Benefits and costs of bringing water, energy grid and Royal Mail into public ownership

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The tables below estimate the savings to be made through reducing the cost of capital under public ownership, and the cost of compensation based on the book value of equity. Data is taken from company annual reports and reports by the regulators OFWAT and OFGEM.

1. Annual savings

Table 1 Future savings from public ownership (£m.)

	Annual dividends (£m.)	Annual net interest (£m.)	Annual net savings (£m.) from refinancing at govt rates (1.81%)	Annual savings £ per household
Water companies	1922	1813	2537	113
Energy grid companies	3711	1332	3734	142
Royal Mail	242	18	171	7
PFIs	n/a	n/a	1400	53
Total	**5876**	**3164**	**7842**	**315**

Sources: see text

The savings are calculated by comparing the current cost of dividends and interest paid by the private companies with the cost of refinancing the current equity and debt with debt raised by issuing government bonds. They also serve as an indicator of the very large scale of extraction of money from the system by current owners.

The government rate is taken from OFGEM's current estimate of the rate on government gilts. The savings would be greater in real terms as the current real rate of interest on government debt is negative, as assessed by all the regulatory bodies (UKRN Sept 2019 Cost of Capital – Annual Update Report).

The savings are a net figure after taking into account the interest payable on gilts, including the interest on the bonds issued to compensate shareholders. The public companies would in effect cover all the future interest costs of the nationalisation, as well as delivering savings equivalent to about a 25% reduction in the costs to consumers.

The savings are quantified on a per household basis to indicate the value gained by each household, whether it is used to reduce prices or improve services through investment.

The savings from the ending of dividends would be delivered immediately on public ownership, the savings on debt interest would be realised as existing debt is refinanced by public sector debt.

2. Cost of compensation

Table 2: Estimated compensation payable to owners of companies to be nationalised (£bn.)

	No. of companies	**Book value of equity 2019 £bn**	*est. Market value July 2019*
Water companies	15	**14.7**	*36.2*
Energy grid companies	26	**27.9**	*41.1*
Royal Mail	1	**4.6**	*2.2*
PFIs	294	**2.5**	*n/a*
Total		49.7	*79.5*

Sources: see text

The general principle proposed for compensation is to return to investors the money they actually have invested in the company. The simplest indicator of the money actually invested in the company by its owners is 'net assets' or 'shareholder equity' as shown on company balance sheets. The results accord with the estimates made by ratings agency Moodys for the Financial Times (FT April 2019).

This principle for compensation avoids using values, such as actual or estimated market value, which are based on expected future earnings, as these expectations are derived from the regulatory regime of the government. Paying compensation on this basis would effectively guarantee to current private owners the perpetuation of their existing excessive returns.

As a corrective to incorrect and inflated figures advanced by lobbying organisations including the CBI and the Social Market Foundation, estimates of market value are shown, based on actual market values of shares of listed companies, in line with normal practice for valuing investments: no investment manager would use the methodology of the CBI/SMF.

As detailed in other reports by PSIRU, the actual impact of UK pension funds and pensioners is negligible. The prospect of legal action by foreign investors under international treaties is also unlikely to have a significant impact on the level of compensation payable.

3. Background note

The companies to be nationalised in water and energy are the operating companies, not parents such as National Grid who also own other subsidiaries. In water that is 9 regional WASCs plus 6 smaller WOCs; in energy the 4 licensed electricity and gas transmission companies, and the 22 licensed gas and electricity regional distribution companies. For PFI it is the SPV companies at the heart of each PFI deal.

Appeal court rulings have clarified that UK law says it is for parliament to decide in each case on appropriate compensation, that there is no set formula, that public interest and economic justice are legitimate bases for fixing compensation, and that courts will not overrule parliament

4. Data sources

- The data on book value of equity, dividends and net interest are taken from the latest ARs of each company (and for water companies the reports by Bayliss/Hall 2017 and Yearwood 2018: dividends are average of last 13 years for WASCs, of last 2 years for WOCs and energy grids, and latest year for Royal Mail).
- Data on net debt is taken from OFWAT and OFGEM reports
- Market value data is taken from the FT: for energy and water companies the portion of market value attributable to regulated UK water or energy grid business is taken, and the sectoral estimate is then based on the proportion of RAV represented by the listed companies.
- The figure of £2.5bn for nationalising SPVs of PFI schemes, and the estimate of annual savings of £1.4bn., is taken from Mercer and Whitfield (2018)
- Household numbers are from ONS data for England (for water companies) and for England, Wales and Scotland for the energy grids, post office, and PFI savings
- Figure of 1.81% for refinancing at government rates is taken from latest OFGEM estimate of risk-free rate

5. Companies to be taken into public ownership under plans announced by Labour party

Water:
Anglian Water Services Limited
Northumbrian Water Limited
Severn Trent Water Limited
Southern Water Services Limited
South West Water Limited
Thames Water Utilities Limited
United Utilities Water Limited
Wessex Water Services Limited
Yorkshire Water Services Limited

Affinity Water Limited
Bristol Water plc
Portsmouth Water Limited
South East Water Limited
South Staffordshire Water plc
Sutton and East Surrey Water plc

Energy:
National Grid Gas Plc
National Grid Electricity Transmission Plc
Scottish Hydro Electric Transmission Plc
SP Transmission Plc
Cadent Gas
Scotland Gas Networks
Southern Gas Networks
Wales & West
Electricity North West Limited
Eastern Power Networks Plc
London Power Networks Plc
South Eastern Power Networks Plc
Northern Powergrid (Northeast) Limited
Northern Powergrid (Yorkshire) Plc
Scottish Hydro Electric Power Distribution Plc
Southern Electric Power Distribution Plc
SP Distribution Plc
SP Manweb Plc
Western Power Distribution (East Midlands) Plc
Western Power Distribution (South Wales) Plc
Western Power Distribution (South West) Plc
Western Power Distribution (West Midlands) Plc

Post:

Royal Mail plc