved in this whole fiasco also getting performance-related pay?

(Mr Scholar) All senior civil servants' pay is in part related to performance.

76. So when your colleagues and yourself made the decision not to advise Ministers perhaps about the potential losses and the lack of phasing, do you feel that you deserved the performance-related bonuses that you might have subsequently got?

(Mr Scholar) Yes, because I do not think that phasing offered any benefit to the taxpayer and in not proposing phasing, we were following the clear line that we knew Ministers to be following.

77. So you do not accept that if the Government had a 40 per cent share retained today in AEA Technology, it would be worth £230 million, which is actually £6 million more than the total proceeds altogether?

(Mr Scholar) No, I do not accept that.

78. You do not accept that?

(Mr Scholar) I do not accept that.

79. Could I just ask Mr Lazarus a few questions about Schroders and this success fee because you are a Director of Schroders—am I right?

(Mr Lazarus) Yes.

80. What were the total earnings that Schroders had from the total fees? I heard that there were 5 per cent handling or advisers' fees in total possibly for the whole of the sale, so what was Schroders' element of that?

(Mr Lazarus) It is in the Report, is it not? It was £2.55 million. It was over an 18-month period.

81. What was the bonus fee? Was that on top of that?

(Mr Lazarus) That was included.

82. How much was the success fee?

(Mr Lazarus) The amount we got at the conclusion was £1.99 million.

83. So that is not on top?

(Mr Lazarus) That was on the flotation of the sale.

84. So it was £2.55 million total fee, plus the success fee of £1.99 million.

(Mr Scholar) No, that included it.

85. What is this about a quality fee? Did you get the quality fee as well?

(Mr Lazarus) What we agreed at the time of our appointment was that we would reduce by £100,000 the amount that we would otherwise be entitled to under the proposal we had originally made and leave ourselves in DTI's hands as to how much of an amount up to £200,000 the team at DTI felt that we were owed on some quality-related criteria.

86. What was that amount?

(Mr Lazarus) In the end they awarded us £185,000 out of that £200,000.

87. I know in the Report it says that your company as at July 1997 had a 13.35 per cent stake in AEA Technology. Is that right?

(Mr Lazarus) I would obviously wish to take this opportunity to emphasise the distinction between what Schroders earns for its own account and its fiduciary responsibilities for its mostly pension fund clients for whom it owns those shares.

88. So they are still all held together, are they, or are they in separate accounts?

(Mr Lazarus) I do not know. I am not on that side of our business.

89. But you are here answering for Schroders? Is that right?

(Mr Lazarus) I am here answering as the DTI's adviser in a corporate finance capacity.

90. Well, it is important because I am just trying to get a grasp at your earnings in this whole matter. It was around about 13.35 per cent in July 1997. Do you know what the stake of Schroders is today?

(Mr Lazarus) It is a matter of public record, but it is around 16 per cent.

(Mr Scholar) But that has nothing to do with Schroders' earnings.

[**Mr Leslie** *Cont*]

91. Well, I can be the judge of that, if you do not mind. May I just ask whether or not Schroders or, Mr Lazarus, you are aware that the DTI had a guideline which suggested that no person should really hold more than 15 per cent in order to avoid jeopardising independence of control over AEA Technology? Do you know about that rule?

(Mr Lazarus) This is of course unrelated to the flotation. At the time of the flotation, the DTI took certain powers, and it has chosen to use those without taking advice from myself or, as far as I know, any other merchant bank, but it has used those criteria entirely unrelated to the flotation and that is a situation which has only cropped up relatively recently.

92. Can you answer the point about the 15 per cent, Mr Scholar?

(Mr Scholar) We received an application from Schroders via the Chairman of AEA Technology in September last year as to whether Schroders could exceed the 15 per cent limit which is laid down in the special share which the Secretary of State holds, because one of Schroders' clients already had some of these shares and by taking on an extra client, they would get themselves above the 15 per cent limit. Our Ministers decided to agree to that request.

93. So I am just trying to look at the total income to Schroders. Do you know, Mr Lazarus, whether or not in fact all of the shareholdings that you have taken subsequently to the privatisation, including from day one, have been for your clients or have they been for the company itself?

(Mr Lazarus) As far as I am aware, they are all for clients and that is our core business within that division. I have to say that our business would not operate if we did not have properly structured Chinese walls, as every regulator that we work for is aware of.

94. But they were a good buy, were they not, the shares?

(Mr Lazarus) The shares have performed in line with some of the relevant market indices. They have done less well than some others.

95. But they made a lot of money for your clients?

(Mr Lazarus) Our managers have done well.

96. So would it be fair to say or would it be very cynical of me to say that by getting them at a good price, it was in your company's interests?

(Mr Lazarus) I am at a loss because I have not answered questions to this Committee before, so I do not know the best way to answer that question, but I think it would be fair to say though that as the company has expanded within the software industry and most of the eight acquisitions have been within software rather than within the old engineering business which previously dominated it, it has come to be rated somewhat more as a software business than as an engineering business. This has given it a virtuous taint. I think it would be fair to say that had our investment managers bought pure software businesses or companies, such as Capita or Misys or Sage, they would have done even better, so yes, it has been a good buy, but not by any means as outstanding as some other software businesses and yes, it has done certainly much better than many of the engineering companies.

97. Let us just get right down to brass tacks. How would you answer these allegations that are made that perhaps Schroders, in advising the DTI and helping to set the price in the first place, were perhaps doing it for their own profit?

(Mr Lazarus) We were not part of the allocation process.

98. But in terms of setting the price and subsequently purchasing the shares, surely there is the perception, right or wrong, that you might have profited from having a very low share price?

(Mr Lazarus) Well, I would answer that by saying that we would have little by way of corporate finance business for any of our corporate clients if anybody seriously thought that that was the way we operated.

(Mr Scholar) I do not think it is right to say that it was a very low share price. There was a premium of 17 per cent which remained for some time in the after-market. The growth that we have seen has been subsequent to that and most of it was attended upon acquisitions made by AEA Technology.

99. Well, I do not have many constituents who can earn a 15 per cent return on their capital in one day. I find that quite an unusual thing, and I just feel it worth trying to get the information right in the first place, whether or not this was a fair price in the market, so I do not think there is anything to be lost in asking those questions. Can I just ask finally about the restructuring arrangements and I think I need to ask Mr Scholar this question. It cost £121 million, this restructuring. Why was it such an abysmal failure? Why was it that there was a report written in December 1995 telling you that there were great financial management control problems and that the company would not be able to live up to the Stock Exchange Regulations?

(Mr Scholar) The restructuring started earlier than that report and took place during 1995 and 1996. As I said before, it followed much earlier restructuring. This was an industry which had over 40,000 people in the 1960s and it now has 4,000 or 5,000 people in it, so it was an industry where, because nuclear power stations were not being built in anything like the numbers that they were in the world and because this body is no longer a nuclear research organisation which it was set up to be by the 1954 Act, it has changed its whole mission and it was, therefore, necessary to engage in very substantial restructuring.

100. But the fact that they were adjudged to have failed largely after a lot of the restructuring came true, that is an embarrassment to the Department and an indication that the £121 million was not necessarily well spent, is it not?

(Mr Scholar) I think on the contrary, that the reduction in the size of the nuclear liability I mentioned indicates the success of the restructuring so far.

Mr Love

101. Mr Scholar, I am afraid I am going to take you back to the issue of phasing and look at it in the light of the duties of your Department and you as the

[Mr Love *Cont*]
Accounting Officer to the Government of the day. Do you feel that you failed in your duty to the Government not to raise the issue of phasing with them at the time of this sale?

(Mr Scholar) No, because it was clear in Ministers' minds that there was to be no phasing and we knew it was clear in their minds that it was government policy that there should be no phasing and it would have been academic to have raised that question. If we had believed that there was a benefit to the taxpayer in doing so, I would certainly have raised it.

102. Can I take the first of those two points? Is it not part of the duty of the Civil Service to bring unwelcome facts to the Government's attention, the ones that they may not feel perhaps inclined to take into account, but it is certainly the duty of a civil servant to make the Government or the Secretary of State aware of them?

(Mr Scholar) Yes.

103. So even though they may well have been inclined to sell AEA Technology in one go, it was surely your duty to remind them of other alternatives?

(Mr Scholar) Well, it would have been if there had been an advantage in doing so.

104. Does that not destroy your argument about using the Government as a cover for not bringing this to their attention?

(Mr Scholar) I do not think so. The Report makes it quite plain that the judgment about phasing is a fine one to make. Shares sometimes go down as well as up, and it is sometimes possible to lose money from phasing.

105. Let me take that point because if you look at Appendix 2 to this Report, it quotes all of the different occasions on which the Committee of Public Accounts and the National Audit Office brought to various departments' attention the attractions and advantages of phasing and particularly the situation that we are describing here where it was difficult to make a valuation. Now, surely in the light of all of those decisions taken before AEA Technology was sold, it was your duty, not you personally, but of your Department, to bring those previous decisions to the attention of Ministers at least to discuss the alternatives that were available to them?

(Mr Scholar) Well, I accept that, as a public authority with a requirement or the highest requirements of accountability which we have, it would have been better if we had written a paper and that paper had been on the file setting out the case against phasing and I regret that we did not write such a paper.

106. Can I go on to the other thing that you did not write which was any direction to your Minister to cover yourself in the situation where there would be a loss to the Exchequer. Was that never a consideration in your mind that with all the difficulties in making a proper valuation, with the fact that phasing was not being considered to protect the public interest, that you could cover both yourself and your Department by seeking a direction from your Minister?

(Mr Scholar) I think no question of a direction arose because we did not believe that phasing would be to the benefit of the taxpayer. We thought we were selling, and we were selling a stock which was going to be difficult to sell. The opinion in the markets and in the press at the time was that this was going to be difficult to move. It was a nuclear stock, British Energy had not done very well, and it was a company without a track record, as I have explained before. So the view we took was that if we phased the sale, if we held back some of the shares, we would complicate the sale. It was not a large sale. It would be an unnecessary complication and might make it quite difficult to get the sale away. Certainly we believed that the effect of holding back some of the stock would be to reduce the proceeds we would get from the sale.

107. We are asked as a Committee to scrutinise public expenditure in the light of the public interest. If we try to envisage that in terms of an individual looking at the way that the Government spends its money, do you think that a person who sees that we gained, and I am taking very bold figures now, but something in the region of £223 million from the sale of AEA Technology with a cost of £121 million in restructuring and a company that is now worth something in excess of £700 million, and that is less than two years after the privatisation, do you think that that member of the public would think that value for money had been attained in this process, and do you think that this Committee should, therefore, think that value for money has been attained in this process?

(Mr Scholar) I think the Committee should think so because I could provide for the Committee, with Mr Lazarus's help, a number of stocks which have risen a similar amount during that time and indeed, as I have explained to the Committee, if you look at the relevant market indices for stocks of this kind, the rise in this stock over this period has not been untoward. So I do not think you can attribute that increase in value to a failure on the part of the department to realise the proper price for the sale.

108. Let me just take you up on that slightly. You mentioned that there had been a 95 per cent increase in the FT Index. If we half the value of the company on that basis it is still over £350 million. If we assume that part of the restructuring costs might not be due to the privatisation, there is still a very substantial discrepancy in that the public, I believe, would not understand, yet ministers were never confronted with this. Is your department culpable in this waste of public funds?

(Mr Scholar) I do not accept there has been a waste of public funds. This has been a company which has been very successful since it was floated and it has been successful because of the skill of its management and in the decisions it has made. Mr Maclennan asked me questions about that and I explained why I thought that the company had been successful and had increased its value over and above the value suggested by the index I mentioned. Mr Lazarus cites other indices which suggests that perhaps it has not been quite so successful in its own right. It has followed the market more closely if you make different assumptions about the nature of the company.

[Mr Love *Cont*]

109. Can I take you to the valuation that you gave to the company. You have explained the reason why you chose a narrow range, although not being someone directly involved in this I remain somewhat sceptical. However, I do not think you have given us an adequate explanation as to why that narrow range should not have been shifted either significantly or perhaps less significantly up the price range so that rather than choose the band that you did you would have chosen a band further up. Can you explain why that was the case?

(Mr Scholar) Yes. When the range was first determined in July 1996 we decided that it should be between 230 and 260 pence. That was the figure which we arrived at after taking advice from Cazenove and Schroders. Subsequent to that market conditions improved. The campaign for selling the stock was going well. Press comment which had been rather mixed at first improved and so we first raised the range from 240 to 270 pence and then, in a somewhat daring manoeuvre, right at the end we raised it to 250 to 280 pence. So we actually raised it twice.

110. With the luxury of hindsight we may not have thought that is as daring as you are suggesting to us now. I would like to take you to figure 9 on page 35. Figure 9 gives the Cazenove valuation. On page 8 under figure 1 you give the turnover, profitability and restructuring costs of AEA Technology. I notice that there was £46 million-worth of restructuring costs in 1995/96. Since that was done part-year presumably there would be a full-year extrapolation that you could do in relation to those restructuring costs which perhaps could have shown that the company was likely to be more profitable than that included within these figures. I know that when you are valuing companies you are not in the job of protection, but was there not some very good estimates that it was likely that the profitability of AEA Technology would go up in future years?

(Mr Scholar) Yes. We had an estimate initially[1] that the operating profits in 1996/97 would be £35 million, which we revised downwards and it subsequently turned out to be lower than that. They subsequently turned out to be £24 million. They had grown somewhat from the 1995/96 level.

111. If you had put that into this multiplier that has been used by Cazenove that would have given a valuation very much in excess of the one that is quoted here even though that valuation was at the higher end of the range that you finally achieved.

(Mr Scholar) Various adjustments were made to the mechanical valuation which was done by applying a PE ratio to that 1995/96 profit figure, by the DTI after a discussion with Treasury colleagues and with advisers. Inevitably that kind of figure has to be a judgemental figure and it has to take account of exactly the point that you are making, that the restructuring costs were not going to go on forever.

112. The other question that springs to mind is the £35 million predicted profit. Even though it may well have been adjusted, presumably that was price sensitive information. Was there any awareness in the marketplace that the profits were likely to go up substantially in the year following privatisation?

(Mr Scholar) There was a prospectus which set out for the whole marketplace what could be said about the profits.

113. And that figure was indicated?

(Mr Lazarus) No, it was a qualitative comment and there was plenty of brokers' comment, but generally speaking the analysis in the market came relatively close to the outturn number.

(Mr Scholar) Which was £19 million.

114. It was actually £19.8. So there was at least some indication that the continued restructuring would deliver benefits in future years.

(Mr Scholar) I think opinion in the market in this case, as in other privatisation cases, would assume that there would be some benefit in future years from both restructuring that had happened and further restructuring that would probably be available.

115. Yet none of that was taken into account in the valuation figure and the range of valuations that you did. Can I take you to figure 10 which is the book-building exercise that was carried out and the paragraphs that follow. There is some indication that there was within the marketplace some willingness to consider a figure higher than the one that eventually emerged. Would you agree with that?

(Mr Scholar) A fifth of those who indicated[2] that they would be interested in making a bid said that they would do so at 270. There was strong price resistance in the marketplace from a number of quarters to any price above 265 a week before the sale. I reviewed the press coverage in those weeks and it was quite clear that 260 to 270 was regarded generally as a full price, with one or two commentators seeing some potential for perhaps a ten per cent premium. Nobody before the sale expected a larger premium than that.

116. There was a rush right at the end of this process. The department must have considerable experience of those brushes with privatisations. Did that give you no indication that a higher figure than you finally went for in the marketplace would have been available to you?

(Mr Scholar) We understood that a number of potential buyers had capped their bid at 280. We subsequently found that five institutions declined to bid at 280. We investigated at great length and discussed a great length with Treasury colleagues and advisers whether it would be wise to go above 280 and we decided that it would be dangerous to do so and that we would be likely to end up with lower proceeds if we did so. So we made the decision to go for 280.

Mr Love: Sadly, a wrong one. Thank you.

Mr Davies

117. This does seem very unfortunate because to the layman it appears the department have given Schroders a strategy to set a price for the sale. They have made a decision to fill with added value a

[1] *Note by Witness:* in 1995.

[2] *Note by Witness:* In the first week of marketing.

[Mr Davies *Cont*]
company they are selling by putting £121 million of restructuring in and then in a situation where the advisers on price and some of the other changes are permitted to buy below par prices and face an enormous appreciation and make enormous profit on behalf of their clients. Do you not feel slightly embarrassed by all this? Do you think my brief potted rendition of the situation is fair?

(Mr Scholar) I do not think it is fair because I believe that the restructuring had to be done in any event. That was accepted by the Treasury. It was a common view. I believe that if the restructuring had not taken place there would have been a great deal of waste of public money as people were employed in doing a task which the government did not want them to do and still would not want them to do.

118. Can I just take you through some of the issues one more painful time. On the issue of phasing you said that the government in 1995 said they wanted a clear break in terms of privatisation and therefore that was taken to mean no phasing was possible. That was your interpretation. It clearly is the case that one could have rapidly privatised an industry, particularly this one over a period of weeks or a slightly longer period even though there was a certain immanence in terms of the General Election. In other words, you could have sold the whole lot off before the General Election in chunks. Would you accept that?

(Mr Scholar) No. It was not a matter of interpretation. We knew that it was the government's policy to make a clean break and sell it in one go. If I could quote Lord Fraser in the House of Lords in July 1995. He said: "Full commercial freedom means the freedom to take risks and to reap rewards. That is not consistent with a degree of public ownership."

119. What was at issue is not the retention of public ownership, it is profit maximisation of the sale. Accepting that the government at the time wanted to sell it off, it is still consistent with that quote that they could sell it off in chunks.

(Mr Scholar) I do not think it is consistent with the quote which said, "That is not consistent with a degree of public ownership."

120. But that means on an on-going basis presumably. What they did not want is BP or someone having a situation where over a period of time we have half public ownership.

(Mr Scholar) That is what I understand phasing to require, that we would hold a substantial rump of shares for some period of time.

121. With the intention of selling. You do not seem to understand my point. The idea would be that it would be announced that you sell and you sell it off in chunks to maximise the price, not that you do not sell. You just hurdled ahead and sold without independent advice, against the advice that was provided on the price and sold at a price well below what was achieved in a couple of days. That is correct, is it not?

(Mr Scholar) No, that is not correct. You have to remember that if we had kept back a proportion of the shares we would have had to have explained in the prospectus what the policy was about for the disposal or the holding of those shares, as you have just mentioned. Just before a General Election in which the Opposition had said that they completely opposed the privatisation of this industry that would have been a difficult thing to do and might well have made the sale impossible.

122. Were there any other privatisations that were done by being phased? Was the Treasury advised? Are there any success stories of phasing?

(Mr Mortimer) Yes, there are. I have not got the instances at my finger-tips to quote to you, but there are examples where phasing has been successful.

123. Remind us of the advice that you gave to the department on phasing. Presumably you were giving advice to a range of departments on privatisation and some of them accepted your advice and privatised and this department did not. So what did you do? How robust were you in this?

(Mr Mortimer) In this case we were associated with the two steering groups in the department and we accepted the arguments that Mr Scholar has outlined against the backdrop that the general policy is that consideration should be given to phasing. Mr Scholar has explained the position as to why the decision was taken as it was in this case and the Treasury, as a member of the steering groups, went along with that decision.

124. Despite the view of the Committee on Public Accounts you were happy to let them get on with it even though you knew it was wrong and you had evidence to show that in other departments they had added value through a phasing methodology. Is that correct?

(Mr Mortimer) It is our job in these sorts of situations to bring to bear the benefits of our experience through general advice, but we do not seek to double-guess the department. In this case, Mr Scholar has explained that there was a political decision to sell off the company, and the Treasury accepted that.

125. Presumably that is why you want a less hands-on influence over departments in the future, because they do not always listen to your advice even though it turns out to be correct.

(Mr Mortimer) The Treasury cannot take all the decisions in Whitehall. We try to bring to bear the benefit of our experience, but the decision is ultimately for the department.

126. It was claimed that the benefit to the taxpayer of the restructuring by you was £1.8 billion, which was the difference between the estimates of the cleaning-up costs of nuclear energy. That is correct, is it not?

(Mr Scholar) Yes. There are a number of ways of getting at this and it is a difficult thing to estimate because what we are talking about is costs which will fall over about 100 years. What I have done is to draw to the Committee's attention the estimate made by AEA, published in their accounts which is audited by the NAO, so this has some authority. I would also point to a separate measure which may be of interest to the Committee. In 1994 we estimated that the costs

[**Mr Davies** *Cont*]
of clean up over the succeeding three years would be around £570 million. The outturn is £330 million.

127. I understand that the restructuring has brought about a reduction in the estimated cost of cleaning up the industry. Would I be right in saying that is nothing to do with the privatisation, that is simply the output of investment in restructuring? Secondly, how much of the £121 million cost of restructuring is linked into that as opposed to getting your financial methodology right as a pre-sale?

(Mr Scholar) The restructuring would have been done in any event because the policy was to create competition and to retain AEA as a lean purchasing authority. In order to create competition it was very helpful to have AEAT as a privatised body because it was completely separate from the government. A clean break had been made, the government had no ownership of AEA Technology and so the competitors in the marketplace did not believe, when they went in for a contract, that the whole thing was fixed with the government owning both AEA Technology and giving a contract to it and regulating the whole thing as well for good measure.

128. What I was trying to ask actually is do you think that the estimate of savings in clean-up could have occurred if it had not been privatised?

(Mr Scholar) I think the estimate would have been smaller.

129. This is because you cannot have competition in an unprivatised company, is that right?

(Mr Scholar) Because if the Government owned the company the competition would not believe it was a real competition; you would not have a real competition. If the Government was both placing the contract and owning the company with whom the contract was placed people would feel that it was fixed and possibly it would be fixed.

130. Okay. It seems to me from you in principle terms you are a firm advocate of privatisation so can I ask whether if your own personal view of privatisation and the benefits it brings in principle have blurred your vision in terms of value for money and perhaps pushed ahead in terms of haste without considering phasing, etc., against the better interests of the taxpayer?

(Mr Scholar) No. This policy was not my policy, it was the policy of the Government.

Mr Davies: You seem to be defending it strongly.

Chairman: I do not think that is a good line of questioning.

Mr Davies

131. I understand obviously this was the responsibility of the ministers. May I ask about the evaluation. You mentioned that in 1996-97 you said there was a projected profit of £35 million for AEA. That is correct, is it not?

(Mr Scholar) The operating profit was first of all forecast to be £35 million.

132. Then it came down to £24 million.

(Mr Scholar) The outturn was £24 million.

133. That is right. What then happened was that the market evaluation of the company continued to escalate. Is it not right to say that on the basis of your previous projection you could have expected an even greater appreciation in the marketplace than you in fact saw at the cost of the taxpayer but that did not happen because obviously the profit projections were not right?

(Mr Scholar) No, because AEA Technology, half of its business was with the Government and the prospectus explained that was going to decline substantially in the years following the sale because of this competition policy. It would have to compete for these contracts, it did not have them in the bag any more. It was likely that its business with the Government would fall. It needed to replace that business with new business overseas and in the private sector. There was no guarantee it would get that business, there could be no guarantee that it would be a successful company.

134. I will probably end shortly given the pressure of time. You mentioned in passing that one of the reasons that you went ahead with this sale in one big lump was because of the market's view of what the political and economic environment might be after the election, namely half owned by the public sector and a new Government that was not as pro-privatisation as the previous one. In terms of your scenario planning did you anticipate being in the current situation you find yourself, both in terms of the valuation of AEA and being in front of the PAC being asked all these questions, or is it a complete surprise?

(Mr Scholar) I think it would be a brave man who would think that the market would go up in the way that it has.

135. Finally, can you tell us, I know regrets you have a few, what regrets have you over doing it your way here? In terms of auditing you have already mentioned you should perhaps have done a paper on phasing but is there anything else that you would accept on the basis of the NAO report has gone wrong?

(Mr Scholar) I think we got fair value for the company at the time. I think that was recognised in the marketplace and it was recognised in the press. I know of no voice who said the contrary at the time.

136. If the Government sell something else again you would recommend they sell it off all at once?

(Mr Scholar) No. I fully acknowledge the benefits of phasing. The Committee has drawn the Department's attention to that. I can see the powerful argument for phasing in many cases and I know that it has been greatly to the benefit of the taxpayer in a number of cases.

Mr Davies: Thank you. I have no further questions.

Maria Eagle

137. Mr Scholar, you think you have done well with all this, do you not, that has come through very clearly from your answers, you think this was a big success?

(Mr Scholar) I do not think I said a "big success", I think it was a success, yes.

[**Maria Eagle** *Cont*]

138. Yet the C&AG has produced what I think can fairly be described as a critical report.

(Mr Scholar) I would not say it was a very critical report.

139. I did not say "very", I said a critical report.

(Mr Scholar) He criticises aspects of the procedure we follow. He does not criticise the main points. He nowhere, for example, says that we could have achieved significantly greater value at that time. He does not take that view.

140. I do see a lot of these reports, being an assiduous attender at the Committee, and I read the ones that I do not come here to question people on. I think in the range of value for money reports that we see before us this is at the higher end of critical. You have not picked up on that. One thing that does interest me is that there are more arguments in here between yourselves and the C&AG and the NAO in an agreed report than I have seen in many of them and it is quite clear that you have had a bit of an argument with the NAO during the preparation of this report and have not been able to agree in the normal sense of the word about various important issues like phasing for example. Do you think that is fair?

(Mr Scholar) It is quite common for departments[1] to have a spirited exchange.

141. It is quite common at the end for the NAO and the department to have an agreed report that does not set out arguments on one side and arguments on the other side and say there has not been an agreement and that is what we see in here, is it not? Surely you have managed to detect that there is a lot of criticism in here that you have not accepted but you can see that this is a critical report.

(Mr Scholar) The C&AG does not argue in this report that we failed to realise the value that was in this company, he does not criticise us for doing so. In criticising the matter of allocation, for example, he criticises the fact that we were not there, he does not say that there was anything wrong with the allocation. On many points he criticises an aspect of the procedure we followed and does not criticise the substance of what was done.

142. Some aspects of procedure that you followed led to vast losses to the public purse, for example in respect of phasing.

(Mr Scholar) I do not agree with that.

143. You do not agree with that?

(Mr Scholar) No.

144. May I can ask the Comptroller and Auditor General if he would view this report at the upper end of critical?

(Sir John Bourn) I find it hard to grade the reports in terms of a kind of index of criticism. I do not think of it in that way. Certainly I wanted to draw the Committee's attention to the areas that I felt could have been looked at and could have been handled in other ways and that is what I have sought to do.

145. Thank you, very diplomatic. The way I look at it, putting aside the question of savings in the future in respect of cleaning up the industry, and there may be many arguments about your figure in respect of that, as you have with the NAO in this report, it seems to me you have raised 227.75 million. If we were to include all of the restructuring costs, which I accept perhaps is unfair, there is £121 million, £8 million worth of advisers' costs, £3 million of free shares to employees, loss in value due to the fact you did not phase up to £110 million, perhaps more as the Chairman mentioned earlier. There are other losses, for example £2.5 million of special early release terms to get rid of people before the restructuring, page 20. One might fairly add those in as well as losses. You appear to have ended up losing more than you made, do you not? I wonder how you can see that as a success?

(Mr Scholar) We made something in excess of £200 million on the sale and we have achieved a situation in which we are going to realise very, very substantially larger savings in the nuclear clean-up costs. I regard that as a good outcome.

146. Throughout this process you were under-estimating the potential for this sale, do you accept that? Whether or not it was foreseeable I leave to one side at the moment but you under-estimated the interest and the potential of this sale, did you not? Did not the fact that there was a 16 per cent premium prove that?

(Mr Scholar) We expected there to be a premium of something under ten per cent.

147. Seven per cent I think.

(Mr Scholar) Yes. We expected that and that would be normal in these cases. It is part and parcel of making the sale. A premium of 17 per cent is not a very high premium.

148. That is not very high?

(Mr Scholar) No.

149. It is more than double what you were expecting.

(Mr Scholar) Several months previously we had sold British Energy and the sale had led to a discount in the market. If you take the two together we came out more or less evens.

150. Perhaps you can answer the question I asked you which is do you accept for whatever reason, and whether or not it was foreseeable I leave to one side, in the event you under-estimated the value of this company? It cannot be that hard to accept this. The shares were trading at 3.23 the next day.

(Mr Scholar) Yes, I would accept that if you take a view of the company over two years ahead the value of the company exceeded all expectations, the growth in the value of the company.

151. And that included your expectations and the expectations of your advisers?

(Mr Scholar) And the whole market.

152. It just surprised everybody. It seems to me that if you look at Part 3 of the report where we go through the process of the way in which the price was set and the shares were sold there were many indications in there to a sharp set of advisers, and I

[1] *Note by Witness:* and the NAO.

[**Maria Eagle** *Cont*]
accept fully that Schroders must be that, I am sure you would not have appointed them otherwise, there seem to me to be very many signals in there that were apparent before the price was set and the sale was made that indicated you were under-estimating the potential value of the company. Do you accept that?

(Mr Scholar) No. A week before the sale date we encountered very substantial resistance to prices above £2.65.

153. Would you have a look at figure 8 on page 34. This is a graph of the book building process within a range of 2.40 to 2.80 which was this 12½ per cent range. These two lines are not coming very close together, are they? I would have thought, you will correct me if I have misunderstood, that you would have been looking to meet the point in respect of the price whether demand would come right down, would you not, in order to set the price?

(Mr Scholar) We discovered from soundings that our advisers made in the market that there was likely to be a precipice above 2.80 There were a number of people who were not prepared to buy above 2.80.

154. There were likely to be. But you did not test the market above 2.80, did you? Why did you not get the figures to prepare this graph so you could see the precipice?

(Mr Scholar) We made the decision that we would get best value from the company by operating in a 30 pence range and we were operating in a range from 2.50 to 2.80. In doing so we discovered we encountered significant resistance at 2.80.

155. Why does that line not fall down at 2.80?

(Mr Scholar) Because we did not do this in the mechanistic——

156. Because you did not ask anybody.

(Mr Scholar) I beg your pardon. We did not do it in the mechanistic way that this graph suggests. Our advisers did not build up a mechanistic picture of this kind.

157. Right. It seems to me that there was a warning there and that a little later on there was a warning when you had the sudden rush of interest at the end, was there not, that was a warning too? By that stage you will say it was too late.

(Mr Scholar) No, we responded.

158. You responded but you did not respond enough.

(Mr Scholar) It is easy to say that with hindsight.

159. Yes, of course.

(Mr Scholar) Very easy.

160. Perhaps you should have had a higher range although a narrower range.

(Mr Scholar) We might have got a lot less money from the sale if we adopted a higher range.

161. It seems to me also that you have got a problem, laying to one side whether or not there were signs and it could have been foreseeable and you should have pitched the price higher, does it not worry you at all in terms of propriety that you had advisers who between them were not only setting the price and taking the success fees on the basis of the price that was set but were also allocating shares to themselves at a price which you had no oversight of?

(Mr Scholar) The success fees are a common feature in privatisations and are recommended by the Treasury and are a way in which in successive privatisations Government departments have raised more money than they otherwise would do. On the second point, as I have explained these gains were not gains to our advisers, they were gains to the funds that their companies were administering.

162. Yes, administering but no doubt taking fees for administering well and having success in respect of that as well. Do not try and tell me that they were doing it out of the goodness of their hearts and they did not take any fees for that.

(Mr Scholar) Perhaps I could add one point in answer to your question. The allocation which our advisers' firm received during the allocation process were precisely of the same size as the allocations received by other companies in the same category in the allocation.

163. But they allocated themselves almost as much as they could, did they not?

(Mr Scholar) No. Cazenoves were placed in category two and category five, they were not placed in category one. Schroders were placed in category two. If you look at the size of their demand you can see why they were placed in quite a high category.

164. Do you think that it may be the case that your advisers capped their expectations of price at the sort of level at which they would maximise their success fee and make sure they got their success fee and were not particularly interested, given the uncertainty, in investigating a higher price?

(Mr Scholar) No, they investigated the higher price.

165. Sorry, how did they investigate the higher price?

(Mr Scholar) Because in their discussions with those who indicated an interest in buying they raised with them explicitly the question of whether a higher price would be realisable and they recorded the responses to those questions. We discussed them exhaustively in the committee with the Treasury, with Treasury colleagues and with our advisers and we came to the conclusion that £2.80 was the price at which we would get the maximum proceeds.

166. I wonder if you can just clear up an answer you gave earlier to the Chairman which I did not understand. You said when he was asking about the valuation of the company that the other tenderers—I assume you meant the other tenderers as advisers to the other four or five companies at the beginning who did not get the job—had all valued the business at about the same amount. Is it the case that you ask your tenderers to value the business before you appoint the advisers? That sounded a bit strange to me.

(Mr Scholar) What we did was we looked at the quality which each of these five applicants offered to us, the kind of team that they were offering. We looked at the costs that we would have to face if we

[**Maria Eagle** *Cont*]
appointed any one of them and we looked at what they indicated to us they thought they would be able to raise from the sale. Each of them indicated a valuation broadly in the area of £220 million which was Schroder's valuation at that time.

167. I understand, Mr Scholar. I did not quite understand why you were saying you had got all your tenderers to value the business. Finally, I just have one more thing really and that is just to say it seems to me that you seem very pleased with the way in which the Department has handled this. I myself have some grave misgivings in that there have been some errors and some worries about this and I am not at all happy that you should be as pleased with yourself and the Department's performance here as you seem to be. I think that when the NAO prepares a value for money report it is incumbent upon the department concerned to take it very seriously and not to just persist in its own view that it cannot be criticised. I detect a certain amount of that in your answers today. I think you should be very careful about being quite so sure of yourselves in an area as uncertain as this.

(Mr Scholar) I do not think that is quite fair to the line that the Department has taken. We have accepted in the report that we should have been present at the allocation process. I have accepted this afternoon that we should have recorded on file the reasons why we did not pursue a phased sale. I do not think that is the mark of a complacent department.

Maria Eagle: I do not think that your replies in respect of phasing have been very convincing.

Mr Clifton-Brown

168. Good afternoon, Mr Scholar. You sold this company, AEA Technology, for 227 million or thereabouts, adjusting for £58 million that has subsequently been invested in buying other companies. The difference in value as between the recent stock market valuation amounts to some £338 million against the sale of £227 million, ie a profit of £338 million or an increase of 248 per cent whereas the FT Support Service Index over that period has had an increase of approaching 70 per cent. How can you be as complacent in your answers as you have been to this Committee today to say that you are satisfied with the advice that you received concerning this sale?

(Mr Scholar) The FT Support Services Index has gone up 95 per cent since the sale so the value of the company has virtually doubled on that basis. If you followed other indices mentioned by Mr Lazarus the increase would be greater. I think the main thing is that this company has been in the private sector. It has been free of any of the constraints which the public sector might have imposed upon it. If there had been a substantial shareholding by the DTI in the company we certainly would have wanted to look very closely at any acquisitions that it made in the United States, in Canada and so on and so forth. It has been free of all those constraints and it has prospered in the eyes of the market.

169. Ah. I should have added in that previous question that of course before you sold it you devolved over a billion pounds' worth of contingent liabilities in terms of nuclear clean-up and the company was debt free. So in other words it makes the whole process even more unsatisfactory.

(Mr Scholar) I do not understand your point about the billion pounds liability.

170. In terms of the nuclear liabilities that the company might otherwise have had.

(Mr Scholar) I do not recognise that figure, I am afraid.

171. Did you not give that figure earlier on this afternoon in terms of the nuclear clean-up that the company would have had had not the nuclear side of it been devolved?

(Mr Scholar) No. I was referring to the nuclear liabilities of AEA which were built up over many years. By 1986 those liabilities were already £8 billion and were accepted by the then Secretary of State as being liabilities to be met by the Government. That is what I was referring to. It is the size of those liabilities that has been reduced by the changes which I have described.

172. But nevertheless a considerable tranche of contingent liabilities have been removed from the company. The report makes that quite clear.

(Mr Scholar) Not from this company. I am sorry, I must come back on that. This company—AEAT—itself did not have liabilities of that scale, it had liabilities of around some fraction of £30 million.

173. Can I move on because that moves me very nicely on to the next set of questions and that really is whether your advisers were fully knowing what exact business they were selling because, for example, in figure two, page nine, the company in that table is described as a "commercial science and engineering services company including plant and process performance, safety technology, risk assessment and environmental protection" and yet in paragraph 3.18, page 35, it was considered as a nuclear stock. Do you not think marketing this company as a nuclear stock was almost a detonated explosion designed to depress the share price?

(Mr Scholar) No. It was in large measure a nuclear stock. In 1995-96 54 per cent of its turnover was in nuclear business.

174. 54 per cent. That still leaves 46 per cent not as a nuclear stock.

(Mr Scholar) It was seen as a nuclear stock. Whether you like it or not it was seen as a nuclear stock and indeed it was in part a nuclear stock.

175. The report goes on and says the business was little known, paragraphs 3.4, 3.23, 3.9. Did any of your advisers at any stage advise you to have a proper advertising campaign so that the institutions and others who were considering buying this company would have a better idea what the company was all about?

(Mr Scholar) There was a substantial campaign which started in July 1996 and went through to the eve of the sale through first of all a research paper and then through the Pathfinder prospectus and then through the prospectus itself. The market was given the fullest possible account of what the company was and the

[Mr Clifton-Brown *Cont*]
kind of business it was in. I do not think there was any deficiency in that part of the operation.

176. Can I take the Treasury officials on to Appendix 2 of the report which has already been referred to. Can I ask the Treasury officials about the allocation, in particular the allocation to financial intermediaries on which this Committee's previous recommendation in 1996-97 says "Such allocations may result in considerable profits for those who receive the shares. We look to all departments to take similar action in future sales." In the event the amount of shares allocated to financial intermediaries were increased from ten to 12½ per cent. Did the official on the steering committee give any advice in this respect?

(Mr Mortimer) Perhaps I could just make one point first of all. The Treasury's view is that it is best practice that the department should be involved in allocation considerations and that ideally it should be on the basis of objective criteria published in advance. I think Mr Scholar has admitted that in retrospect he would have preferred it if the Department had been involved in the allocation decision. My colleague here, Mr Prynn, was the Treasury representative on one of the steering groups and I could ask him what further input the Treasury made to those discussions.

(Mr Prynn) We were in contact with colleagues within the Treasury who had been involved with other privatisations where allocations were made. They were aware that the privatisation of AEAT was going on. We were not approached by the Department for advice on the procedure to follow in relation to this allocation.

177. I am curious about this expression "we were not approached". Can I just continue with my line of questioning to you, Mr Prynn. The PAC recommendation in our Thirteenth Report as long ago as 1989-90 says "Whilst we accept that our recommendations are responsible for arranging privatisations, the Treasury should in future do more to ensure that experience gained and lessons learned from past privatisations are passed on to departments." Treasury Minute reply: "The Treasury will continue to be involved in all privatisations and offer advice." Did you offer any advice in this respect?

(Mr Prynn) No, we did not in this respect.

178. Why not?

(Mr Prynn) We were in touch with the Privatisation Unit in the Treasury to ensure that we got the benefit of their experience of previous privatisations. I was not advised by the Privatisation Unit that we should be involved in the allocation.

179. Did you give any advice on the possible retention of part of the stake in the company rather than the 100 per cent sale?

(Mr Prynn) We were aware of the Department's consideration of———

180. Did you give any positive advice? No. Can I come back to you, Mr Scholar. Can I ask you why it was that the amount of allocation of shares to financial intermediaries was increased from ten to 12½ per cent when this left other applicants with just over 22 per cent of what they applied for?

(Mr Scholar) The decision to increase the allocation to intermediaries from ten to 12½ per cent still left a low proportion of their orders satisfied. 22 per cent was a lower proportion of orders satisfied than was obtained for the institutions where I think we had an average allocation rate of 36 per cent. It brought the two somewhat closer together. It was an allocation procedure which is not criticised in the report in any way at all. We gave everybody who applied, rather Cazenove gave everybody who applied, the same percentage. It did not differ according to the size of the applicant or any other criterion.

181. Are you aware, Mr Scholar, that in paragraph 1.20, page 14, just five institutions subscribed for 30 per cent of the shares and made a profit in so doing based on the sale of the company at the time and the valuation today of 115 million?

(Mr Scholar) Yes[1].

182. Does not that scaling back to just 22 per cent for other applicants give rise to the indictment that the sale was far less than competently handled?

(Mr Scholar) No, the market has gone the way it has gone. It might have gone the other way and they might have all made a loss. I do not see the fact that the market has risen, and with it AEA Technology's value has risen, shows that anything untoward was done.

183. Have any of those institutions other than Schroders applied to you to increase their valuation over the 15 per cent set by the Government?

(Mr Scholar) No.

184. So Schroders is the only one. Do you think that the book making process was widely tested enough or does the report, which indicates that it was tested on far too narrow a range of institutions, hold up?

(Mr Scholar) I think it is very difficult to be dogmatic about these matters. The range that is selected on these occasions varies widely. The report derives an average over a period of time. If it derived an average over a shorter period of time the number would be different. The reasons we selected this range at the time were market reasons based on recent market experience and the belief that this would yield the greatest proceeds for the taxpayer.

185. Can I ask the Comptroller & Auditor General, given that such a large proportion of the company was bought by so few institutions, are you absolutely satisfied in your investigations there could not possibly have been any collusion or insider trading in the flotation of AEA?

(Sir John Bourn) We found no evidence of collusion or insider trading in the course of our investigation.

186. Paragraph 3.28, page 39, which you have quoted from, Mr Scholar: "...a price higher than 280p led Cazenove to believe that there was a precipice just

[1] *Note by Witness*: The four institutions held 30 per cent of the shares in July 1997 as stated in paragraph 1.20 of the NAO report. On the initial allocation they received altogether only 16 per cent of the shares.

[Mr Clifton-Brown *Cont*]
beyond 280p where demand would fall very sharply." Given that that was never tested and given the events subsequently and this huge rise in the increase of the value of the company, indeed the huge rise in the value of the company immediately after floatation, do you consider in hindsight that the Department was given good advice?

(Mr Scholar) I do not accept the premises of your question. It was tested. Five institutions declined to bid at £2.80. That was a test. Secondly, I do not accept that there was a huge rise in the value of the shares immediately after the sale. There was a 17 per cent rise which was higher than the Department expected but it could not I think be fairly described as a huge rise.

187. I cannot see how you can fail to say it was anything other than a huge rise when you set the price for sale at 280p and within a short time thereafter the price was well over £3.00, £3.37 to be precise. How can you possibly say there was not a huge rise immediately following flotation?

(Mr Scholar) One would expect a rise in that time. We expected a rise of something under ten per cent, seven per cent I think was the figure given in the report but that was a rather spuriously precise figure. One expects a rise, in this case around ten per cent or below ten per cent. It was 17 per cent. I do not regard that as a huge difference.

188. Could you let the Committee have a note on those shareholdings that I have already quoted, of the directors' shareholdings, at the time of the flotation and now so that we can see how the directors' shareholdings have moved since flotation, and indeed what allocations the directors in your principal advising companies, Cazenoves and Schroders, actually were.

(Mr Scholar) I am sorry, I am not sure what the———

189. I would like to know, and I am asking the Chairman if we may have a note, as to what the directors' shareholdings were at the time.

(Mr Scholar) The directors of AEAT, is that right?

190. AEA Technology, yes. Your advisers presumably disclosed to you what their directors' shareholdings were at the time of flotation and presumably it is published information as to what those directors' shareholdings are now. Could we have a note of that?

(Mr Scholar) Yes, I am happy to provide that note[1].

Mr Clifton-Brown: I am very grateful. I think, Chairman, looking at this I agree with Ms Eagle's comments that this has to be one of the most unfortunate episodes of the taxpayer being shortchanged that I have sat on in this Committee. I hope when the report is issued that Mr Scholar will reconsider and read carefully the Hansard copy of some of his replies because I have to say that I agree with colleagues, I believe some of the replies have been some of the most complacent I have heard from any of the witnesses who have appeared before this Committee since I have been on it. I have no more questions.

Mr Campbell

191. Good afternoon, Mr Scholar, I will not detain you very long, I just have two points I would like you to help me make my mind up on. The first one leads on directly from what you have just said to Mr Clifton-Brown. I would like you to look at figure three which is on page 15. You have described at some length this afternoon the grounds for believing that there could have been a degree of pessimism about this sale given the problems facing the nuclear industry, including the question of liability. You have talked about the media context in which this decision had to be made. You have also talked about later freeing the company from constraints, making acquisitions and therefore making it a much more viable company. I think the point that my colleagues were getting at is if you look at figure three, from the day of the sale, the view that you had and your advisers had about what this company was worth and the level at which it could perform was significantly different from day one and every single day after that from what the market's view was.

(Mr Scholar) If you look at that graph on page 15, you see for the first month the share price remained fairly static. After that initial rise from day one to day two from 2.80 to 3.23 it did not alter very materially. The volume of trading in those early weeks was not huge. I do not think it is fair to say that because there was some demand at £3.23 in those first few weeks that a price of £3.23 for the whole stock would have been obtainable on 25 September. I do not think that is a reasonable inference to make. I do not think that we seriously under-priced the stock.

192. You are asking us to believe that your view and the position that you took on what this stock would be worth even in 12 months, slightly more than 12 months, you are talking about it being worth three times as much as people were actually paying for it, are you seriously telling us that is a natural market reaction, that there was not anything wrong with your original valuation?

(Mr Scholar) The whole market went up; AEAT went up with it. It also benefited from its freedom in the private sector.

193. And you could not have foreseen this? You must have known before the sale that constraints would have been lifted. You must have known before the sale about the possibility of making acquisitions. If you did not know everybody else did.

(Mr Scholar) Mr Campbell, it is possible to make a disastrous acquisition. It is quite possible to make an acquisition and to see your share price fall like a stone. They could easily have done that.

194. They could have done that but they did not. In fact, this is a hugely significant rise. This is really big bucks, is it not, for the people who have invested in this?

(Mr Scholar) It is wonderful to sit here after the event and to look back and say all of this was foreseeable at the time; it was not.

[1] *Note:* See Evidence, Appendix 1, page 19 (PAC 314).

[Mr Campbell *Cont*]

195. We are not asking you to foresee the future but we are asking you to make a judgment, not just on what was correct on that particular day but could you not have foreseen the different situation which would emerge given the sorts of changes you have described? Were you the only people who did not know of the changes that were going to happen in this sector?

(Mr Scholar) No-one in the market expected this price to rise like that. The expectation in the market was that the price would be £2.60/£2.70 and there might be a tendency——

196. For people who did not take that advice and put money in they have been extremely fortuitous, have they not?

(Mr Scholar) They have been fortuitous in many purchases that they have made, they have been very, very lucky. The market could have gone the other way.

197. And some of the people that were giving you advice instead of sticking with what they believed to be the case, a pessimistic scenario, they did not put their money where their mouth was, they did the opposite, they actually put their money into this and they have been extremely fortuitous as well.

(Mr Scholar) Their clients have done well.

198. Their clients have done well. Thank you. The second point, and I hope you do not think I am going to open up this can of worms about phasing because to some extent—I do not want to insult my colleagues—I think we have been going up the wrong track here because you have actually been giving me the answer to what I want all afternoon. You have talked about a firm Government policy, you have talked about wanting to sell it cleanly, you have talked about a clear line from ministers. The reality is you did not have to ask ministers or advise ministers about phasing at all, did you? You did not have to write a paper because you knew from day one what the Government's position was. They wanted this sold. They wanted it sold as quickly as possible. It had to be sold before the General Election come what may. That is the reality. You did not even have to think about phasing, there was not even time for phasing.

(Mr Scholar) We could have attempted a phased sale.

199. But the ministers did not want that. What is the point of you going to ministers with a paper about the benefits or otherwise of phasing, you knew fine well that ministers were not interested in phasing at all, they wanted this sold before the General Election.

(Mr Scholar) You are quite right, they did not want phasing, they made that perfectly plain, and we saw no market advantage in phasing; in fact we saw the opposite for the reasons I have given.

Mr Campbell: There may have been reasons why they did not want it phased. For example, they may have wanted it privatised because they had some assumption that it would do better in the private sector. They may have been creating a market. We have actually seen that with other privatisations. It also leaves some of us with the view that they wanted rid of this to get the money from it because they were actually stoking up the chest with which to fight the General Election. I will not ask you to comment on that.

Chairman

200. Can I ask you a couple of questions to finish, Mr Scholar. You referred to eight acquisitions?

(Mr Scholar) Eight acquisitions.

201. Of which five were referred to in the report.

(Mr Scholar) There have been some since the report was written.

202. I see. That is the distinction. Are they all post-flotation?

(Mr Scholar) Yes, they are all post-flotation, these acquisitions.

203. Can you give me an approximate timing, at least for the ones in the report?

(Mr Scholar) Yes. There was an acquisition in December 1996 of BR Research; in January 1997, acquisition of Advanced Scientific Computing Limited; January 1997, acquisition of Safeguard International Limited. Do you want me to go on?

204. Yes, please.

(Mr Scholar) March 1997, Joint Nuclear Services Venture formed with Sumitomo Corporation; July 1997, acquisition of Hyprotech; September 1997, acquisition of ERG Environmental Resource Group; February 1998, acquisition of nCode International Limited; February 1998, acquisition of Nycomed Amersham Industrial Division.

205. Thank you. Just so the Committee knows, some of those acquisitions were quite quick, three months after the sale. Were any of those acquisitions planned before the sale?

(Mr Scholar) I do not think so. I am afraid I do not know the answer to that question.

206. They were very fast, three months from flotation to acquisition is quite quick.

(Mr Scholar) I am not aware of that. I do not think so. I would have to check to answer that.

207. The second point relates to page 15 which is the infamous figure three. What it shows in essence, given your use of the Financial Times Support Services Index, is some degree of tracking of that index but a major readjustment around about from—my graph is not accurate—November through to the end of December when the graphs diverge. Do you see the point I am pointing to?

(Mr Scholar) Yes.

208. Do you have any explanation as to why that reassessment was done at that point? It seems to precede the vast majority of acquisitions that you are talking about, if not all of them.

(Mr Scholar) I understand. It is in the private sector so I do not follow its affairs as I would if it——

209. The danger of this Committee is always hindsight. The point that has been put to you a number

[Chairman *Cont*]
of times during the course of the hearing has been that a phased sale would have been a lower risk strategy. By a phased sale we mean a sale in which the majority controls straight away and there is a statement of intent about the remainder. It is not a question of being half in the public sector or the other debates that went on, it is a question of just the mechanism of the sale. Now, the reason that this Committee on a number of occasions has come to the conclusion that this is a good approach is primarily because a phased sale allows the marketplace to arrive at a valuation by its own empirical impartial methods. The other mechanisms for assessing value tend to be cautious, quite reasonably, quite understandably, because a failed sale is a terrible thing to happen as a policy outcome. What I am trying to establish, Mr Scholar, as much as we can, there is no way we can do it for sure, is what was the reason for what was quite a significant divergence of value from the index that you yourself chose quite rightly, not within the next two months but thereafter from two to four months later, most of which precedes most, if not all, of the acquisitions to which you attribute the change in rating? That is what you are talking about, the change in rating level. Do you have any notion as to why that change occurred then?

(Mr Scholar) Well, I do not. I do not because this company is in the private sector and it is not my responsibility.

210. Does your adviser know?

(Mr Scholar) I believe from talking to the chairman of the company that in the months following the sale the management of the company was assiduous in going round in the marketplace, talking to its shareholders, its big shareholders, and explaining to them the plans of the company as they gradually began to develop because I think they did develop pretty quickly. That is the only light I can throw on that. I would just say that I do think it is a rather extraordinary situation for a phased sale in which you are facing a General Election, there is the likelihood of change of Government, the opposition has made the declaration that the opposition made about this company. I think it would have been very difficult to write a prospectus on that basis.

Chairman: I hear that, you have made that point twice I think in the course of this hearing. The point I was trying to establish really was the cause of that significant divergence. It is not immediate, you are quite right. I worry less about the ten per cent frankly than about the later significant change. Arguably, of course, what you describe company management doing is precisely what Cazenoves and the other financial institutions serving you should have done. However, I think I can say now you have come to the end of your trial for the day. It just remains for me to thank you and your two advisers for coming today and giving evidence. I appreciate it has been a difficult day for you. Thank you very much.

APPENDIX 1

Supplementary Memorandum from the Department of Trade and Industry

NOTE OF SHAREHOLDINGS OF EXECUTIVE DIRECTORS IN AEA TECHNOLOGY PLC
(PAC 97–98/314)

Q190. The executive directors obtained shares in two ways: through the preferential offers available to all eligible employees; and by applying for shares at full price, and with no preference, as any employee or any member of the public could have done.

PREFERENTIAL OFFERS

As explained in paragraph 2.10 of the NAO report, there were four elements to the offers available to employees. The following table shows the number of shares obtained by those (including each of the four executive directors) who took maximum advantage of the offers:

	Number of shares	Value of shares (£)	Cost of shares (£)
Free shares up to the value of £160	57	159.60	0.00
For the first £250 of shares purchased, an additional £500	267	747.60	249.20
For the next £300 shares purchased, an additional £300	214	599.20	299.60
Priority in purchasing up to £5,000 of shares	1,785	4,998.00	4,998.00
Total	2,323	6,504.40	5,546.80

NON-PREFERENTIAL SHARES

Each of the four executive directors applied for further shares. Each was scaled back to around 36 per cent of the amount applied for (the average for institutional investors). The following table shows the amounts:

	Value of shares applied for (£)	Number of shares applied for	Number of shares allocated	Value/cost of shares allocated (£)
Sir Anthony Cleaver	100,000	35,714	13,020	36,456
Dr Peter Watson	200,000	71,429	26,050	72,940
Ray Proctor	12,000	4,286	1,560	4,368
Michael Watson	4,000	1,429	520	1,456

TOTAL ALLOCATIONS AND SUBSEQUENT CHANGES

Each of the executive directors has retained his initial holding. The only changes up to the end of 1997–98 have been that each has participated in the profit sharing for 1996–97 and so has received a further 83 shares, the same number as every eligible employee. The following table shows the holdings on initial allocation and at the end of March 1998, except that the figure for Michael Watson is given for the date of his resignation as a director in November 1997.

	Preferential offers	Non-preferential offers	Total initial allocation	Profit sharing	Number of shares held at 31 March 1998
Sir Anthony Cleaver	2,323	13,020	15,343	83	15,426
Dr Peter Watson	2,323	26,050	28,373	83	28,456
Ray Proctor	2,323	1,560	3,883	83	3,966
Michael Watson	2,323	520	2,843	83	2,926

Department of Trade and Industry

29 May 1998

ISBN 0-10-554707-7

9 780105 547075

Printed in the UK by The Stationery Office Limited
8/98 382223 78344

Published by The Stationery Office Limited
and available from:

The Publications Centre
(Mail, telephone and fax orders only)
PO Box 276, London SW8 5DT
General enquiries *Lo-call* 0345 58 54 63
Order through the Parliamentary Hotline *Lo-call* 0345 02 34 74
Fax orders 0171 873 8200

The Stationery Office Bookshops
123 Kingsway, London WC2B 6PQ
0171 242 6393 Fax 0171 242 6394
68-69 Bull Street, Birmingham B4 6AD
0121 236 9696 Fax 0121 236 9699
33 Wine Street, Bristol BS1 2BQ
0117 926 4306 Fax 01179 294515
9-21 Princess Street, Manchester M60 8AS
0161 834 7201 Fax 0161 833 0634
16 Arthur Street, Belfast BT1 4GD
0123 223 8451 Fax 0123 223 5401
The Stationery Office Oriel Bookshop
The Friary, Cardiff CF1 4AA
0122 239 5548 Fax 01222 384347
71 Lothian Road, Edinburgh EH3 9AZ
0131 228 4181 Fax 0131 622 7017

The Parliamentary Bookshop
12 Bridge Street, Parliament Square,
London SW1A 2JX
Telephone orders 0171 219 3890
General enquiries 0171 219 3890
Fax orders 0171 219 3866

Accredited Agents
(see Yellow Pages)

and through good booksellers

Her Majesty's Stationery Office is independent of and separate from the company now trading as The Stationery Office Ltd., which is responsible for printing and publishing House publications.

ISBN 0 10 554707 7