[2011] UKUT 408 (TCC)

CASES NR/001/2010 ONWARDS

NATIONALISATION OF SHARES IN NORTHERN ROCK PLC – Compensation Scheme – meaning and effect of statutory valuation assumptions – assumption that financial assistance withdrawn - interpretation in compliance with human rights – whether decision as to amount of compensation was a reasonable decision - jurisdiction of Upper Tribunal

IN THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

FINANCIAL SERVICES

BETWEEN

NORTHERN ROCK APPLICANTS

Applicants

-and-

(1) ANDREW CALDWELL

(2) HM TREASURY

Respondents

Tribunal: **The Hon Mr Justice Warren, Chamber President**
Judge Andrew Bartlett QC
Sandi O'Neill

Sitting in public in London on 31 May, 1, 2, 3 and 6 June 2011

Legislation:

European Convention on Human Rights, Article 6
First Protocol to the European Convention on Human Rights, Article 1
European Communities Act 1972, s2(2)
Insolvency Act 1986, Schedule B1 paragraphs 3, 4, 42, 66
Insolvency Rules 1986, rule 2.88
Human Rights Act 1998, s3
Directive 98/26/EC on settlement finality in payment and securities settlement systems
Financial Markets and Insolvency (Settlement Finality) Regulations 1999, SI 1999 No 2979
Financial Services and Markets Act 2000, s133(5)
Banking (Special Provisions) Act 2008, s5(4)

Northern Rock plc Transfer Order 2008, SI 2008 No 432
Northern Rock plc Compensation Scheme Order 2008, SI 2008 No 718

Cases:

Bryan v United Kingdom (1995) 21 EHRR 342
Campbell and Fell v United Kingdom (1984) 7 EHRR 165
Capital Bank AD v Bulgaria (2007) 44 EHRR 48
Ghaidan v Godin-Mendoza [2004] UKHL 30, [2004] 2 AC 557
Hentrich v France (1994) 18 EHRR 440
Holy Monasteries v Greece (1994) 20 EHRR 1
Investors Compensation Scheme v West Bromwich BS [1998] 1 WLR 896
James v United Kingdom (1986) 8 EHRR 123
Katikaridis v Greece (2001) 32 EHRR 6
Lithgow v United Kingdom (1986) 8 EHRR 329
Porter v Magill [2001] UKHL 67, [2002] AC 357
R v DPP ex p Kebilene [2000] AC 326
R (SRM Global Master Fund) v HM Treasury [2009] EWHC 227 (Admin), and [2009] EWCA Civ 788
Ukraine-Tyumen v Ukraine (Application no. 22603/02, 22 November 2007

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Summary of the Tribunal's decision

Northern Rock plc was seriously affected by the banking crisis which gathered pace in the latter part of 2007. From September 2007 onwards Northern Rock received very substantial financial assistance from the Government and the Bank of England. On 22 February 2008 all Northern Rock shares were taken into public ownership. By that date some £25.3 billion was owed by Northern Rock to the Bank of England, representing nearly a quarter of Northern Rock's total liabilities. The legislation passed by Parliament made arrangements for an independent valuer to assess the value of the shares immediately before the nationalisation date, so that compensation could be paid by the Government to the former shareholders, depending upon the value.

One of the objectives of the legislation was to strike a fair balance between taxpayers and the former shareholders by ensuring that the amount to be paid to shareholders would not reflect added value resulting from the public financial assistance which had been provided from September to February. In pursuance of this objective the legislation contained some assumptions which the valuer was required to make.

The independent valuer concluded that after stripping out the value of the assistance from taxpayers, Northern Rock's shares had a nil value on 22 February 2008, so that no compensation was due. Many shareholders were unhappy with that conclusion, and appealed to the Upper Tribunal, arguing that the independent valuer had misinterpreted and misapplied the statutory assumptions, that his decision was wrong, and that he should have assessed a substantial value for the shares.

The central point of dispute was the meaning and application of the valuation assumption in the Banking (Special Provisions) Act 2008 section 5(4)(a) that all

financial assistance provided by the Bank or the Treasury "has been withdrawn". The valuer took this to require an assumption that the assistance had been terminated and repaid, following realisations of assets made just before the nationalisation date. The competing interpretations were (in brief) that it required either (a) that repayment of the loans had been demanded but not made, or (b) that the indebtedness had been discharged by deduction of assets at book value from the balance sheet. The applicants contended that on applying either of these alternative interpretations the shares had substantial value on the nationalisation date.

The Tribunal considered these arguments and the many other arguments that were raised, and examined the meaning and purpose of the statutory provisions and their application to the facts. The Tribunal concluded that the independent valuer was correct in his interpretation of the statutory provisions, that his application of them to the facts was reasonable and professional, and that the nil valuation should stand.

DECISION OF THE UPPER TRIBUNAL

Introduction

1. This appeal concerns the valuation of shares in Northern Rock plc ("**Northern Rock**"), following from its nationalisation on 22 February 2008. The events leading up to this nationalisation are described in detail in the judgments of the Divisional Court and of Laws LJ in the Court of Appeal in *R (SRM Global Master Fund) v HM Treasury* [2009] EWHC 227 (Admin), [28]-[55] and [2009] EWCA Civ 788 (which together we will refer to as "***SRM***"). They are also described in detail in paragraphs 3.15 to 3.56 of the Consultation Document mentioned below.

2. Representation is as follows. Mr Mark Phillips QC, Miss Monica Carss-Frisk QC, Mr David Allison and Mr William Willson appear for Harbinger; Mr Mark Howard QC, Mr Martin Chamberlain and Mr Jonathan Dawid appear for the first Respondent Mr Andrew Caldwell ("the **Valuer**"). Mr Cromie appeared for the Second Respondent Her Majesty's Treasury ("**HMT**" or "the **Treasury**") but made no submissions; Mr Hulme attended part of the hearing but he, too, made no submissions and was otherwise unrepresented. None of the other applicants appeared.

3. The events with which we are concerned were, by way of introduction, as follows.

4. On 11 September 2007, the auditors of Northern Rock reported to the Financial Services Authority ("**FSA**") that they had reasonable grounds to believe that Northern Rock would be unable to continue as a going concern. Following a report on 13 September 2007 that Northern Rock had sought (and been granted) emergency support by the Bank of England, a run on the bank began with the result that by 17 September 2007, £4.45 billion (or 20% of Northern Rock's total retail deposits) had been withdrawn.

5. In order to prevent the collapse of Northern Rock and contagion to other parts of the financial sector, the Bank of England, in its role as Lender of Last Resort, extended liquidity facilities to Northern Rock in the form of a secured loan, an exercise which began on 14 September 2007. Additional facilities were provided on 9 October 2007. The facilities provided were secured on Northern Rock's unencumbered assets and were repayable on demand, subject to a final repayment date of 12 February 2008 (subsequently extended to 17 March 2008).

6. In addition, on 20 September 2007 the Treasury issued a guarantee for all retail deposits at Northern Rock existing at that date, extended on 11 October 2007 to all retail deposits regardless of date. By 31 December 2007, the total amount lent by the Bank of England to Northern Rock was, to give a round figure, £27 billion, with the Treasury having assumed contingent liabilities, under guarantees, of £29 billion.

7. Following the deepening of the financial crisis and the inability of Northern Rock, or the Government, to find any buyer willing to acquire Northern Rock on terms which did not require significant on-going financial assistance, the Chancellor of the Exchequer announced to Parliament on 17 February 2008 that the Government intended to take Northern Rock into a period of "temporary public ownership".

8. The nationalisation took place on 22 February 2008. Pursuant to the Banking (Special Provisions) Act 2008 ("the **2008 Act**") and the Northern Rock plc Transfer Order 2008 (SI 2008/432), Northern Rock's shares were transferred to the Treasury Solicitor as nominee of the Treasury.

9. On 12 March 2008, an order was made pursuant to section 5 of the 2008 Act: the Northern Rock plc Compensation Scheme Order 2008 (SI 2008/718) ("the **CSO**"). This provided for the appointment of an independent valuer to assess the amount (if any) of compensation payable to shareholders whose shares had been compulsorily acquired. On 8 September 2008, following competitive tender and a recommendation by an expert committee, the Valuer was appointed.

10. There followed what Mr Mark Howard QC (who appears on behalf of the Valuer) describes as a full and transparent public consultation process. As part of that process, the Valuer issued a consultation document dated December 2009 ("the **Consultation Document**"). The whole process of valuation took longer than the Valuer had anticipated due, at least in part if not entirely, to delays in obtaining information. The Valuer issued his original assessment notices ("the **Original Assessment Notices**") on 29 March 2010. He valued Northern Rock's shares at nil and assessed compensation due to former shareholders at nil. Pursuant to the CSO and following requests from some former shareholders, he carried out a review, following which he issued his final response document and revised assessment notices ("the **Revised Assessment Notices**") on 1 October 2010. He again assessed the amount of compensation payable to former preference and ordinary shareholders at nil.

11. Before the issue of the Revised Assessment Notices, certain former shareholders of Northern Rock had sought to challenge by judicial review the Valuation Assumptions (to which we will come in a moment) in the 2008 Act and the CSO. The challenge included a contention that the compensation scheme established by the 2008 Act and the CSO was incompatible with the European Convention on Human Rights and in particular the right to property under Article 1 of the First Protocol ("**A1P1**"). These challenges were unsuccessful, being dismissed by the

Divisional Court and Court of Appeal in *SRM*. An application for permission to appeal has been refused by the Supreme Court. We will need to consider *SRM* later to ascertain precisely what it did and did not decide, as to which the parties are not at one.

12. Under the terms of the CSO (see paragraph 13 of the Schedule to the CSO), it was open to a former shareholder, as a person "affected", who was "dissatisfied" with the Valuer's assessment, to refer it to the Upper Tribunal. Over 440 former shareholders have made references. One of the applicants is Harbinger Capital Partners ("**Harbinger**"), an entity which had held an interest in some £277 million preference shares in Northern Rock. Another applicant is Mr Chris Hulme, chairman of a shareholders action group, the Northern Rock Shareholders Action Group.

13. Following case management directions on 24 February 2011 the burden of arguing the points to be taken against the Valuer's assessment effectively fell on Harbinger and Mr Hulme. No other applicants gave notice of wishing to make oral submissions to the Tribunal. Mr Hulme did not and does not represent the action group and its members, but he had permission to advance any of the arguments made by applicants other than Harbinger. In the event, the only substantive submissions which we received came from Harbinger. Mr Hulme did attend some of the hearing, but he made no submissions in person. Nor did he have representation, not having the funding to obtain it. Harbinger covered most of the points which had been raised in the hundreds of applications and which arguably fell within the jurisdiction of the Tribunal. We have considered also the points which Harbinger did not advance.

14. The issues before us at the hearing were as follows:

    a. The "**Interpretation Issue**". This related to the interpretation, and to some extent the application, of the statutory assumptions contained in section 5(4) of the 2008 Act and paragraphs 6(a)-(b) of the Schedule to the CSO, in particular the meaning of "withdrawn" in section 5(4)(a). In brief, the Valuer's approach was to assume that all the public financial assistance

from the Government and the Bank of England had been terminated and fully repaid, following realisations of assets made just before the nationalisation date. Harbinger advanced two alternative approaches. On the "Repayment in Kind" interpretation the statutory assumptions were taken to require that the indebtedness had been discharged by deduction of assets at book value from the balance sheet; on the "Demand" interpretation the requirement was that repayment of the loans had been demanded but not made.

b. The "**Methodological Issues**". These were a number of subsidiary issues relating to the details of certain aspects of the valuation exercise.

c. The "**Ultimate Valuation Issue**". This concerned the ultimate valuation of the compensation payable to shareholders.

d. The "**Section 133(5) Issue**". This was a disagreement over the scope of our jurisdiction under section 133(5) Financial Services and Markets Act 2000 ("**FSMA 2000**"), in particular whether we could deal with the ultimate valuation issue or, if we found that the Valuer's approach was incorrect or unreasonable, would be obliged to remit the matter to him to carry out a fresh valuation.

e. Additional issues raised by applicants other than Harbinger.

The legislation: (1) The 2008 Act

15. We start with the 2008 Act. This is a statute making provision to allow HMT to make an order relating to the transfer of securities issued by an authorised deposit-taker. It is not restricted in its application to Northern Rock but is of wide general application (though of limited duration, the main power described being exercisable for only one year after the Act was passed). Section 3 gives power to HMT to transfer securities issued by an authorised UK deposit-taker to any of the Bank of England, a nominee of HMT, a company wholly owned by the Bank of England or HMT, or any other corporate body. Section 6 gives power to HMT to transfer the property of an authorised UK deposit-taker to a company wholly

owned by the Bank of England, HMT or any corporate body. The power under each of those sections is exercisable in accordance with section 2, which provides, so far as relevant, as follows:

> "2 **Cases where Treasury's powers are exercisable**
>
> (1) The power of the Treasury to make an order under—
>
> (a) section 3 (transfer of securities issued by an authorised UK deposit-taker), or
>
> (b) section 6 (transfer of property, rights and liabilities of an authorised UK deposit-taker),
>
> is exercisable in relation to an authorised UK deposit-taker if (and only if) it appears to the Treasury to be desirable to make the order for either or both of the following purposes. ...
>
> (2) The purposes are—
>
> (a) maintaining the stability of the UK financial system in circumstances where the Treasury consider that there would be a serious threat to its stability if the order were not made;
>
> (b) protecting the public interest in circumstances where financial assistance has been provided by the Treasury to the deposit-taker for the purpose of maintaining the stability of the UK financial system.
>
> …."

16. A shareholder whose shares are transferred pursuant to section 3 is entitled to compensation in accordance with section 5, which provides, so far as relevant, as follows:

> "5 **Compensation etc. for securities transferred etc.**
>
> (1) The Treasury must by order—
>
> (a) in relation to an order under section 3 that transfers securities only to the public sector, make a scheme for determining the amount of any compensation payable by the Treasury to persons who held the securities immediately before they were so transferred;
>
> ……
>
> (4) In determining the amount of any compensation payable by the Treasury by virtue of any provision in an order under this section, it must be assumed—
>
> (a) that all financial assistance provided by the Bank of England or the Treasury to the deposit-taker in question has been withdrawn (whether by the making of a demand for repayment or otherwise), and
>
> (b) that no financial assistance would in future be provided by the Bank of England or the Treasury to the deposit-taker in question (apart

from ordinary market assistance offered by the Bank of England subject to its usual terms).

(5) For the purposes of subsection (4)—

(a) the references to the provision of financial assistance by the Treasury to the deposit-taker include any case where the Chancellor of the Exchequer announces that the Treasury (whether acting alone or with the Bank of England) would, if necessary, put in place relevant guarantee arrangements in relation to the deposit-taker (as well as any case where any such arrangements are put in place, whether or not following such an announcement);

(b) "ordinary market assistance" means assistance provided as part of the Bank's standing facilities in the sterling money markets or as part of the Bank's open market operations in those markets.

…."

17. Section 9 makes supplementary provision about compensation schemes. In particular, under section 9(1)(a) and (f) provision may be made

"(a) for the manner in which any compensation or consideration is to be assessed, including provision as to methods of calculation, valuation dates and matters to be taken into, or left out of, account in making valuations;

…

(f) as to the powers of a relevant tribunal (that is to say, the Financial Services and Markets Tribunal or a tribunal appointed by the Treasury for the purposes of the order);"

18. The provision that may be made under section 9(1)(a) includes, by virtue of sub-section (2),

"the making of assumptions as to any matter, including in particular the making of one or more of the following assumptions about the authorised UK deposit-taker in question—

(a) that it is unable to continue as a going concern;

(b) that it is in administration;

(c) that it is being wound up."

19. And by sub-section (6), the provision that may be made under section 9(1)(f)

"(a) includes provision enabling a relevant tribunal, where satisfied that the decision in question was not a reasonable decision, to send the matter back to the person who made the decision for reconsideration in accordance with such directions (if any) as it considers appropriate; but

(b) does not include provision enabling a relevant tribunal to substitute its own decision for that of the person who made the decision."

The Upper Tribunal is the relevant tribunal for the purposes of the present proceedings.

20. It is necessary to refer to one definition which is to be found in section 15(1). It is the definition of "financial assistance", which includes "assistance provided by way of loan, guarantee or indemnity" and "assistance provided by way of any transaction which equates, in substance, to a transaction for lending money at interest (such as a transaction involving the sale and repurchase of securities or other assets)".

The legislation: (2) The Compensation Scheme

21. As required by section 5(1) in the light of the nationalisation of Northern Rock, HMT made a Scheme, approved by Parliament, which is to be found in the Schedule to the CSO. References to paragraph numbers below are references to those paragraphs of the Scheme.

22. Paragraph 2 provides that the amount of compensation payable to a person shall be "an amount equal to the value immediately before the transfer time of all shares in Northern Rock held immediately before the transfer time by that person". The transfer time means the beginning of 22 February 2008, so that the valuation is to have an effective time of the end of 21 February 2008.

23. Paragraph 6 imposes further valuation assumptions on top of those found in section 5 of the 2008 Act. It is as follows:

"Valuation assumptions

6. In determining the amount of any compensation payable by the Treasury to any person in accordance with paragraphs 3 to 5, it must be assumed (in addition to the assumptions required to be made by section 5(4) of the Act (compensation etc. for securities transferred etc.)) that Northern Rock —

(a) is unable to continue as a going concern; and

(b) is in administration."

24. Taking our cue from some of the shorthand expressions used by the parties, we will refer to the assumptions required by section 5(4)(a) and (b) as "the **Withdrawal Assumption**" and "the **No Future Assistance Assumption**"; to the assumption in paragraph 6(a) as "the **No Going Concern Assumption**"; and to the assumption in paragraph 6(b) as "the **Administration Assumption**". It will be noted that the Withdrawal Assumption and the No Future Assistance Assumption are imposed in all cases to which section 5 applies: they are not unique to Northern Rock. In contrast, the Administration Assumption and the No Going Concern Assumption are ones which did not have to be imposed, being authorised, but not required, by section 9(1)(a).

The facts

25. The facts relevant to the issues before us and leading up to nationalisation of Northern Rock are not in dispute. As we have mentioned at the beginning of this Decision, the judgments in *SRM* contain between them a description of the background to the nationalisation of Northern Rock, a description to which the parties referred us, which we see no reason to doubt and which we gratefully adopt. In addition, as we have said, the Consultation Paper contains in paragraphs 3.15 to 3.56 a more detailed history of the events leading to nationalisation of Northern Rock. We have heard no criticism of what is said there and accept it as being factually correct. The Consultation Document can be found at http://www.northernrockvaluer.org.uk/media/uploads/page_contents/downloadables/Consultation%20Document%20December%202009.pdf

26. However, we add some detail about the financial assistance provided to Northern Rock by the Bank. The following Table is abbreviated from fuller details contained at page 77 of the Consultation Document. We take it as an accurate description. It shows the funding as at the nationalisation date, 22 February 2008:

Funding type	**Liability £mn**	**Assets assigned £mn**	**Security**
Bank repo	2,540	4,854	Sale & repurchase agreement over Gilts & Granite 2007-03
Asset	3,977	7,464	Fixed charge over Northern Rock's

Backed Loan			residential mortgage loans
Facility B (revolving loan &/or working capital)	18,760	42,655	Fixed and floating charges over unencumbered assets.
TOTAL	25,277	54,973	

27. We note the following about those figures:
    a. Total liabilities are "covered" 2.17 times by assigned assets (the capital cover or "haircut" as it has been called).
    b. The liabilities exclude the PIK (Payment-in–Kind) interest of £100mn. The PIK interest is the margin over the Official Bank Rate on the non-repo facilities from 9 October 2007.

28. Northern Rock's February 2008 Balance Sheet is the Valuer's starting point. It shows shareholders funds of £1.63bn and liabilities of £104.69bn funding assets of £106.31bn. The Bank's financial assistance of £25.28bn represents 23.8% of the asset base taken at book value.

29. We also note the following matters:
    a. Two bids, and only two out of all those who expressed an initial interest, were made in February 2008. These were from Virgin Consortium and Northern Rock management. Both involved a continuing level of public subsidy from HMT which the Government considered unacceptable as it disproportionately benefited the (new) Northern Rock shareholders over the taxpayer.
    b. In contrast, if Northern Rock were to be in temporary public ownership:-
        (a) the public subsidy would not be directed to a particular group of investors;
        (b) the Government would gain greater recompense for its subsidy and risk taken through sale at some future point; and
        (c) the Government would have commensurate control to protect taxpayers' interests.

Expert evidence

30. Expert evidence was produced on behalf of Harbinger in the form of two reports from Mr Murdoch McKillop of Talbot Hughes McKillop LLP. He is a chartered accountant and a licensed insolvency practitioner. He has enormous experience in complex UK and international insolvency practice and in relation to restructuring projects acting for companies, international bank syndicates and other stakeholders. However, so far as we can tell, he does not profess to have any direct experience or expertise in the operations of central banks, in particular of the Bank. Mr McKillop had assistance, in preparing his evidence, from Dr David Ellis of NERA Economic Consulting, whom he describes as providing senior, experienced retail banking services and product expertise. Dr Ellis specialised in securities and derivatives markets and their valuation and his experience includes the asset pricing of structured finance products similar to those held by Northern Rock.

31. Expert evidence was also produced on behalf of Harbinger in the form of a single report from Mr Paul Thompson. He is (or at least was, at the date of his report) a partner in the Aaronite Partnership LLP but gave his report in his personal capacity. He is a self-employed financial consultant and company director. His previous roles include Head of Lending Services at HSBC Bank plc. During a 37 year banking career, he spent most of his time dealing with lending and credit issues.

32. No expert evidence was produced on behalf of the Valuer. Nor had Mr Howard originally intended to cross-examine either of Harbinger's experts (or to seek to cross-examine Dr Ellis). In the event, he did carry out a limited cross-examination of Mr McKillop in relation to certain aspects of his evidence on which we thought clarification would be helpful and which we will consider later.

33. Mr Howard's position is that the expert evidence is irrelevant to, and inadmissible in relation to, the interpretation issues. The Tribunal will not be assisted, he says, by hearing from an expert in commercial insolvency and restructuring matters, or from an expert in commercial lending and credit in deciding what, as a matter of construction, the Withdrawal Assumption means. And whilst accepting that

expert evidence is in principle admissible in relation to points of methodology, he submits that the expert evidence of Harbinger is not useful for that purpose.

34. Mr Phillips submits that the evidence of Mr McKillop and Mr Thompson is relevant and admissible on both aspects. In relation to the interpretation issue, he says that the Tribunal will be assisted by evidence about the practical consequences of each interpretation. Moreover, if he is right that the Demand Interpretation is the correct interpretation, his case, based on the expert evidence about how the administration would proceed, is that it is so clear that Harbinger would receive the full value of its preference shares that we should direct the Valuer to determine the value of the preference shares in that amount (subject only to discounting to the present time to reflect the current value of repayment of the full amount payable on the shares in the course of a notional administration taking 5 years to complete). He also says that the evidence is directly relevant and admissible in relation to the Methodological Issues.

35. The fact the expert evidence (assuming it is admissible) is not challenged by competing expert evidence does not mean that we must accept it uncritically, particularly given that neither expert is experienced in the operations of the Bank and how it, in contrast with a commercial bank, would approach matters as a lender of last resort. We will be forgiven, we hope, if we do not undertake a detailed review of the expert evidence. For reasons which will become apparent, we do not think that we need to reach any significant conclusions about what the experts say. The challenges made by Mr Howard are really matters of submission which can be made to the Court of Appeal were this case to go further; the Court of Appeal will be as well placed as ourselves to draw from the reports such conclusions as are justified.

The dispute over the Withdrawal Assumption

36. The principal issue in the present references is the proper interpretation of the Withdrawal Assumption. Put very briefly, Harbinger (and other applicants) submit that we should direct the Valuer to adopt one of the alternative interpretations which it has identified, namely what it has termed the "**Repayment in Kind Interpretation**" and the "**Demand Interpretation**". The Repayment-in-

Kind Interpretation was originally Harbinger's primary case, but during the course of the hearing it was relegated to second place behind the Demand Interpretation.

37. In relation to financial assistance in the shape of loans, the Repayment in Kind Interpretation treats Northern Rock as having repaid the loans by a transfer of assets at book value; this is a book-keeping exercise by way of removal from Northern Rock's balance sheet of the loans, on one side, and assets of equivalent book value, on the other side. The Demand Interpretation requires it to be assumed only that a demand for payment has been made. Since, under the Repayment in Kind Interpretation, it is assumed that the loans have been repaid, "withdraw" in section 5(4)(a) is given a meaning which recognises that the loans have been satisfied. In contrast, the Demand Interpretation gives "withdraw" a more restricted meaning which leaves the loans unsatisfied; no assumption is imposed about when actual repayment will be effected. Rather, consistently as Harbinger would have it with the Administration Assumption, the Valuer should proceed on the basis that there will be an orderly realisation of assets over a period of time, perhaps as long as 5 years, which would produce for creditors a far better return than a forced sale, or fire sale, over a short period. On that basis, they assert that not only would creditors be paid in full, together with such interest as they are entitled to, but that there would be a significant surplus, enough to repay the full entitlement on the preference shares with a small return to holders of ordinary shares.

38. The Valuer, in contrast, contends that to "withdraw" financial support requires not only a demand but actual repayment, a result confirmed by the No Future Assistance Assumption since, on his case, there would be future assistance unless the loans were actually repaid. The word "withdrawn" in this context means "taken away". Further, since the Bank is entitled to receive repayment and cannot be forced to take assets whose book value may not reflect their realisable value, it should not be assumed that financial assistance has been withdrawn by a transfer of assets at book value. Instead the Bank must be treated as satisfied in cash. In practice, the Valuer's assumption ("the **Repayment Interpretation**") requires that assets of sufficient value to repay something in excess of £25bn owing to the Bank are realised prior to 22 February 2008.

39. There is no dispute that a net assets method of valuation is the most appropriate especially given that for valuation purposes Northern Rock is assumed to be not a going a concern and to be in administration. Nor is there any dispute that shareholder value is the asset value after all liabilities are met, attributed firstly to the preference shareholders and then to ordinary shareholders. Although parties have assumed, for valuation purposes, a realisation of assets over a substantial period of time, the starting points adopted by the Valuer and by Harbinger are radically different in the light of their differing interpretation of the Withdrawal Assumption. The Valuer's starting position is that any loan given by way of financial assistance has been repaid and so that assets required to effect that (notional) repayment cannot be realised over a substantial period of time. In contrast, Harbinger's Demand Interpretation effectively treats the loans in the same way as any other liabilities to be met over a period of time in the (notional) administration which the valuation assumptions require. The dispute, at its root, is therefore the effect of the Withdrawal Assumption on net assets valuation.

40. Harbinger contends that the Repayment Interpretation is incorrect because:
    a. It is inconsistent with the ordinary meaning of the Withdrawal Assumption.
    b. It is inconsistent with the purpose or object of the Withdrawal Assumption
    c. It is in breach of the Human Rights Act 1998 ("the **HRA 1998**") and A1P1.
    d. It is inconsistent with the rules or presumptions of statutory interpretation.

The dispute over the extent of our jurisdiction

41. As we have indicated, the parties were not in agreement over the extent of our jurisdiction under FSMA 2000 section 133(5) (as amended and renumbered). Our jurisdiction derives from the CSO. Paragraph 13 of the Schedule provides for a reference to "the Tribunal" by a person who is affected by and dissatisfied with the determination of the amount of any compensation which is contained in the revised assessment notice. Following the transfer of the functions previously exercised by the Financial Services and Markets Tribunal to the Upper Tribunal, reference to the Tribunal is now a reference to the Upper Tribunal.

42. Modifications have been made to relevant parts of FSMA 2000 by paragraphs 16 to 18 of the Schedule to the CSO. In its original version, section 133(3) and (4) provide as follows:

> "(3) On a reference the Tribunal may consider any evidence relating to the subject-matter of the reference, whether or not it was available to the Authority at the material time
> (4) On a reference the Tribunal must determine what (if any) is the appropriate action for the Authority to take in relation to the matter referred to it".

43. The CSO (see Regulation 17) provides for the Valuer to be substituted for the Authority in each place where it occurs in Section 133. Subject to that, section 133(3) applies. However, for section 133(4), the following is substituted:

> "(4) Where the Tribunal is satisfied that the decision as to the amount of compensation shown in the revised assessment notice was not a reasonable decision the Tribunal must remit the matter to the valuer for reconsideration in accordance with such directions (if any) as they consider appropriate."

44. Section 133 has been amended by article 45 of the Transfer of Tribunal Functions Order 2010 (SI 2010/22). What were previously sections 133(3) and (4) were in substance carried forward as section 133(4) and (5). So far as concerns the CSO, its provisions were carried forward by article 158(h). Our jurisdiction in relation to references under the CSO is therefore markedly different from that in relation to other references. We have no power to substitute our own decision for that of the Valuer; our only power is to remit the matter to the Valuer for reconsideration and, what is more, we can do so only if we are satisfied that the Valuer's decision was not a reasonable one. We can, however, make directions which we consider appropriate which the Valuer must observe when reconsidering his decision. Thus, if we consider that the Valuer has misdirected himself about the true construction of the CSO concerning the valuation assumptions, we can direct him to reconsider his valuation applying what we determine to be the correct construction. How prescriptive our directions can be is a matter which we will need to consider further later in this Decision.

45. Harbinger's position to put it very briefly is that we have full jurisdiction: that is to say, that it is open to us to consider all matters of fact and law and to make directions which the Valuer is required to reflect when reconsidering his decision. Indeed, it is said that, by making directions, we can effectively impose our own view of value on the Valuer. We are not, it is submitted, restricted to considering the reasonableness of the Valuer's decision along lines similar to *Wednesbury* unreasonableness as applicable in cases of judicial review; we do not, therefore, need to be satisfied that no valuer, properly directing himself, could have reached the decision which the Valuer reached in the present case.

46. In that context, Harbinger relies on Article 6 of the European Convention on Human Rights ("**Article 6**" and "the **ECHR**") as incorporated into domestic law by the HRA 1998. Article 6.1 provides:

> In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly but the press and public may be excluded from all or part of the trial in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice.

47. Harbinger also relies on Article 1 of the First Protocol to the ECHR headed "Protection of Property", usually known as A1P1. We consider this next, and will return to the extent of our jurisdiction, so far as necessary in the light of our conclusions on other issues, later in this Decision.

The requirements of A1P1

48. A1P1 provides:

> Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

49. In the present case, there is no doubt that A1P1 is engaged since the former shareholders' shares were compulsorily acquired. They are entitled to compensation. Compensation must be fair (which will be nil if the value of the shares was nil). It is the determination of that full value which is at the heart of the dispute.

50. We consider that the most helpful way into the jurisprudence of the European Court of Human Rights ("**the Strasbourg Court**") is to consider at some length the decisions of the Divisional Court and the Court of Appeal in *SRM*, containing as they do, when taken together, an exegesis of the relevant principles. We gratefully adopt their conclusions where the two courts concur and, in the limited area of disagreement concerning the applicable test in relation to the margin of appreciation, follow the Court of Appeal.

51. An understanding of those principles is important in the light of Harbinger's submissions about the correct interpretation of the Withdrawal Assumption, and the correct approach to that interpretation.

52. It is also necessary to understand what each of those Courts was saying about the application of those principles to the facts of the Northern Rock nationalisation and the compensation and to identify how, if at all, what they said impinges on the true meaning of the Withdrawal Assumption. It is submitted on behalf of Harbinger that neither Court had anything to say about the Withdrawal Assumption. The arguments addressed to and dealt with by each Court were entirely different and unconnected with the Withdrawal Assumption. It follows from that submission that nothing in the judgments in either Court is inconsistent with the interpretation of the Withdrawal Assumption for which Harbinger contends (or for that matter with the interpretation for which the Valuer contends). In contrast, the Valuer submits that the decision in the Court of Appeal undermines any argument that the Valuer's interpretation results in a violation of A1P1.

53. In *SRM*, the Claimants (who were the Appellants in the Court of Appeal) challenged by way of judicial review the legislation relating to the assessment of

compensation under the CSO. They asserted that the terms of assessment were unfair and incompatible with their rights under A1P1. The judgment of the Divisional Court (to which both judges contributed) was delivered by Stanley Burnton LJ.

54. In [12] to [14] of the judgment, the Divisional Court summarised the roles of the Financial Services Authority ("the **FSA**"), the Bank of England ("the **Bank**") and the Treasury. So far as concerned the Bank and HMT:

> [13] The Bank of England, as the UK central bank, is the bankers' Bank. It is the Lender of Last Resort; and the financial assistance it provides as Lender of Last Resort is referred to as LOLR. The Bank's functions include "ensuring the stability of the monetary system as part of its monetary policy functions. It acts in the markets to deal with fluctuations in liquidity".
>
> [14] The Treasury is responsible for:
>
> "i. The overall institutional structure of financial regulation and the legislation which governs it……
> ii. informing, and accounting to Parliament for the management of serious problems in the financial system and any measures used to resolve them, including any Treasury decision concerning exceptional official operations…..
> iii. accounting for financial sector resilience to operational disruption within government."

55. Those quotations were taken from a Memorandum of Understanding between the FSA, the Bank and HMT. A further, longer, quotation is set out at [15] of the judgment of Stanley Burnton LJ. The passage is concerned with exceptional circumstances giving rise to a need for a support operation going beyond the Bank's published framework. In such exceptional circumstances, the authorities' main aim would be

> "to reduce the risk of a serious problem causing wider financial or economic disruption. In acting to do this, they would seek to minimise both moral hazard in the private sector and financial risk to the taxpayer arising from any support operation."

56. The term "moral hazard" in this context was described at [10] of the judgment of Laws LJ when this case went on appeal to the Court of Appeal:

> "It refers to the possibility that if an institution in trouble believes it will or may be bailed out by the State, it is more not less likely to make poor business decisions; and other banks, perceiving the chance of Treasury support if they too got into difficulty, might also behave less than responsibly. Such conduct would or might in turn lead to an increased chance of economic turbulence including a run on the banks. In order to avoid the onset of "moral hazard" the central bank should not, and should not be seen to, lend support too readily to institutions whose management practices have led them into difficulty. Otherwise LOLR might be seen as a form of insurance against bad banking decisions, and that in turn would encourage more of the same."

57. Section IV of the Divisional Court judgment from [18] to [27] set out the principles on which LOLR is given, discussed by Mr Eddie (later Lord) George when he was Governor of the Bank in his 1993 LSE Lecture. Five general principles were identified by Lord George:

    a. The Bank would explore every option for a commercial solution before committing its own funds and only when those options had been exhausted would the Bank consider providing support.
    b. Central banks were not in the business of providing public subsidies to private shareholders. The Bank would try to structure support so that losses fell first on shareholders and any benefits came first to the Bank.
    c. The aim of the Bank was to provide liquidity. In normal circumstances, support would not be given to a bank which was known to be insolvent.
    d. The Bank looks for a clear exit. As Lord George put it (quoted in the judgment at [26]):

        > "The company may be required to run down or restructure its operations, under our surveillance, to the point where it can do without our support within a given period. Making the terms of our support as unattractive as possible has the great advantage of encouraging this process."

    e. The fact of support from the Bank was to be kept secret when it was made.

58. At [45], the judgment referred to a regulatory announcement issued on 21 January 2008. The announcement considered what would happen if a private sector solution to Northern Rock's difficulties could not be found. The Government would bring forward legislation which would empower HMT to take Northern Rock into temporary public ownership by transferring its share capital including

preference shares into public ownership. It was anticipated that the remaining Tier 1 and Tier 2 capital instruments would continue in their existing ownership as listed securities with the owners of those securities being at risk of first loss ahead of the Bank and HMT. The legislation would provide for the assessment by an independent valuer of compensation payable to any holder of securities transferred to HMT. The principles for assessing compensation would (see as quoted at [45])

> "reflect the principle that the Government should not be required to compensate shareholders for value which is dependent on taxpayers' support and the fact that public sector ownership would be an alternative to an administration of the company. Accordingly, the compensation would be assessed by the valuer on the basis, among other things, that all financial assistance to Northern Rock from the Bank of England or HM Treasury (including HM Treasury's existing guarantee arrangements) had been withdrawn and no other financial assistance (apart from Bank of England assistance on its usual terms through standing facilities or open market operations) were made available by them to Northern Rock."

59. At [48], reference was made to the statement made by the Chancellor of the Exchequer in the House of Commons on 17 February 2008. We do not propose to repeat the extensive quotation, although we mention a few of the paragraphs (using the same numbering as appears in [48]).

> "…….
> 14. The Financial Service Authority continue to assure me the bank is solvent. It believes that Northern Rock's mortgage book is of good quality. And the FSA will continue to regulate Northern Rock.
> …….
> 23. For financial stability reasons, we decided that it was right to support Northern Rock to allow it to continue operating. It was right to protect depositors' money and to protect the wider financial system."

60. The Chancellor then mentioned three objectives which the Government had in providing support: financial stability, safeguarding depositors' money, and protecting the interests of the taxpayer. As to the last we find the Chancellor saying this:

> "33. But it became clear that no institution was prepared to make an offer for Northern Rock without some form of public support because of prevailing market conditions.

> 34. That is why the Government was prepared to consider a backstop guarantee arrangement to allow the Board and shareholders to explore a private sector solution, provided that the terms and conditions were acceptable and met the principles I set out.
> …….
> 42. A subsidy on the scale required would not in the Government's judgement provide best value for money for the taxpayer, in circumstances where the private sector rather than the taxpayer would secure the vast majority of the value created over the period ahead. This would be a poor reflection of the balance of risk borne by the two sides.
> 43. By contrast, under public ownership the Government will secure the entire proceeds from the future sale of business in return for bearing the risks in this period of market uncertainty."

61. At [50], it was recorded that immediately before nationalisation the market price of Northern Rock's ordinary shares was 90 pence, giving a market capitalisation of approximately £379 million.

62. The central complaint of the Claimants (see [61]) was that the restraints imposed on the Valuer of the Northern Rock shares by section 5(4) of the 2008 Act and paragraph 6 of the Schedule to the CSO would inevitably have the effect that the CSO failed to produce a sum for the Claimants which satisfied the requirements of A1P1. An essential aspect of the Claimants' case identified in the judgment was that a fair approach to compensation would have been to leave it to the Valuer to decide the value of Northern Rock's shares immediately before the date of nationalisation without being required to make any assumptions.

63. Section VII of the judgment considered A1P1 and the jurisprudence of the European Court of Human Rights. The cases of *James v United Kingdom* (1986) 8 EHRR 123 and *Lithgow v United Kingdom* (1986) 8 EHRR 329 formed part of that consideration. At [81], reference was made to the possibility of a pre-emption decision being non-compliant with A1P1 in the absence of adversarial proceedings that complied with principles of equality of arms enabling an argument to be presented on the issue of the inadequacy of the price paid by the State (*Hentrich v France* (1994) 18 EHRR 440 at [42]).

64. The essential facts for the purpose of the Divisional Court's decision could be shortly stated: these are to be found at [82] in the following eight paragraphs:

"(a) Northern Rock had a good quality loan book.
(b) At all relevant times the assets of Northern Rock exceeded its liabilities. It was solvent on a balance sheet basis.
(c) However, in August or September 2007 it became insolvent in the sense that it could not pay its debts as they fell due.
(d) Government support for Northern Rock was provided because there was "a genuine threat to the stability of the financial system and in order to avoid a serious disturbance in the wider economy". It may also have been provided in order to protect depositors.
(e) The loans and guarantees provided for Northern Rock were not gratuitous. A premium rate of interest was payable on the loans, and a fee "set at a higher rate than the interest premium" charged for the guarantee arrangements provided on 9 October 2007 and later.
(f) The loans to Northern Rock provided by the Bank of England were repayable on demand. If repayment had been demanded at any time before nationalisation, the company would have been insolvent in that it would have been unable to pay its debts as they fell due.
(g) The financial support required by Northern Rock was not available from any source other than the Government.
(h) The Government may make a profit from the nationalisation of Northern Rock in addition to the price paid for the financial support."

65. It should be noted what was said at [86]. It was common ground between the parties in that case, that the No Going Concern Assumption and the Administration Assumption added nothing to the other assumptions required by the 2008 Act (that is to say, the Withdrawal Assumption and the No Future Assistance Assumption). That was because, as a matter of fact, the continuation of Northern Rock as a going concern throughout the period from September 2007 to nationalisation depended on Government financial support. If that support had been withdrawn, Northern Rock would have been unable to meet its liabilities as they fell due and would have ceased to be a going concern; it would "necessarily have gone into administration (and if not would have gone into insolvent liquidation)".

66. It is important, in determining precisely what it was that the Divisional Court decided, to note the Discussion in Section X of the judgment. One conclusion along the way (see at [94]) was that if there had been no financial support on 13 September 2007, Northern Rock would have had to go into administration, if not insolvent liquidation. If nationalisation had been decided upon at that date the fair value of the shares in Northern Rock would have been assessed on the basis that it

was not a going concern: it would have been unrealistic to expect a price to be paid on the basis that it was a going concern. At that date, of course, and on the hypothesis of no State support, the issue now before us would not arise: there would have been no financial support to which the Withdrawal Assumption could apply.

67. The Divisional Court then asks the following question: Should it have made a difference to the assessment of the fair value in February 2008 that the Bank did in fact provide financial support? The judgment gave the answer "No". The reason for that conclusion is found in [96] and [97]:

> [96] The financial support was, apart from the guarantees of deposits, in the form of on demand loans. The continued trading of the company depended on the continuance of public financial support. In other words, it was precarious. We see nothing unfair in these circumstances in the Compensation Scheme requiring the Treasury to pay compensation on the same basis that it could fairly have paid in September 2007.
>
> [97] It follows that we do not see on what basis it can be said that it became unfair to refuse to pay compensation on the basis of a value enhanced (on the Claimants' argument) by the provision of public financial support that was unavailable elsewhere.

68. The Divisional Court was not, however, faced with the argument with which we are now faced on the part of Harbinger, namely that the Withdrawal Assumption does not require the Valuer to assume that the financial assistance by way of loan has actually been repaid, but only that it has been called in. As we read the judgment, the Court was primarily concerned to address the fairness of excluding from the value immediately before the nationalisation date the effect of financial support since September 2007. Thus the Court, at the end of [98], said this:

> "…We do not see on what basis the shareholders of Northern Rock are entitled to greater compensation by reason of the performance of the public law function [to prevent damage to the banking and financial system]. The Government could, without being in breach of any private or public law duty owed to shareholders, have withdrawn its financial support (and in particular the Bank of England could have called in its loans); if it had done so, the company would have gone immediately into administration, and the shares would have had the value that will be attributed to them under the Compensation Scheme."

69. And fairness to the taxpayer is again reflected at [149] and [169]:

> [149] ... But the expectation or intention of the Government as to any eventual profit does not affect the fair value of the company at the date of nationalisation. The State (in other words, the taxpayer) is bearing the risk of Northern Rock being unable to meet its liabilities in the future; we do not see it as unfair that it should receive the benefits of Northern Rock's trading, if economic circumstances and other factors, including its management, now in the hands of the Government, lead to a financially successful outcome.
> …..
> [168] ... To the contrary, there is a good argument that the excessive burden would, on the Claimants' case, be borne not by the shareholders but by the taxpayer, who, having provided financial support to Northern Rock, would then have to pay to the shareholders the value of their shares enhanced by that support. …..

70. In saying all of that, the Divisional Court could not, we think, possibly have had in mind the dispute before us about the meaning and effect of the Withdrawal Assumption. What they did think, however, was that the result of the Bank calling in its loans would have been an immediate administration. They appear to have thought that the shares would have had the same value as would be attributed to them under the CSO and must therefore have assumed that the Withdrawal Assumption would produce the same result as an administration following the calling in of the Bank's debts.

71. But what they thought that result would be can only be a matter of speculation. They may have assumed that an administration would have required a speedy realisation of assets with all the consequences of something approaching a "fire sale" in terms of receipts. Or they may have contemplated a longer-term period of administration – perhaps over a period of years as Harbinger suggests would happen in the administration to be assumed by the Administration Assumption – perhaps with a better long-term outcome on the realisation of assets. We simply do not know.

72. However, what we can and do conclude is that it was no part of the Divisional Court's actual decision that either an actual administration following a demand for repayment by the Bank or an application of the valuation Assumptions would

result in an actual or deemed realisation of assets to enable the Bank to be paid off immediately or as soon as practically possible.

73. Before turning to the decision of the Court of Appeal in *SRM*, there is one other aspect of the decision of the Divisional Court which we should mention. In Section X(f) of the judgment, [151] to [164], the Court considered the procedural requirements of A1P1. After a review of certain authorities in the European Court of Human Rights, the Court cited extensively from *Capital Bank AD v Bulgaria* (2007) 44 EHRR 48 and *Katikaridis v Greece* (2001) 32 EHRR 6. The Court concluded that the principles established in those cases did not assist the Claimants in *SRM*, saying:

> [162] ….. Quite apart from the requirement for the Claimants to show that the Compensation Scheme is manifestly without reasonable foundation, they have not identified any issue of fact that in our judgment is or should be relevant to the fairness of the compensation determined under the Compensation Scheme. …… In our judgment, all of the relevant facts are undisputed.
>
> [163] What the Claimants would like to challenge before a valuer is the requirement that the public financial assistance provided and to be provided to Northern Rock should be excluded from his consideration. But that requirement is not a fact; it is an expression of policy; and the issue is, therefore, whether the effect of that policy is to impose an individual and excessive burden on the shareholders. That is a policy decision to which the margin of appreciation applies.

74. The Court of Appeal dismissed the Claimants' appeal. Laws LJ delivered a judgment with which the Master of the Rolls and Waller LJ agreed. Laws LJ included in his judgment a description of the principles on which LOLR is provided very similar to that given by the Divisional Court, with the same references to and quotation from Lord George's speech. Laws LJ dealt at greater length than had the Divisional Court with the support given to Northern Rock prior to its nationalisation. He described how, on 14 September 2007, HMT issued a press release announcing the first support given (by way of loan) which, as was known from material disclosed by HMT, was made available at a penal rate of interest. Further measures were taken as explained in a statement made by the Chancellor of the Exchequer on 17 September 2007: he stated that, should it be necessary, arrangements would be put in place that would guarantee existing

deposits with Northern Rock during the then current instability in the financial markets.

75. Laws LJ then went on to explain that the facilities provided by the Bank on 14 September 2007 were virtually exhausted by 9 October 2007. On 9 October an extension (following earlier extensions on 20 and 21 September) was given to cover new retail deposits made after 19 September. In so far as the facilities took the form of loans, they were repayable on demand but subject to a time limit of 12 February 2008 later extended to 17 March 2008 to coincide with the date by which the UK was required to submit a restructuring or liquidation plan for Northern Rock to the European Commission, which had sanctioned the support pursuant to the State Aid provisions of the EU Treaty only up to that date. The additional facilities provided by the Bank were repayable on demand, incurred a premium rate of interest and were secured against all assets of Northern Rock; there were fixed and floating charges over all Northern Rock's assets. The Bank obtained an indemnity in respect of its own potential liability from HMT. On 18 December 2007, HMT announced that the guarantee arrangements were being extended to certain unsubordinated wholesale obligations. By 31 December 2007, the Bank had lent almost £27bn to Northern Rock and HMT had assumed contingent liabilities under guarantees to the tune of about £29bn.

76. It is relevant to add to this description an aspect which is not brought out in the judgment. The security given to the Bank comprised not only fixed and floating charges but also the benefit of one or more repos (that is to say sale and repurchase transactions). The Bank had possession of the security provided by way of repos which was entered in its own books as part of its own assets. We will be considering later the effect of the moratorium which is imposed under our insolvency legislation as the result of a company entering into administration. The point to which we draw attention here is that the moratorium does not apply in respect of a security such as the repos in the present case.

77. As Laws LJ noted at [19], it is important to have in mind that LOLR support was never intended to be other than temporary. Its purpose was to create a breathing space in which a solution to Northern Rock's difficulties might be found which

would promote (or at least not damage) the public interest – the stability of the banking system – for which the support was given. It is also to be remembered that the duration of LOLR was limited by the EU deadline of 17 March 2008 already mentioned. In that context, Laws LJ quoted, as did the Divisional Court, from the announcement made on 21 January 2008. And he set out significant extracts from the Chancellor's statement on 17 February 2008.

78. The principal issue before the Court of Appeal was whether, as the appellants submitted, the valuation assumptions meant that they would be deprived of their shares for nothing (or a derisory amount) and that in those circumstances their rights under A1P1 had been violated. It was, as it had been in the Divisional Court, common ground that the appellants' shares were possessions for the purposes of A1P1 and that the nationalisation itself was lawful. It was also common ground, as it had been below, that the assumptions under paragraph 6 of the Schedule to the CSO added nothing to the case under section 5(4).

79. The appellants' arguments appear to have been different from their arguments to the Divisional Court. As recorded in outline at [38] to [40], Lord Pannick QC (who appeared for the appellants) submitted that at all material times up to the transfer date, Northern Rock was solvent with valuable assets and a sound mortgage book. It suffered only from short-term liquidity difficulties. The Government had provided support on terms for which it was well rewarded. There had been no risk and no cost. Lord Pannick submitted that it was "manifestly disproportionate" for the State, upon Northern Rock's nationalisation, to take the whole benefit of its value, and potentially to collect a handsome profit on re-sale, leaving the shareholders effectively with nothing. But, the argument ran, that would be the result (see [39] of Laws LJ's judgment) which the valuation assumptions would produce. Their consequence was that

> "the shares in the company fall to be valued for the purposes of compensating the deprived shareholders on the basis of a "fire sale" – a forced sale of the assets of a company in liquidation (or other form of insolvency procedure); circumstances in which, notoriously, the return obtained is very depressed."

80. The overall case of Mr Sumption QC (who appeared for HMT) was, as briefly explained by Laws LJ, that the object of the 2008 Act (so far as concerns the compensation provisions) was, as set out in Mr Sumption's skeleton argument, that the proprietors should not be compensated for value attributable to public financial support to which the institution was not entitled as of right, and which was given not for the proprietors' benefit but in the public interest. Thus, so far as the business thrived in public ownership and the State subsequently obtained value for it (*eg* on a resale to the private sector) that value was no more than the reflection of the risks which had to be run to achieve it.

81. Laws LJ then considered at [43] to [60] the three governing principles which were engaged in the appeal: (1) the need for a fair balance to be struck between public interest and private right, (2) the principle of proportionality, and (3) the doctrine of the margin of appreciation.

82. The first of these is a general principle of Convention law. As Laws LJ said at [45]:

> "…the principle's very generality demonstrates the breadth of potential concerns to which a court, adjudicating upon a claim of violation of convention right, may have to pay attention. It is a unifying principle which rationalises the variety and divergence of outcomes which the cases present."

83. In addressing the second principle, proportionality, Laws LJ recognised that "in every case it is through the catalyst of proportionality that the first principle, the striking of the balance, begins to take concrete form". In that context, he cited paragraph 55 of *Ukraine-Tyumen v Ukraine* (Application no. 22603/02, 22 November 2007) (an authority also referred to by the Divisional Court) – in particular, "…there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure depriving a person of his possessions".

84. Then, citing *Holy Monasteries v Greece* (1994) 20 EHRR 1 (in which the Strasbourg Court referred to *Lithgow*), Laws LJ stated that the requirement of proportionality "by no means implies that the erstwhile owner of property taken

by the State must always be compensated at full value if a violation of A1P1 is to be avoided. Such a rule would frustrate, not fulfil, the search for the fair balance."

85. As to the margin of appreciation, Laws LJ contented himself with the summary of the doctrine by Lord Hope of Craighead in *R v DPP ex p Kebilene* [2000] 2 AC 326 at 380. It is worth setting out again in our Decision:

> "The doctrine of the 'margin of appreciation' is a familiar part of the jurisprudence of the European Court of Human Rights. The European Court has acknowledged that, by reason of their direct and continuous contact with the vital forces of their countries, the national authorities are in principle better placed to evaluate local needs and conditions than an international court: *Buckley v. United Kingdom* (1996) 23 EHRR 101, 129, paras. 74-75. Although this means that, as the European Court explained in *Handyside v. United Kingdom* (1976) 1 EHRR 737, 753, para. 48, 'the machinery of protection established by the Convention is subsidiary to the national systems safeguarding human rights', it goes hand in hand with a European supervision. The extent of this supervision will vary according to such factors as the nature of the Convention right in issue, the importance of that right for the individual and the nature of the activities involved in the case.
>
> This doctrine is an integral part of the supervisory jurisdiction which is exercised over state conduct by the international court. By conceding a margin of appreciation to each national system, the court has recognised that the Convention, as a living system, does not need to be applied uniformly by all states but may vary in its application according to local needs and conditions."

86. Laws LJ regarded the decision in *James* as particularly instructive and carried out a much more detailed examination of it than had the Divisional Court. We do not propose to set out what he said. It repays careful reading. The subject matter of the application was leasehold enfranchisement, which was regarded by the government of the day as a necessary social reform. The fact that the application fell within this context of high social policy greatly influenced the Strasbourg court. First it meant that the doctrine of margin of appreciation was applied broadly and secondly the political context furnished a justification for the basis upon which the price to the tenant for the freehold, notably less than the market value, was fixed under the statute. In that second context, Laws LJ cited, as had the Divisional Court, part of [54] and [56] of the judgment to which we have already referred and from which we have already cited less extensively.

87. Laws LJ also referred to *Lithgow*, citing from it rather more extensively than had the Divisional Court. Law LJ noted that the approach in *Lithgow* opened the door to a broad application of the margin of appreciation, citing [122] of that decision:

> [122] Whilst not disputing that the State enjoyed a margin of appreciation in deciding whether to deprive an owner of his property, the applicants submitted that the Commission had wrongly concluded from this premise that the State also had a wide discretion in laying down the terms and conditions on which property was to be taken. The Court is unable to accept this submission. A decision to enact nationalisation legislation will commonly involve consideration of various issues on which opinions within a democratic society may reasonably differ widely. Because of their direct knowledge of their society and its needs and resources, the national authorities are in principle better placed than the international judge to appreciate what measures are appropriate in this area and consequently the margin of appreciation available to them should be a wide one. It would, in the Court's view, be artificial in this respect to divorce the decision as to the compensation terms from the actual decision to nationalise, since the factors influencing the latter will of necessity also influence the former. Accordingly, the Court's power of review in the present case is limited to ascertaining whether the decisions regarding compensation fell outside the United Kingdom's wide margin of appreciation; it will respect the legislature's judgment in this connection unless that judgment was manifestly without reasonable foundation.

88. Laws LJ expressed his conclusion in this way at [55] and [56]:

> [55] …. The overarching principle is the first, the need to strike a balance between public interest and private right. The other two, proportionality and the margin of appreciation, provide the means by which the balance is struck. In the context of A1P1 the application of proportionality to a confiscation will ordinarily mean payment of an amount reasonably related to the value of the property taken, so as not to impose a disproportionate burden on the person deprived. However the relation between proportionality and the first principle is qualified by the third, the margin of appreciation. Its effect is that the relation is not rigid or constant ……
> [56] For the purpose of A1P1 this process takes concrete form as follows. The paradigm case of a reasonable relationship between compensation and the property's value arises, no doubt, where full market value is paid. In that case the relationship between the two is one of identity. That or something not far off is likely to apply in what may be called a "micro-economic" setting, where for example a single property is taken to achieve a specific and limited local objective. In such a case proportionality is likely to require market value or something close to it, and the margin of appreciation may offer little or no scope to justify the deprivation of property for less. But there will be other cases in which the objective of the deprivation is much broader: perhaps a matter of high politics. In such instances the policy aim of the measure in question may be diminished or undermined or even contradicted by a requirement of full market value. The measure's intention may be to re-distribute wealth, or to achieve a necessary social reform, goals which are or

> may be perceived to be inconsistent with full compensation payable to the previous owner. In these cases, the margin of appreciation allows a flexible approach to the right protected by A1P1 which may give place to those aspects of the policy which override the case for payment of full value.

89. Applying the principles which he had discussed to the facts of the case before the Court of Appeal, Laws LJ explained at [62] that the government was "entitled to seek from Parliament terms for the nationalisation of Northern Rock which would not undermine the effects and influences of the LOLR operation". He added:

> "Mr Sumption submitted that the purpose of the assumptions was to put the shareholders in the position they would have occupied had no LOLR support been provided. In my judgment that is correct. If the shareholders had received more favourable treatment than was furnished by these arrangements, the LOLR operation would (through the prism of the government's exit strategy, the company's nationalisation) have been the source of a specific benefit conferred on them. That would not be consistent with a governing principle of LOLR, namely its deployment only in the interest of the financial system as a whole. And it would encourage for the future – at least this would be the risk – the very moral hazard which the LOLR scheme is carefully constructed to avoid. It is not to be forgotten that Northern Rock is not the only company nationalised pursuant to the terms of the 2008 Act. In 2008 Bradford and Bingley plc's mortgage book was taken into public ownership under the same provisions.

90. Evidently Laws LJ was summarising Mr Sumption's submissions in a very abbreviated form. Mr Sumption was clearly not submitting that the valuer was to value the shares in Northern Rock at the valuation date on the hypothesis that financial support had never been given, still less was he submitting that the valuation should somehow take the value in September 2007 as some sort of starting point. Indeed, his oral submissions are likely to have reflected the passages from his skeleton argument set out in [41] of Laws LJ's judgment and referred to by us above. The point is that the shareholders should not reap the benefit of the support given by the Government.

91. Logically, it might be thought to follow from that last point that the shares should be valued on the basis that financial support had never been given. That would involve considering what would have happened to Northern Rock had support not been given in September 2007 and thereafter, in which case there would have been an administration or liquidation. The valuer would then have had to make

assumptions about what would have happened between September 2007 and February 2008, including assumptions about realisations of assets and the value obtained, in order to arrive at the value of the shares on the valuation date, the date of nationalisation. But that is not the approach which the legislation took. Instead, the financial support provided by the Government was to be taken out of the equation by the valuation assumptions and in particular the Withdrawal Assumption. Rather than assuming that financial support had never been given, it was to be assumed that the support which had actually been given had been withdrawn (whatever that may mean – which is the issue for us to decide). Thus history was not to be re-written so that the provision of the financial support was to be altogether ignored. Further, the No Going Concern Assumption ensures that no value is attributable to the shares in Northern Rock as a going concern. It was certainly not a going concern in September 2007 and it would not have been a going concern at the date of nationalisation if Government support had been withdrawn (whatever meaning one ascribes to that word).

92. Paragraph [63] of Laws LJ's judgment should also be mentioned. He referred to the seductive force of Lord Pannick's argument that the substantial assets of Northern Rock, as well as Government support, must have played their part in Northern Rock's ongoing commercial activity after September 2007, so that when Northern Rock was sold back into the market, the assets would be as much a contributor to the sale price as the support put in by the Government. Laws LJ then said this:

> "Yet in the result the shareholders are altogether stripped of the assets' value save for whatever net sum a fire sale in the course of liquidation or other administrative procedure might bring: which is likely to be nothing."

93. Whether that was part of the submission of Lord Pannick or was an expression of Laws LJ's own conclusion may not be entirely clear. But either way, it is clear that Laws LJ did not at any stage of his judgment suggest that this would not be the result nor that, if it were the result, there would be a violation of A1P1.

94. One finds a further reference to fire sale in [76] where Laws LJ referred to the proposition that "there will be some residual value in the assets if on a fire sale

what is got for them exceeds the company's liabilities (the administrator or liquidator being obliged to obtain the best price)". He continued:

> "A major element in Northern Rock's assets is its loan book; there is nothing in the assumptions to prevent the valuer attaching a premium value to the loan book if he is sufficiently impressed with its quality. It is of course true, as was stated in Parliament and acknowledged in argument by Mr Sumption, that a fire sale depresses asset value, in some cases very greatly. The goodwill of a business so disposed of may well be worth nothing. Fixed assets, however, may largely retain their value: the Picasso in the boardroom is not worth less because the company is insolvent, though the timing of the sale may perhaps make a difference. Mortgage assets will not do so well, but are at least likely to fetch better returns than goodwill."

95. Laws LJ clearly contemplated that the valuation might be on a fire sale basis, albeit a fire sale during the administration rather than immediately before the nationalisation date. Indeed, it is apparent that he was considering whether there was a violation of A1P1 in the context of a process which involved realisation of assets. He was not contemplating a long period of administration during which assets were realised and the Bank and HMT, and through them the taxpayer, were kept out of their money.

96. The Court of Appeal disagreed with the (apparent) approach of the Divisional Court that the "manifestly without reasonable foundation" test from *Katikaridis* was always the touchstone for the margin of appreciation. Laws LJ considered (see at [75]) that that could not be right:

> "….The discretion which the margin confers on the State varies according to the subject-matter, and I do not consider that *Katikaridis* (which with great respect I need not cite) holds differently. However although the action impugned in the present case was not taken on grounds of political ideology, it certainly arose in the context of macro-economic policy. The provision of LOLR was a measure which the Tripartite Authorities [*ie* the Bank, HMT and the FSA] considered was objectively required to protect the banking system and thus the national economy. Their concerns were strategic and the outcomes of what was done likely to be profound. The nationalisation of Northern Rock cannot, I think, be separated out from these matters. It was the chosen means of exit from short term LOLR. The s.5(4) assumptions were as I have explained in line with the conditions on which LOLR is provided. In reality they were an application of policy considerations which, as Lord George explained, underpinned LOLR. In these circumstances, the margin of appreciation must in my judgment be a wide one. As in *James* and *Lithgow*,

> the court would only interfere if it were to conclude that the State's judgment as to what is in the public interest is manifestly without reasonable foundation."

97. There is one other aspect of the decision of the Court of Appeal which we mention at this point. It is the conclusion on the Procedural Issue dealt with at [82] to [84]. The case for the appellants was that the section 5(4) assumptions prevented the valuer from hearing argument about the merits or otherwise of the terms on which shares were to be taken. The answer given by the Court was that the procedural requirement inherent in A1P1 was met. So far as the assault was on the assumptions themselves, it was met by the availability of judicial review, a process which gave the court "full jurisdiction". So far as it was intended to take factual points within the framework of the assumptions (for example as to the value to be attributed to fixed assets) the Valuer had full jurisdiction to enter into any factual issues that might call to be decided. His conclusions would be impartial and independent. In saying this, Laws LJ might be taken to be saying that the valuation process taken by itself was compliant with Article 6. We will need to say more about this later.

98. We have spent a considerable time on the judgments in the Divisional Court and the Court of Appeal for two reasons. First, it has provided us with a way of addressing the relevant principles in relation to A1P1. An understanding of those principles is important in the light of Harbinger's submissions about the correct interpretation, and the correct approach to interpretation, of the Withdrawal Assumption.

99. Secondly, it is necessary to understand what each of those Courts was saying which might be relevant to the correct interpretation of the Withdrawal Assumption. In our view, nothing said by the Divisional Court has any impact on that issue. But the judgment of Laws LJ proceeded on the basis of a valuation which might require the Valuer to assume a speedy realisation of assets. He made a number of references to fire sale, saying in relation to mortgage assets at [76], they "will not do so well, but are at least likely to fetch better returns than goodwill". It seems to us that it is a necessary part of his decision that the need for a fire sale of assets – and *a fortiori* for a sale over a reasonable period of weeks

or a small number of months rather than over an extended, 5-year, administration period - with their value on such a sale forming the basis of the value of the shares themselves, would not violate A1P1. We should follow that conclusion.

100. In other words, if it had been made explicit in the Withdrawal Assumption that the withdrawal of financial support entailed not only that a demand had been made for the repayment of outstanding debts owing to the Bank but also that those debts had been paid either before or shortly after the valuation date, there would have been no violation of A1P1.

101. But even if it is not correct to read Laws LJ in that way, we would reach the conclusion expressed in the immediately preceding paragraph, for the reasons which we set out later in paragraphs 143-147.

102. It is for the national authorities to make the initial assessment of what is in the "public interest" for the purposes of A1P1 both in regard to the existence of a problem of public concern warranting measures of deprivation of property and in regard to the remedial action to be taken. Here the national authorities enjoy a certain margin of appreciation: see the decision of the European Court of Human Rights in *James v United Kingdom* (1986) 8 EHRR 123 at [46] and [50]. There is no issue before us about the appropriateness of the compulsory acquisition of the shares in Northern Rock. But there is an issue about the level of compensation to be paid.

103. So far as the level of compensation is concerned, this was addressed in *James v United Kingdom* in the context of compensation for property compulsorily acquired under the Leasehold Reform Act 1967 at [54]. In the third paragraph of [54] the Court agreed with the Commission's conclusions as to the standard of compensation: the taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate interference which could not be considered justifiable under A1P1. However, the Court stated that A1P1

> "does not ... guarantee a right to full compensation in all circumstances. Legitimate objectives of 'public interest', such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value. Furthermore, the Court's power of review is limited to ascertaining whether the choice of compensation terms falls outside the State's wide margin of appreciation in this domain."

104. This is the approach taken as well in *Lithgow v United Kingdom* (1986) 8 EHRR 329 (see in particular at [121] referred to at some length in Section VIII of the Divisional Court's judgment in *SRM* ([70] to [81]). That paragraph is of some relevance in rejecting the contention that, as regards to the standard of compensation, no distinction could be drawn between nationalisation and other taking of property by the State, such as compulsory acquisition of land for public purposes. The Court held that both the nature of the property taken and the circumstances of the taking gave rise to different considerations which may legitimately be taken into account in determining the fair balance between the public interest and the private interests concerned. And, as is expressly recognised at [162] of *Lithgow*, dependence on Government financial assistance may be relevant to the assessment of the question whether compensation represents a fair balance.

105. We are required by section 3 of the HRA 1998 so far as possible to read and give effect to domestic legislation in a way which is compatible with Convention rights. That requirement has been interpreted very widely by the courts. We need refer to only one case to demonstrate just how far the Courts have gone – *Ghaidan v Godin-Mendoza* [2004] UKHL 30, [2004] 2 AC 557. The case concerned the rights relating to an assured tenant under the Rent Act 1977 which extended protection to a surviving spouse of the tenant. The domestic legislation extended the meaning of "spouse" to a person living with the original tenant "as his or her wife or husband". This placed a surviving homosexual partner in a less secure position than the survivor of a heterosexual partnership and thus infringed the defendant's rights under Articles 8 and 14 of the ECHR (the right to respect for his private and family life and his home; and the enjoyment of Convention rights without discrimination on any of a number of grounds including sex or other status). The House of Lords stated that the effect of the HRA 1998 was to require

domestic legislation to be read in a Convention-compliant way wherever possible subject only to the modified meaning remaining consistent with the fundamental features of the legislation. The House (Lord Millett dissenting) held that it was possible to read the Rent Act 1977 in a Convention-compliant way as extending to same sex partners without contradicting any cardinal principle of the Rent Act 1977.

106. This is a far-reaching conclusion, as explained by Lord Nicholls at [28] to [33] of his speech. Section 3 gives rise to an interpretative obligation of "an unusual and far-reaching character". It may even "require a court to depart from the unambiguous meaning the legislation would otherwise bear". The mere fact that the language under consideration is inconsistent with a Convention-compliant meaning does not of itself make a Convention-compliant interpretation under section 3 impossible. But there is a boundary beyond which the court cannot go. As Lord Nicholls put it at [33],

> "Parliament cannot have intended that in the discharge of the extended interpretative function the courts should adopt a meaning inconsistent with a fundamental feature of the legislation……. The meaning imported by section 3 must be compatible with the underlying thrust of the legislation being construed. Words implied must, in the words of my noble and learned friend Lord Rodger of Earlsferry, 'go with the grain of the legislation'. Nor can Parliament have intended that section 3 should require courts to make decisions for which they are not equipped. There may be several ways of making a provision Convention-compliant, and the choice may involve issues calling for legislative deliberation."

107. In the present case, we must if possible construe the CSO in a way which is Convention-compliant. Faced with the competing interpretations, one task facing us is to determine whether the interpretation for which the Valuer contends is Convention-compliant. If it is not, that lends powerful if not conclusive support to Harbinger's interpretation, which is an interpretation which is without doubt Convention-compliant. But if the Valuer's interpretation is Convention-compliant, our task will be to decide, according to ordinary canons of construction, which of the rival constructions – or indeed some other construction – is correct. The extent to which the ECHR and the HRA 1998 should influence the result of that interpretative task given the hypothesis that the rival

interpretations are both Convention-compliant is an aspect about which we need to say more later.

Statutory interpretation

108. In order to consider Harbinger's arguments concerning the Withdrawal Assumption we start with the rules and presumptions of statutory interpretation and identify some well-established principles:

a. Whether one is concerned with a commercial document or a piece of legislation, the search is for the meaning of the document; it is to establish what the parties to a commercial document or Parliament, through the draftsman, would reasonably have been understood to mean using the words which they have against the relevant background. The principles appear in the well-known passage from the speech of Lord Hoffmann in *Investors Compensation Scheme v West Bromwich BS* [1998] 1 WLR 896 at 913. We do not propose to add to the mass of quotation by setting it out again.

b. The starting point is the ordinary meaning of the words used. But a word may have more than one ordinary meaning and, in any particular context, must take its meaning from that context.

c. In the case of legislation, the purpose or object of that legislation is an important factor in the interpretation of the words used. A word or phrase should, so far as is possible without undue interference with the language used, be interpreted so as to give effect to that object or purpose. However, the object or purpose may only be identified by use of admissible material. Often, the object or purpose will appear from the four corners of the document or legislation concerned. But recourse to other documents or statements (for instance, White Papers or Hansard) is sometimes permissible to identify the mischief at which the legislation was directed or the meaning which Parliament intended words to have.

d. So far as possible, legislation should be construed consistently with European Union law and with the Convention. We have already discussed the requirements of HRA 1998 section 3 in this context.

e. Account must be taken of the established and accepted rules or presumptions of statutory interpretation.

f. Sometimes these factors pull in different directions. It is part of the process of interpretation to resolve the tension.

109. Further relevant principles are noted in the course of our discussion of the parties' arguments. We now turn to the consideration of the Interpretation Issue under the following headings:

a. The ordinary meaning of the words used in the Withdrawal Assumption
b. The competing interpretations in light of the purpose of the 2008 Act
c. Impact of A1P1
d. The Interpretation Issue and expert evidence
e. European Union law
f. Robustness and consistency
g. Presumption against illegality or absurdity
h. Conclusion

The Interpretation Issue: (a) The ordinary meaning of the words used in the Withdrawal Assumption

110. We remind ourselves of the words which we have to construe. It is to be assumed "that all financial assistance provided by the Bank of England or the Treasury to the deposit-taker in question has been withdrawn (whether by the making of demand for repayment or otherwise)".

111. Financial assistance can take different forms. The issues in the present case arise in the context of assistance principally by way of loans from the Bank, although it should be remembered that assistance was also given by way of guarantee from HMT in relation to retail deposits, certain wholesale obligations and the Bank's own loans. The draftsman has not addressed different types of assistance separately; except to the extent indicated by the words in parentheses he has not provided any detail of what is meant by "withdrawn" in any particular case. Instead, he has used a portmanteau phrase "…financial assistance….has been withdrawn" to cover all financial assistance, so that the word "withdrawn" will mean different things in practice in relation to different types of financial assistance. It is more general than the word 'repayment': repayment of a loan

would certainly result in withdrawal of financial assistance, but it would make no sense to speak of repaying a guarantee.

112. While the word "withdrawn" will have differing practical implications for different types of financial assistance, we consider it must be interpreted in a coherent manner across the different types of assistance so as to produce a consistency in the light of the objects and purpose of the legislation. In that context, we think it is helpful to consider what it would mean to "withdraw" a guarantee.

113. Consider, for instance, a guarantee by the Bank or HMT of retail deposits with Northern Rock. Such a guarantee could cover (a) deposits existing when the guarantee is given and (b) future deposits. Such a guarantee might, according to its terms, have an end-date so that it would not apply to deposits made after the date of such determination. If the end date is later than the nationalisation date, the Withdrawal Assumption and the No Future Assistance Assumption apply. It is certainly the case that it must be assumed that the guarantee will not apply in relation to deposits made after that date; but that, it seems to us, is because the No Future Assistance Assumption dictates that result, not because the Withdrawal Assumption does so. Rather, the Withdrawal Assumption is that the guarantee has ceased to bite at all: "has been withdrawn" means "has ceased to have effect". We envisage a case, of course, where, as between the guarantor and the depositor, the guarantee of deposits in relation to which the guarantee has already taken effect cannot be withdrawn; the guarantor will remain liable to the depositor if Northern Rock defaults. But that does not preclude the assumption being made as between the Bank and HMT on the one hand, and Northern Rock on the other, that the guarantee has, counterfactually, ceased to have effect as between guarantor and deposit holder. The Valuer would then assume that no guarantee was in place when carrying out his valuation and in so doing would take account of the possible behaviour of deposit holders who would, on this hypothesis, have no guarantee. That might result in a (notional) run on Northern Rock (which was precisely what the guarantee actually given was designed to avoid).

114. It can be said that the Administration Assumption precludes that approach: it is assumed that Northern Rock is in administration, so that depositors will simply obtain whatever is due to them in the course of an orderly administration. That is so in the case of Northern Rock. But there is no statutory requirement to impose the assumptions imposed in the present case under paragraph 6 of the Schedule to the CSO. In another case, it might be that only the mandatory assumptions under section 5(4) apply, so that the Valuer would be obliged to take account of what might happen in the real world were it to be assumed that no guarantee was in place. The true construction of the Withdrawal Assumption cannot depend on whether or not the Administration Assumption is imposed in a particular case.

115. If that is the correct approach to "withdrawn" in the context of a guarantee, it informs, to some extent, the meaning to be given to that word in the context of a loan. Just as the assumption is that a guarantee is no longer in place so too it can be said that the assumption is that a loan is no longer in place, that is to say no longer outstanding. The Valuer thus has to assume that the loan has been satisfied. That, again counterfactual, assumption has to be reflected in the balance sheet of Northern Rock. On one side, the loan is taken out; on the other side, assets have to be taken out, the dispute then being whether assets with a book value of the equivalent amount are taken out (this is Harbinger's Repayment-in-Kind Interpretation) or assets with a realisable value of the necessary amount are taken out (this is the Valuer's Repayment Interpretation). We will deal with that dispute in a moment.

116. We would not want it to be thought that this view of the ordinary meaning of the words used in the Withdrawal Assumption is dependent on our analysis of the treatment of guarantees. We would reach the same conclusion even if we viewed loans in isolation. In that case, it still needs to be remembered that the draftsman is using the word "withdraw" to cover different types of financial assistance and that the focus of the word cannot be exclusively on loans. In the context of loans, an actual loan will, in most commercial banking situations, commonly be made by drawing-down a facility. It can be said that the granting of the facility is "financial assistance" but even if that is so, the actual draw-down on the facility, thereby creating a relationship of creditor and debtor, is itself provision of

financial assistance. It seems to us, therefore, that when section 5(4)(a) speaks of withdrawal of financial assistance it is speaking not only of withdrawing the facility but also of withdrawing the loan itself.

117. In the case of Northern Rock, it may have been that the facility afforded by the Bank had been fully drawn-down. But in other cases that may not be so. Withdrawing financial assistance may then encompass two elements, first the withdrawal of the facility so that further draw-down is prohibited and secondly, the withdrawal of the loan itself. We consider that the ordinary meaning of the word "withdraw" in relation to such a loan (and given that the word is, as we have said, used in a portmanteau phrase covering all types of financial assistance) is that the loan is no longer in place, in other words it has been satisfied. It would be a fallacy, in our view, to focus on the words "financial assistance" without regard to the nature of the particular financial assistance concerned. In the case of loan, it can, we accept, sensibly be argued that "assistance" is withdrawn when a demand for payment is made. But when one acknowledges that "financial assistance" is referring to particular types of support (*eg* a guarantee or a loan) the question is what is meant by withdrawing that support *ie* the guarantee or the loan. To withdraw a loan is not the same thing as to demand repayment of a loan. Indeed, the support or financial assistance which a loan gives in practice is not altogether withdrawn by a demand since the debtor still has the use of the money until it is repaid. If one were to ask whether a debtor had the benefit of a loan following a demand for payment but before actual repayment, the answer would clearly be Yes, in our view: financial assistance continues and it has not been "withdrawn" in the context of the Withdrawal Assumption.

118. The words in parenthesis in section 5(4)(a) "(whether by the making of a demand for repayment or otherwise)" are heavily relied on by Harbinger. Mr Phillips submits that those words demonstrate that one example of withdrawal is the making of a demand: thus, in relation to a loan, the making of a demand is enough to effect a withdrawal of the financial assistance and nothing more is necessary. The assumption, and the only assumption, mandated by section 5(4)(a) is a demand. The words in parenthesis describe the totality of what is required to constitute a withdrawal. We do not read the words in parenthesis in that way.

Rather, the words "whether by the making of demand or otherwise" refer to mechanisms for withdrawal. In the case of an on demand loan, the withdrawal would be initiated by a demand; it does not follow that the withdrawal should be regarded as complete without actual repayment being made in response to the demand.

119. We have considered why the draftsman considered that it was helpful to insert the words in parenthesis. Harbinger's contention would suggest that part of the purpose of the words was to make clear that, in the case of a loan, the making of a demand was sufficient on its own to count as a withdrawal, and thus that actual repayment was not required. We cannot accept this. If this had been the draftsman's intent, much clearer words would have been required. We have some doubt as to the draftsman's actual purpose. We think the most likely explanation is that the words in parenthesis were included as a precaution. He was seeking to make clear that the assistance had to be assumed to be withdrawn whatever its nature or terms. So, for example, in the case of an on-demand loan, the method of withdrawal would be the making of a demand, so as to obtain repayment. But if (contrary, perhaps, to general expectations) some form of assistance had been given which could not be terminated immediately, the assistance must still be treated as withdrawn, even though in the real world the lender might not be able to withdraw it immediately.

120. We do not overlook Mr Phillips' reliance on other indicators in favour of the Demand Interpretation. He relies in particular on the evidence of Mr John Kingman (then the senior HMT official dealing with Northern Rock) in *SRM*. Mr Kingman said this in relation to the real world consequences of the withdrawal of public assistance:

> "If the public assistance had been at any stage withdrawn after having been provided, Northern Rock could not have paid its debts as they fell due (including the very substantial amounts due to the Bank) – that is, it would have been insolvent on a cash-flow basis – and would have had to cease trading and enter into an insolvency procedure (administration, receivership, or insolvent liquidation)."

121. We do not see that as lending much support to Mr Phillips' argument. We accept, of course, that Mr Kingman was using the word "withdraw" in the sense of a demand having been made since he uses the word in the context of a situation where, following the withdrawal, "very substantial amounts" remain due to the Bank. What this shows is that the use of the word (as is the use of virtually any word) is context-specific: the context of his statement is entirely different from that of the Withdrawal Assumption itself.

122. Mr Phillips also asserts that the result of the Repayment Interpretation is to wipe £4bn off Northern Rock's balance sheet and thus unfairly to diminish the value of the company. We gain no assistance from this assertion. Its significance must depend upon the starting point. The value of Northern Rock must reflect its assets and liabilities. Book value may not represent the true value of a company's assets. This may be because, on any view, assets are shown at a value which does not reflect their true value (*eg* a valuable property has halved in value because of a change in the property market); or it may be because assets have to be sold for less than their book value because of the timing of the assumed sale and the extent of the assets concerned. It does not follow from the fact that the value attributed to the assets necessary to reflect the removal of the Bank's loans from the balance sheet is less than their book value that this "wiping" of a large sum from the balance sheet is in any way incorrect, unfair or disproportionate. We examine this aspect later.

123. Our view is fortified by the answer we would give to this question: If a loan remains undischarged, is the borrower still in receipt of financial assistance? Our answer to that is a clear Yes. An ordinary use of the word "withdrawn" in relation to a loan thus requires the loan itself to have been discharged. It is not enough to render the loan immediately repayable by the making of a demand: the financial assistance continues until the loan is actually discharged. Our provisional conclusion, therefore, is that the Demand Interpretation does not reflect the ordinary meaning of the words used in the Withdrawal Assumption. (We say "provisional" because we need to consider the objects and purposes of the 2008 Act and A1P1 to see what, if any, impact they have on that result.)

124. We do not, however, place any reliance on the No Future Assistance Assumption that no financial assistance would in future be provided. If, contrary to our provisional view (that is to say, before considering the purpose and object of the legislation and the impact of A1P1), a demand for repayment of a loan is sufficient to represent withdrawal of the financial assistance, it must logically follow that a loan which has been demanded ceases to be financial assistance. A failure by the institution to repay the loan would not, therefore, amount to continuing financial assistance. However, if we are right in our provisional view, then a demand for repayment is insufficient and the financial assistance would not be withdrawn by mere demand. Accordingly, the financial assistance would continue. (Whether the No Future Assistance Assumption would then be satisfied is not entirely clear; we do not need to decide the point.)

125. Our provisional conclusion is further fortified if one considers the possibility of assistance which is over a fixed term and is not repayable on demand. That is not the present case (except perhaps so far as the PIK interest is concerned, which we explain later), but the legislation applies generally. It is possible to envisage a case where the Bank has made assistance available which (absent perhaps certain specified covenant defaults by the relevant institution in its continuing business) is to remain outstanding for a fixed term. While term loans do not represent current practice for LOLR lending, we do not accept the suggestion that either domestic statutory provisions or EU guidance on State aid require only on demand loans to be made, or that Parliament can have had in mind only loans repayable on demand when passing the 2008 Act; at least, Mr Phillips has shown us nothing which would support that suggestion.

126. Suppose then that the Withdrawal Assumption falls to be applied before the end of the period. It is to be assumed that the financial assistance has been withdrawn. Since the Bank has, in the example now under consideration, no right to make a demand triggering an immediate right to repayment, to "withdraw" the assistance cannot, in that case, mean simply to make a demand. Rather, in our view, "withdrawal" only occurs if the assistance is discharged.

127. We note that our provisional conclusion on the ordinary meaning of the words used in the Withdrawal Assumption is consistent with the description which, if only by way of shorthand, Laws LJ used, namely, to treat the situation as if the financial assistance had not been given in the first place, a treatment which could only obtain if it were to be assumed that the loans themselves were no longer outstanding.

(b) The competing interpretations in light of the purpose of the 2008 Act

128. The primary purposes of the 2008 Act are clearly spelt out in section 2. The power to transfer Northern Rock's shares to a nominee for HMT was exercisable for one or both of the purposes set out in section 2(2) that is to say (a) maintaining the stability of the UK financial system in circumstances where HMT consider that there would be a serious threat to its stability if an order were not made, and (b) protecting the public interest in circumstances where financial assistance has been provided by the Treasury to the deposit-taker for the purpose of maintaining the stability of the UK financial system. Thus an order could be made even where the financial assistance had been provided before the commencement of the 2008 Act.

129. As Mr Howard submits, and as is made clear in the judgments of the Divisional Court and the Court of Appeal in *SRM*, the public interest does not extend to giving shareholders the benefit of financial assistance provided to support an otherwise failing institution. There can be no doubt, in the present case, that had the Bank and HMT not provided support, some sort of insolvency procedure – administration or winding-up – would have been adopted by or imposed on Northern Rock. The Withdrawal Assumption and the No Future Assistance Assumption are imposed to ensure that shareholders in fact receive no benefit from the public assistance.

130. The purpose and objective thus identified supports the provisional conclusion which we have reached. We accept Mr Howard's submission that only the Repayment Interpretation fully satisfies the aim of ensuring that shareholders do not reap the benefit of taxpayer support and of the taxpayer bearing the inherent risk in that support. It is nothing to the point that, in the case of Northern Rock,

there may have been no risk and there may have been a likelihood of profit (as Harbinger maintains but the Valuer, the Bank, and HMT deny). The statutory provisions can apply to institutions other than Northern Rock (indeed they have operated in relation to three other institutions: Bradford & Bingley, Heritable Bank and Kaupthing Bank). The true interpretation of the provisions cannot be ascertained by reference only to the factual position in the case of Northern Rock.

131. Mr Howard also rightly submits that Harbinger's interpretations result in shareholders obtaining an increased return on the basis that financial assistance is either never fully withdrawn or is withdrawn over a long notional administration period.

132. The Repayment-in-Kind Interpretation treats the Bank's loans as discharged by a removal from the balance sheet of assets having a book value equal to the amount of the loans. There are, we think, two (closely related) objections to that. The first is that, on any footing, an asset may have a market or realisable value significantly less than its book value. Consider, for instance, a building owned by Northern Rock which can be sold easily but the market value of which has fallen considerably since its acquisition and the value of which in the balance sheet is shown at considerably above its current market value. In such a case it could not possibly be correct, in our view, that the Bank's loans should be treated as satisfied *pro tanto* by an amount equal to the book value.

133. The second objection to the Repayment-in-Kind Interpretation relates to assets which are not readily realisable, at least if all are placed on the market at once or over a very short period. If it is to be assumed, as it must be, that the Bank's loans are to be treated as satisfied (which is what the Repayment-in-Kind Interpretation, like the Repayment Interpretation, requires), the Bank should be in a position where it is able to recover every penny which it is owed. But the Bank cannot be forced, in discharge of the liability to it, to take assets other than cash in satisfaction of its debt. Even if it could be, it should be entitled, in our view, to receive assets (or, since this is a hypothetical exercise, notionally to receive assets) which it could realise in satisfaction of the amounts owing. It is common ground that a fire-sale or, indeed, any sale over a comparatively short period, of assets

which have sufficient book value to meet Northern Rock's liability to the Bank, would produce nowhere near the amount of the book value. We provide some more detail about this in paragraphs 171-175 below.

134. Accordingly, for the Bank to obtain, in the long run, what is owing to it, it would have to hold sales of the relevant assets over a considerable period. This, it seems to us, is a far cry from the financial assistance being "withdrawn". Instead, Northern Rock is retaining the benefit of financial assistance by itself avoiding a sale at less than book value and passing the risk of an eventual shortfall to the taxpayer, not to speak of keeping the Bank, rather than Northern Rock itself, out of the money for a substantial period. The Repayment-in-Kind interpretation is simply another method by which, as under the Demand Interpretation, the Bank is made to wait for its money over a period, rather than being repaid by no later than the valuation date. In our view, only repayment by no later than the valuation date fully reflects both the words and the purpose of the statutory phrase "has been withdrawn".

135. We accordingly consider that we should reject the Repayment-in-Kind Interpretation as being inconsistent with the relevant purpose of the 2008 Act, subject to any impact of A1P1 to which we will come in due course.

136. The second objection to the Repayment-in-Kind Interpretation discussed above further demonstrates, in our view, why the Demand Interpretation also fails to give effect to the statutory objective and purposes. The Demand Interpretation results in the Bank being kept out of its money for a significant period. Mr McKillop's model suggests that the Bank would not be paid in full for two years. But, so it seems to us for reasons already given, even this two year delay leaves Northern Rock in receipt of financial assistance after the valuation date in the shape of the loans so far as remaining unsatisfied. The Demand Interpretation gives shareholders the benefit of the loans by enabling the administrator to postpone repayment to the Bank for a considerable period, for the ultimate benefit of shareholders.

137. It is true that, had Northern Rock not received financial assistance from the Bank, it would inevitably have gone into some sort of insolvency proceedings in September 2007. Harbinger asserted that, had that happened, shareholders would have received some return. But that is highly speculative, and was not established by evidence. If Northern Rock had not been supported, the consequences for the financial system as a whole could have been dire: it was indeed to prevent an even more serious crisis in the financial sector than in fact occurred that support was given. As to that, Mr Phillips said this in his submissions: "One thing I can say with absolute certainty is the financial sector would not have collapsed if Northern Rock had gone into administration". There was no evidence sufficient to prove that assertion. We certainly do not share Mr Phillips' confidence. What we do know is that there were real fears of contagion in the money markets at the time and that it was this fear, among others, which persuaded the Government that Northern Rock should receive very large financial assistance. We do not think that it could seriously be suggested that the failure of Northern Rock (together with the other failing former building societies) would not have had significant repercussions in the UK money markets and the real economy.

138. In any case, the 2008 Act does not look to the value of the shares at some date prior to the date of nationalisation (for instance September 2007 when financial support was first given by the Bank). Instead, it looks to the value of the shares on the date of nationalisation. The Valuer's task was to value the shares on that date but making the various assumptions required, the purpose of which is to ensure, broadly, that the shareholders do not take any benefit from the public support provided. Thus not only is all financial assistance treated as withdrawn (in the sense which we have identified), with no further assistance to be provided, but it is also assumed that Northern Rock is in administration and that it is not a going concern, effectively restricting any compensation to shareholders to an amount ascertained following a valuation on an assets basis.

139. Parliament has chosen to achieve that end, on our interpretation of the Withdrawal Assumption, by directing the Valuer to assume that loans given by way of financial assistance have been satisfied. In consideration of the Parliamentary purpose we should adopt the Repayment Interpretation in

preference to the Repayment-in-Kind Interpretation and the Demand Interpretation.

140. Mr Phillips tries to deflect us from that conclusion by relying on passages of the judgments of the Divisional Court and Laws LJ in *SRM*. The former referred to the effect of the Withdrawal Assumption as being to require HMT "to pay compensation on the same basis that it could fairly have paid in September 2007" and the latter referred to the object as being "to put shareholders in the position they would have occupied had no LOLR support been provided [*ie* in September 2007]". He points out also that the Valuer did not take issue in his Statement of Case with HMT's submission that "there was nothing disproportionate in requiring the Valuer to adopt assumptions that would reflect the situation that would have prevailed had that [financial] assistance not been given". We consider that it is placing more weight on each of those statements than they can reasonably bear to say that they support the Repayment-in-Kind Interpretation or the Demand Interpretation rather than the Repayment Interpretation. What the Divisional Court and Laws LJ were drawing attention to was that shareholders were to receive no benefit from public support of Northern Rock and, in the context of the arguments which they were actually addressing, it was not, we think, an unhelpful shorthand to refer to the position as it would have been if assistance had not been given.

(c) Impact of A1P1

141. Do A1P1 and section 3 HRA 1998 require a different result? In our view, the answer is No. In summary (we will develop this below), this is because the Repayment Interpretation is consistent with A1P1 in the sense that, had the CSO spelt out that "withdrawn" in the case of a loan meant actual repayment, a challenge to such an express provision on the basis of A1P1 would fail. Further, given that view, we do not consider that the interpretative requirements of section 3 HRA 1998 require us to depart from the interpretation which we arrive at absent consideration of A1P1, even though the Repayment-in-Kind Interpretation and the Demand Interpretation would also be consistent with A1P1 and might result, on the facts of the present case, in a value for shareholders larger than the nil value which the Valuer has in fact arrived at.

142. As to the first of those conclusions, let it be assumed that section 5(4)(a) had expressly provided that it was to be assumed that loans provided by way of financial assistance had actually been repaid by the valuation date. It seems to us, as we have already said, that the decision of the Court of Appeal in *SRM* is a strong indicator that such a provision would have been A1P1 compliant. We have considered the judgments of both the Divisional Court and the Court of Appeal at (perhaps inordinate) length; and we have done so to identify precisely what can be taken from those judgments. It is tolerably clear that Laws LJ had in mind the possibility of a fire sale of assets at a depressed value in considering whether there was a violation of A1P1 and concluded that there was not. He can only have reached that conclusion in the context of the Withdrawal Assumption and the other valuation assumptions which the Valuer would be required to make. For that reason alone, we do not consider that it would be open to us to conclude that an express provision of the sort we have posited would have been in violation of A1P1.

143. Moreover, even if it were open to us to consider the matter afresh, we would conclude that such an express provision would indeed be compliant with A1P1. The discussions of the authorities in the judgments of the Divisional Court and Laws LJ in the Court of Appeal (to which we have added some observations in our own examination of those judgments) demonstrate that it is sufficient to show that compensation for the property taken has been provided in "an amount reasonably related to its value": see *James*, *Lithgow* and *Holy Monasteries*, as well as *SRM* at [48] of the judgment of Laws LJ. They show also that the State enjoys a wide margin of appreciation both in deciding whether to deprive an owner of his property (not at issue in the present case) and in laying down the terms and conditions for doing so, including the amount (or "standard" in the language of the Strasbourg Court) of compensation.

144. Importantly for present purposes, in deciding in the present case whether the basis on which a valuation to be carried out results in compensation which is reasonably related to its value, we remind ourselves of what Laws LJ said at [75]: "the margin of appreciation must in my judgment be a wide one. As in *James* and

Lithgow, the court [*ie* of the State concerned] would only interfere if it were to conclude that the State's judgment as to what is in the public interest is manifestly without reasonable foundation". Adopting that approach, as we must, we conclude that an express provision requiring the Valuer to assume that loans by way of financial assistance had actually been repaid would be compliant with A1P1.

145. We must construe section 5(4)(a) of the 2008 Act so far as possible in a way which is compatible with Convention rights. The State is allowed a margin of appreciation when it enacts legislation which impacts on a person's Convention rights. The margin of appreciation does not, however, operate as a derogation from Convention rights, so that something which is not strictly compliant is nonetheless treated as compliant. Rather, the margin of appreciation is part and parcel of what is, and what is not, actually compliant. Accordingly, before it is possible to ask whether an enactment is compliant with the Convention, it is necessary to establish what meaning would be given to the enactment in the absence of section 3 HRA 1998. In our view, it is only if the construction which we would otherwise accord to that provision is not compatible with Convention rights that we need to address some other construction which is so compatible. Given our conclusion that an assumption of actual repayment would be compliant with A1P1, we do not consider that section 3 HRA 1998 has any part to play.

146. It is true that, in the present case, the Repayment-in-Kind Interpretation and the Demand Interpretation would each be more likely than the Repayment Interpretation to result in a return for Harbinger. In that sense, either of those interpretations would produce something nearer the "full" value of the shares. By "full" value, we mean the realisable value of the shares ignoring the Valuation Assumptions. The "full" value thus takes account of and recognises the existence of the financial support which has been given and the reality that the Government would, after the valuation date, continue to support Northern Rock as indeed it in fact did. Any interpretation of the Withdrawal Assumption (and the other assumptions) is bound to result in a valuation less than the "full" value. We do not see it as a duty of the Valuer (or of this Tribunal) to adopt an approach to the interpretation of the Withdrawal Assumption which gives the shareholders the

maximum possible return. It is one thing (in accordance with the guidance in *Ghaidan*) to construe legislation in an unnatural way and even to depart from the unambiguous meaning the legislation would otherwise bear in order to render it compliant with the Convention when it would not otherwise be compliant. It is quite another to depart from the meaning of the legislation construed according to ordinary canons of construction and which, when so construed, is compliant with the Convention.

147. We consider that the Valuer got matters exactly right in his Independent Valuation Final Document of March 2010 when he said (i) that he should not assume that the book value of assets is the same as their actual value, his task being to ascertain the actual value of the shares at the valuation time and (ii) that an approach which treated loans as withdrawn when demanded (but without being repaid) would be to value Northern Rock on a basis which gave it the benefit of Government money during the course of a potentially protracted administration.

(d) The Interpretation Issue and the expert evidence

148. We do not consider that the evidence of Mr McKillop and Mr Thompson assists us at all on the question of statutory construction, even if it were admissible on that question, which we doubt it is. In so far as the evidence goes to what the Bank might do in a notional administration or why the directors of Northern Rock would have to refuse to repay loans to the Bank if demanded (leaving the Bank to recover its debts in the course of an appropriate insolvency procedure), we do not see its relevance. The assumption which is required is that financial assistance has been withdrawn. The fact that in the real world the Bank would (according to the evidence of Mr McKillop and Mr Thompson) act in a certain way and that the directors of Northern Rock could not act in a certain way is in our view immaterial. It is equally immaterial, on the question of construction, that the alternative Interpretations for which Harbinger contends lead Mr McKillop to different conclusions as to the value of the shares in Northern Rock.

149. In addition, Mr Thompson's evidence focuses on how a commercial lender would be likely to deal with the situation in which the Bank finds itself. As Mr Howard points out, his instructions were "to consider these issues from the

perspective of a commercial clearing bank as if it was [such a bank] (rather than the Bank of England) which provided the financial assistance to Northern Rock". In accordance with that instruction he assumed "a proper commercial relationship between the Bank and Northern Rock". For reasons which we hope we have adequately explained, the Bank, as lender of last resort, is in a very different position from a commercial lender (however great the exposure of that commercial lender). One of the important differences is the presence of constraints placed on the Bank by the State aid rules and practices under EU law. Mr Howard also notes that Mr Thompson is not, and never has been, a central banker and is therefore not qualified to give evidence on what the Bank would or might do. Those considerations would cause us to treat with some circumspection Mr Thompson's evidence even if we thought it relevant on the issue of construction (which we do not).

150. Mr McKillop's first report was based on his instructions, which included a legal analysis of the statutory assumptions set out in submissions made on behalf of Harbinger to the Valuer during the consultation (paragraph 1.6 of his report). The legal analysis indicated that the amount of financial assistance that had been withdrawn should equate to the amount contractually due on an administration of Northern Rock at the relevant date (paragraph 5.29). He observed that the statutory assumptions did not direct how the Bank's loan, the PIK Interest or the guarantees should be treated other than as having been withdrawn, and that he was instructed not to make any assumptions about how they were withdrawn (paragraph 5.38). Against that background, his approach was to give effect to the withdrawal of the financial assistance by withdrawing an equivalent net book value of Northern Rock's unencumbered residential mortgage assets immediately before the relevant date (paragraph 5.40). His first report therefore reflects Mr McKillop's own view of the correct approach, that is to say the Repayment-in-Kind interpretation. In paragraph 5.42 he acknowledges that other treatments could be applied but says he believes his treatment reflects the appropriate economic impact of the Withdrawal Assumption. He prays in aid that the Legal Advisers (*ie* those advising Harbinger) have confirmed that his approach is "consistent with the legal requirements of the Valuation Assumption and also with the views expressed in [the judgments in *SRM*]". However, interpretation of the

statutory words is a matter for us, and we are not obliged to accept Mr McKillop's view.

151. For his second report he was instructed to interpret the Withdrawal Assumption in the manner of the Demand Interpretation. He has never, so far as we are aware, adopted the Demand Interpretation as his own view of the correct interpretation. That does not trouble us in the least, since interpretation is a legal question for us, and is not determined by expert evidence. Clearly Mr Phillips must share our analysis in that respect, otherwise he would have had to restrict his submissions to supporting his own expert's view.

(e) European Union law

152. Laws LJ noted in his judgment the time limit of 17 March 2008 as the date by which the UK was required to submit a restructuring or liquidation plan for Northern Rock to the European Commission, which had sanctioned the original support pursuant to the State Aid provisions of the EU Treaty only up to that date. State rescue aid is generally subject to strict time limits. Usually, the position is that aid by way of loan must be repaid within 6 months. In the present case, the Commission did not regard the initial LOLR on 14 September 2007 as State aid (because it was secured by high-quality collateral). It did regard the support given on and after 17 September 2007 as State aid. The decision of the Commission authorising aid to Northern Rock contained this passage:

> "The Commission expects your authorities to respect their commitment to communicate to the Commission, not later than 17 March 2008, a credible and substantiated restructuring plan or a liquidation plan or proof that the aid measures have been repaid in full and that the guarantees have been terminated."

153. Accordingly, it was incumbent on the authorities to receive actual repayment of any loans given by way of financial assistance on or after 17 September 2007 in the absence of either an appropriate restructuring plan or a liquidation plan.

154. It is also to be noted that, since the nationalisation of Northern Rock, the Commission has issued further guidance in a communication on "The application of State aid rules to measures taken in relation to financial institutions in the

context of the current global financial crisis": OJ C 270, 25.10.08. This recognises the possibility that a Member State might wish to carry out what is termed a "controlled winding-up" of a relevant institution. Paragraphs 46 and 47 of that communication are in the following terms:

> [46] In the context of liquidation, particular care has to be taken to minimise moral hazard, notably by excluding shareholders and possibly certain types of creditors from receiving the benefit of any aid in the context of the controlled winding-up procedure.
>
> [47] To avoid undue distortions of competition, the liquidation phase should be limited to the period strictly necessary for the orderly winding-up. As long as the beneficiary financial institution continues to operate it should not pursue any new activities, but merely continue the ongoing ones. The banking licence should be withdrawn as soon as possible.

155. Although post-dating the 2008 Act, it seems to us that this guidance marches tidily in parallel with the policy behind and approach of the 2008 Act and the CSO in relation to Northern Rock. Indeed, the nationalisation of Northern Rock was itself the subject of a Commission decision which decided that it would be compatible with the State aid provisions provided that "shareholders are only compensated on the basis of an independent valuation of the company without any State support". It is difficult to read that proviso as envisaging anything other than a situation in which the valuation took place on the assumption that there was no continuing State aid – in other words, support by way of loan would be assumed to be repaid. Of course, that passage in the decision cannot directly affect the true interpretation of section 5(4)(a). It is, however, an unsurprising reflection of the Commission's approach and one which, on our interpretation of the Withdrawal Assumption, mirrors the approach which the Valuer is required to adopt.

156. In summary, the default position under European Union law, absent nationalisation or a restructuring, was that the financial assistance would have to be repaid by 17 March 2008 and that, in the case of nationalisation, compensation to shareholders ought to be assessed on the basis that Northern Rock was without State support. The Repayment Interpretation is consistent with that last requirement. In contrast, the Repayment-in-Kind Interpretation and the Demand

Interpretation result in a full return to the Bank and HMT only after a significant period of time, and hence involve ongoing State support, with the result that shareholders would be receiving value attributable to ongoing State aid.

157. Accordingly, we think that support for the Repayment Interpretation is to be found in consideration of the conditions for State aid. Certainly, those provisions lend no support at all to the Repayment-in-Kind Interpretation or the Demand Interpretation.

(f) Robustness and consistency

158. Mr Howard submits that the Repayment Interpretation has the benefit of being robust, consistent and easy to apply. All the Valuer needs to consider for the purposes of the Withdrawal Assumption is the amount of assistance outstanding and what assets would need to be realised to repay that by the valuation date.

159. In contrast, he submits that the Repayment-in-Kind Interpretation does not reflect the quality of the assets treated as effecting repayment or the time needed to realise them. It is to be remembered that the Withdrawal Assumption applies in all cases. Under the Repayment-in-Kind interpretation the shareholders are insulated against any discrepancy between the book value of assets and their realisable value, so the shareholders in a bank with a poor quality book and assets not readily realisable could benefit from this interpretation more than the shareholders in a bank with a large amount of readily realisable assets (such as gilts). We agree with Mr Howard when he says that this cannot have been intended.

160. Where book value accurately represented the readily realisable value of assets, the Repayment Interpretation and the Repayment-in-Kind Interpretation would yield the same result. But in the case where book value was greater than the readily realisable value the latter Interpretation would give the shareholders a windfall of compensation. Conversely, where the book value of assets was less than market value – for instance real property which was in the balance sheet at book value but which had significantly increased in value – the Repayment-in-Kind interpretation would under-compensate the shareholders, by treating the

Bank's loans as satisfied only to the extent of the book value of the assets notionally applied to satisfy the debt and not to the extent of their true realisable value. If it is said, in answer to that, that the market value must be taken in such circumstances, we can see no reason why that should not also be the case in relation to poor quality assets, where the value has gone down or which are not readily realisable. Under the Repayment Interpretation, however, the assets' quality (including the ease with which they may be realised) is fully reflected by the value which can be obtained for them.

(g) Presumption against illegality or absurdity

161. Mr Phillips argues that the Repayment Interpretation is inconsistent with the presumption made against illegality or absurdity in construing a statute. His argument runs this way:

a. The directors of Northern Rock owed legal duties to creditors and shareholders. They could not, consistently with their duties, actually have paid back the Bank prior to, or at the point of, nationalisation without a breach of those duties. To have done so would have been to give the Bank a preference over other creditors.

b. The Repayment Interpretation treats the financial assistance by way of loans as having been repaid; such repayment can only be seen as a preference.

c. Such a repayment would be a breach of the directors' duties so that the Repayment Interpretation necessarily involves an assumption of breach of duty.

162. We do not consider that there is anything in this argument. The Withdrawal Assumption is precisely that – an assumption and no more. The assumption impacts only on the level of compensation to be paid to shareholders; it has no impact at all on the amount which other creditors will actually recover from the real Northern Rock (or any other institution subject to these provisions in other cases) continuing to operate in the real world. Nor does the assumption impact on the priority which is enjoyed as between unsecured creditors or the validity of security held by secured creditors. The statutory assumption, under the Repayment Interpretation, tells us that the starting point for the valuation is a

hypothetical situation in which no loans given by way of financial support are outstanding. A deeming provision of this sort does not, in our judgment, give rise to any issue of illegality or absurdity.

163. Mr Howard gives a second reason why the argument is flawed. He submits that to construe the Withdrawal Assumption by reference to what the directors would have done when faced with a demand for repayment is to give undue weight to those interests contrary to both the general scheme of the 2008 Act (which gives primacy to the public interest) and to the particular purposes of the Withdrawal Assumption, which is to prevent shareholders taking any benefit from public funds. We do not think that this really adds anything to the first reason.

164. Mr Howard also observes that, if the illegality/absurdity argument is enough to defeat the Repayment Interpretation, it must also defeat the Repayment-in-Kind Interpretation. That may well have been one of the reasons why Mr Phillips abandoned the Repayment-in-Kind Interpretation as his primary position and placed the Demand Interpretation as his favoured approach.

165. Mr Phillips further contends that it is inconceivable that in the real world a sale of a large part of the Bank's security consisting of Northern Rock's mortgage book (about £27bn out of a total residential mortgage book of about £84bn in February 2008) on a single day could take place. The market would simply not have capacity to deal with the "dumping" as he put it of this amount of assets even over a short period let alone on one day. That, he submits, undermines the Repayment Interpretation: Parliament cannot have intended that assets which, in the medium to long term could be realised for their full value or something approaching it (*ie* in the case of mortgage loans, reflecting the full amount owing including interest), should fall to be given "a hugely discounted value" effectively allowing HMT (as the owner of the shares) to make a huge profit in the long term. This points, accordingly, to an interpretation which avoids this allegedly unfair result.

166. The actual discount applied by the Valuer was 15%: whether that can be described as "hugely discounted" we do not pause here to consider. We will,

however, consider later in this Decision the Valuer's methodology, including the discount from book value (15%) which he has applied to residential mortgages notionally allocated or matched to discharge the loans to the Bank and PIK interest.

167. We do not, in any case, agree with the submission. It is no more than an assertion, elegantly put of course, of the result which Harbinger would wish to achieve. It is not obvious, at least to us, that there is any unfairness about making an assumption that assets must be notionally realised prior to the valuation time to meet the Bank's loans; nor has the evidence shown that there is any unfairness or any valuation error in a discount of 15% from book value to reflect that requirement.

(h) Conclusion on the Interpretation Issue

168. Taking all these considerations into account, we determine the principal issue in favour of the Valuer. In our judgment, the Repayment Interpretation is the correct interpretation of the Withdrawal Assumption.

169. On that basis, it follows that neither the Valuer nor this Tribunal is able to depart from the Repayment Interpretation. It is not open to us, whatever the correct answer to the Section 133(5) Issue, to direct the Valuer to adopt a different meaning of the Withdrawal Assumption.

Result of the Repayment Interpretation

170. As we understand the position, it is not contended by Harbinger or other applicants that the result of applying the Repayment Interpretation, and of adopting the discount of 15% applied by the Valuer to residential mortgages (which is not disputed by Mr McKillop), would be other than the attribution of a nil value to the shares. There are disputes about the correctness of the Valuer's approach on a number of methodological points, but whatever the correct answers to those issues, the result remains a nil value. We have, however, heard argument on them and it may be helpful if we were to express a view, especially if this case is to go to the Court of Appeal or beyond. We do so in the course of considering the notional administration following the Administration Assumption.

The Valuer's methodology

171. The Valuer, applying his interpretation of the assumptions he was required to make, and in particular the Withdrawal Assumption, assumed that where assets were liquid (*ie* easily converted to cash), they could be realised £ for £ but the value of illiquid assets would be at a discount to book value because of (see paragraphs 10.58 – 10.68 and 12.2 of the Consultation Document):

a. a requirement for immediate realisation;
b. the presence of only a limited number of buyers (with lack of available funding) and no ready market; and
c. the perception of a distressed sale.

172. The table at page 101 of the Consultation Document shows the balance sheet adjustments made by the Valuer in the notional sale of assets. The Bank's loans of £25,277mn plus PIK interest of £100mn were satisfied by notionally realising assets with a book value of £29,445mn comprising:

a. £727mn cash;
b. £1,596mn gilts (at book value); and
c. £27,122mn of residential mortgages (realising 85% of book value).

173. The loss recognised on the sale of the residential mortgages (or discount to book value applied to the notional sale) is £4,068mn. PIK interest (as to which see later) is included at £100mn. It should be noted that the Valuer has (notionally) realised only £1,596mn gilts of the £8,070mn of total assets listed as Treasury Investments. He explains that Treasury Investments other than gilts would suffer a heavy discount (perhaps as much as 30%) on a forced realisation. He has not made any notional realisation of them in his valuation. His rationale for the 15% discount from book value in relation to the residential mortgages is explained in paragraphs 12.6 – 12.8 of the Consultation Document.

174. Mr Phillips submits that the £4.068bn loss is a "destruction in value" which he variously describes as the result of a fire sale and "the dumping of £29bn of mortgage assets in one day" rather than realising the assets over time. However,

Mr McKillop accepted that if the mortgages *had* to be realised to meet the liabilities to the Bank, there would have to be a discount. Not only that, but he accepted the level of discount adopted by the Valuer. In the course of his cross-examination by Mr Howard there was this exchange in the context of the Repayment Interpretation:

> "Q. But if the statutory interpretation requires that one raises cash, and that was the question I started off with, one has to raise enough cash to meet the liability to the Bank of England, on a hypothesis – as I understand it, on that hypothesis, you have never disputed Mr Caldwell's approach to what value could be raised or realised on the mortgages?
> A. No, we accept that if it was a -- I certainly accept that you could not raise in the market the par value of those mortgages. It's a huge sum of money.
> Q. There would have to be a discount and you don't dispute his discount?
> A. No, I don't."

175. In the light of Mr McKillop's acceptance of the level of the discount, we do not consider that we need to address the evidence and reasoning on which the Valuer relied in the Consultation Document in applying the discount which he did. In any case, the discount of 15% does not strike any of us as unfair to shareholders. To the contrary, on the evidence we have seen it was, if anything, materially favourable to the shareholders.

176. The estimated financial outcome statement prepared by the Valuer (which can be found at page 19 of the Consultation Document) shows the actual Balance sheet surplus of £1.629bn adjusted for withdrawal of the Bank's financial assistance to give a deficit of £2.440bn at February 2008. In summary, the position shown is as follows (figures are £mns):

	Actual Feb 08 B/S	**Bank withdrawal**	**Adjusted B/S**
Total assets	106,315	29,445	76,870
Total liabilities	104,686	25,377 (inc PIK)	79,309
Surplus/(deficit)	1,629	(4,068)	(2,440)

177. We understood Harbinger to accept that if there was no shareholder value at the valuation date in February 2008, there would be no value at the end of the 5 or 6-year run off. Thus Mr Phillips said "The value that's destroyed if the repayment

interpretation is held to be correct completely destroys any value so there is no value left" and "the administration becomes something that's just dealing with a bit of a rump and in fact doesn't matter a bean. What really matters is that there has been this immediate sale at distressed prices before you get to the four assumptions …"

178. That is consistent with the Valuer's figures. He states that having dealt with the withdrawal of the Bank's financial assistance, the administrator in the assumed administration would run off the remaining assets as the most appropriate strategy to realise the best return for creditors. He projected total assets remaining on the balance sheet at December 2013 of £21,095mn and total liabilities of £26,772mn including statutory interest (under Rule 2.88 Insolvency Rules 1986) of £7,045mn. This increases the deficit from the adjusted balance sheet at February 2008 of £2,440mn to £5,676mn in December 2013. These figures are shown on pages 142 and 143 of the Consultation Document. We come to Rule 2.88 later.

The notional administration

179. Under each Interpretation, there is a notional administration. Under the Repayment Interpretation, the loans to the Bank are to be treated as having been repaid so that, at the time as of which the valuation is to be effected, no such loans are outstanding. This treatment involves a notional realisation of assets sufficient to satisfy the loans from the Bank and the PIK interest. Mr Phillips submits, as we have already noted, that the resulting discount (on what he says is a fire-sale) is unfair and cannot have been intended by Parliament. In contrast, he says that the Demand Interpretation avoids this unfair result. But does it? That is the question we now turn to examine.

180. According to Mr Phillips, the Demand Interpretation operates with the following consequences:

a. The Valuer is to assume that Northern Rock is in administration; it is not, therefore, in winding-up.

b. It is not assumed that the loans by the Bank have been repaid at the valuation time.

c. The effect of the administration is that a moratorium is imposed under paragraphs 42 and 43 Schedule B1 Insolvency Act 1986 ("Schedule B1").

d. Although the Bank has the benefit of security, it cannot enforce that security without the consent of the administrator or the leave of the court.

e. An administrator would carry out an orderly disposal of Northern Rock's assets. This would entail a lengthy administration period of 5 years or more at the end of which (i) all creditors including the Bank would have been paid in full (including interest – a separate issue which we will come to later) (ii) a large surplus would be left sufficient to discharge in full the rights of the preference shareholders with something left over for ordinary shareholders.

f. Since preference shareholders would be paid in full, the value of their shares at the valuation date is the discounted value of what they would receive at the end of the administration period.

181. We consider some of those consequences in the following paragraphs.

182. As to consequence a., it is true that the assumption that Northern Rock is in administration means that it is not in winding-up. But that is an assumption which applies only at the time as of which the valuation is to be effected. What might happen later is uncertain. The possibility of a winding-up rather earlier than Mr Phillips envisages in his submissions cannot be ignored.

183. The statutory purposes of any administration under paragraph 3(1) Schedule B1 are

> "(a) rescuing the company as a going concern, or
> (b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
> (c) realising property in order to make a distribution to one or more secured or preferential creditors."

184. The Administration Assumption requires it to be assumed that Northern Rock was in administration on the valuation date, although nothing is said about when the administration is to be treated as having commenced. But the fact that Northern Rock is assumed to be in administration must mean that at least one of

the statutory purposes was on the cards since the notional administrator would have had to express his view that the statutory purposes were capable of fulfilment. Since, at the valuation date, it is also to be assumed that Northern Rock was not a going concern, the first statutory purpose cannot be one which, after that date, is capable of satisfaction. Accordingly, the administrator must perform his functions with the objective specified in (b) or (c) on the basis that it is not reasonably practicable to achieve the objective specified in (a): see paragraph 3(3) Schedule B1.

185. By paragraph 3(4), the administrator may perform his functions with the objective specified in (c) only if he thinks it is not reasonably practicable to achieve either of the objectives specified in (a) and (b) and he does not unnecessarily harm the interests of the creditors of the company as a whole. If none of the objectives can, in the view of the administrator, be achieved, the company should be put into winding-up. Subject to that, the administrator must perform his functions in the interest of the creditors of the company as a whole.

186. In any case, by paragraph 4, the administrator must perform his functions as quickly and efficiently as is reasonably practicable.

187. As to consequences c. and d. set out above, it is true that a moratorium, as a general rule, comes into effect on the commencement of administration, and where it does so a secured creditor cannot enforce his security. However, a secured creditor may enforce his security with the consent of the administrator or the court. The Valuer, in conducting his valuation adopting the Demand Interpretation, would need to take into account the possibility of such consent being obtained. Certainly, a hypothetical purchaser of the shares in Northern Rock would take that possibility into account and would surely expect a discount from what Harbinger asserts is the "full" value unless persuaded that there was no possibility at all of the Bank obtaining permission to enforce its security (and even then he might expect some discount because nothing is absolutely certain in litigation). And he would take this into account even before he starts to consider a discount on a net asset value purchase price to take account of unknown factors in realising the assets.

188. Mr Phillips submits that the Bank would not obtain permission to enforce its security. Mr Howard submits to the contrary. He points out that the Bank's position is entirely different from that of an ordinary commercial creditor. It has provided financial support in the public interest and has obtained security for that support. The Bank, acting in the interests of the taxpayer, should be entitled to recover what is owing to it by enforcement of its security sooner rather than later. Further, consideration of the State aid provisions which we have already addressed also points to the early recovery of what is owing. On any view, the Bank's LOLR funding is quite different in its objectives and terms from rescue facilities provided by a commercial bank. It is not for us to decide whether the Companies Court would in fact give permission in an administration such as the notional administration with which we are concerned. But what we can say is that there is considerable force in the arguments which Mr Howard raises; they are arguments which the Valuer would be bound to consider.

189. We add this. As we have mentioned, the administrator must perform his functions in the interests of creditors; no mention is made in paragraph 3 Schedule B1 of exercising his functions in the interests of shareholders, albeit an administrator no doubt has some duties to shareholders. However, when it comes to balancing the interests of creditors and of shareholders, the administrator must act in accordance with his statutory duty under paragraph 3(2) in the interests of the creditors as a whole or, if he has reached the conclusion that he should exercise his functions with a view to achieving the objective specified in paragraph 3(1)(c), he should act with the objective of realising assets in order to make distributions to secured creditors; and he should do so "as quickly and efficiently as is reasonably practicable". Given those considerations, the sort of orderly administration which Mr Phillips submits ought to take place might, we suppose, result in a lengthy administration period in the course of which creditors would be paid in full; but it must be strongly arguable that administration should not be carried out with a view to obtaining as large a return as possible so as to benefit shareholders when to do so would delay the repayment in full of creditors, since that might, on the facts of a particular case, mean that the administrator was not acting as quickly and efficiently as is reasonably practicable in the

performance of his duties to creditors. Again, it is not for us to decide this issue. It is something which the Valuer would need to take into account when carrying out his valuation, a valuation which would have to reflect the risk that an administrator would be in breach of his duties to creditors if he extended the administration period to obtain a return to shareholders to the detriment of creditors by delaying their repayment in full.

190. We have said that, as a general rule, a moratorium is imposed. But there are exceptions. One exception relates to collateral security within the meaning of the Financial Markets and Insolvency (Settlement Finality) Regulations 1999. These Regulations have been amended a number of times. For present purposes it is necessary to note only the amendment to Regulation 19 made by paragraph 19 of the Schedule to the Enterprise Act 2002 (Insolvency) Order 2003, which substitutes reference to certain paragraphs of Schedule B1 for the reference to certain sections of the Insolvency Act 1986 (to reflect the changes made to the substantive law of insolvency by the Enterprise Act 2002). We will refer to the version of the amended Regulations in force at the nationalisation date in 2008 as "the **Finality Regulations**".

191. Harbinger contends that the Bank is subject to the usual moratorium, and that this affects the way that, on the Demand Interpretation, the notional administration would be conducted. But Mr Howard submits on behalf of the Valuer that "it seems" the moratorium would not apply, because of the effect of the Finality Regulations. Mr Phillips responds that the Finality Regulations have no relevance; they are concerned with settlement systems, not with the LOLR powers of central banks or the provision of emergency liquidity. Where they refer to the functions of central banks, the subject matter in view is the function of central banks extending credit qua settlement agent (in exchange for taking collateral) to complete transactions within the European securities settlement system. The regulations therefore have no impact on the collateral security taken by the Bank from Northern Rock.

192. At its heart, this issue seems to us to depend upon whether in the context of the regulations the definition of "collateral security" should be read as restricted to security given in connection with a settlement system.

193. For the purposes of the Finality Regulations, "collateral security" means

> "any realisable assets provided under a charge or a repurchase or similar agreement, or otherwise (including money provided under a charge)
>
> "(a)…….
>
> (b) to a central bank for the purpose of securing rights and obligations in connection with its operations in carrying out its functions as a central bank ("collateral security in connection with the functions of a central bank")"

and "collateral security charge" means, where collateral security consists of realisable assets (including money) provided under a charge, that charge.

194. Regulation 13 provides that the general law of insolvency has effect in relation to collateral security subject to the provisions of Part III of the Finality Regulations. By Regulation 13(2) those provisions apply, *inter alia*, to

> "(a) insolvency proceedings in respect of a provider of collateral security in connection with the functions of a central bank, in so far as the proceedings affect the rights of the central bank to the collateral security…..
>
> but not in relation to any other insolvency proceedings, notwithstanding that rights or liabilities arising from….collateral security fall to be dealt with in the proceedings."

195. Regulation 14(1)(e) provides that "a contract for the purpose of realising collateral security in connection with the functions of a central bank" shall not be regarded "as to any extent invalid at law on the ground of inconsistency with the law relating to the distribution of the assets of a person on bankruptcy, winding up, sequestration or under a protected trust deed, or in the administration of an insolvent estate". And Regulation 14(2) provides that the powers of a relevant office holder (which includes an administrator of a company in administration) shall not be exercised in such a way as to prevent or interfere with "any action taken to realise collateral security in connection with the functions of a central bank".

196. Under Regulation 18, the effect of the general law of insolvency in relation to a collateral security charge and the action taken to enforce such a charge is made subject to the provisions of Regulation 19. Regulation 19 provides that certain

provisions of Schedule B1 do not apply in relation to a collateral security charge. Those provisions include paragraph 43(2). Accordingly, a collateral security charge can be enforced notwithstanding that the company concerned is in administration.

197. The Explanatory Note at the end of the original Regulations explains that Regulations 13 to 19 modify the law of insolvency in so far as it applies to transfer orders effected through a designated system and to collateral provided in connection with participation in a designated system. That fits with Mr Phillips' submission as to the purpose of the Regulations. However, it is later explained that Regulations 13 to 19 "also apply to collateral security which is provided to a central bank in connection with its functions as a central bank".

198. Read in isolation, one might think that the Finality Regulations were directly in point in the present case, as Mr Howard submits is indeed the case. On that reading:

a. The financial assistance with which we are concerned was provided by the Bank in connection with its functions as a central bank.

b. Any assets transferred to the Bank (whether by way of repo or otherwise) and any property of Northern Rock made subject to a charge in favour of the Bank was provided by Northern Rock to the Bank for the purpose of securing rights and obligations in connection with the Bank's operations in carrying out its functions as a central bank, so that the charges provided by Northern Rock to the Bank were "collateral security in connection with the functions of a central bank" within the definition in the Finality Regulations.

c. The present case falls within Regulation 13(2), so that the general law of insolvency takes effect subject to the provisions of Rules 14 and 19.

d. Accordingly, pursuant to Regulation 14(1)(e), the Bank can enforce any contract for the purpose of realising collateral security. It can therefore enforce both the terms of provision of any collateral not involving a charge (such as a repo) and also the terms of any charge over collateral provided

by way of charge. And the usual moratorium on enforcing security under paragraph 43 Schedule B1 does not apply.

199. Mr Phillips, in support of his submission that the Finality Regulations have absolutely nothing to do with the present case, points out that they were made in order to implement Directive 98/26/EC known as "the **Finality Directive**", as the opening words of the explanatory note explain, and that they must be read in light of the purpose of the Directive.

200. To understand his submission, it is necessary to look at some provisions of the Finality Directive. Its main focus is quite clearly on settlement systems and the treatment of participants in such systems. The term "collateral security" is defined in Article 2(m). It means

> "all realisable assets provided under a pledge (including money provided under a pledge), a repurchase or similar agreement, or otherwise, for the purpose of securing rights and obligations potentially arising in connection with a system, or provided to central banks of Member States or to the future European central bank."

201. Where the recitals of the Directive use the phrase "collateral security", they are clearly referring to that definition, albeit the context of the particular recital may indicate the particular type of collateral security falling within the definition with which the recital is concerned. Thus recital (6) refers to "collateral security constituted by their participants [*ie* participants in a particular system]" The phrase "collateral security" is also used in recitals (9) and (10) which we set out in full:

> "(9) Whereas the reduction of systemic risk requires in particular the finality of settlement and the enforceability of collateral security; whereas collateral security is meant to comprise all means provided by a participant to the other participants in the payment and/or securities settlement systems to secure rights and obligations in connection with that system, including repurchase agreements, statutory liens and fiduciary transfers; whereas regulation in national law of the kind of collateral security which can be used should not be affected by the definition of collateral security in this Directive;
>
> (10) Whereas this Directive, by covering collateral security provided in connection with operations of the central banks of the Member States functioning as central banks, including monetary policy operations, assists the European Monetary Institute in its task of promoting the efficiency of cross-border payments with a view to the preparation of the third stage of Economic

and Monetary Union and thereby contributes to developing the necessary legal framework in which the future European central bank may develop its policy;"

202. Recital (9) is clearly focusing on the participants in a system and any collateral security provided by one participant to another. But recital (10) refers to central banks. It is the first recital to do so other than recital (1) which does so in a rather different context *ie* the delivery of a report to the Governors of central banks. Recital (10) is not expressly restricted to collateral security in connection with the functions of a central bank in relation to payment and settlement systems. It is also relevant to note, however, recital (20), which explains that the provisions of Article 9(2) (to which we come in a moment) are intended to ensure that, if the participant or a central bank has a valid and effective collateral security as determined under the law of the Member State where "the relevant register, account or centralized deposit system is located", then the validity and enforceability of the collateral security as against that system and its operator and against any other person claiming directly or indirectly through it should be determined under the law of that Member State. This recital appears to link collateral security – including that given to a central bank – with a settlement system.

203. We have already set out the definition of "collateral security" which is found in Article 2(m). The scope of the Directive is set out in Article 1, which provides as follows:

"The provisions of this Directive shall apply to:

(a) any system as defined in Article 2(a), governed by the law of a Member State and operating in any currency, the ecu or in various currencies which the system converts one against another;

(b) any participant in such a system;

(c) collateral security provided in connection with:

- participation in a system, or

- operations of the central banks of the Member States in their functions as central banks."

204. To complete the picture, we need to refer to Article 9, which is as follows:

> "1. The rights of:
>
> - a participant to collateral security provided to it in connection with a system, and
>
> - central banks of the Member States or the future European central bank to collateral security provided to them,
>
> shall not be affected by insolvency proceedings against the participant or counterparty to central banks of the Member States or the future European central bank which provided the collateral security. Such collateral security may be realised for the satisfaction of these rights.
>
> 2. Where securities (including rights in securities) are provided as collateral security to participants and/or central banks of the Member States or the future European central bank as described in paragraph 1, and their right (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State."

205. It is said that Article 9(2) lends support to the view that the Finality Directive is concerned only with collateral given in relation to settlement systems. We do not agree with that and see Article as providing no assistance one way or the other. The effect of Article 9(2) is, we accept and as is indicated in recital (20), that, where both (i) the collateral given to a central bank does relate to a settlement system and (ii) the right to the collateral is legally recorded on a register, the relevant law to apply is that where the register is found. But neither Article 9(2) nor recital (20) has anything to say about the position where collateral which relates to a settlement system is given but is not legally recorded on a register; and yet collateral security relating to a settlement system but not legally recorded on a register would fall within the scope of the Finality Directive on any view. Thus, the concept of collateral within the Finality Directive goes beyond the collateral identified in Article 9(2) (*ie* collateral restricted to collateral given in relation to a settlement system where the right to that collateral is recorded on a register). It seems to us, therefore, that Article 9(2) is entirely neutral on whether security given to a central bank in connection with its functions as a central bank other

than in relation to a settlement system falls within the definition of "collateral security" and within the scope of the Finality Directive.

206. We are left, therefore, with (a) recitals which, other than recital (10), do not indicate that collateral security goes beyond security in connection with a settlement system, (b) recital (10) itself, which refers to collateral security in connection with the operations of central banks, including monetary policy operations and (c) Article 1, which defines the scope of the Finality Directive.

207. Article 1 restricts the scope of the Finality Directive, so far as concerns central banks, to collateral security provided in connection with "operations….in their functions as central banks". Those quoted words appear as the second indent of paragraph (c), the first indent of which relates to participants in a system; paragraphs (a) and (b) are concerned, too, only with systems. This might perhaps be seen as an indicator that the focus of the Finality Directive is matters concerning settlement systems and that the second indent of paragraph (c) should be interpreted as limited to that context. On the other hand, the two indents of paragraph (c) are divided by the conjunction "or", which seems to indicate that the subject matter of the second indent ("collateral security provided in connection with operations of the central banks of the Member States in their functions as central banks") is distinct from the subject matter of the first indent ("collateral security provided in connection with participation in a system").

208. The definition of "collateral security" in Article 2(m) can be read as containing two limbs, the first of which is security "for the purpose of securing rights and obligations potentially arising in connection with a system" and the second of which is security "provided to central banks of Member States or to the future European central bank". On one view, this is consistent with the restricted contextual meaning for which Mr Phillips contends. But the second limb is not expressly limited to security in connection with a system. And if Mr Phillips is right, strictly the second limb is redundant. Any collateral security given to a central bank in relation to the activities of participants in a settlement system would, it seems to us, be given "for the purpose of securing rights and obligations potentially arising in connection with a system" and thus within the first limb. Indeed, if it was intended that the Finality Directive was to be restricted as Mr

Phillips suggests, then we wonder why Article 9(1) did not add the words "in connection with a system" at the end of the indent referring to central banks (although we acknowledge that it is all too easy to make observations like that about drafting after the event and when an ambiguity has been identified).

209. If "collateral security" is to be given the wider meaning for which Mr Howard contends, then we do not consider that Article 1 is sufficient to cut down the scope of the Directive so that it only applies to collateral security given to a central bank in connection with settlement systems. The issue, it seems to us, is really about the meaning of the definition of collateral security in Article 2(m). Its literal words are clearly broad enough to include collateral security provided in connection with any function of a central bank, without any restriction to security given in connection with a settlement system.

210. Mr Phillips has also referred us to a number of academic and practitioner texts in which the focus is on the role of the central bank in a payment or securities settlement system but it is only right to point out that none of the writers address the point now in issue. One of those texts is *Interests in Securities* (Benjamin, 2004) at paragraph 7.48. But what the learned author states does not support Mr Phillips. He states that Article 9 would only benefit certain collateral takers – central banks, the European central bank, and participants providing liquidity to a relevant system to which the Finality Directive applies. There is no explanation of the scope of the collateral given to a central bank which falls within the Finality Directive.

211. We would add this to the debate about the scope of the Finality Directive. Notwithstanding the width of the literal words on which Mr Howard relies, we would find it surprising if the Finality Directive had been intended by its architects to have the wide scope for which Mr Howard contends without (a) the recitals having explicitly and clearly indicated that that was its intention and (b) the text of the operative parts of the Directive being set out in such a way that its wide scope was made clear.

212. At this stage, we say a little about construction of the Finality Regulations in the light of our discussion of the Finality Directive. If Mr Phillips is correct about

the Finality Directive, then we consider that he is also correct about the Finality Regulations. Those Regulations were without doubt intended to give effect to the Finality Directive, the provisions of which we are entitled (indeed bound) to have in mind when construing them. No doubt it is open to Parliament, at least in primary legislation, to go further than is required in implementing a Directive. But where the wording of the relevant domestic legislation closely reflects, as it does in the present case, the wording of the Directive, it would be approaching the perverse to ascribe to them radically different effects. Quite apart from that, it is to be noted that the Finality Regulations were made pursuant to the statutory power conferred on HMT by section 2(2) of the European Communities Act 1972. That authorises the making of regulations to implement the Directive. If that Directive has the limited scope for which Mr Phillips contends, to disapply aspects of the ordinary law of insolvency, to the extent contended for by Mr Howard, would go far beyond the authorising power. We should adopt an interpretation which reflects the limits of the authorising power.

213. In contrast, if the Directive has the wider scope for which Mr Howard contends, we should adopt the same approach to the Finality Regulations in recognition of the obligation of the UK to implement fully the Finality Directive.

214. Mr Howard makes a further important submission about the application of the Finality Directive and the Finality Regulations to the circumstances of the Bank's lending to Northern Rock. He says that even if Mr Phillips is right about the meaning of "collateral security" and the limited scope of the Finality Directive, the security in fact given by Northern Rock to the Bank falls within that meaning and scope. This is because (as Mr Howard says and we accept – indeed we do not understand this to be challenged by Harbinger) the Finality Directive and the Finality Regulations apply to collateral security provided by a central bank as part of an emergency transaction where that is done in connection with a settlement system. Mr Howard submits that it is not possible, on the facts of the present case, to isolate the settlement systems from the rest of the financial system, because the point of providing LOLR was to protect the whole system from financial contagion and knock-on effects on other banks through the settlement

systems of the EU. Without settlement systems, there cannot be inter-bank transfer and the whole financial system would fail.

215. Mr Howard finds support for that approach in the Finality Directive itself. Recital (1) refers to a report given to the Governors of the central banks of ten Member States. That identified the systemic risk inherent in payments systems which operate on the basis of several legal types of payment netting, in particular multi-lateral netting. The Recital refers to the paramount importance of reducing legal risks associated with participation in real-time gross settlement systems. So, Mr Howard asks, why was the Bank providing LOLR assistance in the first place? It was, he answers, to provide emergency support in order to prevent the very type of systemic failure which is referred to in recital (1), including protecting the integrity of the inter-bank settlement system. That argument, we would add, can also be supported by reference to recital (10), which recognises that the inclusion of collateral security provided in connection with operations of the central banks, including monetary policy operations, assists the European Monetary Institute in its task of promoting the efficiency of cross-border payments.

216. Mr Howard, we think because he had no instructions or information on the view taken by HMT or the Bank regarding the scope of the Regulations, invited us not to reach a final conclusion on their true scope. We accept his invitation. If it were necessary for us to resolve the issue, because an answer one way or the other was necessary in order to decide the applications to the Tribunal, we would need to make a reference to the ECJ for a preliminary ruling on the scope of the Finality Directive. But that is not the case, even if the Demand Interpretation is correct. What the Valuer has to do is to value Northern Rock in the light of what is known to him and in the light of uncertainties of fact and law. Thus the Valuer, like a hypothetical purchaser of the shares at the valuation time, has to place a value on the shares in the light of the uncertainties about what the Bank is entitled to do; he cannot put off his valuation while the scope of the Finality Directive is determined through some, no doubt lengthy, legal process enabling the matter to be brought before the ECJ. He has to take a view, and reflect that view in the value which he attributes to the company.

217. If Mr Phillips' approach to the Finality Regulations is correct, the Bank would be subject to the moratorium and would need the consent of the administrator or the court to enforce its security given by way of charge (although consent would not be needed in relation to the repo facilities where title in the securities given had passed to the Bank). We have already addressed the possibility of obtaining such consent, concluding that the Valuer would need to take into account that possibility.

218. If Mr Howard's approach to the Finality Regulations is correct, the Bank would be entitled to enforce its security without the need for such consent. Although there might be some legal and practical constraints on how the Bank could act – it may not be reasonable or prudent for it to attempt to dispose of the entire book of mortgage debts over the period of a few days – it would not be obliged to dispose of the book over a period of years in order to obtain the best return for creditors generally, let alone to provide a surplus for shareholders. Whether, when and how the Bank would in fact seek to enforce its security in the hypothetical situation of the assumed administration is a matter we will need to address; we do so as part and parcel of considering the fifth consequence of the Demand Interpretation mentioned in paragraph 180 above and to which we now turn.

219. In relation to that, Mr Phillips submits that an administrator would carry out an orderly disposal of Northern Rock's assets. This would entail a lengthy administration period of 5 years or more at the end of which (i) all creditors including the Bank would have been paid in full (including interest – a separate issue which we will come to later) and (ii) a large surplus would be left, sufficient to discharge in full the rights of the preference shareholders with something left over for ordinary shareholders. He also submits that the Bank, even if it was not subject to the moratorium (whether because Mr Howard is right about the Finality Regulations or because the administrator or the court would be willing to give consent to the realisation of the Bank's security) would not in practice seek to effect a speedy sale (even if not a fire sale) because it would not be in its commercial interests to do so.

220. It is part of Mr Phillips' argument that, on the Demand Interpretation, the effect of the making of a demand would have been that Northern Rock would have gone into administration. We note, in any case, that the Administration Assumption requires the Valuer to assume that Northern Rock is in administration at the valuation time. Thus, in one way or another, under the Demand Interpretation, the position is that (i) the Bank's debt is outstanding and (ii) Northern Rock is in administration. We do not accordingly need to consider what the Board of Northern Rock would have done had it been faced with a demand from the Bank for repayment although what Mr Phillips says (that Northern Rock would have gone into administration) seems to us difficult to gainsay.

221. Mr Phillips, as we understand his case, submits that the Bank would not have sought to enforce its security in the notional administration because it would not have been in its interests to do so. And even if it had sought to do so, it would not have obtained consent. Accordingly, the administration would take its proper course which, he says, would result in an orderly realisation of Northern Rock's assets, including its mortgage book, over an administration period of some years. Mr Phillips therefore seeks to apply what he says is a real-world approach to the notional administration, just as the Valuer has sought to apply a real-world approach when discounting the value of Northern Rock's assets in the context of the need to discharge the Bank's loans.

222. In the real world, of course, there was no administration and the Bank did not make a demand for repayment from Northern Rock which the directors needed to consider. Instead, it in fact continued to support Northern Rock once it had been taken into public ownership and did so in the public interest. If Mr Phillips is right to apply a real-world approach to the administration, we suppose that he ought also to consider how the real-world would have viewed an actual administration of Northern Rock, a matter requiring very considerable speculation indeed. But if we ignore the impact which an administration, brought about as a result of the Bank calling in its loans, would have on the financial sector as a whole, we need to address how such an administration would proceed in the light of the statutory objectives of an administration and to address whether Mr Phillips

is right to suggest that the Bank's commercial interests would lead it to agree to the long run-off which he suggests should be regarded as taking place.

223. In doing that, we need to address one sub-issue which has an impact on the Bank's commercial position. It is the question of interest payable to creditors, including the Bank, on their outstanding loans.

224. Harbinger's position here is set out in summary in the skeleton argument of Mr Phillips and his team at paragraphs 69 to 75. Reliance is placed on the expert evidence of Mr McKillop. That summary is itself quite long and in summarising it yet further, as we proceed to do, we hope that we are not losing the substance of the submissions. They are follows:

a. On the Demand Interpretation (and indeed the Repayment-in-Kind Interpretation) Northern Rock would have been balance-sheet solvent to the tune of over £1.6bn at the start of the administration. Significant cash-flows would have been available to the administrator to settle scheduled interest payments on all creditor claims in accordance with contractual rights. Thus creditors could be put in a position equivalent to there being no administration (*ie* they would receive 100% principal and interest).

b. Under Rule 2.88 Insolvency Rules 1986 it is however provided, *inter alia*, as follows:

> "(7) Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the relevant date;
>
> ……..
>
> (9) The rate of interest payable under paragraph (7) is the greater of the rate specified in paragraph (6) [*ie* 8% under section 17 Judgments Act 1838] and the rate applicable to the debt apart from the administration."

c. The purpose of Rule 2.88(7) is to ensure that creditors who have proved for their debts are compensated for the delay due to the time taken in an administration to realise assets.

d. The delay in the administration on Mr Phillips' case would be 5 years (or more) so that creditors would have to wait for that time to be paid any post-commencement-of-administration interest. On the basis of the forecast in the Consultation Document produced by the Valuer, there would be a significant cash flow shortfall in the amount necessary to meet statutory interest in full. The Valuer forecast Rule 2.88 interest payable to be £7.045bn in 2013, which contributed to the deficit of net assets the Valuer forecast of £5.68bn.

e. However, it is clear (according to Mr Phillips) that substantial funds would be available from the realisation of Northern Rock's assets from which payments could be made by an administrator to mitigate delays to the settlement of creditor claims. This is because the nature of Northern Rock's assets (*ie* a mortgage book) would provide a regular and significant monthly cash-flow.

f. With that in mind, a competent administrator in setting out proposals to achieve the second statutory objective (achieving a better result for creditors as a whole than would be likely if the company were wound up) would be obliged to consider an alternative settlement structure. He would therefore put forward proposals which incorporated arrangements for the settlement of interest on secured and unsecured creditor claims on a pay-as-you go basis through a CVA or a scheme of arrangement. This would not extend to subordinated elements of Northern Rock's capital structure (including PIK interest, as to which see paragraph 225 below).

g. There would be compelling commercial reasons why stakeholders (creditors and shareholders) would support such an approach and why such a CVA would be approved. The Bank, it is said, would approve proposals that maximised its recovery prospects in relation to its PIK interest and would be keen to avoid the perception or reality of having caused unnecessary loss to stakeholders. Unsecured creditors would approve proposals that provided for accelerated payment in full of both interest and principal.

h. Alternatively, the administrator would make direct payments of interest as they fell due to both secured and unsecured creditors pursuant to paragraph 66 Schedule B1, which allows an administrator to depart from the strict ranking of claims where he thinks that is likely to assist the broader purpose of the administration.

225. We should explain PIK. One of the terms of certain facilities made available by the Bank was that part of the interest on the facilities (PIK interest) which, as a matter of contract between the Bank and Northern Rock, was payable from time to time was subordinated to the debts owing to other creditors. It was rolled up and capitalised. Accordingly, in an administration, payment of the PIK interest would be made only after other creditors had been repaid in full (including interest) but before any amount could pass to shareholders. The PIK interest did not, therefore, represent further money paid by way of loan to Northern Rock.

226. There is a dispute between the parties about whether the PIK interest is "financial assistance" or not. Mr Howard says it is, Mr Phillips says that it is not. We quite see Mr Phillips' point that no new money was made available as a result of the PIK interest. But the facilities which were made available were clearly financial assistance. If it is a term of a facility that interest does not have to be paid but can be rolled up, we do not understand why the amount of interest rolled up is not the provision of financial assistance just as much as the loan which gives rise to that interest. The fact that it is subordinated does not make it any the less financial assistance. (Moreover, we understood from Mr Howard that PIK interest could not be made the subject of a demand, at least not one giving rise to an immediate obligation to make payment until all of the senior loans had been satisfied. This fortifies the conclusion that the Demand Interpretation is not correct, and supports our view of the purpose of the words in parenthesis in s5(4)(a) of the 2008 Act.)

227. The figures concerned, although large in absolute terms, are relatively insignificant in the context of the huge overall indebtedness to the Bank. The relevant amount was in the region of £100 million by the date of nationalisation; it

would increase, by the end of 5 years, to £193 million on one of the models presented by Mr McKillop in the documents. This, it must be remembered, is in the context of loans of £25.6 billion owing to the Bank at the date of nationalisation. In the context of the Repayment Interpretation, the figures are such as to produce a nil valuation for the shares in Northern Rock whether the PIK interest is treated as repaid or is treated as a debt payable at the end of the administration.

228. But on the Demand Interpretation, PIK interest has some significance on Harbinger's case, essentially because of the commercial reasons to which Mr McKillop refers as mentioned above and set out at 5.83 to 5.92 of his Second Report, essentially to the effect that:

a. The Bank is more than adequately secured and will recover the full amount of principal and interest albeit over a period of time.

b. The proposals would be more likely to maximise the Bank's recovery in relation to its PIK interest claim than would be the case had the Bank rigidly applied its security rights and prevented unsecured creditors from being paid interest currently falling due.

229. This approach, we comment, seems to come to this: that the commercial interests of the Bank in recovering at the end of 5 years something between £100 million and £200 million would lead it to agree to delay realising its security (assuming it was able to realise it) in order to receive full payment of what was owed to it (including interest other the PIK interest) at an early date.

230. We do not have the benefit of knowing how the Bank itself says that it would approach the issue. We are bound to say that we are sceptical about Mr McKillop's approach as we have summarised and about the proposition that the Bank would act as he suggests in the context of a notional administration applying the Demand Interpretation.

231. We do not need to resolve this issue, for two reasons. The first reason is that the issue does not arise under the Repayment Interpretation which we have held to

be correct. But even if we are wrong on that and the Demand Interpretation is to be adopted, Mr McKillop has done no more than give his opinion of how the Bank would act in its own commercial interests. His model, arriving at the valuation for which Harbinger contends, then proceeds on the footing that the Bank would in fact act in the way which he suggests it would. His ultimate valuation makes no allowance for the doubt about how it would act – a doubt which must have existed at the valuation time and which remains today. At the very least, it seems to us that a valuation which reflects the value, according to the statutory assumptions, as of the valuation date must provide for a discount of some sort to reflect this uncertainty.

232. In any case, Parliament has assigned the task of valuation to the Valuer not to us. We can correct errors on the part of the Valuer and direct him to re-assess his valuation in accordance with such directions as we might give him. He did not, of course, in carrying out his valuation, direct his mind to many aspects which it would be necessary to address if the Demand Interpretation were correct. Even if we were of the view that the Demand Interpretation were correct, we would not think it right to direct the Valuer to re-assess his valuation by applying that interpretation on the basis that what Mr McKillop and Mr Thompson say in their expert reports is to be taken as correct. The right course would be to remit the matter to the Valuer. It would then be up to him to take account not only of the views of Mr McKillop and Mr Thompson but also of all other facts and matters, including the Bank's own position, just as if he had adopted the Demand Interpretation in the first place. Mr Howard has identified a number of aspects which the Valuer would need to take into account in implementing either the Repayment-in-Kind Interpretation or the Demand Interpretation. (For the record, they can be found at Appendix B of his skeleton argument, but there is no need for us to list them or explain them here.) Even if, in theory, it were open to us to direct the Valuer to assume the correctness of the expert evidence on the footing that he has not challenged it with his own expert evidence, we would not consider that it would be appropriate for us to take that course here, rather than to remit the matter to the Valuer, and allow him the opportunity to take account of all matters which he considers relevant including any expert evidence which he might obtain.

233. It would also be for the Valuer, on the scenario of a remitter to him, to form a view about the amount which the Bank would receive if it were permitted, in the course of the notional administration, to dispose of the charged assets and were to do so as speedily as consistent with its duties to other creditors to obtain a proper price. We think it is clear, on any footing, that a substantial discount from book value would be likely. And the possible application of the Finality Regulations is a further feature which the Valuer would have to take into account, after taking appropriate legal advice, when effecting a valuation adopting the Demand Interpretation. It would be idle to suppose that he would not make a substantial discount from book value if his advice was to the same effect as our view.

234. The answer to the question we posed in paragraph 179 above (*ie* whether the Demand Interpretation avoids what Mr Phillips calls the "huge discount" consequent upon the Repayment Interpretation) is that it may not do so; on the evidence that is before us, we do not consider that it can be said with any confidence that it does so. Accordingly, even if, contrary to our conclusion, the Repayment Interpretation results in unfairness in the present case, it is far from clear that the Demand Interpretation does not involve the same inherent "unfairness".

The Methodological Issues

235. Since we have decided the Interpretation Issue in favour of the Valuer, and since the resulting value of the shares is nil whatever is the correct answer to each of the Methodological Issues, we do not, strictly, need to say anything about them. Mr Howard submits that we should not do so. Mr Phillips says that we can, and should decide them. In the light of the arguments which have been presented, we will say something about these Issues.

236. The position is made complicated by this factor: the Valuer has adopted the methodologies which he has in the context of his application of the Repayment Interpretation. Let it be assumed, for the sake of argument, that valid criticisms can be made of the Valuer in his methodology as applied to the Repayment Interpretation. It does not necessarily follow that any criticism can be levelled at him in relation to implementation of the Repayment-in-Kind Interpretation or the

Demand Interpretation. He has not as yet considered what he would do and what methodologies he would apply had we ruled (or if the Court of Appeal were to rule) that one of those Interpretations is correct. It may well be that the Valuer would apply different methodologies from those he previously applied if he were implementing Interpretations so radically different from the Repayment Interpretation. It is for him to determine what methodologies to apply so that, unless there is only one right methodology to apply to any particular aspect of the valuation, it is not possible for us to determine how he ought to proceed in relation to those Interpretations.

237. Mr Howard suggests that, contrary to the assumption of the preceding paragraph, Harbinger does not in fact make any criticism of the methodology adopted by the Valuer on the footing that the Repayment Interpretation is correct. Harbinger's case has been presented, he says, on the basis of methodologies which ought to be applied under one or other of the alternative Interpretations. We do not read Mr McKillop's evidence in that way, at least in relation to paragraphs b., c., and d. of the following paragraph. His approach to those issues applies, we think, whichever Interpretation is being implemented, on the basis that the way in which these assets would be dealt with in an administration does not depend in any way on whether other assets have or have not been (notionally) realised prior to the valuation time.

238. The following are the relevant Methodological Issues which we will deal with in turn:

a. Statutory interest;

b. Covered Bonds and Medium term notes;

c. Derivatives;

d. Operating Platform.

239. **Statutory interest**: We have already explained the operation of Rule 2.88 relating to statutory interest. Any surplus remaining after payment of the debts proved is to be applied in payment of interest on those debts and accrues at the

higher of the contractual rate and 8% pa. Under the Repayment Interpretation the Valuer has applied Rule 2.88, arriving at a figure of over £7bn over a 6 year hypothetical administration period. Mr McKillop's approach under either of the alternative Interpretations is that Northern Rock would not incur statutory interest but would (pursuant to an agreement with creditors formalised by a CVA or a scheme) pay contractual interest as it fell due. This approach was not a possibility on the Repayment Interpretation because, as Mr Phillips says, it could only apply where there was a balance sheet surplus at the start of the assumed administration. The pay as you go approach may well be appropriate on Harbinger's Interpretations, but we do not have the Valuer's view on it and Mr Howard rightly points out that it is far from self-evident that it would be the only reasonable approach to adopt. In these circumstances it is not appropriate for us to make any definitive ruling on it.

240. **Covered Bonds and Medium Term Notes:** The issue of Covered Bonds was a way in which Northern Rock was able to expand its mortgage business rapidly. It raised funds on the wholesale money markets by parcelling up residential mortgages which then became security for the lenders to Northern Rock. At the Valuation Date £9.91bn of residential mortgage loans (comprising 12% of Northern Rock's mortgage loan portfolio) were assigned to the programme established in 2004 to cover £9.55bn liabilities on Covered Bonds. The longest dated series matures in November 2020: see paragraph 14.38 of the Consultation Document.

241. The Valuer's approach was that:-

a. An administrator would aim to wind down the mortgage portfolio as quickly as possible by trying to persuade customers to remortgage with other lenders. This would usually be done by manipulating the borrowing rate but this has to be done within FSA's Treating Customers Fairly principles and other commercial constraints. Some customers would not, in practice, be able to remortgage and would have to remain with Northern Rock.

b. 70% of Covered Bond maturing mortgages would be re-financed by third parties within six months of maturity. Additionally, some mortgages would be redeemed by customers because of house moves or events other than the maturity of the mortgage product.

c. £8.184bn of mortgages are redeemed (of which 60% is in 2008 and 2009) by 2013 (from the opening balance of £9.914bn), leaving a closing balance of £1.73bn.

d. By 2013 £5.049bn would be held as cash in the Covered Bond Guaranteed Investment Contract ('GIC') account from principal retained and interest receipts in the six years against outstanding liabilities to the Covered Bondholders of £5.229bn.

e. Although an administration of Northern Rock would trigger an event of default and a Notice of Acceleration could and would be served on Northern Rock, it would not result in any accelerated repayments of the Covered Bonds (Consultation Document, paragraph 14.35).

242. Mr McKillop's approach was:

a. There would be a faster redemption profile so that £9.852bn was redeemed by customers in the five years from total mortgages of £10.39bn at 12 December 2007, leaving after adjustments a closing asset balance of £336.2mn.

b. There is a sufficient inflow of cash from the mortgage holders that a deal could be done between the administrator and bond holders so that all the Covered Bond liabilities would be met by the end of 2010. Subsequent receipts from mortgage holders of £1.694bn would then be available to Northern Rock.

c. The Covered Bond holders would not wish to take the risk and uncertainty of administration if a deal was available to them. The Covered Bond holders would seek early repayment and would come to an arrangement with the administrator of Northern Rock.

243. We comment that it was not clear to us why the Valuer considered that Notice of Acceleration would not result in any accelerated repayments. We are unable to

say, on the evidence, whether an accelerated repayment of Northern Rock's Covered Bond liabilities would be feasible or not.

244. As at February 2008, there were £12.599bn of Medium term notes (otherwise referred to as Wholesale Liabilities) issued by Northern Rock. These liabilities became subsumed within the "unsecured lending" figure in the Valuer's cash flow forecast (see Table 18 on page 140 of the Consultation Document).

245. The Notes were unsecured. The administration of Northern Rock would result in an event of default which could trigger a demand for immediate repayment. A failure to repay immediately would have the effect of incurring default rates of interest. We record that Harbinger complains that these rates were not disclosed to it in good time although we were not invited to take any action in relation to that nor was it suggested that this failure should have any impact on our decision.

246. The Valuer's approach was that the trustee would enforce his rights to accelerate the repayment of the outstanding notes. Since the Notes become immediately payable it is impossible on the Valuer's approach to adopt a strategy to settle interest on liabilities as they fall contractually due: the failure to pay immediately would have the effect of incurring default interest rates arising through non-payment on a contractual date.

247. Mr McKillop does not agree with the Valuer's approach. He says this in his second report at paragraph 5.137:

> "Under Mr Caldwell's disclosures above, it seems clear that the acceleration of the MTNs is not automatic and therefore it can be disregarded under the principles within the Legal Analysis (*ie* that events which do not automatically arise as a result of the Valuation Assumptions can be disregarded for the purposes of the Valuation). Even if the acceleration of the MTNs were to automatically occur, it would have no impact on the timing or priority of the Administrator's obligations to repay the MTNs save in the manner which I would expect an Administrator's proposals to be made as I have outlined above. The acceleration of the MTN might lead to other consequences such as default interest being payable."

248. The Legal Analysis there referred to is the Legal Analysis prepared on behalf of Harbinger and submitted to the Valuer in the course of the consultation process.

We take the reference to "an Administrator's proposals" to be to the wider proposals, discussed in paragraphs 5.80*ff* of Mr McKillop's second report. So, in relation to non-automatic acceleration, he appears to be saying that it can be disregarded; in other words, treat the position for valuation purposes as if no acceleration had occurred. We find it difficult to see why any such assumption should be made. Even if the holders of the Notes were prepared to enter into the sort of proposals envisaged by Mr McKillop, it is not easy to see why they would not put themselves into the strongest bargaining position by accelerating payment and possibly becoming entitled to default interest. Be that as it may, it is apparent that one of Mr McKillop's reasons for disagreeing with the Valuer in relation to Notes where there was no automatic acceleration was based on his understanding of the Legal Analysis which required him to disregard the possibility of voluntary acceleration by the Noteholders/trustee. That, we think, reflects a wrong view of the law; furthermore, it is inconsistent with his approach to Covered Bonds, statutory interest and, as we will see, Derivatives.

249. In oral submissions, Mr Phillips sought to justify the different approach adopted by Mr McKillop in relation to the Covered Bonds and Medium term notes in this way: the Covered Bonds are paper which runs until 2020 whereas the Medium term notes are short-term paper. So the administrator will seek to close out the Covered Bonds in the context of the administration with the bond holders wanting to be repaid rather than wait until 2020. In contrast, Mr Phillips says that the holders of the Medium term notes "have a choice between a paper that goes instantly into default or a performing paper. And again it's not for very long periods, it's just for a short period during the administration". But that was not a reason given by Mr McKillop for the different treatment and we do not know what he would say about that analysis himself.

250. In any case, quite what Mr Phillips says a short-term period actually is or the basis on which he makes the submission is not clear. Mr Howard says that of the €9bn outstanding at the valuation time, over €6bn had a maturity date more than 2 years down the line. There was a spat between Mr Howard and Mr Phillips about what material had been disclosed and what Harbinger knew which we are not in a position to resolve and were not asked to resolve.

251. Quite apart from all of that, it is difficult for us to understand, from the limited information which we do have about the Medium term notes, the financial significance of the different assumptions made by the Valuer and Mr McKillop on the repayment of Medium term notes. The repayment of these liabilities will, of course, depend on the other assumptions made in the models about the realisation of assets, the availability of cash receipts and repayment of secured creditors.

252. We comment that assumptions made by insolvency practitioners in forecasting the outcome of a run-off in administration are a matter of professional judgment. Mr McKillop's proposals each assume that the persons concerned (including the administrator, the bond or note holders and the relevant trustees) would take certain actions where they had a choice of actions. Although they might act in the way that Mr McKillop suggests, they might not do so. And although he holds a different view from that of the Valuer, he does not suggest – and indeed Mr Phillips has not suggested – that no competent valuer could make the assumptions which the Valuer made but could only make the assumptions which Mr McKillop himself made. We agree with Mr Howard when he says that the material before us does not come near to showing that the Valuer's approach to the Covered Bonds and Medium term notes was not reasonable.

253. **Derivatives**: Northern Rock was party to various complex derivatives contracts in standard International Swap Dealers Association form. The administration of Northern Rock is an event of default under those contracts, giving the counterparty (but not Northern Rock itself) the right to "close out" the transactions at a time of its choosing. Depending on timing, this would result in sums becoming payable to, or by, Northern Rock. There may be some derivative contracts which contain automatic termination provisions in certain events, including administration, but we have no idea how many of these there might be.

254. The Valuer makes the assumption that no counterparties would elect to close out early but that they would hold their contracts to term. Mr Howard describes this as a generous assumption from the point of view of shareholders because, in

reality, one might expect counterparties to close out their transactions when "in the money" (*ie* owed money by Northern Rock).

255. Mr McKillop describes the Valuer's approach as being value neutral consistently with his own approach but with this difference. Mr McKillop treats the contracts as being closed out during the initial stages of an administration. He says in his second report that he "would expect an Administrator to take action to realise value in these contracts and mitigate the risks of the contracts moving to "out of the money" positions" [*ie* from Northern Rock's perspective we would add]. Mr McKillop does not further explain in his report the action which he would expect the administrator to take or how he would achieve a closing or on what terms. The natural reading of what he says, we think, is that he is envisaging unilateral action which an administrator could take; we find it hard to read him as saying that, in a case where there is no automatic termination on administration, that action would include negotiating closure. If that had been Mr McKillop's intention, he would surely have said so explicitly and gone on to address the position in detail, just as he did in relation to Covered Bonds and Medium term notes.

256. When it was pointed out that early termination was not in the hands of the administrator, Harbinger's response (in paragraph 55 of their Reply) was to comment that "out of the money" counterparties might terminate to avoid further losses and that counterparties' decision-making would be influenced by the inherent uncertainty of administration, but that is not what Mr McKillop was saying.

257. Mr Phillips recognised that counterparties would have to be persuaded, submitting:

> "experience demonstrates that isn't difficult because out of the money counterparties would terminate their positions to avoid losses, in the money counterparties terminate their positions to avoid uncertainties, and the biggest uncertainty is, of course, administration, and neither the counterparties nor the administrator would speculate."

258. In that context, Mr Phillips refers to the experience with Lehmans where, he says, all but 1,100 of 134,000 derivative contracts held by Lehmans were terminated within 6 months. That may be right as a matter of fact, but without far more detail – and without some expert assistance on the point – it cannot be assumed that the Lehmans experience provides any valid comparison. Mr McKillop himself said nothing at all about this aspect

259. It must be borne in mind that Mr Phillips' purpose in addressing these submissions to us is to seek to establish that Mr McKillop's approach is the only proper approach, or at least that it is one which we should direct the Valuer to adopt. It seems to us, however, that it cannot be said that the Valuer's approach is not a possible approach. It has not been demonstrated to us that no competent valuer could make the assumptions which the Valuer made but could only make the assumptions which Mr McKillop himself made.

260. **Operating platform**: This refers to Northern Rock's branch and operating platform, that is to say its branch network, deposit base and efficient operations. The Valuer attributed nil value to Northern Rock's operating platform on the basis that it could not be realised as an asset. The Valuer recognised that, in ordinary circumstances, the operating platform could be of value to a purchaser. Indeed, he recorded in the Consultation Document that, as part of the sale process, the Northern Rock board considered offers not only for the whole business but also for the operating platform alone. He also recorded that an attraction to a purchaser would be Northern Rock's significant network of operating branches. However, he was of the view that the Valuation Assumptions would result in the loss of Northern Rock's deposit taking licence, so that this element of value would be lost. He concluded that the sale of Northern Rock's operating platform would not have achieved a material value. In addition, there was no value attributable to intangible assets (goodwill and computer software) and there was no value in the brand as the one assumption was that Northern Rock was unable to continue as a going concern – indeed each of the bids by Virgin and Northern Rock's management would have involved a re-branding.

261. Mr McKillop disagrees with the attribution of nil value to the operating platform. He believes that the operating platform has significant intangible value to Northern Rock

> "from the efficient realisation of the mortgage loan assets it allows in the short to medium term. It is highly unlikely that an alternative servicer could be sourced in the near term to take over the efficient collection of mortgage loan assets."

262. He then says that an administrator, the Bank and the trustees of the Covered Bonds and Granite would take that into account in any commercial settlement discussions following administration. The position "would provide the Administrator with commercial negotiating leverage". Mr Phillips also added that a new institution could take over the Northern Rock deposit base, from which we take it that this would be of value to the new institution which would pay for the privilege. However, a new bank would have to have its own licence. There may be value in the portfolio of branches, but the Valuer would have taken that into account in the property valuation.

263. So far as we can see, Mr McKillop does not actually disagree with the attribution of a nil value to the operating platform as an asset. Rather, what he seems to be saying is that it would be possible to use the operating platform as a bargaining chip in negotiations with the Bank and the trustees of the Covered Bond and the earlier Granite securitisations in order to improve Northern Rock's position. We can see that that might be so in implementing the Demand Interpretation, but do not consider that it could have any impact in the context of the Repayment Interpretation, In any case, we do not see where Mr McKillop actually ascribes any direct value to this.

264. In summary, we have concluded in relation to statutory interest that it is not appropriate for us to make any ruling. As regards the covered bonds, medium term notes and derivatives, the material before us has not demonstrated that the Valuer's approach or conclusion was unreasonable. So far as the operating platform is concerned, neither the Valuer nor Mr McKillop ascribes a figure to it in their valuations.

265. Even if Mr McKillop's approach were correct on each methodology issue, and correct in the context of the Repayment Interpretation, the impact on the ultimate

valuation would not produce anything other than a nil value for the shares in Northern Rock, whether preference shares or ordinary shares.

The Section 133(5) Issue and the Ultimate Valuation Issue

266. We have not yet addressed the Section 133(5) Issue concerning our jurisdiction. As we have said, we cannot ourselves effect a valuation; all we can do is to remit the matter to the Valuer making such directions as we think appropriate, effectively to correct any errors which he has made. But we can only remit the matter, so far as domestic law is concerned, if we are "satisfied that the decision as to the amount of compensation shown in the revised assessment notice was not a reasonable decision". For the reasons set out above, we are not so satisfied.

267. Moreover, given our conclusion that it makes no difference to the ultimate value on the Repayment Interpretation which approach is adopted to the Methodological Issues, it is not necessary to decide whether Article 6 entitles or, indeed, requires us to substitute our own views about the correct approach for those of the Valuer and to direct him accordingly.

The additional issues raised by applicants other than Harbinger

268. Most of the matters relied on by applicants other than Harbinger were encompassed within Harbinger's arguments and we have considered them above. However, there were some matters raised in applicants' reference notices which Harbinger did not adopt or advance, possibly because Harbinger's advisers did not consider that they had sufficient prospects of success to make them worth pursuing. Despite there being no active pursuit of these additional issues by any party at the hearing, whether through representatives or in person, we have judged it right for us to consider them.

269. Allegations of bias were made against the Valuer on three grounds: first, that the imposition of the valuation assumptions compromised his independence; second, that his independence was compromised by a newspaper article prior to his appointment in which he expressed the view that the shares were worthless;

and third, that he was not impartial or independent because he was appointed by HMT. We deal with each of these in turn.

270. The valuation assumptions were imposed by Parliament, and it is not within the jurisdiction of this Tribunal to make any pronouncement about whether Parliament was right to do so. Moreover, the Court of Appeal in *SRM* rejected the argument that the imposition of the valuation assumptions compromised the Valuer's impartiality or independence: see in particular the judgment of Laws LJ at [82]-[85].

271. If the Valuer had expressed views on value prior to his appointment, that would be a matter of concern. But the allegation that he had done so was not borne out by the evidence made available to us, and it seems the allegation must have been based on a misunderstanding or misattribution.

272. No challenge was raised in *SRM* based on the method of appointment of the Valuer. In our view the terms of appointment were appropriate for securing the degree of independence required by Article 6 and the case law: see Lester and Pannick, *Human Rights Law and Practice* (2nd edn 2004) para 4.6.55; *Bryan v United Kingdom* (1995) 21 EHRR 342 at [37]; *Campbell and Fell v United Kingdom* (1984) 7 EHRR 165 at [79]-[80]; *Porter v Magill* [2001] UKHL 67, [2002] AC 357, at [93]. Under paragraph 7(4) of the CSO the Valuer, once appointed, was removable only on the grounds of incapacity or serious misbehaviour. Those grounds are similar to those on which a circuit judge can be removed. We do not consider that his independence was undermined by the method and terms of his appointment.

273. We therefore reject the challenges on the ground of bias.

274. It was suggested that, by agreeing to carry out the valuation on the terms imposed on him by the statutory scheme, the Valuer was in breach of professional ethics and of his professional code of practice. In our view this suggestion has no substance. It is certainly true that the terms of his remit affected the result, because his remit required him to adopt the statutory assumptions. But that did not put him in breach of any professional code, and this allegation does not add anything to the other arguments about the validity and effect of the statutory assumptions.

Allied to this was the suggestion that the Valuer ought to have adopted a 'normal commercial basis' for the valuation. This appears to have been intended to mean that he should have been left entirely free to exercise his own professional judgment, without being restricted by the statutory assumptions. This was not open to him, because he was legitimately required to adopt the statutory assumptions.

275. The same answer must be given to the contentions that the Valuer failed to take into account the goodwill and future prosperity of Northern Rock, and that it was an operating company with significant assets. He was required by the statutory assumptions to value on the basis that Northern Rock was in administration and was not a going concern. The operation of Northern Rock and its ability to generate profits in the future depended upon the taxpayer support which the Valuer was required to take out of the equation. Without that support it would have lost its banking licence. The Valuer took into account its assets, including land and property, along with its liabilities, but it was not open to him to take into account future prosperity or to treat Northern Rock as a going concern for the purpose of his valuation.

276. One applicant contended that it would have been consistent with the statutory assumptions for the Valuer to take into account the possibility that the Government might have given financial assistance to potential purchasers of Northern Rock's business. We do not agree. This would have conflicted with the statutory purpose of making the valuation in a way that did not include any value derived from public assistance.

277. Some applicants contended that the valuation was invalidated because the Valuer treated certain foreign nationals differently from UK shareholders. This contention depended upon the allegation that some foreign shareholders received compensation pursuant to bilateral investment treaty arrangements. Even if that allegation is factually correct (as to which we have no reliable information), it does not in our view affect the matters which we have to decide. For the exercise which he was required to carry out, the Valuer made no distinction between UK and foreign shareholders.

278. It was also said that the Valuer had erred in his approach because he had used 'perfect hindsight'. There is a limited degree to which it is legitimate, when valuing at a particular date, to take account of evidence which became available or events which occurred after the valuation date. In our view the Valuer carefully observed the appropriate limit and the allegation of error in this respect is without substance.

279. Many applicants considered that Northern Rock must have had some value because there were two private bidders who were prepared in February 2008 to acquire it, namely, the Virgin Consortium and Northern Rock's management; and some contended more generally that Northern Rock could have obtained replacement financial assistance from a private source. The Valuer obtained information about and analysis of the bids, including the analysis by Goldman Sachs. Both bids required significant on-going support from public funds, so the amounts offered did not represent the value of Northern Rock in the absence of public support. Since the Valuer was required to assume that no future financial assistance would be provided, the bids were on a different basis from the statutory valuation. We have found nothing to suggest that there was any material error in the Valuer's consideration of the bids. There was no bid which did not require public financial assistance and there was no other private source of funds available in the market. If there had been some other source of funds, LOLR assistance would not have been provided: see *SRM* in the Divisional Court at [148] and in the Court of Appeal at [72]. For completeness, we would add that there was evidence that Northern Rock considered, but was unable to obtain, support from the European Central Bank: see the Consultation Document, paragraph 6.34.

280. Some applicants considered that the assets of Northern Rock included valuable claims against the persons and media organisations whose leaks and publicity triggered the run on Northern Rock, against the FSA and the Government for regulatory failings, and against the former directors and auditors for breach of duty. The Valuer gave consideration to all these. They had no material impact on his valuation either because the prospects of a successful claim were slim or because, if a claim were successful, the amount recoverable would not be large

enough to make a material difference to Northern Rock's assets, or for both reasons. We have found no reason to disagree with this assessment.

281. A variant of the argument concerning regulatory failings was that it would be unfair for the Government to get the benefit of acquiring Northern Rock cheaply through its own actions in damaging the business. This seems to imply that the statutory valuation assumptions should be regarded as unfair because, while they strip out the value of public financial assistance, they do not add back the damage done to Northern Rock by Government policies. This contention is not justiciable in the form in which it was presented to us. We have before us no evidence that the Government damaged Northern Rock or that, if it did, the circumstances of such damage were such as to make the statutory assumptions so unfair and inappropriate as to be contrary to A1P1.

282. Applicants also complained about the continuing sponsorship of Newcastle United, about the payment of staff bonuses, and about other payments to former and current senior executives. Most of these matters arose after the valuation date and were not relevant to the statutory valuation exercise. More fundamentally, the amounts involved were too small to materially affect the balance sheet of Northern Rock or to make any practical difference to the outcome for the shareholders.

283. In the result, the additional issues raised by applicants other than Harbinger do not impact upon our decision.

Conclusion

284. The applications of all the applicants are dismissed.

Signed by the Hon Mr Justice Warren on 4 October 2011

Release date 06 October 2011