

**Independent Valuation  
under the Northern Rock plc  
Compensation Scheme Order 2008**

Response to Requests for Reconsideration  
of my Determination

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by Andrew Caldwell

**Independent Valuer appointed under Part 3 of the Northern Rock  
plc Compensation Scheme Order 2008**

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## 1. Introduction

- 1.1. I was appointed by HM Treasury ("the Treasury") on 8 September 2008 as Independent Valuer, under the Northern Rock plc Compensation Scheme Order 2008 ("Compensation Order"), to determine the amount of any compensation payable by the Treasury to persons affected by the transfer of Northern Rock plc ("Northern Rock") into temporary public ownership ("TPO") at the beginning of 22 February 2008.
- 1.2. The transfer into TPO was effected by the Northern Rock plc Transfer Order 2008 ("Transfer Order"), which was made under the Banking (Special Provisions) Act 2008 ("the Act"). The following categories of persons will have been affected by the Transfer Order:
- those who held ordinary, foundation or preference shares in Northern Rock;
  - those whose rights to receive shares in Northern Rock (whether by subscription, conversion or otherwise) were extinguished by Article 4 of the Transfer Order; and
  - those whose "consequential rights" were extinguished by Article 12 of the Transfer Order.
- 1.3. The above persons are called "Affected Parties".

1.4. I was required to determine the value of Northern Rock's shares, and the value of any rights to receive shares that were extinguished by virtue of Article 4 of the Transfer Order, immediately before the transfer of Northern Rock into TPO at the beginning of 22 February 2008. I refer to this point in time as the "Valuation Date".

1.5. I published my Assessment Notices in March 2010, following the completion of a consultation process which began when I published my Consultation Document in December 2009 ("Consultation Document").

### *Purpose of this document*

1.6. The Assessment Notices explained that any person affected by the determination contained in an Assessment Notice could ask me to reconsider that determination, within 5 weeks from the date of the Assessment Notice.

1.7. I have received a large number of requests for such reconsideration together with representations to support these requests, which I have now reviewed.

1.8. I have issued Revised Assessment Notices to all those who requested reconsideration of the Assessment Notices. In the Revised Assessment Notices, I confirm that, after careful consideration, I have upheld the determination in the Assessment Notices and that the amount of compensation payable by the Treasury to former shareholders, and to those whose rights to receive shares have been extinguished, is therefore nil.

1.9. I set out in Section 2 a summary of the material representations made to me by way of requests for reconsideration and my response to those representations.

***Referral to the Upper Tribunal***

1.10. Any person who is affected by the determination in the Revised Assessment Notices, and who is dissatisfied with it, may refer the matter to the Upper Tribunal (Tax and Chancery Chamber). Any such reference must be made within 28 days from receipt of the Revised Assessment Notices. It should be made by way of a Reference Notice (Form FTC3) which must be signed by or on behalf of the Applicant and filed at:

**The Upper Tribunal  
Tax and Chancery Chamber  
45 Bedford Square  
London  
WC1B 3DN**

1.11. To obtain Form FTC3, go to:

[www.tribunals.gov.uk/financeandtax/FormsGuidance.htm](http://www.tribunals.gov.uk/financeandtax/FormsGuidance.htm) or  
call the Upper Tribunal's office on 020 7612 9647 or  
020 7612 9646.

1.12. All referrals to the Upper Tribunal must be sent directly to the Upper Tribunal's office and copied to me as follows:

by post to: **Andrew Caldwell  
Northern Rock Valuer  
c/o BDO LLP  
55 Baker Street  
London  
S1U 7EU**

by e-mail to: **northern.rock@bdo.co.uk**

1.13. Going forward, I will not be responding to any further correspondence received from Affected Parties, but will address any further issues raised in the context of the Upper Tribunal procedures, as appropriate.

***Shareholder register***

1.14. Northern Rock's registrars, Capita Registrars ("Capita"), maintain the database of former shareholders. It is therefore important that Affected Parties continue to update Capita about any change in their personal details at:

**Capita Registrars  
Northern House  
Woodsome Park  
Fenay Bridge  
Huddersfield  
HD8 0LA**

**Telephone: 0871 664 0340  
Fax: 0871 664 0350  
E-mail: northernrock@capitaregistrars.com**

## 2. Summary of material representations in support of requests for reconsideration and my responses to those representations

2.1. The purpose of this section is to summarise the material representations made to me in requests for reconsideration and to provide and explain my response to them.

### *Summary of representations*

2.2. Many of the representations made in support of requests for reconsideration substantially repeat those which were made (i) in response to the letter I sent to Affected Parties on 13 November 2008 and which I addressed in the Consultation Document; or (ii) in response to the Consultation Document and which I addressed in my Final Document of March 2010 ("the Final Document"). I have not repeated my responses to those representations here as they are addressed either in Section 6 of the Consultation Document or Section 2 of the Final Document.

2.3. I have not commented in any detail on those representations which concern the Government's approach to Northern Rock and its decision to place it into TPO or any other matters falling outside the scope of the valuation which I am appointed to undertake.

2.4. I adopt in this document the same defined terms as in the Final Document.

### A. *Valuation Assumptions*

2.5. It has been put to me that I have erred in my interpretation of the Valuation Assumptions and, in particular, that I was in error to deduct from Northern Rock's balance sheet, immediately before the Valuation Date, assets which, if realised at that time, would yield the £25.38 billion necessary to repay the BoE. Alternative approaches to the valuation have been suggested based on different interpretations of the Valuation Assumptions and, particularly, the Withdrawal Assumption.

2.6. Having reconsidered this issue and all of the submissions made, I remain of the view that my valuation method, based on the interpretation of the Withdrawal Assumption explained in the Consultation Document, is correct. I have reached this view for the reasons already articulated in the Consultation Document and because:

- a. I continue to believe that the natural meaning of the words "*has been withdrawn*" is that something that was there has been removed or taken away;
- b. in order to give effect to the assumption that all financial assistance has been withdrawn and no financial assistance would in future be provided, it is necessary to assume that the monies owed to the BoE were actually repaid immediately prior to the Valuation Date;
- c. my interpretation is consistent with the object of the legislative framework in that it disregards any value dependent on public support provided to Northern Rock. The contrary interpretation is inconsistent with the

legislative framework because it ascribes to Northern Rock value that is attributable to public support;

- d. the question of whether Northern Rock was balance sheet solvent at the time financial assistance was first provided in September 2007 is irrelevant to my task. I am required to focus on the position as at the Valuation Date; and
- e. based on my research, I continue to believe that there was no inherent goodwill in the Northern Rock business and no substantial value in Northern Rock's operating platform.

***B. Financial assistance to a potential purchaser***

- 2.7. It has been suggested to me that Northern Rock's business could have been sold on the basis that financial assistance was given to the purchaser rather than to Northern Rock itself and that this would not be contrary to the Valuation Assumptions. Given the Valuation Assumptions, I do not consider it appropriate to consider the possibility of a sale on terms that financial assistance is provided to the purchaser as that would run contrary to the statutory objective of ensuring that value attributable to public support is disregarded. Viewed in the context of the statutory objectives, there is no material difference between financial assistance being provided to Northern Rock itself and such assistance being provided indirectly via the purchaser.

***C. Effect of the Valuation Assumptions on the treatment of financial instruments***

- 2.8. In the light of my interpretation of the Valuation Assumptions, I consider my approach to the Covered Bonds to be appropriate. A submission has been made that consultation with the Bond Trustee would result in accelerated repayment of the Bonds. This necessitates adopting a different (and I believe incorrect) interpretation of the Valuation Assumptions. The contractual position is that upon an Issuer event of default repayment is not accelerated.
- 2.9. I continue to believe that my treatment of the medium term notes, in particular the acceleration of default interest, is appropriate. It has been submitted that accelerated repayment of the medium term notes is not automatic and that, therefore, accelerated default interest would not be triggered automatically. It remains my view that it is likely that the Trustee would require accelerated repayment of the notes, together with interest.
- 2.10. I also continue to consider that it is appropriate to adopt a value neutral approach to derivative financial instruments, by holding them at book value for the duration of the valuation. An alternative view has been suggested that an administrator would close out such contracts during the initial stages so as to prevent those "in the money" moving to "out of the money" positions. It is my view that, in the event of default the non-defaulting party is likely to be the arbiter as to the appropriate course of action, rather than the administrator.

2.11. It has been highlighted that as PIK Interest due on BoE monies is subordinated to unsecured creditors, repayment of these monies might cause the directors of Northern Rock to breach their fiduciary duties.

2.12. In my view, the accrued PIK interest due on BoE monies should be treated as being repaid. Not to do so would constitute the provision of financial assistance which would run contrary to the Valuation Assumptions which I was required to adopt.

***D. Date of the valuation***

2.13. It has been suggested that I should have made my determination of value at a different valuation date and that any compensation payable should be calculated at such date. Suggested dates for the valuation include the date of any Lloyds or Virgin offer for Northern Rock's shares; the date at which Northern Rock is deemed to be financially secure again; or the date of Northern Rock's anticipated sale.

2.14. The Compensation Order requires me to assess the value of shares in Northern Rock immediately before they were transferred into TPO. The Valuation Date is therefore fixed by law.

***E. Alternative valuation***

2.15. It has been put to me that I should be presenting a further alternative valuation which ignores the Valuation Assumptions.

2.16. The relevant legislation, which governs the basis upon which I am to value Northern Rock, determines that I have to apply the Valuation Assumptions. I am not permitted by law, therefore, to adopt an alternative valuation approach.

***F. Inappropriate continued selling of shares***

2.17. It has been alleged that Northern Rock was in financial difficulties long before the transfer into TPO and that the continued trading of shares, with this knowledge, was inappropriate. It has been further argued that shares should have been suspended at some time prior to the transfer into TPO, in which case, it is said, some value would have remained attributable to the shares.

2.18. I have not been presented with any evidence that shares were traded inappropriately. In addition, the Valuation Date is fixed by law – see above.

***G. Bias on my part***

2.19. It has been suggested that I am acting in the interests of the Government and that it is not possible for me to be independent, given that I have been appointed by the Treasury.

2.20. I reject this suggestion and confirm that I have reached my determination of value independently, applying the Valuation Assumptions which I was required by law to apply. I have treated the Treasury in the same way as any other Affected Party throughout this process.

#### ***H. The Government's actions***

2.21. It has been alleged that the Government and its agencies breached a duty of care to all savers and that they deliberately "manipulated" Northern Rock in order to avoid paying compensation. It is further argued that compensation should therefore be paid by the Government and/or its agencies and that this should be considered in the calculation of any compensation payable.

2.22. It has further been put to me that the Compensation Order results in the former shareholders of Northern Rock being treated differently from shareholders of other banks which have required financial assistance and, finally, that the failure by the Government to pay compensation is a violation of human rights.

2.23. The Government's approach to Northern Rock falls outside the scope of the valuation which I am required to undertake and it would be inappropriate for me to comment further.

#### ***I. Former Northern Rock Directors***

2.24. It has been argued that in light of the FSA's sanctions against certain former Northern Rock directors, the integrity of the information provided by Northern Rock may be questionable.

2.25. I am however satisfied that the information I have gathered during the course of my valuation is sufficient to support my determination.

2.26. It has also been suggested that some payments to former and current senior executives were inappropriate and that such inappropriate payments should be reclaimed and considered in my valuation.

2.27. It is my view that payments to senior executives of Northern Rock are not material in the context of the company's balance sheet.

#### ***J. Value of Northern Rock's property***

2.28. It has been suggested that the value of Northern Rock's property alone should have enabled funds to be available to the former shareholders.

2.29. As explained in the Consultation Document and also in the Final Document, I have adopted the net asset method of valuation to value Northern Rock, which requires me to take account of both realisations from Northern Rock's assets and payments to its creditors.

2.30. Therefore, when determining whether any compensation is payable to Affected Parties, it is not appropriate to assess the value of its assets in isolation. Consideration also needs to be given to Northern Rock's ability to repay its creditors from realisations from its assets.

***K. Sale of Northern Rock and its assets***

- 2.31. It has been put to me that some value for the former shareholders should be realisable from the sale of Northern Rock's mortgage loans or other assets.
- 2.32. I have explained in the Consultation Document that my approach to effecting the withdrawal of the BoE funding has been to replicate the realisation of certain of Northern Rock's residential mortgage loans together with other liquid assets, such as cash and gilts.
- 2.33. I have then assumed that, in order to maximise returns, an administrator would choose to continue to trade the business for a period of 5 years and that this business would be funded by partial realisations of assets and cashflows from mortgage loans.
- 2.34. Therefore I have already taken the value achievable from the sale of Northern Rock's mortgage loans into account.
- 2.35. It has also been suggested that Northern Rock would appear to have considerable value given that it is widely reported that it will be sold in the near future. It is further argued that former shareholders should be entitled to share in the proceeds from any sale or to be given back their shares at that time.
- 2.36. Similarly it has been argued that the fact that Northern Rock is now a going concern is inconsistent with a nil value.
- 2.37. I do not agree with these observations. I was required to value Northern Rock at the Valuation Date according to the

Valuation Assumptions. I do not believe that the value of any potential future sale of Northern Rock, in what are now very changed circumstances, is relevant to that task.

***L. Differentiation between different categories of shareholder***

- 2.38. It has been argued that rights to compensation should differ between, on the one hand, staff who received shares in Northern Rock following the participation in a share scheme and account holders who received shares on demutualisation and, on the other, those who bought shares independently.
- 2.39. The Compensation Order does not provide for any such differentiation. I was required to determine the amount of any compensation payable to Affected Parties based on the value of their shares or their right to receive shares at the Valuation Date.

***M. Order of priority of payment in an administration***

- 2.40. It has been argued that it is not appropriate for former shareholders to be the last party to receive compensation for their loss.
- 2.41. The Insolvency Act 1986 determines the general order of priority for payment in an administration. This is set out in full at page 108 of the Consultation Document and it determines that only if there is a surplus after paying in full all the expenses of the administration, all debts of the company, and pre and post-administration interest on the debts, then this money is distributed to the different classes of shareholders in the company.

**N. *Reduction of mortgage debt by set off of lost investments***

- 2.42. It has been argued that it is appropriate to reduce the amount of money an Affected Party owes Northern Rock by way of mortgage loan by the amount of money they invested in Northern Rock shares and subsequently lost when Northern Rock was transferred into TPO.
- 2.43. The amount of money borrowed from Northern Rock by way of mortgage loan is distinct from any money invested in Northern Rock by way of the purchase of shares. There is no right of set-off and this issue does not therefore arise.

**O. *Claims against former executives and auditors***

- 2.44. It is suggested that a claim should be made against the former directors and the former auditors of Northern Rock and that this should be pursued prior to the determination of the amount of any compensation.
- 2.45. Northern Rock announced on 14 October 2008 that there were insufficient grounds to proceed with any legal action against the former directors and that no action was warranted against Northern Rock's auditors.
- 2.46. I have not been presented with any evidence that suggests the contrary and I therefore believe that the chance of success of such a claim to be too remote to incorporate into my valuation.

**P. *Inappropriate sponsorship of Newcastle United***

- 2.47. It is argued that the continuing sponsorship by Northern Rock of Newcastle United is inappropriate and that my valuation should be adjusted accordingly.
- 2.48. The recent renewal of the sponsorship of Newcastle United by Northern Rock took place after the Valuation Date and is not relevant for the purposes of my valuation. Any previous sponsorship of Newcastle United is not material in the context of the balance sheet of Northern Rock.

### **3. Amount of compensation payable**

- 3.1. Having considered all the issues raised in requests for reconsideration, I remain of the view that my approach and the conclusion I have set out in my Assessment Notices is valid and that my original determination should therefore be upheld. I therefore confirm that the amount of compensation payable by the Treasury to former shareholders, and to those whose rights to receive shares have been extinguished, is nil.