

**IN THE UPPER TRIBUNAL (TAX & CHANCERY CHAMBER)
FINANCIAL SERVICES**

BETWEEN:-

NORTHERN ROCK APPLICANTS

Applicants

- and -

(1) ANDREW CALDWELL
(as the Independent Valuer of Northern Rock)

(2) HM TREASURY

Respondents

**VALUER'S SKELETON ARGUMENT
FOR HEARING COMMENCING 31 MAY 2011**

Bundle references are in the form {Bundle/Tab/Page} or {Bundle/Page}

Suggested reading (in addition to this Skeleton and passages referred to therein):

- (i) Harbinger's Grounds for Referral {1A/t18/p96ff}, Statement of Case of the Valuer {1A/t27/p182ff}, Statement of Case of the Treasury {1A/t28/p230ff}, Harbinger's Reply {1A/t29/p233ff}
- (ii) Statement of Case of Mr Hulme {1A/t30/p260ff}, Treasury's Response {1A/t31/p265ff};
- (iii) Harbinger's Note on Expert Evidence {1B/t40/p313ff}
- (iv) Valuer's Skeleton dated 1 April 2011 {1B/t41/p331ff}
- (v) Harbinger's Skeleton dated 20 April 2011 {1B/t42/p347ff}
- (vi) Judgments of the Divisional Court and Court of Appeal in *R (SRM Global Master Fund LP & ors) v HM Treasury* [2009] EWHC 227 (Admin) and [2009] EWCA Civ 788;
- (vii) Consultation Document {2/t47/p1ff}, sections 2, 4, 5, 9, 11 and 12, Figure 13 (p. 101) and Table 11 (p. 106), together with the following individual paragraphs; 6.1-6.17; 8.26-8.27; 13.25-13.28; 14.33-14.38; 14.54-14.57, 14.63-14.66, 15.74-15.80; 16.7; 16.32-16.34.
- (viii) Final Document {2/t48/p201ff}, paras 2.1-2.35;
- (ix) Response Document {2/t50/p222ff}, paras 2.1-2.6, 2.8-2.12; 2.15-2.16;
- (x) McKillop 1 {3/t56/p180ff}, paras 5.29, 5.38-5.42; 6.26-6.27; 6.74-6.76;
- (xi) McKillop 2 {3/t57/p253ff}, section 3 and paras 5.21-5.99, 5.103-5.110; 5.124-5.140;
- (xii) Thompson {3/t58/p292ff}, sections 1-2 and paras 5.13-5.23, 5.29.

Estimated time for reading: 1 day

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GLOSSARY

This Skeleton uses the following definitions and abbreviations:

1999 Regulations	Financial Markets and Insolvency (Settlement Finality) Regulations 1999
2008 Act:	Banking (Special Provisions) Act 2008
2010 Order:	Transfer of Tribunal Functions Order 2010 (SI 2010/22)
A1P1:	Article 1, First Protocol to the European Convention on Human Rights
Consultation Document:	Valuer's Consultation Document dated December 2009
CSO:	Northern Rock plc Compensation Scheme Order 2008 (SI 2008/432)
CSO Schedule:	Schedule to the CSO
Final Document:	Valuer's Final Document dated March 2010
Grounds:	Harbinger's Grounds for Referral of the Respondent's Revised Assessment Notice dated 1 October 2010
FSMA:	Financial Services and Markets Act 2000
HRA:	Human Rights Act 1998
McKillop 1:	1 st expert report of Murdoch McKillop
McKillop 2:	2 nd expert report of Murdoch McKillop
Northern Rock:	Northern Rock plc
NRSAG:	Northern Rock Shareholders Action Group
Harbinger:	Harbinger Capital Partners
SRM:	<i>R (SRM Global Master Fund LP & ors) v HM Treasury</i> [2009] EWHC 227 (Admin) and [2009] EWCA Civ 788
Reference Notice:	Notice submitted by Applicant referring the Revised Assessment Notice issued by the Valuer to the Tribunal
Reply:	Harbinger's Reply to the Respondents' Statements of Case
Response Document:	Valuer's Response to Requests for Reconsideration of my Determination
Rule 2.88:	Rule 2.88 of the Insolvency Rules 1986
Preference Shares:	Series A Fixed/Floating Rate Non-Cumulative Callable Preference Shares issued by Northern Rock.
Shareholders:	Former holders of shares in Northern Rock whose shares were transferred to the Treasury under the Transfer Order
Statement of Case:	Valuer's Statement of Case
Thompson:	Expert Report of Paul Thompson.
Transfer Order:	Northern Rock plc Transfer Order 2008 (SI 2008/432)
Treasury:	The Second Respondent
Tribunal:	The Upper Tribunal
Valuation Date:	22 February 2008
Valuer:	The First Respondent

INTRODUCTION

1. This is the skeleton argument of the First Respondent (“the Valuer”) in respect of the challenge, by former shareholders (“Shareholders”) in Northern Rock plc (“Northern Rock”), to his determination that the amount of compensation payable following the nationalisation of Northern Rock in February 2008, is nil.
2. This skeleton argument has been drafted in accordance with the direction of the Tribunal, at paragraph 3(6) of Case Management Order No 2 dated 24 February 2011 {1B/t34/p281} that the parties’ skeleton arguments be limited to *“identifying their main arguments in point form and (where possible) by reference to their existing statements of case and/or skeleton arguments.”* It should therefore should be read together with the following documents which provide a fuller exposition of the Valuer’s case (subject to new points arising since they were filed, and which are dealt with in full in this Skeleton):
 - (1) Statement of Case dated 10 December 2010 {1A/t27/p182}.
 - (2) Written Submissions dated 1 April 2011 {1B/t41/p331}.

PARTIES

3. The Valuer was appointed pursuant to the Northern Rock plc Compensation Scheme Order 2008 (SI 2008/432) (“the CSO”) to assess what, if any, compensation is payable to former Shareholders of Northern Rock (“the Valuation”). The Valuer has no interest, financial or otherwise, in the outcome of the Valuation beyond his interest to discharge his statutory duties. He is neutral as to the figure reached. His interest in these proceedings is to assist the Tribunal and protect the integrity of the Valuation that he was appointed to conduct. Any compensation due to Shareholders as a result of the Valuation would be payable by the Second Respondent (“the Treasury”).
4. The CSO confers an automatic right on persons affected by the Valuer’s decision to refer that decision to the Upper Tribunal (“the Tribunal”). 440 Applicants have now done so. They can be divided into three categories:
 - (1) Harbinger Capital Partners (“Harbinger”), a hedge fund holding an interest in the £400 million Preference Shares issued by Northern Rock. Since compensation is payable in accordance with the capital structure of Northern Rock, only if the Valuation exceeds £400 million would any Applicant other than Harbinger receive compensation.

- (2) Mr Hulme, the chairman of the Northern Rock Shareholders Action Group (“NRSAG”). While Mr Hulme does not act on behalf of NRSAG or its members, he has been given permission by the Tribunal to advance any of the arguments made by applicants other than Harbinger. Apart from Harbinger, Mr Hulme is the only Applicant to have advanced a formal Statement of Case and to be represented at the hearing.
 - (3) Other individual Shareholders, who have filed Reference Notices setting out their position but have otherwise played no part in these proceedings.
5. This is not the first opportunity the Applicants have had to challenge the Valuer’s view. An important part of the Valuation was an extensive consultation exercise with all interested parties, in the course of which various alternative views were canvassed, including those now put forward by the Applicants. As set out further below, the purpose of these proceedings is not to decide which (if any) alternative view among the hundreds put forward is to be preferred to the Valuer’s. Rather, it is to review the reasonableness of the Valuer’s decision.

BACKGROUND

6. The present proceedings result from the nationalisation of Northern Rock on 22 February 2008. The events leading up to this nationalisation provide important context for the present proceedings. They are described in detail in the judgment of the Divisional Court in *R(SRM Global Master Fund) v HM Treasury* [2009] EWHC 227, [28]-[55], and for convenience are summarised below.
7. On 11 September 2007, the auditors of Northern Rock plc (“Northern Rock”) reported to the FSA that they had reasonable grounds to believe that the company would be unable to continue as a going concern. Following a report on 13 September 2007 that Northern Rock would be seeking financial support, 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.
8. In order to prevent the collapse of Northern Rock and contagion to other parts of the financial sector, beginning on 14 September 2007 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. Additional facilities were provided on 9 October 2007. The facilities provided were secured by a charge over Northern Rock’s assets and were repayable on demand, subject to a final repayment date of 12 February 2008 (subsequently extended to 17 March 2008). 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 £27 billion, with the Treasury having assumed contingent liabilities, under guarantees, of £29 billion.

9. Following the deepening of the financial crisis and the inability of Northern Rock, or the Government, to find any buyer willing to acquire it on terms which did not require significant on-going financial assistance, on 17 February 2008 the Chancellor of the Exchequer announced to Parliament that the government intended to take Northern Rock into a period of “temporary public ownership”.
10. 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) (“the Transfer Order”), Northern Rock’s shares were transferred to the Treasury Solicitor as nominee of the Treasury.
11. Pursuant to section 5 of the 2008 Act, on 12 March 2008 the CSO was made providing for the appointment of an independent valuer to assess the amount (if any) of compensation payable to Shareholders. On 8 September 2008, following competitive tender and a recommendation by an expert committee, the Valuer was appointed. There followed a full and transparent public consultation process, which took longer than anticipated due to delays in obtaining information, and which culminated in the Valuer issuing his final Response Document and Revised Assessment Notices on 1 October 2010. This valued the amount of compensation payable to Shareholders as nil.¹
12. In the interim, certain Shareholders sought to challenge the Valuation Assumptions in the 2008 Act and the CSO by judicial review, including by contending that the compensation scheme it established 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 *R(SRM Global Master Fund LP & ors) v HM Treasury* [2009] EWHC 227 (Admin) and [2009] EWCA Civ 788 (“SRM”).

¹ As noted in the Consultation Document, 16.32-16.34 {2/t47/149}, this was consistent with Northern Rock’s own internal assessments, albeit these assumed financial assistance would continue.

THE ISSUES

13. Section 133(5) FSMA, as modified by paragraph 18 of the CSO Schedule (itself amended by paragraph 158 of the Transfer of Tribunal Functions Order 2010 (SI 2010/22) (“the 2010 Order”)), provides for the jurisdiction of the Tribunal in the present proceedings as follows:

“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”.

14. As is to be expected in a case involving 440 Applicants, a large number of diverse issues have been raised relating to the Valuation, many of which did not obviously fall within the jurisdiction of the Tribunal. Pursuant to the Tribunal’s directions as given in Case Management Orders No 1, paragraph 8 {1B/t33/p277}, and No 2, paragraph 2(1) {1B/t34/279}, the issues to be dealt with at the hearing are limited to those falling into the following categories:

- (1) the “Interpretation Issue”, relating to the Valuer’s interpretation of the statutory assumptions contained in s. 5(4) of the 2008 Act and paragraphs 6(a)-(b) of the CSO Schedule;
- (2) the “Methodological Issues”, relating to the Valuer’s “*application and implementation of the statutory assumptions*” (i.e. his valuation methods and conclusions); and
- (3) the “Bias Issues”, relating to complaints that the Valuer was biased.

15. Related to these are two sub-issues pertaining to the role of evidence and the jurisdiction of the Tribunal. These arise from Harbinger’s desire to rely upon two expert witnesses, Mr McKillop and Mr Thompson, neither of whom make any criticism of the Valuer’s “*application and implementation of the statutory assumptions*”,² but which instead (i) criticise the Valuer’s approach to the Interpretation Issue and (ii) propose alternative valuations on the basis of different outcomes to the Interpretation Issue.

16. As set out in more detail below, Harbinger’s expert evidence is not relevant to any of the issues before the Tribunal. For this reason, the Valuer has elected not to cross-examine Mr McKillop and Mr Thompson.

² See paragraph 57 below.

THE INTERPRETATION ISSUE

17. The CSO requires the Valuer to value the shares of Northern Rock as at the Valuation Date of 22 February 2008. It gives him complete discretion as to what method he is to use for the valuation, subject only to requiring him to adopt four statutory Valuation Assumptions. These are that:

- (1) *“all financial assistance provided by the Bank of England or the Treasury to [Northern Rock] has been withdrawn (whether by the making of a demand for repayment or otherwise)”* (the **Withdrawal Assumption**);
- (2) *“no financial assistance would in future be provided by the Bank of England or the Treasury to [Northern Rock] (apart from ordinary market assistance offered by the Bank of England subject to the usual terms)”* (the **No Future Assistance Assumption**);
- (3) Northern Rock *“is unable to continue as a going concern”* (the **Going Concern Assumption**); and
- (4) Northern Rock *“is in administration”* (the **Administration Assumption**).

The Withdrawal and No Future Assistance Assumptions are required by section 5(4) of the 2008 Act, while the Going Concern and Administration Assumptions are found only in the CSO (at para 6 of the CSO Schedule).

18. The Interpretation Issue concerns only the Withdrawal Assumption. Three interpretations have been put forward:

- (1) The **Repayment Interpretation**, as adopted by the Valuer in the Valuation. Under the Repayment Interpretation, the Valuer treats the word “withdrawn” as meaning “taken away”, i.e. as requiring him to assume that at the Valuation Date, Northern Rock is no longer in receipt of any financial assistance. In particular, this requires that by the Valuation Date, any financial assistance provided to Northern Rock by way of loan from the Bank of England or Treasury has been repaid.
- (2) The **Repayment-in-Kind or “No Assistance” Interpretation**. This is Harbinger’s primary position. It posits that financial assistance by way of loans be treated as withdrawn through the removal, from Northern Rock’s balance sheet, of assets with an equivalent book value. The original basis for this was said to be that “withdrawn” is to be construed as “never was

provided”,³ although Harbinger has since denied this.⁴ In practical terms, however, the Repayment in Kind Interpretation is similar to the Repayment Interpretation, i.e. it treats the financial assistance as having been repaid in full by the Valuation Date, save that it involved two further assumptions: (a) that the Bank of England was prepared to accept assets in lieu of cash, and (b) that the “book value” of the assets in question was the same as their market value. As set out further below, there is no warrant for these further assumptions nor any conceivable purpose to them.

- (3) The **Demand Interpretation**. This is Harbinger’s secondary position. It posits that, so far as financial assistance by way of loans was concerned, these are to be treated as “withdrawn” merely by the presentation of a demand for payment, whether or not that demand was met.

Key points in support of the Repayment Interpretation.

19. The Valuer’s submissions in support of the Repayment Interpretation are found at paragraphs 22-124 of his Statement of Case {1A/t27/p186-209}. The key points are set out below.

20. **Approach to Statutory Interpretation.**⁵

- (1) The meaning of the Withdrawal Assumption is a question of statutory interpretation. The approach to be adopted is well established:
- (a) The starting point is the ordinary meaning of the words used and whether these point towards, or against, a particular construction.
 - (b) To this must be added the extent to which each construction furthers, or detracts from, the broad purpose of the statute.
 - (c) Regard must be had to the need for statutes to be construed, so far as possible, consistently with Community law and Convention rights.
 - (d) Finally, appropriate account should be taken of accepted rules or presumptions of construction.

³ See Harbinger’s 1st Written Submissions at para 103 {3/t52/p33}.

⁴ See paragraph 9 of Harbinger’s Reply {1A/t29/p235-236}.

⁵ Statement of Case paras 53-54 {1A/t27/194}.

- (2) The process of construction involves a balancing of the above factors, and in particular between the need to give the words used their ordinary meaning and the need to accommodate the purpose of the statute.

21. **Ordinary meaning of words used in the Withdrawal Assumption.**⁶

- (1) The Withdrawal Assumption requires the Valuer to assume that financial assistance “has been withdrawn”. The normal meaning of “withdrawn” is “removed” or “taken away”. The thing to be withdrawn is the financial assistance, i.e. the funds and guarantees provided to Northern Rock.⁷
- (2) The natural reading of the statute is therefore that Northern Rock should be treated as if it were no longer in receipt of any financial assistance. This in turn requires, for the purposes of the assumption, that Northern Rock has actually repaid the financial assistance by the Valuation Date. Failing such (assumed) actual repayment, Northern Rock would continue to be in receipt of assistance, contrary to both the Withdrawal and No Future Assistance Assumptions.
- (3) By contrast, the wording cannot be reconciled with the Repayment-in-Kind Interpretation, since by using only book values, no account is taken of the risk that the assets treated as being used to repay the financial assistance may not (and, in the present case, would not) be of sufficient realisable value to enable repayment in full. If, at the Valuation Date, the market value of the assets treated as being used to repay the financial assistance was insufficient to do so, the financial assistance would not have been withdrawn. That follows from the fact that a debt must, in general, be settled in cash, and cannot be effectively discharged by a repayment in kind unless the creditor both agrees to it and the real (not book) value of the assets transferred are sufficient to discharge the debt.
- (4) The Repayment-in-Kind Interpretation can thus be easily tested against the wording of the Withdrawal Assumption. If it is assumed that assets with a book value of £25 billion but a true market value (at the date of transfer) of £15 billion were handed by Northern Rock to the Bank of England or Treasury in purported discharge of its debt, would that operate as a complete discharge? Plainly not.

⁶ Statement of Case paras 55-69 {1A/t27/p194-197}

⁷ See definition of “financial assistance” at s. 15(1) of the 2008 Act.

- (5) Nor can the wording be reconciled with the Demand Interpretation, under which financial assistance is treated as being withdrawn on the presentation of a demand for repayment. That is because for so long as the demand is not met, Northern Rock continues to have the benefit of the funds loaned to it and therefore to be in receipt of financial assistance.⁸ In particular, Harbinger’s case on the Demand Interpretation depends upon the Bank of England not enforcing its security to obtain immediate repayment, (whether by choice or necessity)⁹ thereby conferring on Shareholders the value associated with extended financial support.
- (6) Further, the addition of words “*(whether by the making of a demand for repayment or otherwise)*” also support the Repayment Interpretation:
- (a) The purpose of the words in brackets is to make clear that the withdrawal of financial assistance is not to be treated as limited by the terms on which it was provided. In particular, it does not matter whether the assistance was repayable on demand or not. What matters is that it be treated as “withdrawn” by the Valuation Date.
- (b) Harbinger’s proposal (inconsistent with its primary case) that the words instead indicate that a demand for payment is sufficient to constitute withdrawal cannot be right. Not all financial assistance will be repayable on demand, in which case the making of a demand for payment would have no effect and could not constitute “withdrawal” of assistance in any sense.

22. Purpose of the 2008 Act.¹⁰

- (1) The purpose of the 2008 Act is to provide the Treasury with powers to take over a deposit taker in the public interest in circumstance where it poses a threat to the stability of the UK financial system or where such a threat was averted by the provision of financial assistance: see s2(2).

⁸ The Demand Interpretation treats “withdrawn” as being used in the sense of a bank withdrawing an overdraft. But this is a false analogy because it neglects what is being withdrawn. When a bank withdraws an overdraft, it is merely withdrawing *permission*; it is not withdrawing the overdrawn funds themselves (unless it exercises a right of set-off against some other asset). Here, what is to be withdrawn is the *funding provided*: as with a withdrawal of funds from a bank account, this takes place only when the money is actually returned to its owner.

⁹ As noted below, each contingency is based on a highly dubious premise: Appendix A para 7.

¹⁰ Statement of Case paras 70-77 {1A/t27/p197-199}

- (2) The public interest does not extend to giving shareholders the benefit of financial assistance provided to prop up an otherwise failing institution. For this reason, the 2008 Act requires that any future compensation scheme be subject to the Withdrawal and No Assistance Assumptions.
- (3) Only the Repayment Interpretation fully satisfies this aim by ensuring shareholders are compensated on the basis that any assistance provided in the public interest has been repaid. By contrast, Harbinger's proposals result in shareholders obtaining an increased return on the basis that financial assistance is either never fully withdrawn (as under the Repayment in Kind interpretation if the book value of assets exceeds their realisable value) or withdrawn gradually and after the Valuation Date (as under the Demand Interpretation).
- (4) The Withdrawal Assumption is found at s. 5 of the 2008 Act. It is not limited to Northern Rock but applies to any case of nationalisation of a deposit-taking institution thereunder.¹¹

23. Consistency with Convention Rights¹²

- (1) At paragraph 93 of its Grounds, Harbinger argues that the adoption of the Repayment Assumption is a breach of s. 6 of the Human Rights Act 1998 ("HRA"). As the Valuer pointed out at para 106 of his Statement of Case, that submission is misconceived. It assumes that the Valuer has a choice over which interpretation to adopt, which is not so: only one interpretation can be correct, and that is the one he must adopt. If he has done so, s. 6(1) is of no application because, as a result of one or more provisions of primary legislation, he could not have acted differently (s. 6(2)(a)).
- (2) What Harbinger has **not** said is that it seeks to rely on s. 3 HRA. At paragraph 37 of its Reply, it repeats its argument that s. 6 applies because *"there are several competing interpretations of the Withdrawn Assumption and it was open to the First Respondent to adopt a construction which is compatible with the Applicant's Convention rights"*. At paragraph 38, it says that *"it makes no difference whether this outcome is reached through the application of Section 3 or Section 6"*.

¹¹ To date, the 2008 Act has been used 4 times: for Northern Rock, Bradford & Bingley, Heritable Bank and Kaupthing Edge.

¹² Statement of Case paras 104-111 {1A/t27/p205-206}

- (3) Insofar as reliance is placed on s. 3, this is misplaced for (inter alia) the reasons given in the Valuer's Statement of Case at paragraphs 109-110.
- (4) As to the legal principles, it is common ground that the compulsory transfer of shares to the Treasury amounted to a deprivation of Shareholders' property within the meaning of A1P1. However:
 - (a) Such a deprivation will be compatible with A1P1 provided that it is proportionate to the aim in view: *SRM (CA)*, at [46].
 - (b) Laws LJ noted in *SRM* at paragraph 48 that the European Court of Human Rights has only once upheld a deprivation of property without any compensation at all – and in doing so it emphasised that the circumstances were unique (see *Jahn v Germany* (2006) 42 EHRR 49). But this is **not** a case where the legislation sets out to deprive shareholders of property without compensation. On the contrary, it establishes a valuation mechanism designed to compensate shareholders for such part of the value of their property as is not attributable to public support.
 - (c) To satisfy the requirement of proportionality, it is normally (though not invariably) necessary – but always sufficient – to show that compensation for the property taken has been provided in “*an amount reasonably related to its value*” (emphasis added): see e.g. *James v UK* (1986) 8 EHRR 123, [54]; *Lithgow v UK* (1986) 8 EHRR 329, [121]; *Holy Monasteries v Greece* (1994) 20 EHRR 1, [71]; *SRM (CA)*, [48].
 - (d) The state enjoys a wide margin of appreciation both in deciding whether to deprive an owner of his property **and** in laying down the terms and conditions (including as to compensation) on which property is taken: *James* at [122]; *SRM (CA)* at [53].
 - (e) In deciding whether the basis on which a valuation is to be carried out results in compensation in “*reasonably related to its value*”, “*the [domestic] 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*”: *SRM (CA)*, [75].

- (5) The Valuation Assumptions (interpreted in accordance with the normal principles of domestic statutory construction set out above) represent “*the State’s judgment as to what is in the public interest*”. It follows that s. 3 HRA would be relevant if and only if it were possible to say that that judgment were “*manifestly without reasonable foundation*”.
- (6) But it is impossible to draw that conclusion in the light of Laws LJ’s conclusions in *SRM* at [76]. Laws LJ had in mind that the Valuation Assumptions would require the Valuation to be carried out on the basis of a quick sale of Northern Rock’s assets. He had equally in mind that this would be likely to depress their value, especially where the assets in question were mortgages. Yet despite this, there was no breach of AIP1.

24. Consistency with Community Law¹³

- (1) The provision of financial assistance to Northern Rock fell within the remit of Community law on state rescue aid. Such aid is subject to strict time limits. The default position is that it must be repaid within 6 months, a period the Commission determined would end, in the case of Northern Rock, on 17 March 2008. Extensions to this are available only upon communication of a restructuring or winding up plan, a key principle of which is to exclude shareholders from receiving the benefit of any aid.
- (2) Accordingly had Northern Rock not been nationalised, it would have been incumbent on the Government either to obtain repayment by 17 March 2008, or to provide for its restructuring or liquidation in such a way as to exclude shareholders from receiving any benefit.¹⁴
- (3) Further, the nationalisation of Northern Rock was itself the subject of a Commission decision, which held that it would be compatible with state aid law provided that “*shareholders are only compensated on the basis of an independent valuation of the company without any State support*”.¹⁵

¹³ Statement of Case paras 96-103 {1A/t27/p202-204}

¹⁴ See Commission Decision of 5.12.2007, paras (43) and (45), and in particular section 5: “*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 granted have been repaid in full and that the guarantees have been terminated.*” (Emphasis added.)

¹⁵ See http://ec.europa.eu/competition/state_aid/cases/223064/223064_782115_13_1.pdf
Commission Decision of 3.6.2008 (OJ 2008/C 135/06).

- (4) The Repayment Interpretation is consistent with these decisions, as it respects both the default position, absent nationalisation, that the financial assistance would have had to be repaid imminently, and the requirement that compensation to Shareholders upon nationalisation must be assessed on the basis that Northern Rock was “*without any State support*”. By contrast, the Repayment in Kind and Demand Interpretations each attribute value to ongoing (and long term) financial assistance, and result in Shareholders being compensated for value attributable to state support.

Other points in favour of the Repayment Interpretation

25. Robustness and consistency.¹⁶

- (1) The Repayment Interpretation has the benefit of being robust, consistent and easy to apply. All the Valuer needs to consider, for the purpose 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.
- (2) By contrast, under the Repayment in Kind interpretation, compensation is assessed equally regardless of whether the assets used to repay the financial assistance are high quality and readily realisable (e.g. gilts) or low value and saleable only at a discount (e.g. subprime mortgages), or the extent to which book value represents realisable value. This would result in shareholders being effectively rewarded for having invested in a bank with a poor-quality asset book and insulated them from the fact that the book values of those assets did not at the Valuation Date represent their realisable value, which cannot have been intended.
- (3) Equally, it may be the case that a bank has assets that are significantly undervalued at book value. For example, property is frequently accounted for at cost whereas in reality its market value will be substantially higher. If such assets were treated as used to repay the financial assistance, the result would be to undercompensate shareholders and grant the Treasury an unmerited windfall. Again, that cannot have been intended.
- (4) By contrast, under the Repayment Interpretation, shareholders will be compensated according to the quality of the assets held by the bank and the value which could in fact have been obtained for them.

¹⁶ Statement of Case paras 36-52 and 89-95 {1A/t27/p190-194 and p201-202}

- (5) As for the Demand Interpretation, under this the Valuer needs to consider not only the value of the financial assistance, but the detailed terms of repayment and security granted. This has the result that seemingly minor differences in the financial assistance package can lead to wildly different results for shareholders.¹⁷ By contrast, the Repayment Interpretation is robust and fair in that it looks only to the value of assistance provided and not to the precise terms dictated by the Treasury or Bank of England.

Response to points made by Harbinger

26. Repayment-in-Kind Interpretation and SRM¹⁸

- (1) The original basis on which Harbinger put forward the Repayment in Kind Interpretation was in order to represent the effect of construing “withdrawn” as meaning “never was provided”.¹⁹ While it has since sought to row back from that position,²⁰ it has yet to articulate any clear alternative basis and as such the justification for the Repayment in Kind Interpretation appears to remain that it “*re-creates a similar (but not identical) position to the financial position of Northern Rock in September 2007*” [i.e. before the provision of financial assistance].²¹
- (2) As an aside, it may be observed that, in reality, had financial assistance “never been provided” to Northern Rock, the situation would have been far more serious than that envisaged by any of the parties to date. The reason for providing financial assistance was to avert the catastrophic consequences for the UK financial system and economy as a whole that would have resulted from its failure. Such a scenario is not plausibly modelled by treating financial assistance as being repaid in kind followed by an orderly 5-year run off.

¹⁷ For example, both Northern Rock and Bradford & Bingley received financial assistance in the form of secured loans. However in the case of B&B, the security was in the form of collateral which the Bank of England could sell to obtain repayment. Under the Demand Interpretation, B&B would thus have to be treated as though a demand resulted in immediate repayment, whereas Northern Rock would potentially be subject to a moratorium.

¹⁸ Statement of Case paras 78-88 {1A/t27/199-201}

¹⁹ See Harbinger’s 1st Written Submissions, paras 103, 109 {3/t52/p33, 35}; Supplemental Written Submissions, para 7{3/t53/p114}.

²⁰ At the last Case Management Hearing, Harbinger’s leading counsel sought to characterise the previous submissions to that effect as “lawyer’s wording” which, it was said, failed to properly capture the actual submission being made. He did not however give any alternative explanation as to what was being said, other than to refer to Mr McKillop’s evidence.

²¹ See Harbinger’s Second Supplemental Submissions, para 21 {3/t54/p127}.

- (3) This construction (however phrased) is moreover far removed from the language used in the statute. In order to justify it, Harbinger relies instead upon the evidence and judgments in *SRM*. The high point of its case in this regard is the statement of Laws LJ that

“the purpose of the assumptions was to put the shareholders in the position they would have occupied (vis-a-vis the value of the shares) had no LOLR [lender of last resort] support been provided”.²²

- (4) This reliance is misplaced. *SRM* was not concerned with the precise construction of the Withdrawal Assumption, but with the much broader question of whether the Valuation Assumptions as a whole were compatible with Convention Rights.
- (5) In particular, a key issue was whether the Valuation Assumptions breached Shareholders’ rights to fair compensation by requiring the Valuer to assume a state of affairs that did not reflect reality (since in fact, after nationalisation Northern Rock continued to receive financial assistance, was not in administration and remained a going concern).
- (6) Laws LJ rejected this argument on the basis that shareholders had no right to be compensated for value that only existed because of financial assistance.²³ In describing the purpose of the Valuation Assumptions as being to put shareholders in the position as though no assistance had been provided, he was making a general statement as to the policy underpinning them, rather than endorsing any particular construction. In particular, he referred to “the Valuation Assumptions” and not just the Withdrawal Assumption. What he had in mind was that had Northern Rock received no past or future financial assistance, it would by the Valuation Date have inevitably been in administration and no longer a going concern. As such, the shareholders could not complain if that was the scenario imposed upon them by the Valuation Assumption.
- (7) *SRM* thus provides no support for the Repayment-in-Kind Interpretation. In the absence of any other justification for it, it must be rejected.

²² *SRM* (CA), [84].

²³ See *SRM* (CA) at [66] and [76]. See also [61], where Laws LJ states that “*The decision to take [Northern Rock] into public ownership was a strategic exercise of government policy, intended to preserve for the sake of the national economy the benefits won by the LOLR [lender of last resort] operation at the least possible cost to the taxpayer.*”. (Emphasis added.)

27. Presumption against illegality/absurdity

- (1) Harbinger contends that the Repayment Interpretation “necessitates a breach of English law” and so cannot be correct. The premise for this argument is as follows.²⁴
 - (a) Northern Rock’s directors could not, consistently with their legal duties, agree to repay the financial assistance in preference to other creditors of Northern Rock.
 - (b) The Repayment Interpretation treats the financial assistance as having been repaid in preference to other creditors.
 - (c) Therefore the Repayment Interpretation necessitates a breach of duty by the directors of Northern Rock.
- (2) The flaws in this argument are obvious.
 - (a) Firstly, the Withdrawal Assumption, however interpreted, remains nothing more than an assumption. It cannot and does not require the directors of Northern Rock to do anything at all, let alone act unlawfully. The Withdrawal Assumption sets the **starting point** for the Valuation, not the end-point of some other process. As such it requires the Valuer simply to assume a hypothetical state of affairs – i.e. that financial assistance has been withdrawn. It does not require him to consider the prior steps that might be involved in order to bring about such withdrawal.²⁵
 - (b) Secondly, to construe the Withdrawal Assumption by reference to what the directors of Northern Rock would have done in the face of a demand for repayment is to give undue weight to the interests of shareholders in Northern Rock (in whose interests directors act). That is contrary both to the general scheme of the 2008 Act, which gives primacy to the public interest, and to the particular purpose of the Withdrawal Assumption, which is to **prevent** shareholders taking any benefit from public funds.

²⁴ Harbinger’s Grounds, paras 60-81{1A/t18/p114-121}

²⁵ In essence, the Valuation Assumptions are deeming provisions, of which Ward LJ said in *Secretary of State for Work and Pensions v Selby CC* [2006] EWCA Civ 271, at [16] that their “*essence...is that black may be treated as white*”. In other words, it is irrelevant to the construction of deeming provision to consider how the deemed state of affairs could have arisen.

- (3) Additionally, any criticisms levelled by Harbinger against the Repayment Interpretation on this basis apply equally to the Repayment-in-Kind Interpretation, which also treats the financial assistance being repaid ahead of other creditors prior to Northern Rock entering administration.

28. **Relevance of expert evidence to the Interpretation Issue**²⁶

- (1) At the Case Management Hearing on 24 February 2011, Harbinger indicated that it intended to rely upon the evidence of Mr McKillop and Mr Thompson in support of its case on the Interpretation Issue. While granting permission, the Judge (Andrew Bartlett QC) made clear that he was sceptical as to its relevance, stating at paragraph 11 of his ruling:²⁷

“My present view, which is provisional, is that the particular facts and matters discussed in the expert reports cannot of themselves affect the meaning of the statutory provisions and indeed are likely to be inadmissible for that purpose”

- (2) The Valuer submits, with respect, that this provisional view (albeit formed at a time when the Judge, as he himself made clear, had yet to consider the content of the expert reports) is correct. It is difficult to conceive how expert evidence could ever be relevant to an issue of pure statutory construction. That difficulty becomes an impossibility when one considers the content of the evidence now put forward.
- (3) The evidence of Mr McKillop and Mr Thompson attempts two things.
 - (a) To show why (in the view of Mr McKillop) the directors of Northern Rock would refuse to repay the financial assistance in full upon demand and why (in the view of Mr Thompson) the Bank of England would not insist upon immediate repayment.
 - (b) To set out Mr McKillop’s view of what Valuation would result if the Repayment in Kind or Demand Interpretations were adopted.
- (4) Neither is relevant to the Interpretation Issue:

²⁶ This is a point which arose subsequently to the Valuer’s Statement of Case and is therefore dealt with more fully in this Skeleton.

²⁷ {1B/t35/p283-284}

- (a) As set out above, the Valuer’s position is that the notional approach of the directors of Northern Rock (and, by extension, the Bank of England) to the repayment of the financial assistance is irrelevant to the construction of the Withdrawal Assumption. Parliament has directed the Valuer to assume that financial assistance has been withdrawn. Whether or not, in reality, the Bank of England would press for withdrawal, or the directors would accede to it, is immaterial to and indeed inconsistent with the assumption.
 - (b) It is impossible to see how Mr McKillop’s alternative valuations on the basis of alternative interpretations can inform the construction of the Interpretation Issue. All they do is demonstrate that different constructions lead (potentially) to different outcomes. What his evidence cannot do is to assist in choosing between the outcomes; that would be a clear case of the tail wagging the dog.
- (5) Further, the relevance of Mr McKillop’s and Mr Thompson’s evidence on the Interpretation Issue is also questionable in light of the following:
- (a) Mr Thompson’s evidence purports to describe how a commercial lender would approach its relationship with Northern Rock. His background is commercial banking and his instructions are *“to consider these issues from the perspective of a commercial clearing bank...as if it was the Bank [of England]”*. As such he has assumed *“a proper commercial relationship between the Bank [of England] and Northern Rock”* (see Thompson, paragraphs 2.3 and 2.5).²⁸
 - (b) This is, of course, not the case.
 - (i) The Bank of England provided financial assistance to Northern Rock in its role as a central bank acting in the public interest to preserve financial stability. It cannot be compared to a commercial lender, not least because had Northern Rock been able to access financing from a commercial bank, it would not have required public assistance.
 - (ii) Mr Thompson also fails to take account of Community law which, as noted above, imposes a contingent obligation on the

UK state (including the Bank of England) to obtain repayment in short order.

- (iii) Further, Mr Thompson is not and never has been a central banker. He is thus not qualified to give evidence on what the Bank of England would have done.
- (c) Thus even if the Bank of England's likely approach to Northern Rock were relevant in principle, Mr Thompson's evidence sheds no light on the matter.
- (d) As for Mr McKillop, his starting point is that the Repayment Interpretation is incorrect: see McKillop 2, 5.22 {3/t57/p264}. As such, the criticisms that follow are not criticisms of the Repayment Interpretation itself, but criticisms of Mr Caldwell for adopting it. As such they cannot be relevant to the Interpretation Issue.
- (e) Further, Mr McKillop's "evidence" on the Interpretation Issue is, in truth, nothing more than ill-disguised submission. Thus at McKillop 2, 5.41-5.43 {3/t57/267}, he states:

"5.41. I do not believe that Mr Caldwell's approach is realistic or appropriate for a number of reasons.

5.42. Firstly, neither the Legislation nor the Valuation Assumptions direct that a 'demand for repayment' ipso facto means that an immediate repayment in cash must be made. The Legal Analysis [of Harbinger's lawyers] and Second Legal Analysis are clear on this point.

5.43. Secondly, Section 5(4) of the Banking Act [2008] further specifies that Financial Assistance is withdrawn "whether by the making of a demand for repayment or otherwise" (i.e. the Legislation specifically contemplates that a demand for repayment constitutes "withdrawal"). The Legal Analysis and Second Legal Analysis are again clear on this point."

It is trite law that expert evidence is not admissible on points of English law. As such Mr McKillop's views on the correct interpretation of the Valuation Assumption cannot assist the court.

GENERAL POINTS CONCERNING METHODOLOGY ISSUES

Relationship between the Interpretation Issue and the Methodology Issues

29. The Valuation involves a two-stage process.
- (1) At the first stage, the Valuer determines the initial balance sheet to be used for the Valuation. This is done by taking the actual balance sheet of Northern Rock at the Valuation Date and adjusting it as required to take account of the withdrawal of financial assistance pursuant to the Withdrawal Assumption (however interpreted).
 - (2) The second stage involves the application of the remaining Valuation Assumptions in order to reach a value for the shares. Because the Administration Assumption requires the Valuer to assume that Northern Rock is in administration, this involves consideration of how the initial balance sheet would evolve during a hypothetical administration.
30. These two stages are not independent of each other. Rather, the second stage depends upon the first, as the choices made by an administrator will depend upon the assets and liabilities at the outset of the administration. For example, the administration of a bank will proceed differently according to whether the bank is in a position of asset surplus, and so able to pay debts as they fall due, or is in deficit and forced to default on those debts.
31. The Interpretation Issue concerns only the first stage, and is thus capable of determination by itself. The Methodology Issues, however, are predominantly concerned with the Valuer's approach to the hypothetical administration and thus cannot be isolated from the Interpretation Issue. That is particularly so given the very different conditions that result from of the competing interpretations of the Withdrawal Assumption:
- (1) Under the Repayment Interpretation, Northern Rock's balance sheet is adjusted to account for the realisation of assets in order to repay the financial assistance outstanding at the Valuation Date. This results in an initial net asset deficit of £2.4 billion.²⁹
 - (2) Under the Repayment-in-Kind interpretation, Northern Rock's balance sheet is instead adjusted by striking out the financial assistance together

²⁹ Consultation Document, para 12.10 {2/t47/p103}.

with an equivalent book value of assets. This results in an initial net asset surplus of £1.6 billion.³⁰

- (3) Under the Demand Interpretation, there is no initial adjustment to the balance sheet as the financial assistance is treated as being repaid after the Valuation Date. This also results in an initial net asset surplus of £1.6 billion,³¹ but with a very different mix of assets and liabilities to Repayment-in-Kind.
32. This has important consequences for the present proceedings:
- (1) Any criticism of the Valuer's methodology as applied under the Repayment Interpretation cannot be assumed to be valid under an alternative interpretation, as there is no *prima facie* reason to assume that the Valuer would adopt the same methodology under different conditions.
- (2) Similarly, any argument as to the appropriate methodology to be applied under an alternative interpretation cannot be treated as criticism of the Valuer for not applying the same methodology under the Repayment Interpretation.
33. This second point is of particular relevance here since, as set out further below:
- (1) Harbinger does not make any criticisms of the Valuer's methodology as applied to the Repayment Interpretation, but presents its case solely on the basis of the methodologies it says should be applied under the Repayment-in-Kind and/or Demand Interpretations.
- (2) The Tribunal is not in a position, and/or has no jurisdiction, to determine for itself, how the Valuer would treat the hypothetical administration of Northern Rock on the basis of a different interpretation to that which he has hitherto adopted. Nor, prior to the Tribunal's finding on the issue, is it open to and/or appropriate for the Valuer to conduct alternative valuations based upon interpretations of the Withdrawn Assumption which he considers to be incorrect.

³⁰ McKillop 2, 5.48 {3/t57/p268}. This is derived from the opening balance sheet as at the Valuation Date prior to the "repayment in kind" being effected; however the net figure does not change since the essence of the Repayment in Kind interpretation is that assets are taken out to an identical book value of the liabilities corresponding to the financial assistance.

³¹ Ibid.

34. Thus the Methodology Issues raised by Harbinger are a dead end. If the Repayment Interpretation is upheld, they do not arise.³² If it is not, then (as set out further below) the matter will have to be remitted for the Valuer to consider the second stage of the valuation process anew.³³

Role of the Tribunal when considering the Methodology Issues

35. Before addressing the particular points of Valuation methodology raised by the Applicants, it is necessary to address the role of the Tribunal in this regard. This is because, as became apparent at the Case Management Hearing, the Valuer and Harbinger have sharply divergent opinions on this point.
- (1) The Valuer contends that the role of the Tribunal is to review the reasonableness of his decision as to the amount of compensation payable. If the decision is found to be unreasonable, then the remedy is to remit the matter to the Valuer for a fresh decision, together with such directions as may be required to avoid repetition of the unreasonableness found to exist.
 - (2) Harbinger contends that the Tribunal is instead to review the reasonableness of the amount of compensation decided by the Valuer. If the Tribunal finds the amount to be unreasonable (i.e. wrong), then it should proceed to make its own finding as to the compensation payable.
36. The Valuer's Case on the proper scope of the Tribunal's jurisdiction is set out in its Written Submissions of 1 April 2011 {1B/t41/p331}. However, in light of Harbinger's Skeleton dated 20 April 2011 {1B/42/p347}, it is necessary to include full argument here upon the additional points raised therein.
37. Essentially:
- (1) Section 9(1)(b) of the 2008 Act enables the Secretary of State to make provision for compensation to be determined by an "independent valuer". Paragraph 7 of the CSO Schedule, which provides that the independent valuer is not removable save for incapacity or serious misbehaviour, guarantees the valuer's independence. Thus what is now referred to the Tribunal is the decision of a fully independent decision-maker, who is also an expert in valuation.

³² As Harbinger has accepted in correspondence: letter of 2.12.2010, 2nd page {5/t72/p18}.

³³ The Valuer will also need to consider the first stage anew, as he will not necessarily agree with Harbinger as to the immediate financial consequences of the Repayment in Kind or Demand Interpretations. However the impact will be most obvious on the second stage.

- (2) Secondly, s. 9(1)(e) of the 2008 Act enables the Secretary of State to make provision for decisions relating to the assessment of any compensation to be “reviewed” by the Tribunal. The purpose of a reference under paragraph 13 of the CSO Schedule must therefore be to enable a “review” to take place.
- (3) Thirdly, in an ordinary case (i.e. outside the context of the 2008 Act and the CSO), s. 133(5) of FSMA requires the tribunal to “*determine what (if any) is the appropriate action for the decision-maker to take in relation to the matter referred or appealed to it*” before remitting the matter to the decision-maker with appropriate directions. In this case, however, the CSO, as amended by the 2010 Order, modifies FSMA so as to omit this provision entirely. The result is that, on a reference under the CSO, unlike in other cases, there is no duty, nor scope, to determine “*the appropriate action for the decision-maker to take*”. Rather, any reconsideration of the decision is expressly left to the Valuer.
- (4) Fourthly, the modified version of s. 133(5) makes clear that the Tribunal’s duty to remit the matter to the valuer arises if and only if a threshold condition is met: namely, that “*the Tribunal is satisfied that the decision as to the amount of compensation shown in the revised assessment notice was not a reasonable decision*”. This wording makes clear that the trigger for the Tribunal’s jurisdiction is a finding that the valuer’s decision was *not a reasonable decision*, rather than a finding that the amount of compensation was *not a reasonable amount*.
- (5) Fifthly, it would have been easy for the legislator to say that the Tribunal should remit if satisfied that the decision of the valuer was “*wrong*” (i.e. the test applied by the Court of Appeal under CPR r. 52.11(3)). But the legislator did not say that. It obliged the Tribunal to remit only where it was satisfied that the Valuer’s decision was “*not a reasonable decision*”.
38. Where, in general, a statute confers power to interfere with the decision of a public authority on the ground that it has acted “*unreasonably*”, the conduct has to be “*such that no reasonable authority would engage in it*”,³⁴ i.e. conduct

³⁴ *Secretary of State for Education and Science v Tameside MBC* [1976] AC 1014, 1054, per Viscount Dilhorne.

*“which no sensible authority acting with due appreciation of its responsibilities would have decided to adopt”*³⁵. That is because

“[t]wo reasonable [persons] can perfectly reasonably come to opposite conclusions on the same set of facts without forfeiting their title to be regarded as reasonable... Not every reasonable exercise of judgment is right, and not every mistaken exercise of judgment is unreasonable.”³⁶

39. There are sound reasons why the legislator should have intended the Tribunal to adopt an equivalent test to the standard public law test of reasonableness:
- (1) Valuation involves the exercise of an expert professional judgment; and different valuers may adopt different approaches.
 - (2) This is a paradigm situation in which two professional people may reach different conclusions from the same underlying facts without either *“forfeiting their title to be regarded as reasonable”*.
40. Additionally, the automatic right of reference to the Tribunal conferred by the CSO makes it inevitable that any valuation thereunder would be subject to challenge by not just one, but hundreds and potentially thousands of affected parties. As with the case of administrative decisions that affect large numbers of people, the adoption of a high “unreasonableness” standard is essential to allow any degree of certainty in the Valuer’s performance of his function. Otherwise – if the Tribunal were simply free to put aside the Valuer’s decision and substitute its own on the basis of a mere difference of view – the Valuation process would serve no practical purpose, and the time and cost spent on it (including on the consultation exercise) would be a waste of time.
41. Harbinger’s response is based squarely on its A1P1 rights. As with its reliance on those rights in relation to the Interpretation Issue, it is misplaced. In particular, Harbinger argues that, when assessing the compensation payable for expropriated assets, A1P1 requires that (i) any valuation by the Valuer should be subject to review by a judicial tribunal with “full jurisdiction”; and (ii) that this means jurisdiction to substitute its judgment for that of the Valuer.
42. Both propositions are wrong. As to (i), Harbinger submits that the Valuer’s case leads to the following “undesirable position”:

³⁵ Ibid at 1064, per Lord Diplock.

³⁶ Ibid at 1070 per Lord Salmon, quoting Lord Hailsham in *In re W (An Infant)* [1971 AC 682, 700.

“A non-judicial individual who is appointed by HM Treasury decides how much, if anything, HM Treasury is to pay by way of compensation. This is the determination of a civil right or obligation but the Tribunal can only undertake a light touch review of the approach of the Valuer (not even of his decision as to amount) and an applicant can then only appeal on point of law against the Tribunal’s decision. Unless it is the Valuer’s case that an applicant can in parallel bring judicial review proceedings invoking ‘full jurisdiction’, the Valuer’s arguments if correct lead to an obvious violation of the state’s obligations under the HRA.”³⁷

43. This passage reveals a sleight of hand. It starts with two irrelevant facts. The first is that the Valuer is a “non-judicial individual”; the second is that he is appointed by HM Treasury.
44. As to the first, it is true that the Valuer is an expert in shares and business valuations rather a lawyer. But this makes him better (rather than less well) equipped to perform the function conferred on him. He is an expert, appointed to perform a task requiring special expertise. As the Strasbourg Court said in *Lithgow v United Kingdom* (1986) 8 EHRR 329 (a case about the assessment of compensation in respect of nationalised property), at [202]:

“the word ‘tribunal’ in Article 6(1) is not necessarily to be understood as signifying a court of law of the classic kind, integrated within the standard judicial machinery of the country; thus, it may comprise a body set up to determine a limited number of specific issues, provided always that it offers the appropriate guarantees.”

45. See also *Campbell & Fell v United Kingdom* (1985) 7 EHRR 165, at [76]. In *Campbell & Fell*, a board of prison visitors which did not (or did not necessarily) contain any lawyers was held capable of being a “tribunal” within the meaning of Article 6.
46. As to the second irrelevancy, it is again true that the Valuer is appointed by HM Treasury, but that does not prevent him from being an “independent and impartial” for the purposes of Article 6, even though HM Treasury is one of the parties to the dispute that he has to determine (any more than the fact that a circuit judge is appointed by the Lord Chancellor prevents him or her from hearing cases brought against the Lord Chancellor or his department): see e.g. *Campbell & Fell*, at [77]-[82]. Though some of the Notices take the point that the Valuer’s appointment prevents him from being independent and impartial, Harbinger’s does not – and advisedly so, since there is clear Strasbourg authority that appointment by the executive of members of a tribunal does not prevent those members from being independent and impartial, provided that (as

³⁷

Para 43 of Harbinger’s Skeleton dated 20 April 2011 {1B/t42/p367}

here) they are not easily removable: see Statement of Case, paragraphs 175-6 {1A/t27/p219-220}..

47. Having started by suggesting (without actually submitting) that the Valuer is himself less than “independent and impartial”, Harbinger then argues that the Valuer must himself be subject to judicial review with “full jurisdiction”. The correct analysis is in fact as follows: because the Valuer himself is both independent and impartial, the first question is whether *he* has “full jurisdiction” within the meaning of Article 6. As Laws LJ put it in *SRM (CA)* at [84]:

“The answer to Mr de la Mare's argument is that the procedural requirement inherent in A1P1 is met. So far as his ... assault is upon the assumptions themselves for violation of A1P1, it is met by the availability of judicial review. The judicial review court is amply equipped to receive all the material, fact or law, that might properly be required to mount such a challenge. It therefore possesses what in the cases is sometimes called “full jurisdiction”: see for example *Albert and Le Compte v Belgium* (1983) 5 EHRR 533, paragraph 29, and *Alconbury* [2003] 2 AC 295 paragraph 29. So far as it may be 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 has full jurisdiction to enter into any factual issues that may call to be decided. His conclusions will be impartial and independent. All he is prevented from doing is to decide the merits of the policy, constituted by the assumptions, within which he is to carry out his task. But given the availability of judicial review nothing requires him to do so.” (emphasis added).

48. Once it is seen that the Valuer himself has “full jurisdiction” to determine any factual issues that are relevant to the valuation, there is no reason to suppose that Article 6 requires an appeal to a tribunal with jurisdiction to enter into those issues afresh.
49. Harbinger’s submissions on the jurisprudence of the Strasbourg Court take the matter no further. It seeks to rely, first, on *Forminster Enterprises Limited v Czech Republic* (Application No 38238/04, 9 October 2008). That was a case in which the relevant legislation allowed a prosecutor in pre-trial criminal proceedings to seize property without affording the affected individual any opportunity to challenge the prosecutor’s decision. The passage in [69] of the judgment relied upon by Harbinger (in para. 24(f) of its Skeleton of 20 April 2011 {1B/t42/p360}) was simply a statement that the rule of law requires that “*measures affecting fundamental rights be, in certain cases, subject to some form of adversarial proceedings before an independent body competent to review the reasons for the measures and the relevant evidence*”. The Court elaborated later in the same paragraph: in the context of an interference with property rights, the State must provide “*procedural guarantees affording to the*

individual or entity concerned a reasonable opportunity of presenting their case to the responsible authorities for the purpose of effectively challenging the measures interfering with the rights guaranteed by this provision". Contrary to Harbinger's submission, there is nothing in the judgment to suggest that questions of valuation in expropriation cases should require determination by a *judicial* body or that there should be any formal adversarial proceedings.

50. Harbinger also relies on *Katkaridis v Greece* (2001) 32 EHRR 107, which it says establishes that individuals subject to expropriation must be able to challenge the facts in issue before an independent tribunal. That case concerned the compatibility with A1P1 of an irrebuttable presumption imposed by legislation affecting the compensation paid to owners of property on expropriation. The Court held that the irrebuttable presumption was incompatible with A1P1 because it provided no opportunity at all for consideration of evidence calling into question its validity in the case at hand. Again, there is nothing in the Court's judgment to suggest that valuations should be conducted by judicial tribunals. All that is required is an independent and impartial tribunal. Given that Harbinger does not challenge the Valuer's independence or impartiality, that case too provides no assistance to Harbinger.
51. Harbinger's reliance (in paragraph 37 of its Skeleton of 20 April 2011 {1B/t42/p365}) on Lord Hoffman's dictum in *Runa Begum v Tower Hamlets LBC* [2003] 2 AC 430 at [42] that "*certain decisions, of which the paradigm examples are findings of breaches of the criminal law and adjudications as to private rights, should be entrusted to the judicial branch of government*" is equally misplaced. Contrary to Harbinger's submission on that point, the Valuer's function is manifestly not to carry out an adjudication as to private rights. It is a valuation exercise for the purposes of a statutory compensation scheme. Deciding how much compensation to award for expropriation is not a task traditionally given to the judicial branch of government, although it must of course be subject to judicial review for compliance with the law.
52. Moreover, in the same paragraph of *Runa Begum*, Lord Hoffman explained that if the adjudication of private law rights were entrusted to an administrator, "*the possibility of an appeal [would not be] sufficient to compensate for lack of independence and impartiality on the part of the primary decision maker*". As noted above, in this case the Valuer is independent and impartial. The only "deficiency" that could conceivably require "compensation" by an appeal to a court would be the fact that the Valuer is not a judge. But that "deficiency"

could not have any bearing on the accuracy or fairness of his expert appraisal of the value of the shares. The most that can be said is that Article 6 ECHR or the general principle of the rule of law requires that an appeal to a court be available to address any errors of law in the Valuer's approach. But that requirement has been more than satisfied by the judicial review and Upper Tribunal appeal processes that are available to (and have been used by) the affected parties.

53. As to the second of Harbinger's propositions, (i.e. that A1P1 not only requires judicial review of the Valuer's appraisal but moreover requires a full merits review by that judicial body), Harbinger is on even weaker ground. As was explained in paragraph 13(1) of the Valuer's Written Submissions on this issue dated 24 February 2011, it is well established that even where there is an Article 6 ECHR deficiency in the original decision making process such that some further review is required, a review by an Article 6 compliant body that is limited to error of law or perversity will generally be sufficient to satisfy the procedural requirements of Article 6 ECHR when the decision under review is that of a decision-maker exercising specialist expertise with quasi-judicial safeguards falling short of Article 6 independence and impartiality (*Bryan v United Kingdom* (1995) 21 EHRR 342 at [45]-[47], *Tsfayo v United Kingdom* (2009) 48 EHRR 18 at [46]-[47]). It follows *a fortiori* that that in the present case where there is no deficiency in the independence or impartiality of the decision-maker exercising specialist expertise, a review that is limited to error of law or perversity should be sufficient.
54. The same principles apply to the procedural requirements of A1P1. As the Strasbourg Court said in *Jokela v Finland* (no 28856/95 at [45]), all that is required is that the party whose rights are affected have "*a reasonable opportunity of putting his or her case to the responsible authorities for the purpose of effectively challenging the measures interfering with the rights guaranteed by this provision*". There is no requirement that the affected party should have the opportunity to do so twice or that the "responsible authorities" need all be judicial in character. On the contrary, as to a requirement for an opportunity to put its case twice, it is well established that Article 6 does not confer a right of appeal: see, for example *R (Aru) v Chief Constable of Merseyside* [2004] EWCA Civ 199 at [12]. As to the requirement that the "responsible authorities" be judicial, the Court in *Jokela v Finland* said (at [45]) that "*a comprehensive view must be taken of the applicable procedures*", and in *Forminster*, it emphasised (at [69]) that that "comprehensive view" must include both the judicial and administrative procedures. Given that in this case

Harbinger has already had extensive opportunities to put its case to an independent and impartial decision-maker (i.e. the Valuer), a requirement that the Upper Tribunal reconsider Harbinger's case on the factual issues afresh would be wholly duplicative and counter-productive.

55. Harbinger's attempt to limit the principle that judicial review can be sufficient for Article 6 ECHR purposes to discretionary policy decisions in regulatory and welfare settings is therefore flawed. As is clear from the authorities cited above, where an Article 6 ECHR compliant review of the original decision is required, the extent of review required must depend on all of the circumstances. The examples of such circumstances provided by Lord Hoffman and Lord Bingham in *Runa Begum* are no more than that: examples. Moreover, they are examples of cases where judicial review will be sufficient *despite a defect in the independence or impartiality of the original decision-maker*. There is nothing in *Runa Begum* to suggest that where a decision is taken by a fully independent and impartial (albeit not judicial) expert, anything more than the standard judicial review should be required on appeal to a judicial body.

Nature and relevance of Harbinger's expert evidence to the Methodology Issues

56. The nature and relevance of Harbinger's expert evidence to the Methodology Issues is dealt with at paragraphs 29-44 of the Valuer's Written Submissions dated 1 April 2011 {1B/t41/p341-345}. In light of Harbinger's response thereto of 20 April 2011 {1B/t42/372-379}, the Valuer takes the opportunity to expand upon these arguments below.

57. Role of expert evidence & inappropriate nature of Harbinger's evidence

- (1) It is plainly right that, in principle, expert evidence be admissible on points of methodology. Valuation is a technical field and without such evidence it will frequently not be possible for the Tribunal to determine whether a criticism of the Valuer's methodology is made out or not.
- (2) The expert evidence adduced by Harbinger is not of this nature, however. Rather, Mr McKillop and Mr Thompson each (i) starts from the premise that the Repayment Interpretation is wrong and that either the Repayment-in-Kind or Demand Interpretations is right, and (ii) goes on to explain how, on the basis of these alternative interpretations, he would approach the Valuation.

- (3) Inevitably, their approaches differ from that taken by the Valuer. But such differences are not indicative of any criticism, since they result from different starting points. Harbinger accepts this, since it states at paragraph 65 of its Skeleton Argument dated 20 April 2011 that (emphasis added):³⁸

“The Valuer takes the point...that Harbinger did not produce ‘any report or other document’ based on the Repayment Interpretation which criticised him for the conduct of his valuation. Again, this suggestion is misguided. As the Valuer well knows, such a report would have been a waste of time and resources: the opening deficit under the Repayment Interpretation (as the Valuer has recognised) necessitates an even greater deficit at the end of administration, so any analysis of methodology is nugatory”.

- (4) In other words, the only real criticism Harbinger’s experts make of the Valuer is that he adopted the Repayment Interpretation. If that interpretation is upheld, they have nothing more to say. Rather, the only purpose of their evidence is to provide a factual basis for Harbinger’s attempt to persuade the Tribunal, if it rules in Harbinger’s favour on the Interpretation Issue, also to rule on the amount of compensation payable.
- (5) As set out at paragraphs 35-55 above and 58-59 below, this is inappropriate and impermissible. It seeks to short-cut the statutory process and, in effect, replace the Valuer with Mr McKillop who – for all his experience – is not the Valuer appointed by the Treasury under the CSO and thus does not share the Valuer’s powers to consult and obtain information necessary to the proper conduct of the Valuation.

58. Harbinger’s experts not equivalent to the Valuer

- (1) The Valuer was appointed, pursuant to statute, to conduct the Valuation in accordance with the 2008 Act and the CSO. As such he is subject to public law duties, including to allow Shareholders a fair opportunity to make representations. This he discharged via the consultation exercise, in which he received over 2000 representations in writing and 1900 to the special telephone helpline set up for the purpose, as well as engaging in numerous face-to-face meetings.³⁹ He then responded in detail to the representations made to him in the Consultation Document, which was followed by a further round of representations and response. By comparison, Harbinger’s experts have consulted one party: Harbinger.

³⁸ {1B/t42/p377}
³⁹ Consultation Document, para 6.13 {2/t47/p52}

- (2) Further, the Valuer is in a privileged position as regards the obtaining of evidence and information relevant to the Valuation. This derives both from the nature of his office, and from his statutory power to obtain information.⁴⁰ As set out in section 5 of the Consultation Document, he in fact obtained information from a wide range of sources, both public and private, including Northern Rock's former directors and advisors, the Bank of England, the Treasury and the FSA. He is thus uniquely able to perform the Valuation on the basis of all relevant information.
- (3) By contrast, Mr McKillop's sources are limited to public information, requiring him to fill the gaps with guesswork. For example, he did not have access to the terms on which financial assistance was granted, and so had to speculate as to the amount of interest payable.⁴¹
- (4) Similarly, Mr McKillop and Mr Thompson's treatment of the Demand Interpretation relies on speculation as to how the Bank of England would have reacted to a failure of Northern Rock to meet a demand for repayment. They assume (in Harbinger's favour) that the Bank would and could not have enforced its security and would have given up its right to statutory interest. The Valuer, by contrast, has no need to speculate. He can produce evidence of what the Bank of England says it would have done in that scenario.⁴²
- (5) Another reason that Mr McKillop and Mr Thompson are not to be equated with the Valuer is that they have been chosen by a party, Harbinger, with an interest in a particular outcome.⁴³ Further, that interest is not even aligned with the interests of other Applicants: Harbinger's interest in the

⁴⁰ See para 9A of the Schedule

⁴¹ McKillop 2, 5.46, 5.100, 5.101 {3/t57/p268, 277}. Mr McKillop assumed that the interest payable on financial assistance from the Bank of England accrued at LIBOR plus 1.25%, and LIBOR plus 2% on the PIK component. The actual interest rate is subject to confidentiality restrictions but can be provided to the Tribunal in writing if required. The Bank of England has requested that it not be disclosed publically whether in hearings or judgment.

⁴² As set out at Appendix A, para 7, there are 3 issues the Valuer would need to take into account: whether the Bank of England is subject to the statutory moratorium against enforcement upon administration; if so, whether it would have applied to enforce; and if so whether the Court would have allowed enforcement. All are matters on which evidence and/or submissions from the Bank would be *prima facie* relevant to the Valuation under the Demand Interpretation.

⁴³ An expert is, of course, also subject to strict duties of independence. But these cannot alter the fact that he is only being put forward as an expert because his views support those of the party putting him forward. Thus without impugning the professional conduct of Mr McKillop and Mr Thompson, it is easy to see that their evidence, as presented by Harbinger, is not "independent" in the sense that the Valuer's conduct of the Valuation is independent. In particular, while Harbinger can always substitute a new expert if its previous one proves not to its liking, once the Valuer is appointed he cannot be removed..

Preference Shares means that its only interest is for the Valuation to equal or exceed £400 million. By contrast, ordinary shareholders will receive nothing unless the Valuation exceeds £400 million, and so their interests would be best served by an expert willing to put a higher figure on Northern Rock, even at the risk of being less robust.

- (6) Unlike Harbinger, the Valuer is fully independent and has no interest in the outcome of the Valuation. Thus, were the Valuation remitted to him with a direction to adopt a different interpretation of the Withdrawal Assumption, the possibility cannot be excluded that he would reach a higher figure than Mr McKillop, and thus one more beneficial to ordinary Shareholders (though it would make no difference to Harbinger).⁴⁴
- (7) It is also relevant to note that the question of the Tribunal substituting Mr McKillop and Mr Thompson's views for that of the Valuer only arises at all because of the pure accident that, of several hundred Applicants, only Harbinger has led evidence of how Northern Rock might be valued on the basis of alternative interpretations of the Valuation Assumptions. Had the Tribunal instead been faced with multiple Applicants each putting forward a different interpretation with a different expert in support (none of whom actually criticised the others), there could have been no question of it simply adopting whichever valuation report coincided with the interpretation chosen. Nor could there be any question of the Valuer having to respond to multiple experts, each opining on a different basis, and therefore in effect conducting multiple valuations.
- (8) For all the above reasons, Harbinger's experts cannot be treated as a potential substitute for the Valuer. If the Tribunal determines that the Interpretation Issue should be decided other than in favour of the Repayment Interpretation, the only appropriate course – and the only course that is fair to all Shareholders – is to remit the matter to the Valuer.
- (9) Of course, if the Tribunal determines the Interpretation Issue in the Valuer's favour, Harbinger's evidence falls away by its own admission.

59. Valuer's alleged failure to respond to Harbinger's evidence

⁴⁴ It is to be noted that in his original Valuation, where faced with a range of views available on any given point the Valuer's general approach was to select those more favourable to Shareholders: Consultation Document, paragraph 2.49 {2/t47/p22}.

- (1) In its Skeleton of 20 April 2011, Harbinger seeks to criticise the Valuer for not adducing evidence of his own to contradict Mr McKillop, or Mr Thompson, and argues that the Valuer has thereby given up the opportunity to challenge their evidence: see paras 68-69 {1B/t42/p379}.
- (2) This suggestion is misguided. As noted above, the Valuer is not to be confused with a private party or expert witness, and similarly the present proceedings must not be confused with private litigation between the Valuer and Harbinger alone. Rather, these proceedings involve a review, under statute, of the Valuer's performance of a public function with Harbinger being one of many thousands of Shareholders affected by the Valuation and one of several hundred Applicants now challenging it.
- (3) In particular, the Valuer's function is to perform the Valuation in accordance with statute. Part of that function is interpret and apply the Valuation Assumptions (subject to judicial guidance). He has no remit to engage in speculative exercises as to what alternative valuations might be appropriate under different interpretations of the Valuation Assumptions. As noted above, it would have been inappropriate for him to conduct a separate valuation exercise, at public expense, each time a Shareholder proposed an alternative interpretation of the Valuation Assumptions.
- (4) Further, the Valuation is not a question of the Valuer sitting in a room and working out a number (as an expert witness might do). Rather it is a process that involved extensive public consultation addressing both issues of interpretation and methodology. The only appropriate forum for the Valuer to engage with Mr McKillop and Mr Thompson is via the consultation process, on an equal basis with other Shareholders.
- (5) That is in fact what happened. The reports of Mr McKillop and Mr Thompson were not produced by Harbinger for these proceedings. They were originally provided as part of Harbinger's submissions in the course of the consultation process, and as such were considered and responded to by him in the various consultation documents resulting from that process. It is therefore simply wrong to assert that the Valuer has not engaged with Harbinger's evidence. He has already done so and, given that the evidence has not changed, it is difficult to see why he should now do so again.

RESPONSE TO SPECIFIC POINTS OF METHODOLOGY

Methodology points raised by Harbinger

60. For the reasons given above, the Valuer does not consider that the “issues” raised by Harbinger call for a response. By Harbinger’s own admission, they do not arise in relation to the Valuation as it stands.⁴⁵ As such they can throw no light on whether the Valuation was reasonable and are of no relevance.
61. Despite this, Harbinger argues that the methodology points it raises are “issues” that fall for decision, on the basis that:⁴⁶
- (1) The Valuer chose to address them in his original Statement of Case; and
 - (2) The Tribunal directed that all issues be heard together.
62. Neither provides any support for Harbinger’s position.
- (1) The reason that the Valuer addressed Harbinger’s methodology points in his Statement of Case was that it was not yet clear whether Harbinger was relying on them as criticisms of the Valuation as performed or not. See paragraphs 135 and 136 of the Valuer’ Statement of Case {1A/t27/212}:

“To the extent that Harbinger’s methodology submissions are themselves premised upon a particular interpretation of the Withdrawal Assumption, it is premature for the Tribunal to consider them now ... It is therefore only to the extent that Harbinger’s methodology submissions are capable of standing independently from the interpretation of the Withdrawal Assumption that it is open to the Tribunal to consider them now. It is in this sense that the Valuer has approached Harbinger’s submissions”

Since it is now apparent that Harbinger’s methodology submissions are indeed premised upon alternative interpretations of the Withdrawal Assumption, the fact that the Valuer chose to address them on a different basis cannot be used to imply that they are now in issue.
 - (2) As for the Tribunal’s direction that all issues be heard together, this did not extend to anything asserted to be in issue, but only to issues that arose in relation to the Valuation. As the Judge stated at para 14 of his ruling:

⁴⁵ This must follow from its admission that it has no evidence in relation to the Valuation as it now stands. While Harbinger asserts that some of its issues do still arise on the Valuation as conducted, in the absence of evidence it is impossible to see how this can be maintained. See Skeleton of 20 April 2011, paras 65-66 {1B/t42/p377-378}

⁴⁶ See Harbinger’s Skeleton dated 20 April 2011, 59-61 and 66(c)-(d) {1B/t42/p372, 378}

“It would be unfortunate, as Mr Phillips submitted, if there were a decision by the Tribunal which meant that the valuer re-did his valuation, and then the same methodology points were raised again which have already been raised in relation to the current valuation.”⁴⁷

(Emphasis added.)

In fact, none of Harbinger’s methodology points were “*raised in relation to the current valuation*”, as Harbinger has now accepted.⁴⁸

63. As such, it is not necessary to deal with the “Methodology Issues” raised by Harbinger. Nonetheless, at Appendix A to this Skeleton the Valuer recaps briefly why, even on Harbinger’s view on the Interpretation Issue, its proposed methodologies on these points cannot be characterised as the only ones reasonably available to a valuer (and indeed in some cases cannot be characterised as reasonable at all). As such, it would be clearly inappropriate for the Tribunal to adopt them, thereby depriving the Valuer of his statutory discretion to choose from the range of reasonably available methodologies, and denying other Shareholders the opportunity to make representations thereon.
64. Further, the impact of a change to the interpretation of the Withdrawal Assumption is not limited to the points raised by Harbinger. Appendix B to this Skeleton gives examples of various points addressed by the Valuer in the Consultation Process on the basis of the Repayment Interpretation and which he would need to reconsider if a different interpretation were adopted.

Response to methodological issues raised by Applicants other than Harbinger

65. Paragraphs 179 – 222 of the Valuer’s Statement of Case {1A/t37/p220-228} deal with Methodology Issues raised by Applicants other than Harbinger. Rather than dealing with individual Reference Notices one by one, the Valuer’s approach (consistent with the Tribunal’s Case Management Memorandum and Case Management Order No 1) was to identify, and where appropriate group together, all those points arguably within the Tribunal’s jurisdiction, and the deal with each distinct point (or group of points) separately.
66. A number of these points were raised by Mr Hulme in his original Reference Notice {1A/t14/p73}. However, these points were not pursued by Mr Hulme in

⁴⁷ {1B/t35/p284}

⁴⁸ Indeed, at the hearing Mr Phillips specifically identified the statutory interest issue – which he described as the most important of Harbinger’s methodological points – as one which might arise “again”. But para 66(c) of Harbinger’s skeleton of 20 April 2011 states that “Mr McKillop has not considered how interest would be treated on the Repayment Interpretation because such an exercise would be pointless”: {1B/t42/p378}

his subsequent Statement of Case filed on 31 March 2011 {1A/t30/p260}, and which is stated (at paragraph 1) to replace section E of his Reference Notice. Instead, Mr Hulme adopts Harbinger's submissions, and while he makes various statements in support of them, he does not provide any new legal arguments.

67. As for Applicants other than Mr Hulme and Harbinger, the Tribunal directed that any such Applicant wishing to make submissions should give notice of their intention to do so by 16 May 2011.⁴⁹ No such notice has been received. Accordingly, there will be no further submissions to the Tribunal by Applicants on such points and it is unnecessary for the Valuer to address them further save by referring to his position as already set out in his Statement of Case.

BIAS ISSUES

68. At paragraphs 170-178 of his Statement of Case {1A/t27/p219-220}, the Valuer addresses allegations of bias raised by various Applicants (including Mr Hulme in his original Reference, but excluding Harbinger).
69. As with the Methodology Issues raised by Applicants other than Harbinger, it does not appear that any points on these will be taken at the Hearing given that (i) Mr Hulme no longer advances them in his Statement of Case and (ii) no other Applicant has given notice of an intention to appear at the Hearing.
70. Again, therefore, rather than repeat simply his position, the Valuer refers to his prior submissions on the Bias Issues as set out in his Statement of Case.

CONCLUSION

71. In conclusion, for the reasons set out above, the Valuer asks that the Tribunal:
- (1) Confirm the Repayment Interpretation of the Withdrawal Assumption and uphold the Valuation as conducted on that basis.
 - (2) In the alternative that the Tribunal finds the Repayment Interpretation to have been erroneous, remit the matter to the Valuer for a new Valuation with directions as to the interpretation to be applied.

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25 May 2011

⁴⁹ Para 3(4) of Case Management Order No 2 {1B/t34/p280}.

APPENDIX A

1. This Appendix addresses the “Methodology Issues” raised by Harbinger in the context of Harbinger’s proposed outcomes to the Interpretation Issue. As set out at paragraph 63 above, its aim is to demonstrate that Harbinger’s proposed approach cannot be said to be the only one reasonably available to a valuer under the relevant interpretations. As such it would be inappropriate for the Tribunal to direct the Valuer to adopt them, instead of calling upon him to exercise his statutory discretion in choosing between the available approaches.

2. **Discounted sale values**⁵⁰
 - (1) At paragraphs 130-131 of its Grounds,⁵¹ Harbinger alleges that the Valuer was “wrong” to treat Northern Rock’s assets as being sold at substantially discounted prices, on the basis that such discounts could be avoided through the sale of smaller packages of assets over time.

 - (2) As Harbinger now accepts, the reason the Valuer took this approach was that the Repayment Interpretation required it.⁵² Further, the Valuer only treated as substantially discounted those assets required to be sold at their then market value in order to repay the financial assistance in accordance with that interpretation. There is no question of him applying such an approach where such a sale is not necessary.

 - (3) There is therefore no issue under this head. That is so regardless of the outcome of the Interpretation Issue.

3. **Statutory interest under r. 2.88 of the Insolvency Rules 1986 (“rule 2.88”)**⁵³
 - (1) Under rule 2.88, payment of interest to creditors in an administration is deferred and accrues at the higher of the contractual or statutory rate (8%). In the Valuation, the Valuer (on the basis of the Repayment Interpretation) applied rule 2.88 in calculating interest due to creditors. This resulted in an interest charge of £7 billion accruing over the 5 years of the hypothetical administration.

⁵⁰ Statement of Case, paras 145-147 {1A/t27/p215}.

⁵¹ {1A/t18/p134}

⁵² Harbinger’s Reply, para 52 {1A/t29/p256}.

⁵³ Statement of Case, paras 140-144 {1A/t27/p214-215}.

- (2) Mr McKillop's position is that under the Repayment-in-Kind or Demand Interpretations, the administrator of Northern Rock would not accrue statutory interest but would instead pay creditors contractual interest as it fell due, resulting in a substantial saving.
- (3) Even if the Administrator proposed this, however, such an approach is reliant upon creditors agreeing to it. Rule 2.88 is the default provision, and it is not obvious why creditors who would enjoy enhanced interest thereunder would necessarily agree to depart it. Nor is Mr Thompson's evidence as to why the Bank of England (being the largest creditor under the Demand Interpretation) would so agree at all convincing since, as noted above, he has treated the Bank of England as if it was a commercial lender instead of a central bank subject to public law duties.
- (4) It may also be noted that Mr McKillop has based his approach to statutory interest upon assumed figures relating to the interest that would otherwise be payable to the Bank of England. As will be demonstrated to the Tribunal, those figures are incorrect which inevitably must affect the financial consequences of the Bank agreeing to contractual in lieu of statutory interest and, therefore, whether it would be likely to do so.
- (5) Accordingly, while Mr McKillop's approach may be one possibility, it would be wrong to consider it to represent the only reasonable choice available to the Valuer in such circumstances, while in any case at present it proceeds upon a demonstrably false basis of fact.

4. **Covered Bonds and Medium Term Notes**⁵⁴

- (1) Northern Rock's liabilities at the Valuation Date included:
 - (a) £9.54 billion in Covered Bonds, secured over a pool of mortgages.⁵⁵
 - (b) £12.599 billion in unsecured Medium Term Notes ("MTNs", also called Wholesale Liabilities).⁵⁶
- (2) Under the terms of the Covered Bonds and the MTNs, the administration of Northern Rock is an event of default, with the effect that:

⁵⁴ Statement of Case, paras 149-157 and 164-169 {1A/t27/p215-216, 218}

⁵⁵ See p 101 and 156-159 of the Consultation Document {2/t47/p101, 156-159}.

⁵⁶ See p 101 and 119-129 of the Consultation Document {2/t47/p101, 119-129}

- (a) The trustee of the Covered Bonds could issue an acceleration notice, the effect of which is to enforce the security by retaining all interest from the mortgage pool against the bond liabilities.
 - (b) The trustee of the MTNs could declare the notes immediately due and payable.
- (3) The Valuer assumed that, under the Repayment Interpretation, these steps would be taken by the relevant trustees to protect the position of bond and noteholders. Mr McKillop, by contrast, proposes that under the Repayment-in-Kind and Demand Interpretations:
- (a) Holders of Covered Bonds would seek early repayment and would therefore come to an extra-contractual arrangement with the administrator of Northern Rock.⁵⁷
 - (b) Holders of MTNs would not seek early repayment and so the MTN trustee would not make a declaration.⁵⁸
- (4) Again, it cannot be said that Mr McKillop's approach is the only one reasonably available even under Harbinger's preferred interpretations.
- (a) In the first place, Mr McKillop himself takes a different approach to the Covered Bonds than he does to the MTNs. It is not clear from his evidence why he believed Covered Bond holders would seek early repayment when MTN holders would not.
 - (b) His proposals each assume that individuals (including the administrator, bond/noteholders and their trustees) would take discretionary actions in a certain way, in circumstances where it would plainly be open to them to do otherwise.

5. Derivatives⁵⁹

- (1) At the Valuation Date, Northern Rock was party to various derivatives contracts in standard ISDA form. Under these contracts, the administration of Northern Rock was an Event of Default giving the

⁵⁷ McKillop 2, 5.130 {3/t57/p281}

⁵⁸ McKillop 2, 5.137 {3/t57/p282}

⁵⁹ Statement of Case, paras 158 – 163 {1A/t27/p217}.

counterparty (but not Northern Rock) the right to “close out” the transaction at a time of its choosing. Depending on timing, this would result in a sum payable either to or by Northern Rock.

(2) The Valuer assumed that no counterparties would elect to close out early but would instead hold their contracts to term.⁶⁰ If anything, this was generous to shareholders since, in reality, counterparties would close out only when “in the money” (i.e. owed money by Northern Rock).

(3) Mr McKillop describes the Valuer’s approach as being

“value neutral consistent with my own, save that I have treated these contracts as being closed out during the initial stages of an administration since I would expect an Administrator to take action to realise value in these contracts and mitigate risks of the contracts moving to ‘out of the money’ positions”.⁶¹

(4) The problem with Mr McKillop’s approach here is not that it relies upon a different interpretation of the Withdrawn Assumption, but that it proceeds on the basis of an error as to the operation of ISDA contracts. He assumes that the Administrator would act to close out contracts, when in fact the power to do so lies only in the hands of the counterparties.

(5) Harbinger’s Reply did not deny this mistake but sought to gloss it over by asserting that “*counterparties might terminate to avoid further losses and... would be influenced by the inherent uncertainty of administration*”.⁶² But that is not what Mr McKillop said nor is it the basis for his view. It is mere supposition unsupported by evidence.

(6) In the premises there is no basis on which the Valuer’s approach to derivatives can be criticised at all, let alone castigated as unreasonable.

6. Operating platform

(1) In its Note on Expert Evidence, dated 23 March 2011, Harbinger identified as a Methodology Issue the valuation of Northern Rock’s operating platform.

⁶⁰ Response Document, para 2.10 {2/t50/p227}.

⁶¹ McKillop 2, 5.125 {3/t57/p280}.

⁶² Harbinger Reply, para 55 {1A/t29/p257}.

- (2) This issue was raised in McKillop 2,⁶³ which formed part of Harbinger's submissions in the consultation process. It was not, however, mentioned in either Harbinger's Grounds of Reference to the Tribunal, nor in Harbinger's Reply. As such the Valuer did not understand Harbinger to be pursuing it further.
- (3) In normal circumstances it would be too late to resurrect this point. However, it is also an issue raised by other Applicants, and was responded to as such in the Valuer's Statement of Case, it is dealt with herebelow.
- (4) The Valuer attributed a nil value to Northern Rock's operating platform on the basis that it could not be realised as an asset.⁶⁴ Mr McKillop does not contradict this view, but suggests that – under the Demand Interpretation – the existence of the operating platform could be used as a bargaining chip in negotiations between the Bank of England, the Covered Bond trustee and Granite (Northern Rock's securitisation vehicle) in order to improve Northern Rock's position.
- (5) It is not clear how this impacts the Valuation under the scenario considered by Mr McKillop. But in any case, it is impossible to characterise the Valuer's approach as unreasonable. As set out above, while it is possible that the Bank of England and the Covered Bond Trustees would enter into negotiations with the hypothetical administrator of Northern Rock, there is no certainty that they would do so, nor that their outcome would be as Mr McKillop suggests.
- (6) Thus again it cannot be said that Mr McKillop's view represents the only reasonable outcome under the Repayment-in-Kind or Demand Interpretations. As such, it could not be right for the Tribunal to direct the Valuer to adopt it notwithstanding his statutory discretion to take a different approach taking into account the views of all stakeholders.

7. Additional problem with Harbinger's evidence on the Demand Interpretation

- (1) The financial assistance provided to Northern Rock was fully secured over Northern Rock's assets. Enforcement of that security would result in a

⁶³ McKillop 2, 5.111-5.114 {3/t57/p279}.

⁶⁴ Consultation Document, p 81-82 {2/t47/p81-82}.

forced sale of assets materially identical to that envisioned by the Valuer under the Repayment Interpretation, and therefore the same outcome.

- (2) Mr McKillop's evidence as to what would take place under the Demand Interpretation is however premised upon the Bank of England not enforcing its security and instead awaiting payment out of the proceeds of the administration together with other creditors (secured and unsecured).
- (3) This premise, is itself predicated upon a number of assumptions:
 - (a) That the enforcement of security granted to the Bank of England would be caught by the moratorium upon administration imposed by paragraph 43(2) of Schedule B1 to the Insolvency Act 1986, such that security could not be enforced without a court order;⁶⁵ and
 - (b) that the Bank of England would not seek an order allowing it to enforce its security,
 - (c) alternatively, that the Court would not make such an order.
- (4) Each of these assumptions is highly questionable.
- (5) As for the first:
 - (a) Regulation 19 of the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 ("the 1999 Regulations"), implementing Directive 98/26/EC, provides that paragraph 43(2) of Schedule B1 of the Insolvency Act 1986 does not apply in relation to a "*collateral security charge*", defined as a charge over realisable assets given "*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*".
 - (b) Given that a key function of central banks is to act as a lender of last resort, the security given to the Bank of England in respect of its financial assistance to Northern Rock would seem to fall within this

⁶⁵ McKillop 1, 5.9 {3/t56/p191}; McKillop 2, 3.5, 5.65 {3/t57/p257,271}; Thompson, 5.13-5.16 {3/t58/p299}.

definition.⁶⁶ If that is correct, then the Bank of England would not be subject to the statutory moratorium on enforcement of its security over Northern Rock's assets, and the premise Mr McKillop's evidence on the Demand Interpretation falls away.

- (c) It should be added that the Valuer has not yet taken a final view as to the interpretation and applicability of regulation 19. That is because it is not relevant under the Repayment Interpretation. Further, given its potential implications for emergency central bank assistance across the EU, it would require careful consultation and consideration with at least the Bank of England, and possibly the European Central Bank and the Commission. For the same reasons it would be inappropriate for the Tribunal – in the absence of any representations from, at least, the Bank of England – to now try and reach a definitive decision on the question.
- (6) As to the question of what the Bank of England would do, this only arises if it were subject to the moratorium. Even if that were the case, it is not clear from Harbinger's evidence what it is saying would happen. Mr Thompson simply suggests that the Bank "*would be prepared to be flexible in its expectation of the timing of recovery from its security*", without explaining what that means.⁶⁷ But in any case, as noted above:
- (a) Mr Thompson is a commercial and not a central banker and so his evidence on the matter is fundamentally irrelevant.
- (b) By contrast, upon remission the Valuer could adduce evidence from the Bank as to what it would have done.
- (7) As for the approach the Companies Court would take upon an application of the Bank for enforcement of its security, this involves a mixed question

⁶⁶ See also Opinion of the European Central Bank of 7 August 2008 (OJ 2008/C 216/01, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:216:0001:0011:EN:PDF>), at para 2.1: "*Under Article 9(1) [of Directive 98/26/EC, implemented in the UK by reg. 19], the rights of the ECB and the Member State central banks to collateral security provided to them are not affected by insolvency proceedings brought against the participant or counterparty that has provided the collateral security. Such collateral security may be realised for the satisfaction of these claims. Some ambiguity would arise if Article 9(1) were to be interpreted as meaning that the collateral security provided in connection with central bank operations, including emergency transactions, is only insulated from the effects of insolvency proceedings brought against a central bank's participant or counterparty which has provided the central bank with the collateral security*" (emphasis added). Article 9(1) is implemented by Regulation 19 of the Thompson, para 5.22 {3/t58/p301}.

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of law and fact (since it depends upon how the Bank of England would put its application). As such it is not amenable to expert evidence and Mr McKillop's views on the subject⁶⁸ are, with respect, irrelevant. Nor can it be decided on the basis of submissions alone⁶⁹ - particularly when those submissions treat the Court as taking no account at all that the Bank would be seeking to enforce security not as a private creditor, but as a public body acting in the public interest to recover public money.

- (8) Indeed, the fallacy of the Demand Interpretation is well illustrated by the difficulties of trying to reconstruct how the Companies Court might act upon a hypothetical application by the Bank of England to enforce security, in ignorance of both how the Bank would put its application⁷⁰ and how other creditors would respond. It can hardly have been Parliament's intention for the Valuer to engage in such a speculative exercise, far removed from the normal sphere of company valuations.

⁶⁸ McKillop 2, 5.64-5.65 {3/t57/p271}.

⁶⁹ Harbinger's 2nd Supplemental Submission's, paras 80-81 {3/t54/p149-150}.

⁷⁰ For it is one thing for the Valuer to ask the Bank of England whether it would seek to enforce its security, and something quite different to ask it what evidence and submissions it would put in.

APPENDIX B

The table below gives examples of methodological points addressed by the Valuer and which he would need to reconsider if the Tribunal found against the Repayment Interpretation. Some of these are points which do not arise in the absence of a net asset surplus, whereas others did not need detailed consideration on the basis that they would be incapable of affecting the position of overall deficit resulting from the Repayment Interpretation.

Issue	Document reference	Reason for treatment
Treatment of Foundation Shares	Consultation Doc, 6.74 Final Doc, 2. 36-2.38	Treatment of Foundation Shares did not arise in absence of surplus for distribution to Shareholders.
GIC Account	Consultation Doc 14.10-14.20	Impact of non-transfer of GIC accounts on flow of excess spreads to Northern Rock not material in light of deficit.
Granite Basic Rate Swaps	Consultation Doc 14.21–14.24	Claims resulting from administrator not funding/providing collateral for swaps not material in light of deficit.
Account Bank and GIC Provider	Consultation Doc 14.44	Non-transfer of the covered bond GIC account not material in light of deficit.
Interest Rate Swap Provider	Consultation Doc 14.47 – 14.48	Impact of the termination of the interest rate swap agreements not material in light of deficit
Valuation of Northern Rock's property	Final Doc 2.43 – 2.45	Possible enhancement of property value through continued development not material in light of deficit.
