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The *Commonwealth Development Corporation Bill* [HL]

Bill 2 of 1998-99

The main purpose of the *Commonwealth Development Corporation Bill* (HL Bill 2) is to allow CDC to convert from a public corporation to a public limited company so that a majority shareholding can be sold.

The Bill was introduced into the Lords on 25 November 1998. It had its Second Reading in the Lords on 7 December 1998 before being considered in Grand Committee off the floor of the House (Moses Room) on 12 January 1999. The Bill went through the Committee stage on 2 March 1999 without amendment. However, four technical amendments were agreed at Report Stage on 2 March 1999. A further amendment was made on Third Reading on 9 March 1999. In the Commons, the Second Reading is expected to take place in late March or early April.

Mick Hillyard

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Summary of main points

The Commonwealth Development Corporation (CDC) is, and has been for 50 years, an important part of the UK's effort to assist international development. CDC's primary role is to provide equity and long term loans in order to promote productive investment in the private sector in developing countries. CDC is perhaps better known in many developing countries than it is in the UK. It has investments in some 400 enterprises in 54 countries, ranging from agribusiness in Nicaragua to telecommunications in India and retail development in Soweto, South Africa. Around 80% of the portfolio is in countries with a per capita GNP of less than $1,600. CDC has sought to support enterprises that are commercially viable and economically and developmentally sound. CDC is funded by concessional (now interest free) loans from the Department for International Development (DFID) and accumulated reserves. Overall, CDC is charged with making a return on capital of 8 percent.

CDC is governed by its own legislation, primarily the *Commonwealth Development Corporation Act 1978*. Under that legislation, CDC is prohibited from supporting projects in the public sector such as schools, colleges and hospitals, although it can invest in public sector utilities. CDC also supports privatisation programmes in developing countries. CDC makes a contribution to the development of poorer countries that is additional to and separate from that made by DFID.

In October 1997 the Prime Minister announced that the Government proposed that CDC would be transformed into a so-called Public/Private Partnership (PPP). The principal reason was to facilitate the injection of private capital into an organisation that the Government described as an under-used asset. It has been the Government's intention, set out in the White Paper: *Eliminating Poverty: A Challenge for the 21st Century*,[1] to put legislative proposals to Parliament to pave the way for the creation of a PPP with the Commonwealth Development Corporation. This partnership, the Government argues, will benefit from its association with both Government and the private sector. In short, the PPP will enable CDC to contribute more effectively to the sustainable development of poor countries.

The Bill's main purpose is to allow the conversion of CDC from a statutory corporation into a public limited company, governed as other plcs, primarily by the *Companies Act 1985*. Perhaps most notably, the conversion will take place in such a way that the legal identity of CDC is continued uninterrupted by the conversion.

The purpose of the conversion is to establish a so-called Public Private Partnership (PPP) in which private investors can buy a majority stake of the shareholding, not exceeding 75%. The Bill also allows the Government to continue to provide financial assistance to CDC during the transitional phase when CDC is wholly Government owned. This financial assistance will be used to restructure the CDC financially with a view to making it attractive to private investors. Although the intention is to sell the majority shareholding of CDC, the

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1 Cm 3789, November 1997

Government will retain a substantial minority holding and certain rights as a holder of a so-called Golden Share. Successive Governments have retained similar special rights in a number of privatisations. A short background note of Golden Shares is set out in annex 1. There are strong views on both sides of the House about whether or not the conversion of CDC represents the latest example of a long line of UK privatisations. The Bill has no financial effects, although in due course the Consolidated Fund will receive the proceeds form the sale of shares and dividends arising from the Government shareholding. The Government, however, is committed to providing additional funds to DFID.

After Royal Assent is given, the next crucial date will be filing day, which will be determined by the Secretary of State and will culminate in the registration of CDC as a plc. At that time, the rest of the *Companies Act 1985* (amended by certain provisions in this Bill) will apply to CDC.

In terms of compatibility with the European convention on Human Rights, Lord McIntosh of Haringey told the Lords that:

> "In my view, the provisions of the CDC Bill are compatible with the Convention rights".

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I What is the Commonwealth Development Corporation?

> The Government fully agrees with the need to ensure that the attractiveness of the Public/Private Partnership to private investors is based on a successful record in managing equity and other investments, whilst retaining a focus on the poorer countries where CDC's distinctive expertise lies. The Government aims to secure the greatest overall development impact from the Public/Private Partnership.[2]

CDC is a public corporation that was established in 1948 as a statutory body with the purpose of promoting economic development in the developing countries in which it operates (mainly but not exclusively Commonwealth countries).[3]

CDC's primary role is to provide equity and long term loans in order to promote productive investment in the private sector. CDC also supports privatisation programmes in developing countries. It also manages and owns a number of its own companies, such as the fund management company, Comafin Management (Pvt) Ltd.[4]

Successive UK Governments have regarded CDC as an important part of Britain's overall aid effort and the Government's principal vehicle under the aid programme for directly helping the private sector in developing countries. Under the *Commonwealth Development Corporation Act 1978,* CDC is prohibited from supporting projects in the public sector such as schools, colleges and hospitals, although it can invest in public sector utilities. By investing in commercial enterprises, CDC seeks to make a contribution to the development of poorer countries that is additional to and separate from that made by DFID.

CDC's importance is reflected in the scale of its financial operations. As at 31 December 1997 estimated total investments were £1,600 million in 400 businesses in 54 countries.[5] In each of the last three years, CDC has made new investments of more than £275 million. New investments in 1997 totalled £284 million.[6] Further details are given on page 13.

A. How is it governed?

Although a public body, CDC operates on a quasi-commercial basis outside government-to-government channels.

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[2] Seventh Special Report, Government's Response to the Committee's Eighth Report, HC 1100, 1997-98.
[3] In 1994, CDC received permission to operate in South Africa and El Salvador.
[4] Comafin Management (Pvt). aims to provide long term capital for its investors by investing in private sector enterprises in Commonwealth countries. Comafin is based in Zimbabwe.
[5] CDC Annual Report 1997 and Annex A evidence to International Development Committee
[6] CDC Annual Report 1997 and Annex A evidence to International Development Committee

CDC is governed by the *Commonwealth Development Corporation Act 1978* as amended by the *Commonwealth Development Corporation Act 1982 and 1995*[7]. While fulfilling its primary purpose of helping developing countries, CDC must ensure that its income covers its expenses, taking one year with another. CDC is subjected to a framework of policy supervision by the Government, which comprises the following elements:

- five yearly reviews carried out by CDC and the interested Government departments under DFID chairmanship (Quinquennial Reviews);
- CDC's annual Corporate Plan, looking three years and 10 years ahead on a rolling basis;
- a twice-yearly submission by CDC, called a "Planning framework" submission setting out its financial projections for broadly the same period as the Corporate Plan;
- a requirement on CDC to seek political clearance through DFID for all individual investments over £2 million and also capital sanction for all investments over £5 million; and
- Government approval of countries, other than dependent territories, in which CDC may operate.[8]

As is normal for public corporations, the chairman and the board members are appointed by the Secretary of State. The current chairman is The Rt. Hon the Earl Cairns CBE and until recently the deputy chairman was Sir William Ryrie KCB. His successor is Ms Jane Armond. The chief executive is Roy Reynolds.[9]

II Funding

This section considers the sources and uses of CDC funding.

A. Sources of funding

Although CDC has a number of sources of funding, it relies most heavily on internal sources. These funds are supplemented each year by loans from the UK Government's aid programme and other providers such as the European Investment Bank.

1. Internal sources

Most of CDC funding for net investments is generated from its own portfolio of investments. In 1997, CDC generated some £254 million from its operations and made net investments of £284 million.

[7] These Acts essentially increased the borrowing limits for the CDC.
[8] Cm 1983, June 1992
[9] Full details of the membership of the corporation are set out in the annual report and in the CDC's website.

CDC's internally generated resources comprise interest receipts on its loans to projects, dividends on equity holdings, fees, the proceeds of equity disposals, and the difference between repayments of loans from projects and CDC's repayments of its own borrowings from the UK Exchequer. Essentially CDC borrows long (25 years) and lends short (average of 7 years). This difference in the maturity of its borrowing and lending allows CDC to exploit interest rate differentials, thereby adding to its surpluses. For example 27% and 39% respectively of CDC's internally generated funds in 1990 and 1991 were generated in this way.[10] Despite the heavy reliance on internally generated resources, the previous Government recognised the need to increase the borrowing powers of the CDC in order to allow CDC to expand further. Thus, the Commonwealth Development Corporation Act 1995, which amongst other things, increased the borrowing powers of CDC.[11]

2. Government loans

CDC is mainly funded by advances or loans from the Exchequer, most of them at concessionary rates, and since 1995 at zero rates of interest, reflecting the developmental value of its activities. At the time of the Bill's introduction, the cumulative total of outstanding Government loans was some £755 million. Loans are (notionally) for 25 years, although repayment (in equal instalments) begins after a grace period of seven years.

From April 1994 CDC was placed on "nil net funding regime" whereby interest payments were waived and new Exchequer loans limited to the level of principal repayments due from CDC to the ODA/DFID. This was later changed such that CDC was required to make net repayments of between £5 million and £10 million per year. However, for the fiscal year 1998-99, DFID has indicated that nil net funding will be re-established. This was announced on 3 November 1998. Clare Short said:

> The External Finance Limit for CDC for 1998/99 will be increased by £15,000,000 from minus £15,000,000 to zero. Advances to CDC in the current financial year will total £35,919,000 equal to loan repayments by CDC, achieving net zero financing in 1998/99. The increase will be offset within DFID's existing provision and will not therefore add to the planned total of public expenditure.[12]

As mentioned above, one important feature of CDC funding is the relatively little (net) cash support which it receives from the UK Government.

Net capital flow between CDC and Government comprises new loans from Government to CDC minus loan repayments. In 1997 this amounted to £10 million being paid by CDC to the Government. In the last five years net capital flow from Government to CDC has

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[10] Monopolies and Mergers Report, Cm 1983, June 1992

[11] The main purpose of the Act is to alter the limits on borrowing under section 9A and 10 of the Commonwealth Development Corporation (CDC) Act 1978; to make provision in relation to interest on advances to the CDC; and to make provision in relation to remuneration, pensions and compensation of members of the Corporation.

[12] 3 November 1998 c450W

amounted to £77 million, or 5.8% of the value of CDC's total net investment over the period. It is important to note that this refers to the flow of capital funds (before interest) for investment. This illustrates that Government has not been a major source of capital. Indeed in recent years, CDC's loan repayments to Government have exceeded new loans from HMG. See the table below.[13]

In terms of the net cash, CDC made a net cash payment to Government in 1997 of just over £23 million, down from £31 million in 1996.[14] Over the past five years, CDC has made a total net cash payment of £29 million to HMG. The table below sets out figures for each of the last five years.

Cash Flow from Treasury to CDC 1993-1997

£m

	1993	1994	1995	1996	1997	5 yr Total
New loans from HMG	75.0	45.1	53.7	26.4	23.0	223.2
Repayments to HMG	-26.2	-27.5	-28.0	-31.5	-33.0	-146.2
Net Capital Flow from HMG to CDC	**48.8**	**17.6**	**25.7**	**-5.1**	**-10.0**	**77.0**
Interest Paid to HMG	-14.5	-4.6	-2.8	-	-	-21.9
Net Capital Flow to CDC after Interest Paid	**34.3**	**13.0**	**22.9**	**-5.1**	**-10.0**	**55.1**
UK Corporation Tax Paid	-6.8	-15.5	-22.5	-26.3	-13.4	-84.5
Net Cash Flow to CDC	**27.5**	**-2.5**	**0.4**	**-31.4**	**-23.4**	**-29.4**
Memo:						
CDC's new investment	*217*	*240*	*276*	*305*	*284*	*1,322.0*
Net Capital Flow as % of CDC's new investment	*22.5%*	*7.3%*	*9.3%*	*n.a.*	*n.a.*	*5.8%*

Source: CDC and successive CDC Annual Reports

In terms of net capital flows over the last five years, CDC is a relatively small burden on the UK taxpayer. And when interest and corporation tax payments are included, CDC has contributed cash to the Government in three of the last four years. Overall, CDC has contributed some £29 million to public funds over the last five years, although it should be noted that it has had some benefit of interest free loans.

3. Reserves

Although CDC has no equity capital as such, it has built up substantial reserves over the years by earning surpluses on its operations. As at 31 December 1997, its reserves stood at

[13] Detailed financial information on the CDC is available from their Annual Reports that are available from the Library and are also posted on the internet.

[14] Net cash flow to CDC from Government comprises loans from Government minus loan and interest repayments and UK Corporation Tax Payments.

£486 million, some 39% of its capital employed (£1,243 million). Of the remainder, £755 million consisted of long term Government loans.[15]

4. European Investment Bank

ODA/DFID have supported CDC's borrowing from the European Investment Bank under Lomé IV (£27 million) to finance loans to small and medium sized enterprises in African, Caribbean and Pacific countries.

B. Use of funds

CDC has investments in over 400 enterprises in 54 countries. The enterprises cover a range of sectors, including agriculture, fisheries, minerals, industry, public utilities, transport, communications, housing, hotels, the processing, storing or marketing of products, building, engineering, enterprises providing financial managerial and consultancy, wholesaling, retailing and tourism services. For example, in 1997, CDC's investments included £4 million in Nicaragua's largest poultry producer, £4 million in Uganda's textile industries, £36 million in India's telecommunications services, another £6 million in polyester chips and £13 million in Philippines' cement industry. CDC also has property developments in Kenya, Uganda, South Africa and Zambia and retail development in Soweto, South Africa. CDC has generally participated in the smaller projects that tend not to attract large international banks.

Around 80% of CDC's portfolio is in countries with a GNP/capita of less than $1,600. Sub-Saharan Africa is CDC's largest single destination for investment, accounting for 33% of the portfolio by value.[16] DFID has also apparently requested a target of 70% of the portfolio by value in countries with a GNP per capita of less than $1,670. CDC also has an internal target of 30% of investments being made in Sub-Saharan Africa. These are the countries that have the most undeveloped private capital markets and least capital. CDC invests in new or existing enterprises, mainly in the private sector and across a range of industries. CDC's strategic direction is presently agreed with Government on the basis of Quinquennial Reviews. The strategic targets were last agreed in 1992: the targets and most recent performance against them are shown in the table below.[17]

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[15] Some £2.3 million is in the form of creditors, .CDC 1997 Annual Report, p44

[16] CDC's 1997 Annual report, p10

[17] Approvals refer to the number of projects that have been authorised by the Management Board.

Targets

	Minimum %	1997	1996	1995
Return on Investment (3 yr average)	*8*	7.6 (a)	8.1	8.1
Board approval in poor (IDA) countries	*70*	85	81	90
Approval in private sector	*80*	100	96	95
Equity as % of approvals (including quasi-equity)	*25*	52	33	43
Approvals in Africa (internal CDC target)	*30*	35	32	47

Notes:

(a) 8% before exceptional investment provisions for investments in SE Asia.

Source: DFID: Memorandum to International Development Committee

The table below shows the distribution of equity investments as at the end of 1997 by region and sector.[18]

Distribution of total CDC Equity Investments as at end of 1997 by income and sector.

Countries	Agri-business £m	Financial Markets £m	Infra-structure £m	Manufacturing and Commerce £m	Minerals, Oil and £m	Total E quity / Quasi-Equity £m
Upper-Middle Income	-	-	2.5	-	-	2.5
Lower-Middle Income	1.3	12.5	-	26.4	4.6	44.8
Low-Income	14.7	6.3	8.6	47.3	8.1	84.9
Least-Developed	8.8	0.5	-	3.6	5.0	18.0
TOTAL	**16.1**	**18.7**	**11.1**	**73.7**	**12.6**	**132.2**

Source: Eighth Report from IDC, 1997-98, Table 1

According to the CDC's 1997 annual report, the value of outstanding investments stood at £1,600 million at the end of 1997. Some 52% of the approvals for investment made throughout the year were equity or quasi-equity investments, compared with 33% in 1996. All the deals approved were with the private sector and 85% were in countries that fell within the World Bank's low income and lower middle income categories.

[18] CDC figures relate to calendar years.

Technical Box 1

Geographical Coverage

Commonwealth Development Corporation currently has investment in the following countries:

Anguilla, Bangladesh, Barbados, Belize, Bolivia, Botswana, British Virgin Islands, Cameroon, Cayman Islands, Costa Rica, Cote d'Ivoire, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, Fiji, Gambia, Ghana, Grenada, Guatemala, Guyana, Honduras, India, Indonesia, Jamaica, Kenya, Laos, Lesotho, Liberia, Malawi, Malaysia, Mauritius, Mozambique, Namibia, Nicaragua, Nigeria, Pakistan, Papua New Guinea, Philippines, St. Lucia, Seychelles, Sierra Leone, Solomon Islands, South Africa, Sri Lanka, Sudan, Swaziland, Tanzania, Thailand, Trinidad and Tobago, Uganda, Vanuatu, Vietnam, Zambia and Zimbabwe.[19]

III Financial performance

Various figures on the financial performance are set out in the table below.

CDC's Financial Performance 1994 to 1997

	1994 £ million	1995 £ million	1996 £ million	1997 £ million
Revenue	129	155	141	158
Surplus before tax and provision	116	152	130	139
Provisions	29	42	36	55
Surplus after tax and provision	63	75	63	64
Gross investments	1,373	1,487	1,526	1,562
New investments	240	276	305	284
Internally-generated funds	222	236	313	254
Return on capital employed (a)	8.7	8.1	8.3	7.6
Aid programme loans (net)	12 (b)	20 (b)	(-5)	(-10)
UK corporate tax paid	15.5	22.5	26.3	13.4

Source: CDC annual reports and evidence to International Development Committee
Notes:
(a) Three year average - as per target agreed with HMG.
(b) Net of interest.

In 1997, CDC's revenue rose by 12% to £158 million owing to higher levels of interest income and equity investment income. CDC's surplus before tax and provisions was £139 million compared with £130 million in 1996, an increase of 7%. The surplus after tax and

[19] HC Deb 14 December 1998 c342-343W

provisions was £64 million in 1997 almost unchanged from 1996. The investment provision against loss was increased from 2.3% of the gross investment portfolio in 1996 to 3.5% in 1997, reflecting the higher risk to CDC investments in South East Asia in the wake of the Asian financial crisis. Overall, this translated into a fall in the return on capital employed from 8.3% in 1996 to 7.6% in the three years to 1997.

The downward trend in the rate of return may prompt some concern about CDC's ability to attract private partners. However, the Government has sought to put effect of the Asian crisis on CDC's finances in context.

> The Government's target for CDC's return on capital employed has been a three year average of 8%; adverse market conditions in 1997 (which have continued into 1998) have had an impact on returns but, in general, CDC has achieved the target with profitability levels above those of other Development Finance Institutions. However, Government and CDC are aware that returns at this level will not be sufficient to attract funds from the private capital markets and CDC will be seeking to increase profitability. This will come partly from continuing the shift to equity investments, which give CDC a better balance between risk and reward in their investments. Strong private sector skills and willingness to take risk are required to make equity investment successful, an approach which will be reinforced by creation of the Public/Private Partnership. CDC's method of working, which relies on close management of equity positions, also improves its ability to identify and pursue good investments.[20]

IV Overall purpose of the Bill

The Bill is the first stage in the creation of a Public Private Partnership (PPP) for CDC.

> The purpose of the Partnership may be summarised as "to maximise CDC's success in creating and growing long-term viable businesses in developing economies, especially the poorer economies, achieving attractive returns for shareholders and implementing ethical best practice".[21]

In making the announcement in October 1997 that CDC would become a PPP the Prime Minister said that he believed CDC was an under-used resource. The Prime Minister said:

> I think Lord Cairns, the Corporation’s chairman, will agree that the Commonwealth Development Corporation has demonstrated how effective well-targeted investment can be in increasing prosperity. It has £1.6 billion invested in projects from the regeneration of tea plantations in Western Uganda to computer

[20] Seventh Special Report, Government's Response to the International Development Committee's Eighth Report, HC 1100, 1997-98

[21] DFID Memorandum to International Development Committee, May 1998

> software development in South India. The Corporation has made a major contribution to Britain's efforts to promote economic development, particularly in areas of greatest need, such as sub-Saharan Africa and South Asia.
>
> But, despite this success, I believe it is an under-utilised asset. It can do more. It has the capacity to play a much greater role in mobilising new private finance for poor countries.
>
> One of the most important developments in new Labour was the breaking down of public-private barriers. I am less interested in whether an institution is public or private, than whether it works. The CDC is a public institution. I believe it can be improved by becoming a public/private partnership.
>
> I can announce that we have decided to allow the CDC to develop a new relationship with the private sector. This will require legislation to allow private investors to invest money in CDC, turning a state corporation into a partnership between the public and private sectors. Some of this money will take the form of lending and some will be equity. The Government will retain a substantial minority holding and will continue to set a framework for the corporation's operations in order to preserve its unique character and special skills.
>
> This new partnership will allow the CDC to borrow on the capital markets. It will give the Corporation substantial extra funds each year to invest in development.
>
> I can also promise that all the money the Government raises from this sale will be ploughed straight back into our development programme.
>
> For investment to prosper, investors need clear rules, honest practices and stability. The Code of Good Practice discussed by Finance Ministers in Mauritius needs to be agreed quickly. It should encourage investment throughout the Commonwealth. Businesses will only invest if they know that their money is properly protected.[22]

The case for establishing a Public Private partnership was recently outlined by CDC in the evidence to the International Development Committee.

> As part of the wider Departmental Spending Review DFID considered the future policy options for CDC. It was recognised that CDC, with its long experience of managing businesses and investing in developing countries, was a unique asset that could make a more substantial contribution to the sustainable development of these economies and help mobilise other, private, capital. A dynamic CDC, successfully investing and mobilising private capital into the poorer economies of the world, could not only have a direct effect on growth but also a strong

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[22] Commonwealth Business Reform, Speaker: Prime Minister, Location: Edinburgh, 22 October 1997

> demonstration effect by showing that private investors can achieve attractive returns from investing in poorer countries.[23]

The Bill covers three main areas: registering CDC as a public limited company (plc), capital restructuring and establishment of a partnership.

A. Conversion into a Public Limited Company

The Bill allows CDC to become registered as a public limited company under the Companies Act after being a public corporation. Under a typical privatisation, legislation would usually transfer the assets of the public corporation to a newly formed "successor company". But under this Bill, however, the corporation is directly converted into a public limited company without creating a new legal entity. The legal identity of CDC continues uninterrupted.

The effect of taking this unique route is that no assets will be transferred out of the existing CDC. The significance of this is that CDC's assets throughout the world will not need to be transferred to a successor company, according to the national laws of the host country. Not only does a direct conversion avoid time-consuming work, but also probably avoids paying unnecessary fees and taxes in a number of host countries. Lord McIntosh of Haringey told the Lords:

> We were advised that, had the "successor company" method been used it would have been necessary also to make sure that all CDC's individual assets were successfully transferred under local laws applying in all the countries in which CDC operates. That could have been a costly and time-consuming exercise which would have diverted CDC's staff around the world from getting on with the real business of the corporation.[24]

Although the precise date of conversion is not specified, the Government's stated intention is to proceed with this conversion soon after the Bill receives its Royal Assent.

B. Capital restructuring and financial assistance

The Bill contains provisions needed to restructure CDC's balance sheet to give it a financial structure that better suits the needs of the partnership. This area of the Bill also makes provision for the continuation of Government financial assistance in the period when CDC plc is wholly owned by Government. Lord McIntosh of Haringey told the Lords how the restructuring would take place:

> CDC currently does not have any share capital. Once it is restructured, CDC will be in a legal form which will provide a vehicle for the introduction of private

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23 DFID Memorandum to International Development Committee, May 1998
24 HL Deb 7 December 1998 c724

> sector capital through the sale of shares and the function of debt. This in turn will establish a more appropriate financial structure for CDC and provide a cost of capital over and above which CDC must generate a required return.
>
> The restructuring will be achieved by initially converting a proportion of CDC's historic loans from the Government into share capital which will be owned by the Government and held by the Secretary of Sate as nominee. The conversion will be achieved by the waiver of existing loans made by the Government in return for the issue by CDC of new share capital. All the share capital initially issued by CDC will be owned by the Government.
>
> The new balance sheet will also contain loans from the Government on commercial terms. The amount of these will be set to balance the need for capital efficiency with an appropriate degree of risk and to allow the business to grow in the future. Post the partnership CDC will be able to raise the funds it requires to support its ongoing operations by borrowing from the private sector on commercial terms.[25]

The Bill allows the Secretary of State to waive loans made to CDC while CDC remains wholly owned by the Government. Since the Government will initially own all the share capital in CDC, there will be no loss in value through the waiver of these loans: share capital is simply substituted for the existing loans. When the Government subsequently sell part of their shareholding they will effectively receive the value for the financial support they have provided to date.[26]

C. Partnership and listing on Stock Exchange

In order to secure a spread of interest in the partnership, the Government will seek a listing on the stock exchange. The Government has not given any specified date when this will occur, evidently because of the number of factors, especially market conditions, that could affect the timing.

> It will take time to prepare for listing and for CDC to establish a financial track record attractive to the market. Because of this, listing may not be possible at the time when other conditions are right for the creation of the partnership. In that case we would look at alternatives for a transitional period. Decisions will be taken on these matters in the light of advice nearer the time. The important thing will be to secure the greatest overall development impact and to ensure that capital is introduced at the right time for the business.
>
> That timing depends on a number of factors, including market perceptions of pre-emerging markets and of CDC's track record and forecast performance. The Asian crisis, for example, has had a serious impact on current market perceptions

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[25] HL Deb 12 January 1999 CWH5-6

[26] HL 12 January 1999 CWH5-6

> of emerging markets. But as Asia recovers, appetite for investing in emerging markets is likely to return, although perhaps with more concern about the type of investment. Financial track record is also key. The Government's target for CDC's return on capital employed has been a three year average of 8%. Adverse market conditions in 1997, which have continued into 1998, have had an adverse impact on returns but, in general, CDC has achieved the target with profitability levels comparable to or above those of other development finance institutions. But we are aware that returns at this level will be too low to attract private funds, and CDC will be seeking to increase profitability. This will come partly from continuing the shift to equity investments which provide a better balance between risk and reward than long-term loans, as well as doing more to help create and develop long-term sustainable business. CDC's method of working, which relies on close management of equity positions, puts it in a strong position to identify and pursue good investments.[27]

Baroness Amos said the Government was seeking to maximise proceeds from the sale when the market conditions are right. She said:

> There is a clearly a need for CDC to build a track record of successful equity investment in preparation for sale. Our intention is to create a long-term partnership in which Government will have a significant stake; it is not to exit CDC.
>
> A decision on the timing of the sale will be taken in the light of what is best for development. These interests would not be served by going to the market too early. Market conditions are one factor and if those were right, say, 20 months after enactment and if CDC was ready, we would not want to miss the opportunity.[28]

In the Grand Committee Baroness Amos sought to reassure Peers that transformation would proceed as soon as practicable after the Bill was enacted. She said:

> I should like to reassure him that there is no danger that the CDC will be left in limbo. It is intended to proceed with the transformation as soon as is practicable after the Bill has been enacted. We shall need to undertake a number of administrative steps before transformation can be effected, some of which are quite simple. The only reason not to proceed quickly would be if some unforeseen major difficulty arose which would not make it appropriate so to do. In that case it would not be helpful to have an enforced time limit.[29]

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[27] HL Deb 7 December 1998 c723
[28] HL Deb 12 Jan 1999, CWH8
[29] HL Deb 12 January 1999 CWH2

V Issues

The following section considers a number of issues that have been raised by the Government's proposals to establish a PPP.

A. The case against privatisation

During the quinquennial review of 1993 the then Government decided that CDC should remain unchanged as a public corporation and should continue to form an important part of the overseas aid effort.[30] The relevant extract from the 1993 review setting out the case for and against privatisation is reproduced below:

> Privatisation
>
> 3.5 CDC already seeks to operate in accordance with private sector disciplines. However, privatisation would bring private sector pressures to bear even more sharply on CDC operations. Depending on the nature of the privatisation, CDC's management team (already largely drawn from the private sector) might remain intact. Privatisation would also provide CDC with access to commercial sources of finance, which are at present unavailable other than in exceptional circumstances when it is able to meet HMG's criteria for such borrowings.
> 3.6 Under certain circumstances, ODA could also still use a privatised CDC to secure its aid objectives. Aid funds could be provided to be managed by CDC for specific aid purposes (e.g. investment in poorer developing countries).
>
> 3.7 However, there would be some major drawbacks and difficulties in privatisation. The main one is that Government would lose strategic control: a private sector CDC would not deploy the total resources available to CDC including proceeds built up over the years from previous Government finance in support of the Government's aid objectives. To secure an improved rate of return, private sector owners would be likely to have to change the geographical distribution of CDC's portfolio and would be less willing to undertake what they perceived to be riskier investments in poorer markets.
>
> 3.8 We also considered whether there were alternative bodies which could fulfil CDC's functions. We concluded that the main alternative bodies, in particular the IFC, tended to work mainly in stronger developing countries; and to complement rather than substitute for the work of CDC. The argument in paragraph 3.6 also suggests that it is unlikely that the private sector would fill the policy gap left if CDC ceased to operate.
>
> 3.9 One argument (though not the decisive one) for privatisation is the financial return to Government which might result from the sale of CDC or of its Portfolio. At first sight this could be substantial: CDC Group assets net of loans due to

[30] Evidence to Foreign Affairs Committee, 21 April 1993.

> Government (i.e. its Reserves) at 31 December 1992 were £284 million. We did not make a detailed estimate of how much of this could in practice be realised. Much would depend on the time scale in which a sale could be undertaken. However, it is reasonable to conclude that an early sale of most or all of CDC's business could only be carried out at a substantial discount to book value. In regard to sale of individual assets there would also be serious practical and legal difficulties in selling particular loan obligations.[31]

In a written statement Mr Hurd, the then Foreign Secretary, confirmed that CDC would stay in the public sector and would maintain its role in the UK aid programme. He said:

> As previously announced, the Government have decided to retain CDC in the pubic sector. As a consequence, no fundamental changes are proposed in CDC's capital structure at present. However, to allow for the planned expansion of activities the Government intend subject to parliamentary time, to legislate to increase the ceiling on CDC's outstanding borrowing power.[32]

Amongst the reasons for not privatising CDC at that time was the concern that a privatised CDC would have a financial structure and aims and objectives that were inconsistent with its developmental role.

B. The case for establishing a PPP

The case for establishing a PPP was outlined by DFID in a memorandum to the International Development Committee. The relevant section is reproduced below:

> 4. OPPORTUNITIES AND CONSTRAINTS
>
> 4.1 As part of the wider Departmental Spending Review DFID considered the future policy options for CDC. It was recognised that CDC, with its long experience of managing businesses and investing in developing countries, was a unique asset that could make a more substantial contribution to the sustainable development of these economies and help mobilise other, private, capital. A dynamic CDC, successfully investing and mobilising private capital into the poorer economies of the world, could not only have a direct effect on growth but also a strong demonstration effect by showing that private investors can achieve attractive returns from investing in poorer countries.
>
> Equally, it was recognised that while CDC remained wholly in the public sector it would not expand substantially. Like other similar public sector bodies it is subject to public sector financial controls. The CDC has the power to borrow commercially but if it did so in the UK in order to invest more in developing countries, this would count against the Public Sector Borrowing Requirement (PSBR). Within an agreed public expenditure framework this would require a

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[31] Review of the Commonwealth Development Corporation, ODA, 1993

[32] Evidence to Foreign Affairs Committee, 21 April 1993.

corresponding reduction in DFID's development assistance expenditure allocation. CDC would, additionally, be required to borrow on terms no less advantageous as those on which Government could itself borrow (the least cost rule).

4.3 CDC could borrow overseas to a limited extent in order to invest in developing countries without it counting against the PSBR, though it must still meet the least cost rule. In practice the scope for meeting the least cost rule is very limited as CDC has found in recent years. The only example of such borrowing is from the European Investment Bank which has provided limited funds on favourable terms for onward investment in developing countries.

4.4 CDC can and does manage third party funds to a limited extent (for example the Commonwealth Private Investment Initiative Funds) but it cannot as a statutory corporation introduce private capital directly into its own operations.

4.5 Even with a growing development assistance programme, financing CDC exclusively from public funds will always face firm limits and have an opportunity cost: i.e., we would have to do less in other areas.

5. PUBLIC/PRIVATE PARTNERSHIP

5.1 We therefore concluded that CDC could contribute more effectively to the sustainable development of poorer countries if we established a long-term public/private partnership that would benefit both from its association with Government and from the participation of the private sector. The introduction of private capital would enable CDC to make a lager contribution to development.[33]

C. The case for delaying the establishment of a PPP

The International Development Committee (IDC) was sufficiently concerned about the future of CDC that in its report it recommended that the PPP be delayed. The relevant extract is reproduced below:

We therefore recommend that the establishment of the Public/Private Partnership be delayed until:

(a) the precise details of the Public/Private Partnership have been decided, and further research has been undertaken to establish private sector interest in the transformed Commonwealth Development Corporation;

(b) the Commonwealth Development Corporation has undertaken the necessary shift in management focus and skills-base necessitated by the move to increased equity investments; and

> (c) the Commonwealth Development Corporation's equity portfolio has been expanded sufficiently for a track record to have been established which demonstrates the profitability of equity investments in developing countries.[34]

The Government's response to this recommendation was that the process of making CDC attractive to the private sector would take time, the process had already begun, and that it was important to maintain momentum.[35]

D. Use of proceeds

The Prime Minister said on 22 October 1997:

> I can also promise that all the money the Government raises from this sale will be ploughed back into our development programme.[36]

This promise was reiterated in the White Paper, *Eliminating World Poverty* and again in the *Comprehensive Spending Review*.[37]

> The Government has therefore decided to sell a majority share of the CDC as soon as possible - which should realise several hundred million pounds - and to recycle this money into aid spending. Some of these resources have already been included in the aid budget. The remainder will be added to the aid budget in the financial year 2002-03.[38]

Finally, at Second Reading, the Minister said:

> The proceeds from introducing private capital into the CDC will be used for development assistant programmes...and not go straight into the Treasury pot.[39]

In a written answer Clare Short said that the extra funds for the development budget were guaranteed even if the proceeds were not realised in full. She said:

> There was no expectation of any proceeds in 1999-2000. As I have made clear, the figures for the development budget announced at the time of the Comprehensive Spending Review took account of some of the anticipated proceeds in subsequent years from the sale of the Commonwealth Development Corporation. However, if the proceeds were not realised in full, the development budget would nevertheless be maintained at the levels announced for 1999-2000 to 2001-02.[40]

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33 HC 766 1998/99 DFID Memorandum to International Development Committee May 1998

34 International Development Committee, Report into CDC

35 Seventh Special Report, Government's Response to the Committee's Eighth Report, HC 1100, 1997-98

36 Commonwealth Business Reform, Speaker: Prime Minister, Location: Edinburgh, 22 October 1997

37 Cm3768 and Modern Public services for Britain: investing in reform, Cm 4011 (chapter 16) respectively.

38 Modern Public services for Britain: investing in reform, Cm 4011

39 HL Deb 7 December 1998, c 739

40 HC Deb 1 February 199 c435W

Lord McIntosh of Haringey said:

> It is certainly true that every single statement by Ministers, from the Prime Minister down, from the beginning of this exercise to date and from now on, has confirmed that it is the intention of the Government that the proceeds of any sale should go into the development budget rather than into the general Consolidated Fund. We have already agreed with the Treasury that the proceeds will be used for the development programme. This will be reflected in the public expenditure accounts. As the noble Baroness knows, the Comprehensive Spending Review, which was carried out last year and which resulted in the Statement on the Comprehensive Spending Review, operates for three years ahead. Therefore, it is prudent that the Comprehensive Spending Review should include, as it does, provision for receipts from privatisation towards the end of that three-year period.
>
> As we do not know the date of the final stage of the public/private partnership, clearly there might need to be some moving of these receipts from one year to another. We cannot be any more precise than that. Nevertheless, I can confirm that the Government's income and expenditure plans include the provision that receipts from the public/private partnership will go into the development budget, and only into the development budget. It makes sense for us to have an allocation in advance of the sale in order to plan expenditure and make best use of it, rather than spending receipts in one particular year.[41]

E. Minimum Government shareholding and the Golden Share

The Government proposes to retain a minimum shareholding of 25% and a Golden Share for a non-specified time. The Bill proposes that this shareholding can only be reduced by approval from the House in the form of statutory instrument by virtue of clause 18.

The Government sees the Golden Share as ensuring that the ethical investment policies that are fundamental to the CDC are protected and so enshrined that they can only be changed with the approval of Parliament. Lord McIntosh of Haringey said:

> The Golden Share does not mean that the Government will take the largest share of the risk; the Golden Share will ensure that the ethical investment policies, which are the fundamental basis of the CDC and will remain so, are enshrined in legislation, and are protected and cannot be changed without the will of Parliament.[42]
>
> It is one thing to have a golden share, but it is another to convince investors that we are also willing to put our money where our mouth is. For the Government to put a significant minimum into these investments - which are defined by the Memorandum and Articles of Association of CDC plc - and in order to attract the private investment we want, we think it is necessary both to insist on investment

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41 HL Deb 12 January 1999, CWH9-10

42 HL Deb 2 Jan 1999 : cCWH12

> policies and to maintain a substantial economic interest to enable the Government to continue to have a stake in and benefit from CDC's future success. I am grateful to the noble Lord, Lord Redesdale, for what he said in that regard.
>
> In practice the 25% shareholding is significant, as the noble Baroness well knows. This is the point at which the golden shares can be redeemed by CDC without Government agreement. That is in Article 11(F)(ii) of the draft articles of association. The Golden Share contains rights over a number of important areas such as investment policy and the right to appoint directors. We believe that the market would not respond positively if the Government's retention of such rights were not backed by this substantial interest in CDC through their ordinary shareholding.
>
> Under company law, 25% is the level at which minority shareholders have the right to block unwanted changes in the articles of association, so it has a legal as well as an economic significance.[43]

The Government's retention of 25% of the shareholding may be significant in symbolic terms. However, in terms of exercising control over CDC, it may be argued that the Government's minority shareholding is somewhat superfluous given that the Government retains special powers by virtue of its Golden Share.

F. Special tax treatment

One controversial issue is whether CDC should be allowed to engage in tax avoidance measures such as moving its headquarters offshore to a so-called tax haven when operating as a plc.

The issue attracted much interest in the Lords. In Grand Committee, Lord Redesdale expressed concern that CDC's profit would be significantly reduced by corporation tax. According to Lord Redesdale, CDC would be expected to make a return of around 15%, which would be difficult to achieve if CDC is forced to repatriate its profit to the UK.

One option for CDC would be to allow it to do what other companies in the field apparently do which is to go off-shore, perhaps to the Cayman Islands, and avoid paying UK corporation tax. Another, but exceptional, option would be to provide some special tax provision for the CDC[44]

Although moving offshore would be lawful and perhaps justifiable in such narrow terms as probably increasing both net profits and the level of investments in poorer countries, such a move would be considered by some to be generally unacceptable for an enterprise with a substantial Government shareholding.

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[43] HL Deb 2 Jan 1999 : cWH11-CWH12

[44] 12 Jan 1999 : Column CWH13

In Committee, Lord McIntosh of Haringey told the Lords that:

> I had hoped that by the time we reached Committee stage we would have something definite and final to say about the way in which this problem will be solved, but, as it is, I do not believe that I can do more than read out the current state of play.[45]

And later:

> The Secretary of State for International Development has said publicly - the noble Baroness has reminded us of this - that it is politically unacceptable for CDC to go offshore.[46]

In early February 1999 the Secretary of State for International Development, Clare Short, told the House in a written answer that:

> We are working with HM Treasury and the Inland Revenue to produce a tax solution that will encourage investment in the poorest countries through the CDC public private partnership. Parliament will have the opportunity to scrutinise our proposals.
>
> The Commonwealth Development Corporation needs to be tax efficient if it is to be able to achieve its goal of investing in developing countries using private capital raised within the context of a competitive private investment market dominated by offshore funds. In order to compete directly with offshore funds for private capital for investment in its area, CDC would need to provide a similar financial return. A material UK tax charge within CDC would make this less achievable.[47]

In a written answer in mid February, Lord McIntosh of Haringey said:

> The Government have agreed the broad principles for a tax solution that will provide the Commonwealth Development Corporation Public Private Partnership (PPP) with the required tax efficiency. Work is continuing on the details. Necessary amendments to the CDC Bill will be introduced at the appropriate time. We do not anticipate that this work will delay the creation of the PPP.[48]

However, these assurance did not fully satisfy Baroness Rawlings who moved the following amendment to clause 27:

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[45] 12 Jan 1999 : Column CWH15
[46] 12 Jan 1999 : Column CWH15
[47] HC Deb 3 Feb 1999 c639W
[48] HL Deb 16 February 1999 C74WA

> Page 11, line 27, at end insert--
> "(3) With the exception of this section this Act shall not come into force until the Secretary of State has laid in draft before the House of Commons an order contained in a statutory instrument making such provision relating to the tax liability of the CDC as will encourage private sector investment in it, and the order has been approved by resolution of that House."[49]

Lord McIntosh of Haringey made it clear that if the amendment were added to the Bill it would be the Government's intention to ask the House of Commons to remove it and to make the necessary substantive provision about tax by further amendment to the Bill. He concluded by saying that on that basis, he would advise his noble friends not to oppose it. The amendment was subsequently agreed and made.

When announced, the solution to the dilemma over CDC's tax treatment may involve the following elements:

- CDC will not be permitted to move offshore, at least for some time, perhaps for as long as the Government retains its Golden Share;

- Some special arrangement may be available to CDC which will provide the same degree of tax efficiency as private investment market dominated by offshore funds; and

- The necessary amendments will require primary legislation and will be introduced to the CDC Bill at the appropriate time in the House of Commons.

G. CDC's investment policy and developmental role

A CDC operating in the private sector with a purely commercial orientation may conflict with a desire to maximise the developmental impact of its operations. This conflict may manifest itself in terms of CDC moving away from certain projects or countries. This potential conflict between developmental impact and commercial viability in the choice of country was recognised in the previous Government's Fundamental Expenditure Review into the ODA.[50] That review recommended that on balance the department should confirm its preference for CDC to maximise its developmental impact rather than its financial return. The potential conflict between commercial and developmental objectives has also been recognised by Clare Short.

> If you just privatised [the Commonwealth Development Corporation] and left it to commercial imperatives it would pull itself out of the poorest countries. Commercial imperatives do not work there, you can get a more reliable, higher

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[49] HL Deb 9 March 1999 c128-131
[50] ODA Fundamental Expenditure Review, July 1995

> rate of return if you move off to the middle-income countries or richer countries.[51]

The tension between commercial and developmental objectives in the choice of projects supported is also implicitly recognised in the CDC's Investment Policy to the extent that certain investments, such a tobacco and arms manufacturing, are prohibited. The Government also recognises that private investors may seek to change the nature of business somewhat.

> 6.2 The nature of business activities may change to some degree as a result of the new Partnership. Investors would be buying into CDC because of its strengths and existing competitive advantage and it is unlikely that they would seek a material change in the nature of the business. The focus on agri-business, infrastructure, manufacturing and financial services is expected to continue. CDC would continue to operate equity funds, which offer finance for smaller business. There would also be opportunities for CDC to manage programmes for DFID, for example to target micro enterprise.[52]

According to the Government, by protecting CDC's investment and ethical policies, its development role will not be sidelined. The elements of the Government's approach are outlined below:

- CDC's Memorandum will set out the objectives of the company as being to invest in developing economies and to implement policies designed (in the opinion of Directors) to maximise the creation and long-term growth of viable businesses in developing economies, especially the poorer economies, to achieve attractive returns for shareholders and to implement ethical best practice.

- The Articles will set out the requirement for CDC to have, implement and report on investment and ethical policies designed to achieve CDC's objectives.

- Both Investment and Ethical policies will be put in place before inviting private participation and establishing the Partnership.

- The Investment policy will set specific targets for the percentage of new investments that are made for the benefit of poorer economies. There will also be a requirement to continue to focus on sub-Saharan Africa and South Asia, reflecting CDC's present strategic direction. The investment policy could only be changed with the agreement of the partners. The details are set out below:

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[51] Eighth Report from the International Development Committee, Session 1997-98: The Future of the Commonwealth Development Corporation, HC 1100, 1997-98, para.26

[52] DFID Memorandum to International Development Committee, HC 766, 1997-98

> Projects that provide an "immediate or prospective economic benefit of a country in CDC Universe or geographical area as stated in the First Schedule.
>
> Other countries may be added to the list provided they are classified by the World Bank, on the basis of GNP per capita, as "low income", "lower middle income" or "upper middle income" and their addition has the approval of an ordinary resolution of CDC shareholder and, while CDC has a special shareholder, the approval of the special shareholder.
>
> At least 70% of the aggregate costs of Investments by CDC or Approved Investment Vehicles over any five consecutive financial periods, will be, in the opinion of the Directors, for the immediate or prospective economic benefit of poorer countries.[53]

- Any changes to either will require the consent of the Golden Shareholder, as well as a majority of ordinary shareholders. This is designed to safeguard the content of the investment policy.

- The CDC Partnership will also be required to implement and report on a code of ethical policy and practice which meets international best practice. The code will cover various issues including social and environmental appraisal, response to human rights abuses, activities which CDC will not invest in, and standards, for the managed businesses, for a range of issues including health, housing and employment. Entrenchment of the ethical policy will protect CDC's Statement of Business Principles and other elements of the ethics policy, and enable this to set the guide and standard proposed by the Committee.[54]

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[53] See CDC Investment Policy -in draft. http://www.dfid.gov.uk/public/news/news_frame.html

[54] Seventh Special Report, Government's Response to the International Development Committee's Eighth Report, HC 1100, 1997-98

Technical Box 2

Potential Mismatch between Commercial Viability and Developmental Value

The potential mismatch between commercial viability and developmental value can be summarised in the table below:

Commercial Viability	Developmental Value	Comment
Low value	High value	**A** Conflict between commercial and development value. CDC may require some financial assistance to support such projects, perhaps from DFID or some other development agency. Subsidies may be needed.
High value	Low value	**B** Conflict between commercial and development value. CDC may be discouraged from engaging in this commercially profitable project. Restrictions may be needed.
High value	High value	**C** Consistency between commercial and developmental value. No problem as investment scores highly on both commercial and development.

Situation A denotes an investment that while having a poor commercial value may nevertheless have a high developmental value. For example, this may be typified by some investments in impoverished but risky countries. By agreeing targets on its allocation of investment funds amongst poorer countries, CDC will go some way towards addressing this mismatch. However, a commercially driven CDC may require further encouragement to support such developmentally sound investments even in countries that it has targeted. For example, the project may have a weak commercial case because of very high transport costs or low purchasing power in areas in or adjacent to undeveloped rural areas. And yet the project could have the potential to score highly in developmental terms such as through job creation or service provision. A CDC with a sharper commercial orientation may become less interested in supporting such projects. CDC may require some form of financial support, possibly form DFID or some other developmental agency in order to support such projects.

Situation B represents those projects that while very commercially attractive may generate very little or no developmental value. Possible examples might include projects in upper middle income countries or projects in poorer countries such as tobacco companies, arms manufacturers and toxic waste dumps that cause environmental damage. An enterprise with a high developmental focus would avoid such projects. In the past, CDC has refused to support some commercially profitable projects that have shown low developmental value, such as projects that rely on market distortions like excessive import tariffs or abusive monopoly power. In future, however, some limits may be necessary to ensure that this balance towards development is maintained when CDC becomes commercially driven. Of course, such externally imposed limits may become unnecessary if CDC establishes itself as an important niche private investor; supporting only those projects that show high developmental value, even when the commercial case may be less emphatic.

H. Terminology

Terminology is another issue that that attracted some interest. There are two terms (privatisation and development) that are conspicuously absent from the Government's argument for transforming CDC into a PPP.

1. Privatisation

The term privatisation is absent from the Bill and accompanying documentation. Despite this, the conversion of CDC into a PPP is in most respects fairly typical of a partial privatisation.

In a typical partial privatisation a public corporation is converted into a plc and, under Treasury rules, a majority of the shareholding is sold to the private sector. Once sufficient control has passed from the Government, CDC, like previous privatisations will not be classified to the public sector. As in all privatisations where the Government retains a minority shareholding and has limited control, future borrowings by the enterprise will no longer score in the public finances. As in some previous privatisations, the Secretary of State retains a Golden Share, with important rights, for an indefinite period. As with a typical privatisation, the PPP will generate capital proceeds for the UK public purse.

However there are some important technical differences between the PPP and previous privatisations. First, whereas in typical privatisations the capital proceeds were paid into the Exchequer, the proceeds arising from the sale of the majority shares in CDC will then be recycled back to the Department for International Development. A second difference between a typical privatisation and the conversion of CDC is that the latter will be converted directly into a plc whereas the typical route usually involves the formation of a successor business. Under CDC conversion there will be a continuity of legal identity. Although this unique treatment requires modifications to be made to the *Companies Act 1985*, it is nevertheless a fairly technical feature and has more to do with a desire to avoid costly and bureaucratic conversions in each of the separate countries in which CDC operates. It has little to do with any substantive difference with established features of privatisation.

Baroness Rawlings said that she could not understand the Government's distinction between privatisation and public private partnership. She said:

> During the Second Reading debate, the Minister felt that I did not understand the difference between part privatisation and public/private partnership. He explained, too, that the difference between the two lies in the destination of the proceeds. That is highly innovative semantics, which I cannot accept.
>
> The Oxford English Dictionary, under the heading "privatisation", refers only to the source of money, namely, the private sector, and not its destination. The label "partnership" appears to suggest that the public and the private sectors are on an

> equal footing. In this case, this is not true, as the public partner has powers to veto changes on crucial areas, such as the investment policy, the business principles, the right to appoint directors and their number.[55]

In reply Lord McIntosh of Haringey said:

> I am perfectly prepared to accept the dictionary definition in relation to the source rather than the destination of the proceeds, although it is a hugely important political point that we want to make, and perhaps I chose the wrong occasion to make it. Any proceeds from the private sector will go into the development budget rather than into the Treasury pot.
>
> Even in semantic terms, I do not agree with the noble Baroness that partnership requires that the partners should be on an equal footing. There can be minority and majority partnerships, and this is indeed what is proposed in this Bill. It is proposed, in primary legislation, that the participation of Government in the ultimate partnership shall be not less than 25%, which is deliberately a significant element and justified by the word "partnership".[56]

2. Development

Development is a term that is absent from the Bill and seems to have only one significant mention in the accompanying documentation. Again this may simply be a question of semantics but on the other hand it may also represent something more substantive such as change in the investment approach of CDC as it becomes increasingly detached from DFID.

CDC's constitution and powers are laid down by Acts of Parliament, consolidated in the *Commonwealth Development Corporation Act 1978*, supplemented by the *Commonwealth Development Corporation Acts of 1982 and 1986*. Under the legislation, CDC is charged with the task of assisting overseas countries in the development of their economies. In the 1978 Act, section 2(1) states:

> The purpose of the Corporation shall be to assist overseas countries, in accordance with the provisions of the Act, in the **development** of their economies. *[Emphasis added*].

Without defining the meaning of development, the legislation then went on to identify the classes of enterprises that would be supported. CDC's 1997 annual report stated:

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[55] HL Deb 12 January CWH2
[56] HL Deb 12 January CWH3

> CDC's **Development** Role and Investment Criteria
>
> CDC contributes to the **economic development** of poorer countries by investing in and supporting he operations of business enterprises which are commercially viable, economically sound and which meet international social and environmental standards. It does so on the basis that through its participation CDC can add value and that the enterprises will become self-sufficient.

The 1997 Annual Report went on to state that

> Alongside a detailed assessment of the financial viability of an investment, CDC gives careful consideration to its social and environmental impact.

The importance of development was underlined by the Secretary of State for International Development in a speech on the role and functions of the new department in May 1997. She said:

> So what will DFID do that is actually different from its predecessors? In brief, it will ensure that we will protect the long-term interest of the people of the UK, which is the development of a safer and more just world. We are also committed to bringing ethics into our foreign policy. And this means that the needs and interests of the developing world are properly considered. Within the framework of overall UK policy, DFID will act as an advocate for **development** - and has been given the weight to act as an effective advocate.

And went on to say:

> So the key difference between the approach of this Government and its predecessor is that we are determined to keep **development** and the elimination of poverty at the centre of our agenda. This is a Government with a clear vision of where we want to go and how we want to get there. Our relationship with developing countries is a crucial part of that vision; and I am delighted that I and the Department for International Development will be at the heart of the process.[57]

As noted above, in contrast, the term development is missing from the CDC Bill and its accompanying documentation. The way that CDC is expected to do business is set out in its Mandate:

> To maximise CDC's success in creating and growing long term viable businesses in developing countries, achieving attractive returns to its shareholders and implementing ethical best practice.[58]

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[57] Speech by Rt. Hon Clare Short MP, Secretary of State for International Development: The Role and Functions of the DFID, 28 May 1997, London

[58] Statement of Business Principles, CDC

This is narrower in its scope. CDC argues that its Business Principles will support and reinforce its development focus, keeping in mind the PPP mandate of long term viability, attractive returns for shareholders and best practice. CDC's Business Principles, which are largely its ethical policy and code of conduct are: honesty, confidentiality, objectivity, integrity, professionalism and respect for human dignity.[59] According to the CDC these values shape a group of four policies (Business Integrity, Environment, Social responsibility and Health and Safety) that in turn ensure that CDC fulfil the mandate of "ethical best practice".

However, development is mentioned on the last page of the *Progress Report* under the section on evaluation.[60] This section states that evaluation is carried out some 5 years after Board approval for the investment and. is performed by CDC's Evaluation of Development Impact (EDI) programme. EDI evaluates the performance of CDC's investments against commercial, economic, social, environmental and health and safety criteria. The EDI is to be expanded to include specific assessment of compliance with the overall statement of business principles and with the Business Integrity Policy. The CDC's website contains the following information of the EDI programme.

> The Evaluation of Development Impact (EDI) programme, launched in 1996, reviews CDC’s performance in its development role. For a random sample of projects which have been implemented and are now operational, the evaluation assesses how effective they have been in terms of each element of the investment criteria. In order for a project to be considered successful, it has to demonstrate satisfactory returns in financial and economic terms, a positive social and environmental impact and appropriate policies on health and safety. Of the 22 projects selected by random sample for the 1997 EDI programme, 64% by number passed on every aspect and were classified successful. The unsuccessful projects tended to be the smaller ones. 91% of the total amount evaluated was classified successful in every aspect of the investment criteria. CDC added value in 95% of cases. The evaluations annually cover only a small random sample of CDC’s total investments so it will take some years to establish the developmental effectiveness of CDC’s portfolio as a whole.
>
> The EDI programme also provides a useful forum for lesson learning. Conclusions from the evaluations are fed back into appraisal procedures so that CDC can continue to increase the positive development impact of its operations.
>
> The results of the 1997 EDI programme have helped to confirm that CDC is substantially meeting its investment criteria and that CDC is therefore effective in its development role.[61]

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59 Statement of Business Principles, CDC

60 *Building the Public private Partnership-Developing CDC's Business Principles and Policies*, see DFID's website.

61 CDC website.

Despite the work of the EDI programme, the term development seems to be less prominent in the literature of the CDC than previously. This is perhaps curious given that the term development will remain in the name of the enterprise itself and was also retained when the Overseas Development Administration was renamed after the general election as the Department for International Development.

CDC argue that the change in emphasis from long term lending to direct equity investment and attractive rates of return from these investments will help lead to the successful development of poorer countries. CDC is also likely to argue that the Golden Share provisions in the draft Articles will ensure that the bulk of CDC's investment will go to countries at or below the lower middle income level.

The International Development Committee (IDC) in its report, written before the investment policy and Memorandum and Articles of Association were published, disagreed with the argument by both Government and CDC that successful equity investment automatically led to good development.[62] In its response to the IDC's report, the Government stated:

> Equity investors tend to be much more active partners than debt investors, and to play a significant role in the management of companies. CDC will be able, for example, to use its equity position in order to promote ethical best practice in the enterprises concerned. By developing sustainable businesses, equity investment helps create jobs and livelihoods in poorer countries, as well as contributing to tax revenue. It is of course possible to have successful business which is not appropriate to a country's circumstances: but CDC's ethical policy and practice will help guard against such investments, and will include sectors and activities which CDC will not invest in. CDC will also be able to draw on its long experience, during which it has developed knowledge of what sort of investment is appropriate and ultimately sustainable in the countries in which it operates.[63]

[62] Eighth Report from the International Development Committee, Session 1997-98: The Future of the Commonwealth Development Corporation, HC 1100, 1997-98, para 24

[63] Seventh Special Report, Government Response to the Eighth Report from the International Development Committee, Session 1997-98: The Future of the Commonwealth Development Corporation, HC 1100, 1997-98

Technical Box 3

Additionality Test

In the past, CDC applied a strict additionality test in its investment activities. The checklist was a method of identifying areas where CDC's involvement added value. The checklist comprised 21 questions grouped into five categories. For example, augmenting capital flows, adding to a catalytic effect, improving project structuring and design, enhancement of management and adding value to the broader economic issues. The relevant extract on broad economic issues is reproduced below:

	CDC's contribution*			
	1	2	3	4
To what extent did CDC contribute to:				
Government issues eg regulation, taxes, duties				
Improving development impact				
Raising the profile of envirnonmental and health and safety issues				

* 1 = none, 2 = a little, 3 = a lot, 4 = a great deal

Overall score for broader economic issues – Total score/3

A maximum score in all five categories would give a total score of 20. The classification criteria used by CDC was as follows;

Classification	*Criteria*
Very significant	Score more than 13
Significant	Score between 10 and 13 inclusive
Limited	Score between 6 and 9 inclusive
None	Score 5

Although CDC is keen to demonstrate "additionality," they no longer consider it sensible to apply a strict additionality test as in the past to each individual project. CDC argue that to do so in a competitive situation can result in CDC being the financier of last resort, to the detriment of they portfolio performance, which in term could reduce the contribution to development. Instead any investigation of potential investments will include an assessment of compatibility with CDC's ethical values.

VI Commentary on Clauses

This paper should be read in conjunction with the Explanatory Notes that accompany the Bill and provides a more detailed description of each clause. The following section aims only to provide a brief overview of the clauses for quick reference.

A. Overall purpose of the Bill

The Bill's main purpose is to allow the transformation of CDC from a statutory corporation, governed by its own legislation (primarily the CDC Act 1978), into a public limited company (plc) governed primarily by the Companies Act 1985. The Bill has three main areas:

- provision for registering CDC as a plc (clauses 1 to 7)
- provision relating to the financial relationship between the Government and CDC during the transitional phase after registration but before the sale of shares to private investors (clauses 8 to 17); and
- provision relating to of the corporate relationship between the Government and CDC to the effect that the Secretary of State cannot lose her special share, vary her rights relating to that share or reduce her shareholding in CDC below 25% without Parliamentary approval (clause 18).

The Bill also has some supplementary provisions such as expanding CDC's powers in the period before registration and widening the scope of the information and assistance it may give to the Secretary of State in preparing the PPP.

The Bill does not contain any details on the relationship between the Government and CDC plc under the subsequent PPP or the list of special rights provided by the Golden Share. The Bill should be read in conjunction with four documents: the draft Memorandum and Articles of Association, Investment Policy and Statement of Business Principles. The first three documents have been deposited in the library and, in response to a request from the Chairman of the IDC, the department has also made the documents available on its website.[64]

[64] http://www.dfid.gov.uk/public/news/news_frame.html

B. Registration under the *Companies Act 1985*

Clause 1: Initial steps

Gives the Secretary of State the power to decide the timing of the registration of CDC and lists the steps to be taken, in consultation with CDC, prior to the day for filing of documents with the registrar. Steps include, amongst other things, nominating the directors and company secretary

Clause 2: Filing of documents

This clause places a duty on CDC to deliver to the registrar the documents listed in schedule 1 on the filing day. The list of documents are closely modelled on the filing requirements of the *Companies Act 1985*, although there are modification; reflecting the fact that CDC is not following the normal route of company formation but is being transformed from the public corporation.

If CDC is unable to state that it has adequate net assets then clause 2(3) provides for a release from its statutory duty under clause 2(1) to provide documents on the filing day and the Secretary of State will be able to restart the process of registration on a later day by virtue of clause 2(4). However, it is unlikely that this will occur.

Clause 3: Appointing day for registration

This clause provides for a mechanism to ensure that before the Secretary of State makes the order appointing a day as registration day, all documents have been filed and to allow CDC to prepare for registration. The Secretary of State need not specify the appointed day until she has received notification from the registrar that he is satisfied that the documents are in order. If necessary, the Secretary of State can restart the process at a later day by virtue of clause 3(4).

Clause 4: Registration

This clause sets out the process whereby CDC is registered by the registrar under the *Companies Act 1985* as a plc. Subsection (1) and (2) ensure that provisions of the Bill are consistent with the provisions of the *Companies Act*, again reflecting that CDC is being transformed directly into a plc. Subsection (3) describes the contents of the certificate given to CDC by the registrar upon registration. This certificate will be similar, but not identical, to that given under s13 of the *Companies Act 1985*. The main difference is that the certificate indicates that CDC remains incorporated and is not incorporated as a new company.

Clause 5: Effect of Registration

This clause relates to the matters that occur on CDC's registration under the *Companies Act 1985* and makes provision for the consequences of CDC's transformation. Subsection 1 provides for the fact that CDC is not established under the usual route of company formation. It is therefore necessary to amend certain parts of the *Companies*

Act 1985. Paragraphs 70 to 85 of the explanatory note set out the detailed amendments that will be required to be made to the *Companies Act 1985*.

Clause 5 (subsection 2) provides for the repeal of CDC's current constitution on registration so that CDC effectively swaps constitutions. Subsection 3 provides for CDC to be known by its name in its Memorandum, although it will be free to change its name in accordance with the *Companies Act 1985*. Subsection 4 provides for those persons nominated by the Secretary of State (under clause 1) to take up their offices on CDC's registration.

Clause 6: Initial allotment of shares

This clause, together with the Secretary of State's order under clause 1(3), provides the mechanism by which CDC acquires its initial share capital as a plc and its first shareholders. Subsection (1) makes clear that the persons nominated by the Secretary of State as allottees will acquire the same rights as if those shares had been allotted in accordance with the *Companies Act 1985*. These allottees are then entered in CDC's register of members on registration, thereby becoming the first members of CDC plc. Subsection (2) specifies how the shares are to be treated, specifically that the shares are intended to be paid up from CDC's existing reserves rather than a cash payment. Paragraphs (a) and (b) ensure that the provisions of the *Companies Act 1985* relating shares not fully paid up do not apply. Paragraph 9c) specifies the tax consequences of this initial issue of shares. Subsection (3) disapplies section 88 of the *Companies Act 1985* in respect of providing details of allotment of shares since this information is already contained in the Secretary of State's order.

Clause 7: The repeal of 1978 Act; savings etc

This clause deals with matters arising from the repeal of *the Commonwealth Development Corporation Act 1978* (CDC's current constitution) and preserves certain provisions of that Act. Subsection (1*)* simply confirms the continuing legal identity of CDC. Subsection (2) and (4) requires CDC to produce a report on its activities, together with audited accounts (as required by the 1978 Act) for the last full financial year before registration. Subsection (3) repeals section 14 of the 1978 Act concerning the use of a reserve fund and underlines the point that CDC plc will be subject to the same obligations in respect of its funds as any other plc.

C. Financial assistance by Government

The Bill will put CDC into a form that will allow the introduction of private finance for the sale of shares and other securities. The Bill will also allow continuing Government financial assistance during the transitional period before the sale of shares.

Clause 8: Repayment of old loans etc

The main purpose of clause 8 is to maintain the relationship between the Government and CDC, pending financial restructuring. The effect of clause 8 is to allow CDC to continue to borrow from the Government under the powers of the 1978 Act, even after registration.

Clause 9 New loans to CDC

Clause 9 allows the Secretary of State to provide loans to CDC from the National Loans Fund (NLF), while CDC remains wholly Government owned. The terms will be determined by the Secretary of State with the consent of the Treasury. Subsection (4) ensures that the Secretary of State pays repayments and interest into the NLF.

Clause 10: New guarantees

This clause permits two kinds of guarantee: those which are given by the Treasury to CDC itself and those which may be given by the Secretary of State with the consent of the Treasury to companies associated with CDC. There are limits on the extent of the guarantees. For example, the Treasury is not permitted to guarantee sums borrowed by CDC and associated companies from the Secretary of State. A guarantee may only be given when CDC is wholly Government owned.

Clause 11: Supplemental guarantees

Clause 11 contains provisions to supplement clause 10. For example, subsection (1) to (3) are technical provisions concerning the sources from which sums needed to meet calls on guarantee are to be drawn. Subsection (4) to (7) place on the Treasury and the Secretary of State certain duties to give information to Parliament about guarantees, such as laying a statement as soon as practicable after the financial year. Under subsection (6) the Secretary of State shall lay before each House as soon as practicable a statement of guarantee. Subsection (7) requires the Secretary of State or Treasury to lay a statement before each House if CDC or an associated company fails to make a payment as part of an agreement made under clause 10(7).

Clause 12: Other assistance

Clause 12 repeals the restriction in s1(1) in *the Overseas Development and Co-operation Act 1980* that the Secretary of State cannot give financial assistance to CDC. This effectively gives CDC the same access to funding from the Overseas Development Assistance budget as other bodies.

Clause 13: Accounts

This clause places a duty on the Secretary of State to produce accounts for each financial year on any loans made to CDC under clause 9 and any monies received from it under that clause. This clause also allows for the accounts to be examined by the Comptroller and Auditor General.

Clause 14: Waiver of payments

This clause allows the Secretary of State to waive the requirement for CDC to repay advances or make payments in respect of sums issued to meet guarantees while CDC is wholly owned.

Clause 15: Limit on Government assistance

This clause places a limit of £1,500 million on the total amount of financial assistance by Government to CDC. The types of assistance are listed in subsection (2). The existing limit of £1,000 million can be raised to £1,500 million by order.

D. Miscellaneous

Clause 16: Requirement to issue securities

While CDC is wholly Government owned, and subject to Treasury consent, this clause allows the Secretary of State to direct the Corporation or one of the associated companies to issue securities to the Secretary of State or to persons nominated by her.

Clause 17: Acquisition of securities

This clause empowers the Secretary of State or nominees, subject to Treasury consent, to acquire securities of CDC or one of its subsidiaries. The monies will be provided by Parliament. The securities can be bought at any time and not just when CDC is wholly Government owned. It is thought that debt securities will be purchased rather than equities but at a commercial rate to the Secretary of State.

Clause 18: Crown shareholding

There will be two aspects of the Government's involvement. First, it is intended that the Government will retain at least 25% of the issued ordinary share capital of CDC. Second, the Government will hold a special or Golden Share, which will consist of special rights in the form of a redeemable preference share of nominal £1 in the capital of CDC. This Golden Share will give the Secretary of State special rights under the articles of association of CDC. For example, the investment policy cannot be altered with the consent of the special shareholder. Clause 18 will prevent the Secretary of State from reducing her shareholding below 25% or losing her special share or varying her rights under the articles without Parliamentary approval by making an order. Subsection (5) gives the Secretary of State powers to amend the section by returning to Parliament for approval to a restructuring of CDC or, for example, to be absolved of the need to maintain the 25% Government share-holding.

Clause 19: Securities held by or for Crown

This clause stipulates that proceeds of the sale of shares CDC or income received by Secretary of State or nominees should be paid into the Consolidated Fund.

Clause 20: Trustee Investment Act 1961.

Trustees of trust funds are limited to investing in funds that a have proven track record of five years. However, this limitation presents problems for CDC. Therefore this technical provision avoids the limitation by having CDC be treated as if it had paid the necessary dividends in the past years to allow trustees of trust funds to invest in CDC.

Clause 21: Treasury consent

This clause ensures that the Secretary of State requires Treasury consent for a number of measures, such as giving guarantees, or forgiving debt.

Clause 22: House of Commons disqualification

Members of Parliament and the Northern Ireland Assembly are disqualified from becoming Directors of CDC. After registration, this disqualification will apply only to Directors appointed by the Secretary of State.

Clause 23: Powers and duties of Corporation before Registration

This clause provides CDC with additional powers and duties to enable it to prepare for the PPP during the transitional phase after Royal Assent and before registration.

E. General

Clause 24: Interpretation: companies and share

This clause describes the meaning of wholly Government owned and associated companies.

Schedules

Schedule 1: Documents to be filed.
This schedule contains the list of documents CDC is under a duty to deliver to the registrar by virtue of clause 2. The list is closely modelled on the filing requirements of the *Companies Act 1985*. The first two documents are the Memorandum and Articles of Association of CDC.

Schedule 2: Modification of the *Companies Act 1985* etc
This allows some modifications of the *Companies Act 1985* to take account of the fact that CDC will not be formed as a newly formed company. For example, it removes the requirement for subscribers to be named to CDC's Memorandum of Association, as would be the case for a newly formed company, and substitutes the term "registration" for "incorporation".

Annex 1

Golden Shares

In a number of privatisations, the Government has retained a special share (or 'golden' share) in the company, even when 100% of the Ordinary shares have been sold to the public. A special share does not generally carry any voting rights but entitles the holder (the Secretary of State or another person acting on behalf of the Government) to attend and speak at general meetings. It does not confer any rights to participate in the capital or profits of the Company, and generally has a nominal value of £1. The government insist that the special share does not give the Government any control over the commercial management of the company.

The powers of the special shareholder are narrowly defined. Usually the share requires that certain provisions in the Articles of Association of the Company cannot be changed without the prior written consent of the special shareholder. The details of these provisions may vary from company to company, but typically they include a limitation which restricts any one person, or group of persons acting in concert, from controlling more than 15% of the equity of the company. This is the most important implication of the special shareholding as it protects against unwelcome takeover. With very few defence-related exceptions constrains apply equally to foreign and domestic shareholders. Other provisions may include measures to prevent foreign ownership or give the Secretary of State the right to appoint a number of directors.

In some cases the special share has a time limit attached to it, but it may also be non-time limited. The share can be redeemed at any time - for example, in 1990 the Government redeemed its non-time limited special share in Britoil after BP successfully bid for the company.

Most of the temporary special shares (in the electricity supply and water industries) have expired. The current list of companies with special shares is set out below.

The provisions attached to a special share can be amended or waived where circumstances are deemed to warrant it. For example, the non-time-limited special share in BT was redeemed in 1997 in the context of the BT's then planned alliance with MCI.

The enclosed list[65] shows the Government's current holdings of special shares and their expiry dates.

[65] Source: 'HMT: Information on Privatisation in the UK February 1998

UK GOVERNMENT'S HOLDINGS OF SPECIAL SHARES

Company	Expiry Date
Cable & Wireless	Non time limited
Sealink Stena Line	Non time limited
British Aerospace	Non time limited
VSEL Consortium	Non time limited
BG plc	Non time limited
Rolls-Royce	Non time limited
BAA	Non time limited
National Grid	Non time limited
National Power	Non time limited
PowerGen	Non time limited
Scottish Power	Non time limited
Scottish Hydro-Electric	Non time limited
Northern Ireland Electricity	Non time limited
Belfast International Airport	Non time limited
Nirex	Non time limited
British Energy	Non time limited
AEA Technology	31 March 1999
Rosyth Dockyard	on completion of
Devonport Dockyard	nuclear refitting

Source: HMT: Information on Privatisation in the UK