Public Accounts Committee

Oral evidence: Privatisation of Royal Mail, HC 1221-ii

Wednesday 30 April 2014

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Members present: Margaret Hodge (Chair), Mr Richard Bacon, Stephen Barclay, Guto Bebb, Jackie Doyle-Price, Chris Heaton-Harris, Meg Hillier, Mr Stewart Jackson, Mrs Anne McGuire, Austin Mitchell, Nick Smith, Justin Tomlinson

Amyas Morse, Comptroller and Auditor General, National Audit Office, Gabrielle Cohen, Assistant Auditor General, National Audit Office, Matthew Rees, Director, National Audit Office, and Marius Gallaher, Alternate Treasury Officer of Accounts, were in attendance.

Witnesses: William Rucker, Chief Executive, Lazard & Co., Alan Custis, Managing Director, UK Equities, Lazard Asset Management Ltd, James Robertson, Managing Director, UBS Ltd, Richard Cormack, Managing Director, Co-Head of Equity Capital Markets, Goldman Sachs, Martin Donnelly, Permanent Secretary, Department for Business, Innovation and Skills, and Mark Russell, Chief Executive, Shareholder Executive, gave evidence.

Chair: Good, are we there? Apologies for being late, but information was published at 1.30 pm by the Department for Business, Innovation and Skills—your Department, Martin. Perhaps I may start by thanking everyone for coming. I declare that the financial advisers who manage my late husband's pension pot bought shares in Royal Mail at an early stage. I don't know if anyone else has any.

Mr Bacon: Chance would be a fine thing.

Q118 Chair: Right. We have a lot of witnesses and a lot of Members want to ask questions, so I would be grateful for direct, succinct answers. I will interrupt if I think that people are going off the question or going on for too long, otherwise we will be here all night.

I would like to start on the issue of priority investors, as the list has now been published by the Department for Business, Innovation and Skills. What were the criteria which you adopted in determining who were to be the priority investors?

Martin Donnelly: I will ask Mark to walk us through the precise process in a moment but, as you know, our objective for this sale was to provide the Royal Mail with a successful entry into the private sector—

Q119 Chair: Can I ask you to answer the question, Martin? This is just what I said at the beginning. I don't want a statement, I want to know the criteria which were used. We all know what the objective was, and there have been quite a lot of sessions on this. What were the criteria which were used to determine who were the priority investors, full stop? That is all I want the answer to.

Mark Russell: The short answer is that it was the institutions which showed the most interest in Royal Mail from a marketing campaign that went over the period of a year.

Q120 Chair: So, looking at the very interesting box in figure 17 which shows the number of institutions, we started with 94 institutions being targeted. 180 other institutions were considered to be high quality and 506 institutions received nothing, but only 16 institutions were priority investors. What were the criteria that got you down to that 16? Was that decided by you, the Department, or was it decided by the syndicate?

Mark Russell: No, we were advised by our advisers—

Q121 Chair: Who were you advised by? The syndicate, or Lazard?

Mark Russell: The syndicate, overseen by our independent advisers.

Q122 Chair: So what were the criteria which got you down from—let me do my maths—522 to 16?

Richard Cormack: Perhaps I could refer the Committee to figure 12. We started the exercise over a year ahead of the privatisation. In the period up until July 2014, we met 65 institutions, which were located in the UK and also globally. We had extensive feedback from those 65 institutions, which represented the largest institutional investors globally in the UK, the US, Canada and continental Europe. From feedback from those 65 we narrowed the list down to 24 institutions, which we pilot-fished, and the 16 came out of the 24. The 16 were those institutions that we met during the pilot-fishing process which were prepared to give us an indication of their order for day one of the book build. A number of the institutions didn't give us that indication, and were therefore not part of the 16 which featured in that tier.

Q123 Chair: I am still unclear how the others didn't fall into that category, but I take that as read. In the letter written to the Chair of the Business, Innovation and Skills Committee, the Secretary of State states a number of times that one of the criteria was to get in long-term, supportive investors. There are about five examples of this, including: "we are focused on the long-term success of Royal Mail… Our objective required us to have a positive share price performance supported by a high-quality, long-term investor base". He says that again and again, referring to "a range of high quality institutions of the type that would form the core of a long-term, supportive investor base". He also says: "This was still regarded as compatible with securing a stable, long term shareholder base".

There are about five or six references to that. Was that not a criterion when you were deciding who should be these 16 priority investors, who made £750 million on day one? Was that not a criterion that you looked at?

Mark Russell: The answer to that is, not exclusively. I think that it is worth Richard explaining the type of investors, and what we mean when we say "long" and "hedge".

Richard Cormack: Absolutely. One of the criteria was to find institutions that believed in the Royal Mail story, and would therefore be supportive and longer-term investors. They were selected based on the feedback that they had given us. These institutions had met the company two or three times prior to the pilot-fishing exercise. Those institutions came from a range of different types of investor. There were some sovereign wealth fund investors, hedge fund investors, and what were called long-only investors. The clear majority were long-only, but there was a cross-section of investors. We thought it was important to go to a cross-section of investors so that we were not getting pricing points from just one narrow constituency.

Q124 Chair: I am trying to sort out whether it was a policy objective. My understanding before today's evidence was that it was a policy objective. Of course, a policy objective was also to sell the company, but my understanding was that it was an important policy objective, which is why you went for priority investors, to seek out long-term commitment to the company. That was my understanding, but I am muddled. Is it a yes or a no to that?

Mark Russell: Yes. If you look at those IPOs, the mix between long and hedge is about 70:30. Our Secretary of State said he would like if possible to increase that percentage. We tried to get it to 80:20, between what we defined as long investors and hedge investors. So the answer to your question is yes. He certainly wanted a large proportion of long investors in the investor base. He never contemplated we would ever get to a situation in which it was 100%. That would be sub-optimal, partly for the reason that Richard gave, and partly because hedge funds typically buy and sell more frequently than others.

Q125 Chair: But was it in his mind that 42% of the shares would be traded in the first week?

Mark Russell: No.

Q126 Chair: Which is what happened.

Mark Russell: Which is what happened, because a number of long investors—

Q127 Chair: Long investors? They can't be long investors if they have sold.

Mark Russell: A lot of what we call long investors will typically be buying on fundamental value. They will not be like hedge funds who will buy not just on fundamental value, but for technical reasons as well. A number of them sold because the price took off. It is as simple as that. They did not see the value any more. That is why they sold.

Q128 Chair: This is a question for you, Mr Donnelly, because you are an accounting officer and you in the end should have to take responsibility for the massive taxpayer loss. Why did you not contractually commit some of those long-term-investors to not selling their shares, in the same way as the individual post office workers are committed? Why did you not commit them contractually? Why did you not get that into the contract?

Martin Donnelly: The answer is simple: it would clearly have led to a less good deal for the taxpayer.

Q129 Chair: Did you try?

Martin Donnelly: Our very clear advice—

Q130 Chair: I am asking you a question: did you try?

Martin Donnelly: Our advice was that that would not be a way of maximising value for the taxpayer.

Q131 Chair: You are not answering the question.

Martin Donnelly: Yes, I am.

Q132 Chair: Did you seek advice from your advisers—both the syndicate and Lazard? Did you make any attempt to try and build in a contractual commitment by some of these people so that you could meet the policy objective of having long-term investment?

Martin Donnelly: We followed the advice of our advisers—

Q133 Chair: Did you try, Mr Donnelly?

Martin Donnelly: And therefore the answer is no—

Q134 Chair: You did not try.

Martin Donnelly: Because it would not have led to good value for the taxpayer.

Q135 Chair: You did not try.

Martin Donnelly: Because the advice was clear.

Q136 Chris Heaton-Harris: In a number of privatisations and company buy-outs you can ask people to stay with the company shareholding for a decent period of time. Although that was a policy objective, you did not have any such covenant or attachment to the shares. Is that because you thought, or a judgment was made, that that would drive the price of the shares down? If so, could you articulate that so that we can understand it?

Mark Russell: To answer your question, at the time of the IPO, we did not look for contractual commitments. We did not attempt to get contractual commitments, because we knew we would not get them. It is as simple as that. At a prior stage when we were looking at alternatives to the IPO—such as if we couldn't get enough interest in an IPO could we do some sort of cornerstone investment and could we take a couple of institutions and sell a minority stake—we looked at the possibility of asking people to buy in just to take a minority stake pre-IPO. But the price that they would have paid for that—we got no commitments—would have been substantially below the price that we achieved on the IPO. So it is about liquidity. If you are told that you have got to lock up and not sell you will want a premium for that. If we had, unusually—really unusually—gone to investors at the time of IPO and said, "Could you hold?" the vast majority would have said, "Not at all; we want the ability to trade."

Q137 Chair: What that whole argument demonstrates is that the concept of the priority investors was dead before it started in terms of maintaining it long term. Once you didn't give them a contract, there was no way. Obviously they had a fiduciary duty to maximise their profits on behalf of their companies. So why on earth you had the concept at all, I fail to understand.

Mark Russell: And it is really important that we explain why we went to priority investors. We narrowed down the number of priority investors—or what we call the pilot-fishing investors—the people we believed were most interested in the business. We asked them at what price they would be prepared—this was before the book-building exercise—to invest in the business even if the industrial relations situation started to deteriorate. We had a figure back for that which was about £2.50. That gave us the confidence to advise Ministers, "You can now announce an intention to float". You do not want to make that announcement if you don't carry it through." We wanted to be sure that even if the situation deteriorated—remember, we were in a situation where people might have come out on strike—we had a group of investors who were able to take these shares at a price so that we could cover the book.

That is what they gave to us. That is why they got preference on allocation. But then once we got into book building—they had given us a figure of £2.50 or so that they said they would take if the situation deteriorated—we went out to over 500 investors and said, “Actually, what are we going to do now? What is the price we are going to charge?” That conversation with the 500 investors was instrumental in setting the price range that we went to. Then we said to the priority investors, “You are only going to get an allocation if you go right up to the amount that everybody else is prepared to pay—£3.30.” So, yes, they had preference because they gave us that confidence to commit.

Q138 Chair: And you chose to ignore right up to the end the over-subscription both from individuals and from companies. Whatever it was—£32 billion was what people were willing to buy—and in the end it was less than £2 billion. You chose to ignore that. You had no advantage of long-term priority. You got no long-term commitment and you had this massive over-subscription and you chose to put a maximum price on it.

Mark Russell: When you look at that over-subscription figure we are entirely satisfied that only a fraction of those people—

Q139 Chair: On what basis?

Mark Russell: Because some of them were bidding for amounts that were about 10% of their assets under management. They would never have been able to buy it.

Q140 Nick Smith: Mr Cormack, when you talked about the development of the priority group of 16, you said that the main criterion for choosing them was that they indicated that they would make an order. You said that they believed in the Royal Mail story. What did they tell you that made you think that they believed in the Royal Mail story?

Richard Cormack: For one thing, they gave us an order and some solid demand in the transaction. Secondly, we had extensive dialogues with each of those accounts around the investment case of the company, around the prospects of the company and, indeed, about the risks of the company. As Mark has said, there was the real threat of industrial action as we were having these discussions. The fact that these investors were willing to give us a firm indication of demand, notwithstanding the risk of industrial action, speaks to their support and, indeed, the fact that they are prepared to look at the company on a longer-term basis rather than just the short-term.

Q141 Nick Smith: So how do you explain that you thought they were believers in the Royal Mail story and were committed long term to it, and then sold the next day?

Richard Cormack: It goes back to the point that as the share price got to levels that they believed were excessive relative to value, they had a fiduciary duty to sell.

Q142 Nick Smith: So they just filled their boots?

Chris Heaton-Harris: No—

Chair: Let them answer the question, Chris. You can come in on a question afterwards.

Chris Heaton-Harris: You have already essentially—

Chair: Chris, you can come in on a question afterwards. Let everybody have their own question and answer.

Q143 Nick Smith: So what did they do after you thought they supported the Royal Mail story?

Richard Cormack: As the share price increased sharply—more sharply than I think they would have anticipated it to increase—some of them held, some of them bought and some of them sold. Those actions were based on their own view in terms of where they saw value on a medium to longer-term basis.

Q144 Nick Smith: It sounds to me as if they didn't really support the story. They just filled their boots.

Martin Donnelly: Can I underline the point that Mark made, because it is very important? They helped us to have confidence that we could successfully launch this IPO, even if there had been industrial action. It was obviously at a lower price but that was key for taking the decision that we could go ahead. We had the advice that these investors were prepared to commit and ensure that we would have a successful IPO, which was critical to the future of the Royal Mail, its work force and the universal service obligation.

Q145 Chair: Okay. Let me move on to another set of questions. The concern is that there appeared to be massive interest in this share launch, but only a very few people benefited to an enormous extent out of it. So I have to ask you some questions around that. I would like to ask James Robertson and Richard Cormack how many of those priority investors were also your clients in the trading arm? What proportion? Out of the 16, how many are your clients in the trading arm?

James Robertson: I do not know for definite, but I would assume all of them. We are the largest equity trader in the London market, they are the largest asset managers in the London market—I would assume all of them.

Q146 Chair: And how many of the 16 hold shares in any of your companies?

James Robertson: I do not know that answer.

Richard Cormack: In terms of holding shares in Goldman Sachs? I do not know the answer.

Q147 Stephen Barclay: It would not really be shares, it would be trading volumes. Perhaps the question might be: how many of the investors are significant clients?

Richard Cormack: I do not have the information around the trading activity of different institutions. As a matter of policy, that is information that I do not have, so it does not influence decisions that we make on allocation.

Q148 Stephen Barclay: But obviously Goldman and UBS are major players in prime brokerage. The fees would be much higher from traded volumes than they would actually be from the IPO, wouldn't they?

Richard Cormack: First, I do not have that information. Secondly, our client in this IPO was the Government. We were paid by the Government to execute the IPO.

Q149 Stephen Barclay: Sure, but it could be widely seen as a soft sell. What I am driving at is the existence of a conflict. Of course, you will have a conflicts policy. I know that you will say you adhere to that conflicts policy, but you must accept that there is a potential conflict between priority investors who trade high volumes through your firms, particularly if the share price is lower and trades up. There is going to be more trading volume and therefore more fee income for your firms as a group. You would accept that conflict?

Richard Cormack: We have a policy in place to manage any conflicts between the public side of the wall and—

Q150 Stephen Barclay: Of course you have a conflicts policy. How much in fines as a group have you paid in the last two years for regulatory breaches?

Richard Cormack: I do not know the answer to that question.

Q151 Stephen Barclay: It is significant as a group, is it not?

Richard Cormack: I do not have the answer to the question. It will be on our regulatory filings.

Q152 Stephen Barclay: So in other words, you have conflicts, but the conflicts policies are not always managed. You therefore would not know what the volume of business would be from the priority investors through a firm like Goldman's trader volumes?

Richard Cormack: No.

Q153 Stephen Barclay: Would you be able to give us a note on that?

Richard Cormack: As I said, that is not information that I have access to. I would have to go back to ask.

Q154 Stephen Barclay: Right. But the firm might be able to. What would be interesting to see is what profit priority investors made and what the trading volumes with a firm like Goldman were over 12 months, set against what the IPO profits would be.

Richard Cormack: There was never any consideration around that in the selection of the investors and the allocation of the shares—

Q155 Stephen Barclay: Of course. If you were to give consideration to that, it would be a regulatory breach. But you must accept the existence of a potential conflict if, as a firm, you are making much bigger profits from trading volumes through your prime brokerage. You must accept that; that is what your conflicts policy is there to address.

Richard Cormack: We accept the existence of potential conflicts, which is why we have that policy.

Q156 Chair: Can I ask something of Lazard? We have now had the list of priority investors published, and Lazard's investment arm was one of the priority investors.

Alan Custis: That is correct.

Q157 Chair: First of all, what proportion of the 13 million shares went to you? What page is it?

Matthew Rees: Paragraph 3.9 on page 28.

Alan Custis: We got 6 million shares.

Q158 Chair: Mr Rucker, even if we were to accept that the Chinese wall rules were adhered to, does it seem appropriate to you? You were there in a different position to the banking syndicate. You were there to provide completely, utterly and totally independent advice—technical advice and expertise—to Government on this privatisation. Do you really think that it is appropriate that, in those circumstances, another arm of your company, however Chinese-wally you made it, picked up nearly half the shares that went directly to clients of those with an interest there? Do you think that that is appropriate?

William Rucker: We were hired in February 2013. The conversations that had been taking place with the 65 potential investors dated back to the start of 2012. When we were hired, we were unaware that Lazard Asset Management had had any discussion at all with Royal Mail.

When we became aware—having been hired—that Lazard Asset Management was on a list of investors that Royal Mail was talking to through Goldman Sachs, UBS and others, we made it quite clear, as did ShEx, that we should have no input whatsoever into any discussion about allocations for LAM. I think the NAO Report makes that clear.

The Chinese wall is complete and utter. We have had no contact throughout. We deliberately exempted ourselves from any discussion about any allocation for Lazard Asset Management.

Q159 Chair: But the benefit that the Government were trying to obtain from having you as the independent adviser to Government was to ensure that there was absolutely no conflict of interest, which inevitably arises as a suspicion in the way that the financial institutions are managed. That was the entire benefit. You diluted that benefit, without a doubt, by having that situation where nearly half the shares that went directly to the syndicate or the adviser went to you. You diluted that and undermined the confidence that, certainly, I feel that you were providing fully independent advice. It is just inappropriate. Can you not see that?

William Rucker: Look, I think it is a question of perception and what actually happened. At no point did we play any part whatsoever in any discussion about Lazard Asset Management. Their involvement predated our—

Q160 Chair: I understand that, but at the heart of the structure that the Government established to try to protect the taxpayer's interest was that you were there to give advice separate from the syndicate, who clearly have trading arms on which, as Stephen Barclay said, they make much more money by trading, whether their share goes up or down, than you do. You were there to do that, and yet for whatever reason you, as an organisation, allowed an arm of your organisation to benefit hugely. I assume you sold in the first week, because before I got the Secretary of State's letter and before we were allowed to publish it, you were not on my list because you were not registered as a shareholder with Royal Mail; presumably that was because you sold in the first week. Did you?

Alan Custis: As has been mentioned earlier, we were involved with the Royal Mail back in 2011.

Q161 Chair: Did you sell in the first week, Mr Custis?

Alan Custis: We had a price target, and—

Q162 Chair: Did you sell in the first week?

Alan Custis: The share price went beyond the price target, so yes, we did sell on behalf of our clients—on behalf of the clients of Lazard.

Q163 Chair: That is why you weren't on the list. I have to say this. I don't know what you think, Mr Donnelly, but you employed Lazard specifically to ensure independent advice—that was the whole purpose. I am afraid, at the end, the buck stops with you as accounting officer.

Chris Heaton-Harris: Are you accusing him of doing something wrong?

Chair: No, I am not saying that. Listen carefully to my question, Chris.

Chris Heaton-Harris: I was listening very carefully to it.

Chair: I want Mr Donnelly to respond.

Martin Donnelly: This is a very serious issue. The NAO Report covers it accurately in paragraph 3.10. We wanted, on behalf of the taxpayer, to give ourselves the best available list of independent advisers. We did not want Lazard to self-censor off that list, on the basis that sufficient regulatory controls were in place—you discussed this in some depth on Monday, I think—to safeguard the taxpayers' interest. I am personally satisfied that that was the case.

Q164 Mr Jackson: It is important that we put this in context. The Leader of the Opposition made unfounded allegations during Prime Minister's questions, which have not been helpful to the deliberations of this Committee in coming to a reasonable judgment on the situation. Just going back, there was a reference to industrial relations and the possibility of industrial action. Was that the only issue that affected the culture in respect of the pricing of the shares or were there other issues that led to a consensus on the price, both in the Department and with your professional advisers? Was media coverage an issue? My colleagues have already said that people are wise after the event, and before, people were not talking about the share price—in fact, across the spectrum, it was quite the opposite.

Martin Donnelly: That is a very important point. From my perspective as accounting officer, I relied on our excellent ShEx team, and of course on the advice, but I also stayed close to what commentators across the media were saying. From the period through from the spring, you would have to say that the comments were somewhere between cautious and lukewarm. In fact, they became rather more cautious as it became clear that there would not be an industrial relations settlement of the wages issue before the sale. One important newspaper said in September that there was "an alarming list of risks", including a strike, so the sale would "not be for the faint-hearted". I think it was the Lex column that said, even in early October, "At the low end of the price range, Royal Mail shares have some appeal. At the upper end, investors have other options." We were consistently getting that message. It was part of the wider environment. Mark, you may want to say a bit about the change in perception through July and August as the industrial relations issue became more apparent.

Q165 Chair: Ironically, I have to say to you that it was not July and August; it was October. You may try to push it back, but look at the charts in the NAO Report: they are all about the movement both in demand for the shares—I am trying to find the right ones—and in the valuations of the syndicate banks. Those movements are all in October and were way above what you eventually put the shares on the market for. I will ask Lazard one more question, and then I am going to come to Austin. The other interesting thing with Lazard is that if you look at the valuation chart—please guide me, Matthew, where is the valuation chart?

Matthew Rees: Figure 9, page 30.

Q166 Chair: Looking at the valuation chart, Lazard's asset management arm buys a whole load of shares, sells them in a week and makes a killing. I don't know how much money you made out of it, but it was a heck of a lot. We can work it out, actually. You sold £6 million in the first week, did you?

Alan Custis: For Lazard's clients, which are pensioners, unit trusts and others. On behalf of our clients, we made approximately £8 million.

Chair: £8 million. But if you look at—

Chris Heaton-Harris: Is there anything wrong with that? You said it in a very accusing tone, and I just wondered.

Chair: To be absolutely honest Chris, I am here on behalf of the public, trying to look after the public interest.

Chris Heaton-Harris: Why did you buy the shares?

Chair: This is nothing to do with partisanship—it is the public interest. The public interest is that, in that first week, three quarters of a billion pounds of taxpayers' money went down the pan. Three quarters of a billion pounds is a lot of money. I am going to pursue this, without any politics in it, because it is a public interest issue.

Chris Heaton-Harris: But why did you do it?

Q167 Chair: Pardon? It is a public interest issue. Can I go back to figure 9? I am not trying to play politics with this. It is a public interest issue. Lazard, in figure 9, was among those that had the very lowest valuation.

William Rucker: To be clear, that isn't anything to do with Lazard Asset Management. This is the Lazard advisory business, which is completely separate from the asset management activities. This was an independent valuation, which we came up with on behalf of ShEx and the Government.

Q168 Chair: Why were you so low?

William Rucker: Our valuation had some different assumptions from other people's. We had some more bearish assumptions about the threat of industrial relations and the consequences of that, so when you are taking these valuations it is important to realise that they're not entirely comparable. Everybody had slightly different assumptions. We were more bearish on the industrial relations aspect, and all those assumptions were laid out clearly for the benefit of our clients.

Q169 Guto Bebb: You sold the shares because obviously you hit your target price. What was the share price at which you sold? Are you willing to disclose that?

Alan Custis: Yes, approximately. There was a range of prices because it was conducted over a period of 48 hours, but it was roughly £4.70 a share.

Q170 Guto Bebb: And with the price today at £5.29, do you feel that you should have hung on? Do you think that your reflection of the price was correct?

Alan Custis: No, we have a very clear process, where through extensive contact with the company we generated a price target of £3.95 per share, and therefore we were happy to participate in the IPO at £3.30. When the share price went materially above that target price, we felt that there wasn't sufficient value in it for our clients, so we took the decision to sell.

Q171 Guto Bebb: Which was roughly at a 15% premium?

Alan Custis: Yes.

Amyas Morse: I wonder if I could ask a question of Lazard, regarding when you found out that your asset management arm was involved. Did you consider withdrawing as advisers at that time? I am not saying that you should have done. I am just asking as a matter of fact whether you had a discussion with the Department at that time about whether that was manageable.

William Rucker: We did discuss it with the Department, and we made it clear that we could take no part in any discussion regarding allocations to Lazard Asset Management.

Q172 Chair: But you were there. You just don't see it, but I have to say that you were there, your position was—

Amyas Morse: I just wanted to ask a little bit about this, I wasn't really trying to take you any further than just to elicit those facts. Was one of the reasons why the conclusion was that you shouldn't withdraw that there was judged to be a lack of other potential advisers who could fill that role? Was that a factor?

William Rucker: I think that is a question for Mark—

Mark Russell: It goes to the heart of whether we were satisfied that there was regulatory compliance and, absolutely, we were satisfied.

Amyas Morse: So you did conclude that, first, there weren't other advisers available and, secondly, you were satisfied that there was good regulatory compliance around this?

Mark Russell: I think the last first. We didn't even go to whether we needed to find another adviser. We were satisfied.

Martin Donnelly: We had already approached seven advisers at the start for the competition, which Lazard won.

Mr Bacon: I would like to return to this subject after we've voted.

Sitting suspended for a Division in the House.

On resuming—

Chair: Two missing, one on each side, so that is fair.

Q173 Mr Bacon: May I ask you, Mr Donnelly, how you define independence in terms of independent advice?

Martin Donnelly: I would expect our advisers to give us professional, direct and sincere counsel on the various issues on which we have to make a judgment, and to ensure that our evidence base was as rigorous as it could be in the circumstances.

Q174 Austin Mitchell: You didn't mention honest.

Q175 Mr Bacon: Hang on a sec. Professional, direct, sincere and with an evidence base. Those are your definitions of independence?

Martin Donnelly: Those are what come to mind as the core criteria.

Q176 Mr Bacon: Professional, direct, sincere and with an evidence base. You did not mention conflict of interest. To me that would be the first criterion of independence—not merely that the regulations would work, that you were satisfied that they would work, and that the Chinese walls would work, but that there was no possibility of conflict of interest because it could not exist architecturally. That would be my first definition of independence, but you did not even mention it. You mentioned four other things.

Martin Donnelly: No, because if I may come back on that I would take that as a precondition for anyone giving us advice.

Mr Bacon: Not necessarily.

Martin Donnelly: If I had doubts about that, they would not become advisers.

Q177 Mr Bacon: Not necessarily at all. There are many, many advisers in the world. Many of them are lawyers and many are economists, who are not disinterested and it is certainly not a precondition. One is often looking for interested rather than disinterested advice, particularly if you want a certain outcome, so that does not necessarily follow.

I return to my question. It was not: what is it that is so obvious that you need not even state it? It was: what do you consider the basis of independence?

Martin Donnelly: One of the relevant factors, in addition to those I have mentioned, is the incentivisation structure. If you incentivise advisers for a particular outcome, you can expect at the margin a preference in that direction. Therefore, we were careful not to incentivise, in this case Lazard, in a way that might skew the advice in a form unhelpful to the taxpayer, whereas we had the banks incentivised to maximise proceeds.

Q178 Mr Bacon: So in addition to professionalism, being direct and sincere in your advice and having an evidence base, you have added incentives.

Martin Donnelly: Having the correct incentive structure to support those, yes.

Q179 Mr Bacon: The correct incentives. I am still not clear about what that has to do with independence. If anything, you might create the correct incentives if you want people to perform in a particular way for you—in other words, not to give you independent advice but to perform as you, the client, wish them to perform. It is not obvious that incentives are necessarily the highest on the list. It seems to me that the basis—I am sorry that you have not mentioned it—the most obvious criterion of independence is that you are disinterested. That would be the first point—the starting point.

Mr Custis, you bought 6 million shares. You were doing a job. At Lazard Asset Management, your job is to buy cheap and to sell dear, and you did that. You don't hold any now. You cleared out.

Alan Custis: That is correct.

Q180 Chair: Okay. So, Mr Donnelly, Lazard Asset Management did its job. It bought cheap and it sold dear. It had a target value and the shares went significantly over the target value so it decided, quite reasonably—it was doing its job—that the shares no longer represented value and it was a good time to exit, which is exactly what it did. The issue that then arises is: was your adviser acting completely independently, or did it have an interest at financial group level in the success of one of its subsidiaries—Lazard Asset Management? It plainly did. It had a substantial group interest in the success of one of its subsidiaries and indeed the subsidiary performed well. It produced a profit for Lazard Asset Management's clients. So what then arises is whether your adviser was really independent. Could it have been truly independent when it was not disinterested as a group? You are saying, "Yes, yes, yes, but there were rules in place", and that you were completely satisfied. You said a minute ago that the rules ensured that nothing could really go wrong. I have not misinterpreted what you have said; I have reflected, in a précis form, accurately what your view is. Is that right?

Martin Donnelly: The rules are, as you say, clearly—

Q181 Mr Bacon: Have I précised accurately, or more or less accurately, what you have said?

Martin Donnelly: There are legal issues, and there is also a judgment to be made about the integrity of the—

Q182 Mr Bacon: Have I précised accurately, or more or less accurately, your view?

Martin Donnelly: Yes. I was just adding a judgment about the integrity of individuals and organisations.

Q183 Mr Bacon: I am just looking for the word "yes", thank you.

Mr Rucker, you are from Lazard & Co., the advisory business which was advising BIS—that is right, isn't it?

William Rucker: Correct.

Q184 Mr Bacon: I will just read out some sentences from this book: "Lazard has lost the almost unique position that the three houses"—Lazard UK, Lazard Frères and Lazard New York—"occupied in the 1980s. It no longer comes near the top of the league tables in either New York, Paris or London. Financial advice has become dominated by the likes of Goldman Sachs, Morgan Stanley and Merrill Lynch—and the creatures of the big money banks, such as Warburg"—of course, it got taken over, although they all did, didn't they?—"Morgan Grenfell and Kleinwort, owned respectively by UBS, Deutsche and Dresdner. But this will change. Money is a corrupting influence on advice. One-stop financial shopping is the current fashion, but it will not last. The internet bubble has already revealed the lack of quality control being exercised by the big investment banks"—Mr Barclay referred earlier to the fact that a number of banks involved in this had been the subject of fines for regulatory breaches, and I think I am right that both Goldman and UBS topped the tables for fines for regulatory breaches—"and it is only a question of time before a mighty scandal demonstrates the inherent flimsiness of their so-called 'Chinese walls'. There will be an irresistible demand to separate again the integrity of advice from distribution and investment analysis. Moreover, so substantial are the overheads of the big investment banks, and so spoilt and greedy are their key 'rainmakers', that rather than deny these people their inflated expectations, they will overtrade to sustain bonuses and profits. Trading, trading, trading—that way lies disaster, mark my words." Mr Rucker, do you know who wrote that?

William Rucker: It is a junior ex-colleague from Lazard back in the 1980s—

Mr Bacon: It is who, sorry?

William Rucker: It is a colleague from Lazard back in the 1980s—

Mr Bacon: Yes, it was John Nott, who was a Cabinet Minister. He was the chairman of Lazard. He was not a junior colleague; he was the chairman of your business.

William Rucker: Sorry, I thought you were referring to a different book. Yes, I am familiar with John.

Q185 Mr Bacon: I am just wondering whether you agree with that?

William Rucker: I would say a number of things. First, we have no trading activities—

Mr Bacon: I know that you do not.

William Rucker: Yes. It may be clear to you, but not everyone knows that in this room.

Q186 Mr Bacon: I thought that the point of John Nott's paragraph there was that Lazard was standing back from the fray to some extent, because it understood, in a way that many other investment banks did not, the importance of the integrity of advice.

William Rucker: Yes, and that model remains intact. We have no trading activities. I think you mentioned our position as reduced. In my experience, and I have been at Lazard now for 27 years, these things come and go—right now, we are high up the league tables—and those other aspects. If you take the independent financial advice in relation to IPOs, in the UK I think we have done over half of IPOs in which people have used independent advisers—to give you some impression of where we stand in the league tables.

The key conflict that John Nott refers to is the conflict between distribution, sales and trading, and advice. We have no distribution, sales and trading at all. We have two businesses: one is Lazard Asset Management, which manages about £190 billion in assets; and it is entirely separate from our advisory business. The businesses are entirely ring-fenced, as the NAO vindicated. We have no conflict; we have crossed no Chinese walls; and we had at no point during the Royal Mail flotation any influence whatever over the allocation to Lazard Asset Management.

Q187 Mr Bacon: Mr Barclay wants to come in and I want to hear what he has to say as well, but I agree with you that John Nott was referring to the risks from sales and trading and the creation of big integrated investment houses that did all of these activities and that floated into a financial supermarket, then making money out of sales and trading volumes.

Lazard stood back from that. But it must be the case, if you have as part of your group a fund-management arm—

William Rucker: As we did then.

Mr Bacon: Indeed. It must be the case, as you have a fund-management arm, that there is still the possibility of a conflict of interest—you acknowledge this yourself, which is why you have conflict policies—even on the asset-management side, as opposed to the high-volume sales and trading side. Surely the most obvious way to manage this is, if you are going to be an adviser and to maintain what John Nott calls the integrity of the advice, to say to a potential client, such as the Department for Business, "We will happily be your adviser, but in order to make it crystal clear that there is no possibility of a conflict, and that we not only want to be clean, but to be seen to be clean—as virtuous as Caesar's wife, as it were—we will advise you, but our group will not be involved in anything to do with investment in anything we are advising on." That is essentially the heart of what he is saying here.

William Rucker: No, I think he is talking about distribution of sales and trading versus advice; that is what he refers to. We have always had an asset management business. If we had influenced, in any way, what Lazard Asset Management was doing here, I think we would have some issue to discuss. But at no point did we have any influence whatsoever in what they did.

Q188 Chair: You keep saying influence. Can I just ask: as the adviser to Government, you saw and signed off the list of investors, didn't you?

William Rucker: We did not sign off on the list. We were aware of the list. This list started—

Q189 Chair: And you knew that your asset management arm was on the list?

William Rucker: Yes, we did, but we did not comment at all—

Q190 Mr Bacon: Did you see the final allocation?

William Rucker: Yes, and we did not comment on any allocation—

Q191 Chair: But you knew they were on the list?

William Rucker: Yes. We were made aware, when we were hired, that the company had been talking to Lazard Asset Management since, I thought, the start of 2012, but from what Alan has now said, it was 2011.

Q192 Mr Bacon: Of the priority investors, which one got the largest allocation?

William Rucker: I don't have that detail to hand.

Mr Bacon: Mr Donnelly, you should know the answer to this.

Martin Donnelly: I would look to Mark and the ShEx team; I am not sure whether we have that to hand.

Q193 Mr Bacon: I would have thought that that was basic information—who got what.

Mark Russell: The largest was Threadneedle.

Q194 Mr Bacon: If you ranked the priority investors in order, who came where? Who was second?

James Robertson: Would you like me to jump in? Lazard Asset Management was the second bottom.

Q195 Mr Bacon: So they were 15th. So Threadneedle was first. Can you just run through them? Who was second, third, fourth, in order?

Mark Russell: Sorry. Threadneedle was No. 3. It was: Capital Research; BlackRock; Threadneedle; GIC; Lansdowne Partners; Fidelity; ADIA; KIO; Schroders; Standard Life; Artisan; Och Ziff; Henderson; Soros; Wellington; JP Morgan; Lazard—have I got them all there?

Mr Bacon: I wasn't counting.

Mark Russell: There is also Third Point.

Q196 Mr Bacon: Can you send us a note with what you just said, but also put next to it—we know that Mr Custis has 6 million shares—who got what at issue on flotation? Can you do that?

Chair: Mr Donnelly, yes or no?

Martin Donnelly: I am pausing only because I may need to check on the commercial confidentiality.

Chair: Well, they are all out there now, thank goodness. Otherwise we would have put them out this afternoon anyway, because we have them by other means.

Martin Donnelly: The names are, but the allocation was not. We will come back to you—

Q197 Mr Bacon: I am curious. This phrase “commercial confidentiality” gets used a lot and, of course, in commerce, there are things that are commercially confidential. But what we are talking about here is public assets that were sold to a group of priority investors, who had, as it were, special access to the purchase in a way that others did not. They were able to buy at a special price—

Mark Russell: No, not at a special price.

Mr Bacon: I am sorry; forgive me. What I mean by a special price is the price at flotation. I am not saying that they were paying a different price from everyone else, but they had the opportunity to buy at that price, which many others who might like to have bought did not. It is common that investors bid and then either get scaled down or don’t get any. When I say “special access”, I mean special access to buy at a price, in a way that others did not.

Mark Russell: And they were all scaled down; you understand that.

Q198 Mr Bacon: Yes. So this is a privileged group in a way. When this privileged group is buying assets at a special price that they have access to in a way that others do not—and they are public assets—there is a public interest in knowing who they are. I am not quite sure what is suggested: that somehow their appetite to buy something when they think there is a very high chance that they will be able to, especially when there are lots of index funds that have to own it, so they will be piling in later because they could not get any of the initial allocation, so they will be pretty sure that the price will go up and that they can bail out if they want to, like Mr Custis did; are we seriously saying that that appetite to participate in this privileged opportunity to buy something cheap and then sell it, which is after all Mr Custis’s job, would somehow be diminished if people knew who Mr Custis was? Mr Custis has come here this afternoon. He has told us quite openly who is, who he works for and that he bought 6 million shares. He has done his job. What I am trying to get at is where the commercial confidentiality is in this. Mr and Mrs Taxpayer, our constituents, surely have the right to know that information.

Mark Russell: I think what you are saying is that you think the public interest trumps a general duty of confidentiality. I think our Secretary of State agrees with that.

Q199 Mr Bacon: Okay. Mr Donnelly, why can’t we have a note that has not only the ranking in the way that our colleague from the Shareholder Executive just said, but also what the allocation was? That would seem quite reasonable, wouldn’t it?

Martin Donnelly: It does and I understand the point you are making. The public interest test is the one that led the Secretary of State to make the names public. All I need to do is—

Mr Bacon: Check with him, which is fair enough.

Martin Donnelly: Yes, and also that there are no—

Chair: Late in the day.

Q200 Mr Bacon: Can I be clear that you will check with, as it were, your masters and, assuming it is okay, you will send us a list including the allocation?

Martin Donnelly: Just to repeat what I said and, assuming that there are no legal issues we are unaware of, yes.

Q201 Chair: Thank you. I am going to go to Stephen but I wanted to ask how many shares you asked for.

Alan Custis: Approximately 45 million.

Chair: And you got 6 million.

Q202 Mr Bacon: Did you ask for 45 because you knew that you would be scaled back in a big way?

Alan Custis: No.

Q203 Mr Bacon: You wanted 45?

Alan Custis: Forty-five million was reflective of the position that we would put of a company of that size into the funds where it was appropriate. So we got 13% roughly of what we put in for.

Q204 Stephen Barclay: I think what we are seeking to clarify is figure 20 on page 48. It actually lists the shareholdings but without the names. Given that the names have now been disclosed, the logic would follow that the names would be attached to figure 20. I think that is what Mr Bacon is seeking.

Mr Rucker, I was a little confused, because a moment ago you said, "We have no conflict." Surely, the position is that you have a conflict but you are managing it. Would that be correct?

William Rucker: I said the description of an independent adviser is normally one who is free from a conflict between their advisory business and any sales and trading activity. We do not have a sales and trading activity. The only potential conflict is the one that you are all highlighting, which is Lazard Asset Management. That is an entirely separate ring-fenced business where we have no contact. There are complete Chinese walls between the two.

Q205 Stephen Barclay: But you would accept that there is a reputational relationship, and that reputational damage from the asset management arm would affect the brand of Lazard as a whole?

William Rucker: They are branded Lazard Asset Management and we are branded Lazard.

Q206 Stephen Barclay: Yes, but the name Lazard.

William Rucker: Is common to both.

Q207 Stephen Barclay: I accept that there is complex policy and that these things are ring-fenced, but you would say that there is the potential for contagion from one to the other reputationally.

William Rucker: We are linked by a common brand. We are owned by the same parent company ultimately.

Q208 Stephen Barclay: Indeed. If you are advising the Government independently and you were to feel hypothetically that the offer was low, you would be criticising part of your own group, because you would know that the asset management arm was one of the parties suggesting that low price. That is correct, isn't it?

William Rucker: We were unaware of what the Lazard Asset Management view was throughout and I remain unaware to this day what Lazard Asset Management's view is on the Royal Mail.

Q209 Chair: But you saw the list, Mr Rucker.

William Rucker: I was aware that they were a buyer at 330p.

Chair: You were aware.

Q210 Stephen Barclay: If you have got a number of firms saying that the value of this company is X and one of those firms has a relationship with yourselves, if you say that X is low, you are criticising the firm that has a relationship with you.

William Rucker: That would not in any shape or form come into our thinking when we are looking at the book and deciding prices. I think the checks can speak to that. At no point did we say, "Hang on a minute; we think that Lazard Asset Management will not buy at this price." Quite the contrary. We never had any contact whatsoever, or even any discussion about Lazard Asset Management in the context of this.

Q211 Stephen Barclay: I did not suggest that you had a discussion.

William Rucker: Our advice was never tainted by that.

Q212 Stephen Barclay: What value did you place on the company's tax losses and when was that value placed?

William Rucker: I would have to refer to my notes.

Q213 Stephen Barclay: It is a potentially significant sum. I think it is in the region of £3.1 billion of losses, which would be worth in the region of £500 million. We are not talking about small change. What I am trying to establish is whether the figure is correct that the potential tax holiday would equate to £500 million. In other words, this is a company that is likely to have to pay very little corporation tax, which obviously is a very significant factor for price. You are the independent adviser.

William Rucker: Yes, and when we valued the company we took into account all of the financial characteristics of the business including, ultimately, the cash flows of the business. The cash flows of the business reflect the tax position of the company.

Q214 Stephen Barclay: So when did you attach the values in terms of tax losses?

William Rucker: The values are implicit in our valuations because our valuations took account of the future cash generation of the business. That cash generation reflects the tax-paying or non-paying position of the company.

Q215 Stephen Barclay: So that will have been set at the date the prospectus was put out?

William Rucker: Sorry, that is in our valuation statistics: the figures you see in the NAO Report with our numbers in there will reflect that position.

Q216 Stephen Barclay: Likewise, on the property side, the Report refers on page 31, paragraph 3.16, to equity research carried out by UBS which describes surplus property as "hidden value worth £330 million to £830 million". Is it your evidence that that equity research from UBS was wrong?

James Robertson: Shall I take this?

Q217 Stephen Barclay: I would like Mr Rucker to answer first and we will obviously come to you, Mr Robertson, in due course.

William Rucker: There is a range of opinions on what the likely outcome could be from surplus properties. UBS's top end of the range was above most other people's expectations. But we had independent valuations of the property that you will be familiar with from the prospectus and this was discussed at some length. Most people's cash flows took into account potential proceeds from future surplus property generation. Indeed, when we looked at the appropriate level of gearing in the business at the time it was floated, we took into account equally what proceeds could be realised through the property portfolio. That was part of the dynamic to try to establish what was the consistent cash generation the business could sustain that would enable it to continue to pay a dividend and grow earnings in the business. Rather than seeing these valuations as a mistake, they should be viewed in the round, just as tax losses, surplus property and so on.

Q218 Stephen Barclay: So you think they were over-egging it, they were overvaluing it? When they talk of hidden value—

William Rucker: This is a very indeterminate sum because it depends on the property market, the future proceeds, planning permission—a host of things. It is extremely difficult to say that the value should be X. UBS came up with a range of values based on a range of outcomes.

Q219 Stephen Barclay: The impression, Mr Robertson, is that you are telling your investors one thing but advising the Government, as a soft seller, something else.

James Robertson: Our research analyst is independent from us as an adviser. He comes up with his own views on the value of the company.

Q220 Stephen Barclay: So their independence meant they were wrong?

James Robertson: If they want to be wrong they are independent from us. We cannot correct them. We can only point them towards the disclosure that we made with respect to that surplus property and point out that that seemed a very optimistic number.

Q221 Stephen Barclay: Notwithstanding what is happening in property prices, for example, the Vauxhall site and the potential value of a prime London site?

James Robertson: At the time, that was why he wrote that particular part of his research report. He was the only person to talk about the surplus property and put those sorts of valuations on it. The other research analysts took the guidance that they had been given by the company of around £100 million worth of surplus property over the next three years.

Q222 Chair: I am really interested in this. The UBS valuation was £830 million. You valued the surplus property at £200 million. Can we, Mr Donnelly, see a copy of the full valuation report?

Martin Donnelly: I might ask Mark about the status of the report then come back to the wider point.

Q223 Chair: Again, there is a public interest because it was your decision to put it in rather than to take it out and give benefit to the taxpayer. UBS might have been over the top, but there is a big difference between £200 million and £830 million, and I agree with Stephen about London property prices. We need to see the valuation report to protect the public interest.

Mark Russell: As you know, the NAO has seen it. It is not our valuation.

Q224 Chair: It saw a redacted version; I want to see the full original version.

Mark Russell: We have not seen the full original version.

Q225 Chair: So who has got it?

Mark Russell: It is the company's valuation; it is not our valuation.

Q226 Mr Bacon: So Royal Mail owns the valuation.

Mark Russell: Yes. They commissioned it.

Q227 Mr Bacon: Just remind me: until it was sold, who owned Royal Mail?

Mark Russell: A few months ago, we did.

Mr Bacon: Yes. Just checking.

Q228 Chair: The valuation was done when it was in public ownership.

Mark Russell: It was, yes.

Q229 Chair: So, Mr Donnelly, can we see it?

Martin Donnelly: On the point that Mark makes—I know it sounds a bureaucratic one, but it is an important one—my understanding is that this was a report done by Royal Mail for Royal Mail management and directors.

Chair: When it was in public ownership, Mr Donnelly.

Q230 Mr Bacon: The Shareholder Executive exists to protect and manage the public interest in companies that have a public shareholding, doesn't it?

Martin Donnelly: Yes, and the company was responsible, of course, for what went into the prospectus.

Q231 Mr Bacon: Is it right, Mr Rees, that what the NAO saw was a redacted version of this valuation report?

***Matthew Rees**:* That is correct.

Q232 Mr Bacon: Why? Why, Mr Donnelly, did the NAO, which audits the security and intelligence services for heaven's sake—it doesn't necessarily publish it, of course, but it sees it—see a redacted version?

Mark Russell: May I say what redacted means? The figures that we saw were the net values of the property. Those figures were disclosed, and we can ask the company if you can have those figures. The basis of these valuations was that they started with assumptions that in 10, 13 or 15 years' time, if we have x number of flats or whatever, we might get a gross value—it will be many, many times. Then they deduct from that those various assumptions, and you can put in all sorts of assumptions. I think that what Royal Mail will argue is that those assumptions are commercially sensitive. You can make all sorts of assumptions as to what the total gross value should be. As a shareholder, we should be interested in the net value, and that is the figure—

Q233 Mr Bacon: I think, Mr Russell, it would be possible for any expert in the world of property to make a series of assumptions and to come up with a range of valuations—many do that for a living all the time—once you know what the portfolio is, where it is, which parts of London it is in, how many acres there are and so on, which are the things that were available. I am struggling to understand why this information should have been kept from the National Audit Office. How is it to do its job when it is getting redacted information?

Mark Russell: My response, as I gave it to you before, is that it was given the net value—the value of the asset itself.

Q234 Mr Bacon: Based on a whole series of assumptions that may be heroic or may be very conservative, but the point is that they are based on assumptions. To do its job, the National Audit Office needs to see the underlying working.

Mark Russell: We can ask the company.

Q235 Stephen Barclay: Just to be clear, did the Department see the full report before the IPO?

Mark Russell: No, we didn't. We saw a redacted version.

Q236 Stephen Barclay: So you are setting the price on property—with yourself as the client paying for the report—without seeing the full report?

Mark Russell: To be clear, these valuations—

Q237 Stephen Barclay: Is that a yes?

Mark Russell: It is a yes.

Q238 Nick Smith: Why did you not ask for the report, given that the property portfolio could be worth up to £800 million?

Mark Russell: Because our focus was actually on what the cash proceeds of selling this property would be in the medium term. That was where our focus was, and on the due diligence that was done on the business before that.

Q239 Stephen Barclay: It was a short-term arrangement for the investors.

Mark Russell: It was short to medium.

Q240 Stephen Barclay: Short to medium in what they get in yield, so if you dispose of the property after that point, in your view that was not relevant.

Mark Russell: Remember these developments are fairly speculative and fairly undeveloped. These valuations make all sorts of assumptions about planning permission and access. There are lots of assumptions.

Q241 Stephen Barclay: But the Vauxhall site is in the middle of a local enterprise zone.

Mark Russell: Yes, but I don't think there was planning permission on all those sites.

Chair: Mr Russell, the whole point here is that there is a massive difference.

Q242 Mrs McGuire: Notwithstanding the debate about valuations, may I ask about the principle? On page 17 of the Report, paragraph 2.4 clearly states: "The National Audit Office has recommended that surplus assets should be removed from public companies prior to privatisation where possible". If that is not possible, it says that there should be alternative arrangements, including a "clawback". Given that National Audit Office recommendation, why did you include private leased assets in the privatisation, or whatever words you feel most comfortable with? If you still think that they should have been included, have you any way in which you can claw back any surplus profits?

Mark Russell: We don't have a way of clawing back.

Q243 Mrs McGuire: So you haven't built in any way of doing that if these assets come in at £830 million? Given that a garage in London was sold this morning for £700,000, we could probably err on the higher level—those of you with garages might be interested in selling up.

Mark Russell: I think we disagree with that; we don't think the value—

Q244 Mrs McGuire: You can disagree with what you want, but I am asking you whether, given that the property market in most areas, but certainly in London, is on an upward trajectory, you thought it appropriate to put in place some way in which the taxpayer could get some benefit if those assets were way above the £230 million, or indeed above the £830 million.

Mark Russell: And the answer is that we absolutely debated that point. The advice we got was that if we put in sale and leaseback arrangements or clawback agreements, it essentially takes cash out of the business. With sale and leaseback, you take cash out up front; if it is clawback, you take it out over a period of time. If we were to do that, we would essentially be gearing up the business further. You probably won't quite believe us, but in July it was by no means clear that we were going to be successful with an IPO. We were looking at every measure we had to make this attractive to the market. One key measure was a dividend policy, and we fought hard to get the directors of the company to agree a dividend expectation of some £200 million. I am entirely satisfied that if we had gone to them and said "Let's do some sale and leasebacks; let's take away that opportunity for cash in the next few years, either through sale and leaseback or through clawback," we would not have got that commitment for a dividend. As a result, we would not have been able to achieve the value that we did. The way we approached property was to disclose the acreage—you can look at that in a number of ways—and let the market make a decision, and we are satisfied that the market did value it, because we saw the equity analysts' valuations and the cash flows that they attached to that before the float.

Q245 Mrs McGuire: Given the National Audit Office's extensive experience of dealing with such situations over many years, it had a recommendation, which I indicated to you. Did you take that recommendation into account? Did you not see the National Audit Office's recommendation as part of the portfolio of advice?

Mark Russell: Yes, we did.

Q246 Mrs McGuire: But you sought to reject its recommendation—not on this specific point, but in general terms.

Mark Russell: Sorry, but you have put that in a pejorative way: "We rejected it." We absolutely considered the recommendation. There was another reason why we didn't go down that route, which was the state aid reason. This company was in distress and required EU state aid approval for our support only two years ago. Part of the agreement was that the company would contribute property and asset disposals to that settlement.

Q247 Stephen Barclay: The case of London and Continental Railways shows that you could have entered into a contractual arrangement to return disposal proceeds.

Mark Russell: I think that was a separate situation.

Q248 Stephen Barclay: But it is a precedent. I was slightly lost by your answer to Mrs McGuire a moment ago, because you said that you didn't see the full property report, but if I understand what you said correctly, you relied on equity analysts' valuations.

Mark Russell: We saw the net values, which was what we were interested in.

Q249 Stephen Barclay: We have an equity analyst valuation from UBS talking about value.

Mark Russell: We saw the net values, and our focus was on what cash could be realised—this is very speculative stuff—in the next four or five years and will we get value for that. We are satisfied we do get value.

Q250 Stephen Barclay: In coming to that valuation, you were looking at a four to five-year horizon and saying some of these sites do not have planning permission even though, in the case of Vauxhall, it has two underground stations planned, it is an enterprise zone, and it is likely to have huge development opportunity linked to the US embassy. That might not crystallise within the next four years, but I would have thought an investor would see that as a pretty likely scenario.

Meg Hillier: And there is Mount Pleasant.

Mark Russell: That would have come out in the valuation. We would have had a higher figure.

Q251 Chair: Mr Russell, two other things on this, and then I will go back to Stephen, if he has other issues to raise. First, we do want the original valuation. We want to look at the assumptions that gave you your net value. Secondly, I am told by the local MP, who has an interest in the Mount Pleasant site, that she wanted two things to be raised—perhaps you can answer them. I can understand where you were in July and the really interesting thing about this is your failure to act in October when it was clear that demand was going through the roof and Royal Mail was doing better. All those indicators were coming in, so in July you took one view, but I would have reviewed it in October had I been responsible. But what you did, she tells me, was that nine days before selling off, you signed off that you wanted only 12% of affordable housing on the Mount Pleasant site, which clearly had an impact on the value, although you had originally agreed 19%. Why did you do that?

Mark Russell: I am not aware of having signed off anything.

Q252 Chair: I can't believe she is wrong because she has a great interest in this. She rang me five times to make sure I knew about it.

Mark Russell: Is she suggesting the Department signed that off?

Chair: You. The Government signed it off. The Government, responsible for the launch of this, thought they could increase the value by decreasing the amount of affordable housing. Obviously that had an impact on the value of the site. It was signed off nine days before. You said you did the rest in July—I can vaguely feel that maybe you were much more worried in July than you would have been in October—and you signed it off at only 12%, although the original planning application was for 20% affordable housing.

Mark Russell: I am not aware of that.

Q253 Chair: Mr Donnelly.

Martin Donnelly: That would not, I believe, have been a decision for the Department for Business, Innovation and Skills. It would have been a separate decision, perhaps for CLG or certainly through the planning system.

Q254 Chair: It was part of the valuation. For heaven's sake, a whole lot of factors came into determining the value and whether we as taxpayers got value for money out of this.

Martin Donnelly: And we chose to approach this. It is an important and serious issue. It is right to pause over it, and we certainly did, by going for transparency about the details of the Royal Mail's property portfolio so that analysts could come to their own judgment as part of their overall valuation.

I underline one other point that Mark made because it is something that we had very clearly from our advisers: this was a sufficiently complex sale already with a range of risks—

Q255 Chair: Can we stick to the property and not have one of your general answers that you are so keen on giving?

Martin Donnelly: The point is that if we had had to explain the complexity of a sale and leaseback or clawback clause to the large number of investors who were already struggling with the complexity of this sale, it would have put more of them off.

Chair: That is why you had such a massive over-demand.

Q256 Mr Bacon: Before we move off this subject, may I return briefly to the valuation report? I want to be clear in my own mind. We know, because you have just told us, Mr Rees, that the NAO saw only a redacted version of the valuation report. Is that correct?

***Matthew Rees**:* Yes, we received a paper copy of the redacted version when we had a face-to-face meeting with Royal Mail and saw a copy with numbers, but we were not able to take notes or any details away with us.

Q257 Mr Bacon: I find that surprising and absurd, but there we go.

Mr Russell, am I right in thinking from what you said earlier that you did not see a full copy of the valuation report?

Mark Russell: Correct.

Q258 Mr Bacon: You didn't. Okay. Mr Donnelly, did you or the Department for Business see a full copy of the valuation report?

Martin Donnelly: No. It would have gone to the Shareholder Executive if we had had it.

Q259 Mr Bacon: Mr Rucker, did Lazard & Co. have a full copy of the valuation report?

William Rucker: No.

Q260 Mr Bacon: So Royal Mail did—that's right, isn't it?

Martin Donnelly: It was their report.

Q261 Mr Bacon: Yes, indeed it was their report, and you as the Government, representing British taxpayer, were selling the Royal Mail business, including this report that they owned. Who saw the full report, apart from the Royal Mail?

Martin Donnelly: I am not aware of anyone.

Q262 Mr Bacon: You are not aware of anyone who saw the full report?

James Robertson: We saw the summary numbers.

Q263 Mr Bacon: So UBS saw the full report?

James Robertson: No, we saw summary numbers.

William Rucker: And the summary report was discussed with the company as well.

Q264 Mr Bacon: But as far as you are aware, Mr Donnelly, no one else apart from Royal Mail saw the full report.

Martin Donnelly: I am not aware that anyone else did, no.

Q265 Mr Jackson: I will come down to brass tacks here: cock-up or conspiracy? I am not sure whether my colleagues are alleging cock-up or conspiracy, or both. Can I move away from cock-up, which might be a moot point, on to the conspiracy side? It seems to me that unless there is, demonstrably, evidence to the contrary, it is unhelpful to make assertions and allegations.

Can I ask you, Mr Donnelly, specifically, given that we heard from the FCA on Monday, whether there has been any regulatory challenge or legal challenge—or any other challenge—as to rules not being followed in this process, rather than a value judgment on a broken market and a wrong valuation? The FCA, the police or anyone else: is there any evidence of impropriety, inappropriate conduct, illegality or any breach of rules?

Martin Donnelly: No. Nothing I am aware of.

Q266 Austin Mitchell: I want to go back to the earlier point. Mr Donnelly said that you wanted to get the best possible price. I can understand that, although you did not get the best possible price, but the Department also wanted a stable, long-term and supportive shareholder base. Did you ask for any undertakings or guarantees at all from the preferential shareholders—the ones who got a bigger allocation—that they would hang on to the shares?

Martin Donnelly: No, we did not, because we were aware that if we had sought to put that type of arrangement in place, it would have significantly reduced the price we could have achieved.

Q267 Austin Mitchell: Surely, then, you were being naive. Whom was it meant to con or persuade that there would be a stable shareholder base? The FCA told us on Monday that asset managers acted in the way that other shareholders would act, which was that, having bought something, they decided the price was right for them to sell. That is the way the market works, so you were naive in not expecting that. How could you expect a stable shareholder base in such a situation without guarantees?

Martin Donnelly: We were seeking to do what successful companies have, which is build a long-term stable base of investors. That does not mean that that base is completely frozen. We expect liquidity, and of course as the price moves, some investors will choose to sell and some will choose to buy more. What we had was a set of investors at the beginning of this process who understood the Royal Mail and its issues and were prepared to give us a base on which we could have some confidence we could have a successful IPO to benefit the company, the universal service obligation, and the employees.

Q268 Austin Mitchell: You can't have any confidence unless that is sustained. I suppose now that we have got the full list of preferential shareholders, you will be looking at how many shares they retained for this firm base and how many they sold on. We don't know, do we, how many have gone to hedge funds that speculate?

Martin Donnelly: I am pretty sure we know that the majority of those who bought in at the start still hold shares.

Q269 Chair: Forty-two per cent. of those shares were traded on day one.

Mark Russell: No, I don't think that is right. We think that less than 10% were traded on day one.

Matthew Rees: Forty-two per cent. represents the total trading volume. It is impossible to tie volume to individual shareholders.

Q270 Mr Bacon: So the same shares could have gone round many times?

Mark Russell: We believe the same shares were moving on that first day five or 10 times.

Q271 Stephen Barclay: Mr Donnelly, if you had locked institutional investors into holding the shares, would you not have reduced the number of shares available and therefore increased volatility, rather than reducing it?

Martin Donnelly: That would also be true.

Q272 Stephen Barclay: That is the opposite of what you said just a moment ago. You said that we were seeking to lock in the priority investors. You didn't succeed in doing so, but that was one of the original criteria of which Mr Cormack spoke—wanting them to invest for the long term—and that would have increased volatility.

Martin Donnelly: I don't believe I ever used the words "lock in." If I did, I shouldn't have, but I don't think I did. We were trying to build a stable investor base, which doesn't mean an unchanging one. We did not seek any formal commitments from investors to stay invested for a certain time because that would have come at a price, and we didn't want to pay that price for the taxpayer.

Q273 Stephen Barclay: So, going back to the criteria, that wasn't a criterion.

Martin Donnelly: I think Mark can put this more lucidly than I can, but our objective was to build a stable base for Royal Mail with high-quality shareholders. That doesn't mean that they wouldn't buy and sell or increase and decrease their stakes, and of course they had fiduciary duties, but it did provide a quality shareholder base on which to move forward. We believe that we largely achieved that.

Q274 Mr Jackson: Can I just ask about the valuation? It is quite striking that page 29 uses the model of bpost, the Belgian postal service. Who took the decision to use that as a comparator? The Report actually says that there are "substantial differences in the characteristics of Royal Mail and bpost". Did you become locked in to that being the best comparator and informing the valuation? It seems perverse that it is allegedly so dissimilar and yet you used it as a comparator.

Martin Donnelly: There was no precise comparator. The Belgians, the Austrians, the Dutch and the Germans all had factors that were relevant and that we looked at as we sought to analyse the price and the average return. I don't know whether our advisers want to say any more about how we did that.

Richard Cormack: I think that is right. The investors and the analysts looked at comparable companies. There are a number of listed postal companies in Europe, and Martin has listed the countries. The most recent one was bpost, which is why it was fresh in investors' minds as an IPO happened last July, three or four months ahead of the Royal Mail IPO. As a result, it was definitely comparable.

Q275 Mr Jackson: Does bpost have a universal obligation?

Richard Cormack: In Belgium I believe it does.

Mark Russell: Yes.

Q276 Mr Jackson: Did it have issues with large-scale pension liabilities, like the Royal Mail, at the time of its IPO?

Richard Cormack: It had many lesser issues than Royal Mail, i.e. from a union perspective. It has much higher margins than Royal Mail. In many ways, bpost is further down its modernisation plan. It has come out of private equity ownership, which would argue that it should have a higher value than Royal Mail. On the other hand, Royal Mail is seen to have more opportunity because it is further away from completing its modernisation.

Q277 Mr Jackson: Forgive me for labouring the point, but if you are using bpost as a comparator and it is a more mature business with a higher share price, one would have thought that that would be reflected in your assessment of Royal Mail's share price.

Richard Cormack: It was. There was an assessment against bpost, Austria Post and PostNL in the Netherlands. Deutsche Post is the other listed entity in Europe, and it is a very different business that owns DHL, so only part of the business is postal services in the same way as Royal Mail. All those businesses were assessed not just by the banks and the advisers on the corporate finance side, but by the research analysts and, ultimately, investors.

Q278 Stephen Barclay: Can I just ask for clarification, because I am still a little confused by Mr Cormack's evidence on the criteria. Did you share the criteria with the NAO?

Richard Cormack: We discussed with the NAO the process in which we engaged with the market – i.e. the figure in the report I was going through earlier in terms of the funnel—

Q279 Stephen Barclay: Is there a document setting out the criteria used?

Richard Cormack: The criteria for selecting the pilot-fishing accounts?

Stephen Barclay: For selecting the priority investors.

Richard Cormack: As I said, we did not use the term priority. The 16 investors who received the preferred allocation, by virtue of the fact that they had indicated demand from the outset to give us the confidence to put out the intention to float announcement, came from the pilot-fishing investors.

Q280 Stephen Barclay: Yes, but that is not the question that I am asking. I am asking this. You are talking to 65 firms six months before Lazard had been appointed as independent assessors.

Richard Cormack: That's not—

Q281 Stephen Barclay: And on a set of somewhat confused criteria. We have had a long debate around whether the priority investors were guaranteeing to get the sale away—and that is why the price was lower and people were less concerned about price than how much they could get away and whether it would be fully sold.

I am concerned about the criteria. You are talking to firms that trade heavily with you as a group, which put a lot of fees through. There is a benefit to them if they are able to get the opportunity to bid for these shares and then sell them quickly, so there is a short-term value, but there is also a big value for you in terms of the ongoing relationship. They will then put volume through Goldman.

I am trying to get a sense of the criteria when you have discussions with clients who are going to give you significant trading fees. I am not aware that there was a document shared with the NAO that set those criteria out. Was there such a document?

Richard Cormack: There were multiple discussions with ShEx and Lazard through the whole investor engagement process, some of which predated our own involvement in the transaction.

Q282 Stephen Barclay: So who were you working for at that point? When you were having those initial discussions, who were you formally working for?

Richard Cormack: The first round of investor engagement that we participated in, at that point we were working for the company, not for ShEx.

Q283 Stephen Barclay: The company being Royal Mail?

Richard Cormack: Yes.

Q284 Stephen Barclay: So you were working for Royal Mail, not the Department?

Richard Cormack: To introduce them to investors.

Q285 Stephen Barclay: Mr Donnelly, are you satisfied that everyone has had access to the same information?

Martin Donnelly: It has been very important in this process that our advisers and the Royal Mail had the maximum transparency with investors and had the opportunity to meet them, put the points they were concerned about and so on. My answer would be, yes, we made a really big effort, more than I think almost any other IPO, possibly any IPO, over a longer period, to get that information out there.

Q286 Stephen Barclay: Because I am struck by paragraph 3.4. UBS was appointed and was working between 2010 and 2013 for the Department and for the company as independent corporate finance advisers. I seem to recall that Goldman was the only bank appointed to advise on the pensions asset disposal. I think it is correct, isn’t it, Mr Donnelly, that BlackRock, Russell Investments and Goldman were the three advisers on that deal?

Mark Russell: To be honest, I cannot remember.

Q287 Stephen Barclay: I have got a letter from Norman Lamb, the then Minister, that says that they were the three advisers. In the prospectus, there was more than £600 million set aside for future pension liabilities. There is a clear set of information and relations. Goldman itself was introduced by Royal Mail in November 2012. I am trying to clarify whether there was a level playing field, Mr Donnelly, around the appointment of the advisers.

Martin Donnelly: The answer to that is yes, because we had a very rigorous open process involving ourselves and the Treasury. We had a set of criteria, which we were marking banking advisers against. Mark can run through those if you want. We followed best practice to ensure that we achieved the best set of advisers for this sale.

Q288 Stephen Barclay: But you appointed UBS and Goldman, which were two of the four lowest in terms of the valuation they were giving. I know it is not a correct analogy, but usually if you have an estate agent you do not tend to go for the one who offers the lowest value. I know your priority was not purely on price; it was about getting it away. But it’s just striking that you have gone for the advisers who started working six months before your independent adviser started, who were having those preliminary discussions, who already have access to advanced information and who give a lower valuation, compared with a number of the other players.

Martin Donnelly: Your estate agent analogy only gets us so far.

Stephen Barclay: I accept that.

Martin Donnelly: So do I. Price was one of the things we looked at, but only one, Mark, because there was a wider set of criteria we needed for a successful sale.

Mark Russell: Yes. This was something, I think, the NAO looked at and, I think, it acknowledged that we didn’t attach much—

Chair: Can you speak up?

Mark Russell: I’m sorry. Value was one of the criteria we looked at in choosing our syndicate, but we attached a very low weighting to that—5%. The reason was that most of those valuations were uninformed valuations. They just used information from the market, whereas Goldman, for instance, which had been working with the business, had a better understanding and so came up with a more sensible—that is one reason why the valuation is lower. It would have been crazy, if people were putting together valuations using very different assumptions, to be using that as a significant reason for choosing somebody to—

Q289 Stephen Barclay: Sure, but Lazard Asset Management was one of the firms giving a low valuation as well, and then the assessor comes in. Could I just clarify—*[Interruption.]* Yes, of course it’s part of the group. How, Mr Donnelly, was Lazard remunerated in terms of the total proceeds to Government from the privatisation?

Martin Donnelly: There was a flat-rate payment—I think it was a maximum of £1.5 million—and there was within that a payment for—*[Interruption.]* A retainer, which was paid, I believe, on a monthly basis, but capped at that figure.

Q290 Stephen Barclay: In other words, the money made is a fraction of what the asset management arm would be making?

Martin Donnelly: I can't speak for the asset management operation. That gets us back to our wider issue as to whether you are satisfied, as we were, that there was no risk of the advice being skewed.

Alan Custis: Sorry, can I just add something on the asset management side? As I said earlier, we made an approximately £8 million profit for our clients. That is for our clients. If you were to take the uplift in the value of our funds—that's £8 million on £110 billion—and if you were to annualise that uplift, it would equate to a revenue to Lazard Asset Management of about £40,000.

Q291 Stephen Barclay: Sure. I have already made the point in terms of Mr Cormack that actually it's not around the profits of the IPO; it's about the relationship with your major clients. That's the issue. Mr Donnelly is satisfied on it, but the question in my mind is: were Government seen as a soft seller with a one-off relationship, compared with the ongoing relationships with major clients who put trading volumes through the firms? Mr Cormack has given evidence to say, "We managed that conflict." The FCA gave evidence on Monday to say, "We're so satisfied we haven't looked at that issue." But you must accept, Mr Custis, that there is a potential conflict there.

Alan Custis: As I think was mentioned earlier, we were involved in this IPO a number of years before it actually came to the market. From our standpoint, it was an incredibly complex IPO, a very substantial IPO, and there were a lot of headwinds, which we have touched on in this meeting. We were acting, as Mr Rucker said, completely independently of Lazard & Co. during this whole process. We were just acting for our clients.

Q292 Nick Smith: Mr Cormack, I want to pick up on a question that Mr Barclay asked you earlier, which was whether there was a written document about the criteria you used to decide who the priority investors would be. You bobbed around a lot, but you didn't say either yes or no. What's the answer?

Richard Cormack: There are documents in the presentations that we prepared for SHEX [the Shareholder Executive] during the execution of the transaction that go through all the feedback, which includes investors' perspectives on the company, their longer-term perspectives on the company and their tolerance for industrial relations risk. The feedback on those points was how we selected the accounts who went to pilot-fish. The fact that that pilot-fishing list narrowed to 16 in terms of those accounts who got a preferred allocation was due to the fact that they were the 16 accounts who were willing to give us an indication of demand at the early stage of the process, as opposed to those who were not.

Q293 Nick Smith: So, you had a number of documents, which talked about a range of criteria, but it all boiled down to the 16 companies within this. Is that the nub of it?

Richard Cormack: We went to 65 institutions over that period. We got different feedback from different institutions. Some of those institutions ended up never participating; 17 of the institutions never participated in the transaction at all. Some had given feedback that was more concerned with the industrial relations risk than others. We could not go to 65 institutions in the one week ahead of launch—and practically get to that number. We had to refine it to a more manageable number in order to be able to do the pilot-fishing exercise.

Q294 Chair: What we cannot understand is the principles on which you did that. You talk about discussion—blah, blah, blah—but I think it is really important for the public interest to be able to articulate why A, B, and C were chosen.

Richard Cormack: The 65 as a whole had been selected as the largest asset managers on a global basis. The 24 that we went to pilot-fish got selected on the basis of the feedback that they had given in anything between one and four meetings of management over a period of 12 months or so prior to that pilot-fishing exercise, based on their willingness to invest, their enthusiasm for the transaction, the indications that they had given us about the potential size of order, and importantly, post the 31 July CWU conference vote against the privatisation and supporting a strike ballot, their willingness to invest against a backdrop that could include industrial action. As Mr Donnelly has said, we were anxious to make sure that we could get from a base and range of institutions enough demand so that, should the industrial action take place and the industrial relations environment deteriorate meaningfully, we had institutions who would still participate.

Amyas Morse: I really don't disagree with any of that, frankly. The real question for me is this—and I understand very well that you were worried about getting the issue away, and your preoccupation in approaching the issue was to get it away. However, things started going a lot better late in the run-up to the actual issue. What I am interested in, and what we tried to examine in the Report, was how agile you enabled yourselves to be, and how much public value you were able to protect, when it turned out better than you thought—I agree that it was not obvious earlier on; we are not trying to accuse you of something that nobody says. What is interesting is whether you were agile enough or gave yourselves the means to recover some of the upside in public value, given that it turned out better than you thought. It is good news that it did. Did you give yourself that, or were you locked into a process that was based on your assumptions about how difficult it was all going to be and industrial relations? All those things subsequently—very fortunately, and we are delighted that they did—turned out to be somewhat better. There was also the effective action that the company took, no doubt with guidance from the Department, to improve its profitability. It did that successfully and therefore, the numbers started getting better. What we are trying to test is whether there was an adequately agile and active response to that to capture the public value. As you know, our conclusion in our Report was that taking all that conservatism that we understood for the reasons for, we felt that it probably was conservatism piled upon conservatism.

I ask this in retrospect, and I know retrospect is a very dangerous thing. Our Report does not suggest any impropriety at all, but what we were asking was whether you moved fast enough or gave yourself enough ways of recapturing value. What do you think about that? If you will pardon me for intervening to ask that, that was a question that the Report addressed. This is an agreed Report. I would like to know what your views on that are, please.

Martin Donnelly: If you agree, Chair, may I offer a first accounting officer answer, let Mark comment on the detail of those days, and also ask our bankers? I agree that it is an important question. From my point of view as accounting officer, I am conscious that I am unlikely ever to have to deal with a sale of this value and importance, not just to the taxpayer, but to 150,000 Royal Mail workers across the UK. It was important to get the sale successfully off but also to maximise taxpayers' value.

I will start by underlining two points. First, you used the word "caution", not "conservatism", and I agreed the word "caution". We were cautious, but we did put those questions, to ourselves in checks and to our advisers. We had advice all the way through. One comment we had in writing in that key week from our advisers was, "Over-subscription is no guarantee of a strong after market". We were looking at this and our Ministers, who were very professional throughout this, were looking at it, and we were having to answer that question.

The second point I want to make before passing over to Mark on how we had to handle the timing—including the complexities of the retail offer, which was important too, as those people were buying in price blind—is on the background. We have talked about the industrial relations side. There was a strike ballot going on until 16 October. The result of that was probably going to be a relevant factor—it might have affected the whole prospectus issue and certainly the timing. Also, it is worth remembering that we were in the potential run-up to an at least partial closure of the US Government. There was a significant uncertainty in the market and I think it is fair to say that the media commentary continued to be less than enthusiastic. We had to take those points into account as we were asking those questions. Mark, do you want to comment on how we did it in that week?

Amyas Morse: I know you are going to pass on, but could you just give me your own answer to the question?

Martin Donnelly: My answer to the question—and it is a question I asked myself at the time; immediately afterwards, I had an internal audit report look at this, which we have shared with you—is that, on the information available, having tested those assumptions, we came to the correct decision.

Mark Russell: This is really important. My answer to the question is that I think we were as agile as we could be given the situation we were facing. If I was sitting on your side, the two decisions I would be quizzing are why we set the lower price—the bottom of the range—at 260p and why, when we saw it zoom up, we didn't reprice. Those are the two real questions.

The reason we set 260p as the bottom range was that that was the price at which we were confident that, if we went into a strike situation—and a strike situation could have wiped out the profits of this business in two weeks—we had just about enough priority investors to be able to sell the company. That set the bottom. We then said—and this is part of the restriction of the process—"What is the maximum range we can go to?" Retail investors have to be given that band. They are not price takers; they are just told the price, so they have to have some expectation as to roughly where the price is going to be—you can't set a band that goes several pounds. The maximum precedent was a 25% range from the bottom to the top. We set it at 27%, so we went well beyond, because we knew that this was difficult. We were at the bottom end, pricing on the basis that we could get this away in the event of a strike. But to the extent that we could, we absolutely wanted to explore what we could do in terms of the upscale.

As you see, the demand did not build up not immediately. It took quite a bit to get above £3. But when it finally got up, of course we asked the question, "Can we reprice?" The main reason we did not reprice is because we did not have the confidence that we could get anything significant and still run the risks.

Q295 Stephen Barclay: There are two issues with what you have just said. The first is that you sold the maximum when you saw the movement that the CAG is alluding to in the final week. You may want to address that. The second issue is that in that final week you saw that there was over-subscription and that this would be going on to an index. If it goes on to an index, a number of firms that had expressed interest and not been able to buy would, under the sort of computer programmes that I am sure Mr Custis runs, automatically buy. You are likely to see movement by dint of the size of strike price rationalisation. Could you address these two issues?

Mark Russell: On the first point, it was 50 rather than 60. This was a matter for debate, I can tell you. The Secretary of State was highly involved in that debate—do we sell 50? Do we sell 60?—as we saw the price going up. The key reason the advice came out at 60 from our advisers is that we had no confidence that this momentum would continue. You must remember the 43 IPOs that occurred before this: 21 of them on the first day—all of them over-subscribed—fell to a price either at strike price or below. So there was a risk here.

Q296 Stephen Barclay: The issue of risk is addressed by my second point that this was going on to an index which would trigger automatic buying.

Mark Russell: Of course, it was always going to work. It was a near certainty that this company would go into the FTSE 100. We knew that for some time. But it all goes back to the same point. How did you test? We knew there was massive over-subscription. We know that people would never have gone through with those full orders. Of course the question must be: why does that supposed over-demand suddenly evaporate? Of course we were asking: could we not push this further? But the very clear advice we had was that if you push this further, and take the various risks that you extend the timetable into the other side of the ballot, etcetera, you could well end up not even repricing above 330p, turn the momentum of this transaction, and be left with a float that in the first day traded below the current market value. Remember, the VFM of this was to get a good price on the first deal and give us the ability to place the second deal. We would never do that if the price had dived. Thirdly, and most important, leave the company with access to the capital markets if it ever needed it. The one way we would have shut up access to the capital markets would have been a flopped float.

Mr Bacon: That is the best summary I have heard from any of you, frankly.

Mark Russell: Well good, it just needs to be said.

Q297 Mr Bacon: You mentioned 42 IPOs. Are you referring to the 42 privatisations?

Mark Russell: No, 42 recent IPOs.

Mr Bacon: There is a chart on page 47—figure 19—and it doesn't have anything like 42. This is 2014, the whole of 2013 and a bit of 2012. How far back do your 42 IPOs go?

Mark Russell: I think it was from July 2010, the 43 main market IPOs—

Mr Bacon: Since then? Okay, thank you.

Q298 Chair: I hear what you say and I am grateful for that. I know you keep saying that over-subscription was not certain. I hear that. You could equally look in this Report at the equity valuations of your syndicate banks and see that they were all way above the price. You could ask why on earth you had to put a top price on. I can understand why you would want a bottom price. You didn't need to put a top price. There are as many arguments the other side, Mark, as on the side you presented. Why did you get it so wrong so that this in the end cost the taxpayer—this is our public interest—£750 million on day one?

Mark Russell: Crucially, that assumed we could sell 600 million shares at that price. That is the thing we were testing.

Q299 Chair: But in the end, the increase in the price on that chart which Richard mentioned was massively greater than any of the other IPOs. You got it wrong. Why? You have given the arguments that led you in one direction. I could mount a list of arguments that lead you to take a different view. You ended up getting it wrong on price.

Mark Russell: It wasn't massively different. There are many IPOs—

Q300 Chair: Hang on. Look at figure 19—

Mark Russell: We could quote you many cases, certainly in the US markets, where it has bounced up.

Q301 Chair: Why did you get it wrong?

Mark Russell: We don't think we did get it wrong. Why did the price go up? The price went up so fast. We always said we never thought it was going to go up as much as this. We knew it would go up. We hoped it would go up. But we never thought it would go up as much as this. Why did it go up so quickly on that first day? There was just enormous momentum behind it. This was on thin volumes. It is the same shares trading around again and again and the activity of a few hedge funds, which were, yes, taking a different view of value—

Q302 Austin Mitchell: Will it now come down, if this is a temporary phenomenon?
Mark Russell: It would be dangerous of me to comment on valuation.

Q303 Austin Mitchell: No, you are saying that it was a temporary boost, caused by swirling hedge funds, or whatever.

Mark Russell: There is a diverse view on the prospects of this business. If you look at the analysts' forecasts a year out, the range is twice the average of a FTSE 100 company. There are many who think this company will fly and many who believe it will not fly. It is a very operationally geared business. A 1% movement in turnover converts into a 17% movement in profit. It does not take very much to move that profit.

Chair: Hang on. We are six months in now.

Q304 Austin Mitchell: This does not sound like the stable shareholder base that was promised to me.

Mark Russell: What happened in the middle of March? The share price dropped by 20%.

Q305 Chair: Yes, but what is it today?

Mark Russell: It dropped by 20%.

Q306 Chair: But what is it today?

Mark Russell: It is 527p.

Chair: Which is higher than it was on day one.

Justin Tomlinson: But all these brokers are listing this as a sell and are saying that it is overpriced. That is why people are doing that. Also, you do not get that price if you suddenly dump it all in one go. It is not a cash price.

Jackie Doyle-Price: The taxpayer has not lost all that money; it is about market transactions.

Chair: That is one view around the table. We are asking questions and not putting our views, Jackie.

Q307 Mrs McGuire: It has been said that you as a company decided that you had reached the point where you thought it was a good thing to sell. If the British taxpayer was your client, would you think that they had a good deal, in the same way that you made the assessment for your own client base?

Alan Custis: I think that we look at companies very much on a fundamental analysis basis. We have analysts based around the world and we derive our own valuation completely independent of everyone else here. We derived a valuation, bearing in mind all the issues we have touched on today, of £3.95. As we have said, the share price moved ahead of that quite materially. We revisited our assumptions at that point and said, "Have we missed anything here? Now that we are in the quoted market, is there something that would make us change that materially?" We concluded at that time that there was not and that we therefore had a fiduciary duty to our clients to sell. We felt that the shares were materially overvalued at that point.

Q308 Mrs McGuire: I am not asking you about the clients, who you have served very well and I have absolutely no difficulty about that. I am asking for a little bit of role playing here. Pretend that the British taxpayer is one of your clients. Do you think that they have been served well by what has happened in the past few months with the sale?

Alan Custis: I think that they have been served well, because the circumstances at the time of the IPO, as I have mentioned, were extremely challenging. We have focused on industrial action, which was clearly one of the major facets. We also had the macro backdrop in the US and TNT launching end-to-end delivery of mail. We still have a very substantial pension overhang, although the deficit has been moved on to the Government books. If we look at our numbers today, our profit expectations for this business are lower than they were at the time of the IPO. So, yes, in those circumstances, I feel that the taxpayer has been well served.

Q309 Mrs McGuire: In spite of all those risks, the pensions, the backdrop of the US situation and the threat of industrial action, you said, in response to a question from Richard Bacon earlier, that you were looking for 45 million shares, which you had hoped you would get.

Alan Custis: Yes. That was with the valuation that was substantially lower than the one at which we had subscribed to the shares.

Mrs McGuire: Fine.

Q310 Austin Mitchell: Has the taxpayer been served as well as Lazard Asset Management?

Alan Custis: As I said earlier, the revenue that Lazard Asset Management derived from this transaction was tiny. It was less than £50,000, if we had held that gain for 12 months. Obviously, we are only six months into that.

Q311 Mrs McGuire: You were willing to put your toe in the water for 45 million shares, given all the difficulties that you have identified in the past two or three minutes. You must have thought in terms of how you would serve your clients—we have no difficulty about that—that it was a good buy.

Alan Custis: We felt at £3.30—

Q312 Mrs McGuire: I am not asking you about the price.

Alan Custis: Yes. We felt it was attractive value for our clients.
Mrs McGuire: For 45 million shares—*[Interruption.]*.

Chair: Do not comment. Ask questions, please.

Q313 Chris Heaton-Harris: I have got a question, if I may? It is for Mr Rucker. The 16 preferential investors obviously had concern about the industrial action and the vote on 16 October. You had your toes in the water and you thought that you could place the whole issue at £2.60, roughly, if there was industrial action. Is that right?

William Rucker: Yes. The feedback from those investors was that we could just cover the issue at that price in the event that there was full-scale industrial action.

Q314 Chris Heaton-Harris: So, when it was sold at £3.30, that is a difference of 70p a share. So industrial action would have potentially cost the taxpayer 20% of the value that we got. Is that fair to say?

William Rucker: Yes. The threat of industrial action was a constant theme throughout in discussions with investors—maybe Richard should speak to it as well. It undoubtedly had an impact on price. Exactly what that was, we cannot counter-invent it.

Q315 Stephen Barclay: Can I ask a quick clarification question? Mr Russell, in your evidence a moment ago I think you said that the decision to sell the 60% was based on advice from the syndicate and from Lazard.

Mark Russell: And market analysis.

Q316 Stephen Barclay: Indeed. Two things: would those advisers' fees that not increase if you sold 60% as opposed to 50%?

Mark Russell: Yes, they would.

Q317 Stephen Barclay: Secondly, given that a number of their clients had priority and knew at that stage that it was over-subscribed and of their ability, as Mr Custis did, to trade out quite quickly, for them there would also be an increase in profit from you selling more.

Mark Russell: Factually, you are correct, but you are making an inference.

Q318 Stephen Barclay: I am grateful that you said that that is factually correct. I am sure that they managed their conflicts under regulatory duties—that it is for them to demonstrate that to the regulator if it decides to look at that. But you are saying that the advisers telling you to sell the maximum benefited both themselves as firms and their clients. Is that a fair summation?

Mark Russell: Factually, that is correct.

Q319 Chair: One thing to get clear, following up from what Stephen said. This is a question to UBS and Goldman Sachs. It is right that for your trading arms, which I accept are separate, from the IPO the fees were £12.7 million, which is a commission of less than 1%. But, on the trading fees, if one assumes that 1% of the available shares traded every day—which is what happened—over 200 days, which is about the time frame over which you trade each year, with a commission of let us say 0.5% and a share price of £5, which is less than it actually is and probably has been since day one, that still gives you, on trading of 600 million shares, an annual commission from secondary trading of about £30 million. Do you want me to go through those figures again?

Richard Cormack: I got the gist. There are a lot of assumptions in those figures, including trading commissions. Those are not as high as 50 basis points; trading commissions in the London market can be as low as, I think, five to 10 basis points and not much higher than 20 to 25 basis points.

Q320 Chair: But there is also an assumption there that the share price is much lower than it is. So it is swings and roundabouts on the assumptions.

Richard Cormack: There is an assumption about the share price there, and clearly, as soon as the shares are traded, every broker in the street is participating in that market. The market—

Q321 Chair: Doesn’t necessarily come to you.

Richard Cormack: Doesn’t actually come to us.

Q322 Chair: Okay. But, on the whole, the money available for trading is twice the amount that is available from commission—crudely?

Richard Cormack: I have never done the maths. As I say, there are some differences—

Q323 Chair: Well, I will take you through it again. I hear what you say about the commission perhaps not being 0.5%, but I would say that the share price was higher. So, during 200 days a year, 1% of the 600 million available shares were traded, which makes for an annual commission of about £30 million. That is what I have got it at. You can come back to me if you think that I am completely out, but I do not think that I am.

James Robertson: That is much higher than the reality. I think that 50 basis points for trading would be very, very high, and it would be a fraction of that. These days, a lot of the trading that is done is automated or done electronically, where almost no fees or commissions get paid. It is probably a factor out in terms of the amount of commissions generated across the City—across all the brokers that cover this, and there are dozens of them—in terms of overall commissions on Royal Mail trading.

Q324 Stephen Barclay: I absolutely accept that, Mr Robertson. Who are the firms that trade the highest volumes of Royal Mail shares? Are two of the largest players UBS and Goldman?

James Robertson: No, I do not believe that they are. I believe that they are brokers. Merrill Lynch and Barclays have quite large shares.

Q325 Stephen Barclay: Who are also involved in the deal. Barclays were advising Royal Mail, and Merrill Lynch, I think, was advising Mr Donnelly.

James Robertson: They are corporate brokers, so it would be natural for them to have a leading position. I do not know, but it can be found out publicly.

Q326 Chair: Okay. Can I just ask some other short questions that have not been covered? This is really to you, Mr Russell. If you look at Royal Mail's performance on page 19, figures 2 and 3, it improved massively. Did you have regard to that in the valuation?

Mark Russell: Yes. Sorry, figure 2?

Q327 Chair: Figures 2 and 3 on page 19. You did your stuff early, by 2012-13. Let's go through it, because you deregulated the price, and the price has gone up massively. It is, what, 62p for a first class stamp now? You have taken out the pension liabilities, you have given them all this property. You did not make them get as much money out of debt, which might have helped the taxpayer, as you could have done. You took a very conservative view on that. They were doing very nicely, thank you. Why did that not help you push up the valuation?

Mark Russell: First, valuation would be forward looking. It is about what a company is doing in the future and what we think the profits and cash flow would be. I would be cautious with figure 2. This only goes down as far as what we call earnings before interest and tax. If you go down to profit before tax, this company was loss making until two years ago.

Q328 Chair: That was the point that Stephen raised earlier about carrying forward their losses, which was a benefit to this new privatised company because it does not pay tax. I would put that on the plus side, not the minus side.

Mark Russell: Yes. The valuations that were conducted looked at future profitability and future cash flows. I go back to the point that this is, operationally, a highly geared business. By that I mean that it only takes a small movement of turnover—of revenue—to have a very dramatic effect on profit. This is why we have the situation where very contrary views are taken by analysts as to where this business will go. There are scenarios where it does very well, and scenarios—

Q329 Chair: Which ones? One hears these contrary views, but I have to say that on figure 9, I cannot see very many outliers. Those are the syndicate of banks dealing with it, and they all seem to have pretty positive views. I think you do not look at July; you look at September and October. You keep telling us about the outliers, and you might send us some outliers. The views here were much more positive, as indeed was Mr Custis's view.

Alan Custis: Our view was predicated on 2015, so when we talked about a £3.95 price aspiration, we are talking about: that is where we anticipate the share price being in 2015. I think these are forward-looking expectations and valuations, rather than the immediate point on the IPO.

Chair: Helpful. Thank you.

Mark Russell: Just to try to reinforce this point, if you look at current brokers' estimates of earnings per share, which is a measure of profitability, it ranges from 51p per share down to 32p per share. That width is one of the widest in the FTSE 100. There are some who have a pessimistic forecast, and there are those who have fairly optimistic forecasts.

Q330 Chair: Can I ask about the ordinary punter—what you call the retail demand? If you look at figure 17 on page 44 of the Report, you will see that retail demand was seven times the number of shares available; you could have sold them all to individual shareholders. I have to say that I think Mrs T would be turning in her grave to see whose hands those shares ended up in, considering that level of demand just from ordinary individuals who recognised this as a good investment. Demand was seven times the number of shares available—why did you keep the retail demand at so short a level? That is particularly important because you did not get the stability of institutional investment that you were seeking.

Mark Russell: This was a long-debated point—how much do we allocate to the retail community and how much to the institutions? There was certainly a policy imperative to ensure that we allocated as much as possible to the retail. Did we think—

Q331 Chair: I accept all that you say about being not sure that demand would have translated into real purchasing and all that—I accept that there is an element of that—but this was seven times the number of shares available. They could have bought the entire 60%, although we think you should probably have sold only 50%. With her privatisations, Mrs Thatcher always talked about a shareholder democracy. Here you are, you had an opportunity, and you turned it down. She would be turning in her grave.

Mark Russell: I would refer you to figure 15 just to show how retail demand really took off in the final two or three days.

Q332 Chair: Of course—I accept that. We are on common ground that what you saw in July and what happened in October were very different, but this is the agile point: you just did not react to it. One thing that I think would have made all of us around the table feel better was if, rather than benefiting the clients of Mr Robertson and Mr Cormack, you had benefited the ordinary British public.

Martin Donnelly: We did provide shares to nearly 700,000 members of the public.

Q333 Chair: I know, but they could have bought the lot. To be fair, they had 30%, but there was more than enough of them to buy more than the 60%.

Martin Donnelly: I think it is fair to say that that would not have given the Royal Mail the sort of shareholder basis that it needs to be successful going forward.

Q334 Austin Mitchell: You are saying that you prefer the hedge funds to Sid—poor Sid; I feel sorry for him and his team. Paragraph 4.5 says: "The demand from retail was not used to put upwards price pressure on the institutional investors as had often been the case in the privatisations of the 1990s." Why wasn't it?

Mark Russell: We would say that, within this price range, retail demand did act as a mechanism to drive up the price. The advisers can comment on this, but I think that was the case as we saw retail demand moving up, so that was certainly underpinning our ability to increase the price with institutions.

James Robertson: I think that that is right. Also, at the end of the process we did upscale the amount that we expected to sell to retail by 10% to try to ensure that we satisfied the most amount of demand.

Q335 Austin Mitchell: It means that you were preferring the hedge funds to Sid.

Mark Russell: It was a mixture.

Q336 Chair: I know that some of my colleagues around the table might not like this, but I want to go back to the potential conflicts of interest raised by Stewart—I am sorry that he is not in the room. I have had the list of the priority investors for some time—I am looking at you, Mr Cormack, particularly, from Goldman Sachs—because it has been in the public domain. You can match one of the graphs here to the shareholding interests listed by Royal Mail themselves—that is how you can identify it. In looking through that list, what comes out really strongly, particularly with Goldman Sachs—it is also true with UBS, but it is even harder with Goldman Sachs—is how strong your relationship, and not just the trading relationship, was with a lot of these priority investors.

Take, for example, BlackRock. My researcher spent an hour on the internet on this. If we had spent a day and a half, no doubt we would have got much more. In the end, I had to draw a little map—I am very keen on maps, as some people know—of the relationship you have with those priority investors. I am not accusing you of anything; I am just saying this is how the punter feels, the member of the public. BlackRock has a 5.79% share of Goldman Sachs. BlackRock also acquired State Street, a US-based financial services holding company, which also has a share in Goldman Sachs.

Capital Research, another of the priority investors, has a 4.14% share in Goldman Sachs. The Government of Singapore Investment Corporation announced in September 2013 that it was planning to take a 30% stake in Rothesay Life, an insurance company wholly owned by Goldman Sachs. The head of the Kuwait Investment Office, Osama al-Ayoub—I hope I am pronouncing that right—is a former managing director of Goldman Sachs who worked for the Kuwait Investment Authority, then for Goldman Sachs, then as head of KIO.

Schroders is a hedge fund. It became a shareholder in Goldman Sachs Dynamic Opportunities, which is your hedge fund, in 2006. That is a London-based but Guernsey-registered fund of hedge funds. George Soros had shares in Goldman Sachs valued at $40 million in May 2012—we could find no evidence that he had sold them—and also has shares in another priority investor, J.P. Morgan, valued at $28 million. Soros, Goldman Sachs and J.P. Morgan all have shares in Essent Group, a Bermuda-based company that deals in mortgage insurance, reinsurance and risk management. Essent is not a priority investor, but it owns a shareholding in Royal Mail, as does Quantum Partners, another Soros investment vehicle which, again, is not UK based. As of January 2014, Goldman Sachs held shares in Henderson Global Investors.

That is literally after one hour on the internet. It is not a thorough research exercise. There are 16 priority investors—whether or not the price is right and whether or not the cautious approach was right—who, in the end, made a killing on how the price moved on this share. It leaves the general public with an uncomfortable feeling that there is too cosy a relationship between Goldman Sachs and the others. Accepting your walls and all that, it ended up being too cosy a relationship. What then happened was that this little group of high asset management made a killing at the expense of the ordinary taxpayer, who lost out on day one to the tune of £750 million, whether that could have been predicted or not.

That is really, really uncomfortable. It just feels wrong. It almost felt to me, when I was thinking about it, like an institutional Masonic lodge. You all know each other, you all work together, you trade with each other and you are part of this little clique, and we, the ordinary taxpayers, lose out on it. I do not know how you can comment on that.

Chris Heaton-Harris: You didn't, because you bought shares.

Q337 Chair: I didn't personally, but yes, in my husband's pension pot. I agree with that, but the ordinary taxpayer loses out. That feels grossly wrong. It just feels wrong to us, and I want you to try to explain to this Committee how you can justify that sort of settlement, and how we can give assurance to the general public that everything that happened here really was above board and met the taxpayer and the public interest rather than the financial interest of a few people who made a huge buck out of this flotation.

Richard Cormack: First, I have absolute confidence that the process was appropriately undertaken and that there was no impropriety at all in any of our, or any of the syndicates', activities. Commenting on some of the specific points you made, it is not surprising, as we are a large, listed, global financial institution, that large, global institutional investors invest in us, or that we should be targeting similar large, global institutional investors to buy Royal Mail. One of the criteria, as I said earlier, is that we were looking to access the largest pools of global capital, because they are the institutions that can put in the largest orders and that tend to have the most fundamental and longer-term perspective. So the fact that there are cross-shareholdings between investors who invest in Goldman Sachs and those who have invested in Royal Mail is not, in my mind, indicative of any impropriety.

Chair: But it seems that a cosy clique at the heart of this made a heck of a lot of money at the expense of the taxpayer. That is what it looks like; that is what it feels like. I cannot see how you can give assurance, not to me, because as Chris said—

Chris Heaton-Harris: But—

Q338 Chair: Let me ask the question, Chris. You can come in and ask your question afterwards.

I just want to see how you think that you can give assurance to the general public, given what happened, whether predictable or not, that the public interest and the taxpayer interest was properly protected in this flotation. I cannot see it.

Richard Cormack: The public interest and the taxpayer interest were absolutely protected. We executed the transaction alongside a syndicate of banks—seven banks in total, four of which were bookrunners—and there was obviously an independent adviser as well, who participated in the process. All the decisions were taken within the global co-ordinator and bookrunner level in terms of investor selection. It was a standard IPO process.

Q339 Chair: But your loyalty as a company is more to all these people who got the shares than it is to the taxpayer.

Richard Cormack: Our loyalty is to our client, which was the Government. I run our IPO business. Our IPO business depends on clients wanting us to do IPOs for them. If we were not working for our IPO-issuing clients and we were seen to be always acting in the interests of investing clients, we would not have a business to prosecute.

Alan Custis: It is worth reflecting that the beneficiaries of the £8 million that we made on behalf of clients were the taxpayers—the pensioners of local authorities, the members of corporate pension schemes. That benefit did flow down to taxpayers.

Q340 Chair: But, Mr Custis, you make your money by having those loyal clients who will come to you and commission, and from whom you earn your money. That is why, with you in particular, I am astounded that Mr Rucker allowed that list to go forward. I am astounded by that. You saw the list, you approved the list and it was then approved by the Department—

William Rucker: We were very clear. At no point did we ever comment on any allocation to Lazard Asset Management.

Q341 Chair: But you saw the list and approved it.

Chris Heaton-Harris: But, Chair, you acknowledged that there was absolutely nothing—

Chair: I acknowledged that there was no proof at the moment. I think, if I were the regulator, that I would be looking at this in greater detail than he has chosen to do.

Okay, thank you very much indeed.