

IN THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

FINANCIAL SERVICES

Cases NR/0001/2010 onwards

BETWEEN:

NORTHERN ROCK APPLICANTS

-and-

(1) ANDREW CALDWELL

(2) H M TREASURY

Respondents

STATEMENT OF THE CASE OF HM TREASURY

1. This statement is filed on behalf of Her Majesty's Treasury ("**the Treasury**"). It is made in accordance with rule 4(2) of the Upper Tribunal rules and the directions of the Tribunal as set out in the Case Management Order and Case Management Memorandum of Andrew Bartlett QC, dated 18 November 2010. It employs the same abbreviations as have been used by the Valuer in his Statement of Case of 10 December 2010.
2. The Treasury has seen the Valuer's Statement of Case and agrees with his interpretation of the Withdrawal Assumption: that is, the Repayment Interpretation.
3. As the Valuer observes, the subjective intentions of the Treasury in drafting and promoting the Act and making the Order are of no relevance in construing the relevant provisions, and therefore the Treasury will say nothing about them.

The judicial review proceedings

4. **The Treasury's case:** Harbinger seeks to suggest that the Treasury's case in the JR Proceedings was that the Valuation Assumptions sought to replicate the position as if financial assistance had not been provided in September 2007: in particular that Northern Rock would have gone into administration without its best assets being realised in a fire sale.
5. How a valuer would interpret and apply the Valuation Assumptions, and in particular the Withdrawal Assumption, was not in issue in the JR Proceedings. This was because the claimants brought their case, supported by evidence from Mr Ashton and Mr Katz, on the basis that the effect of the Withdrawal Assumption was that a valuer would have to assume that an administrator would sell Northern Rock's assets in a fire sale. They alleged that therefore he would have to assume that mortgages would be sold at

below book value and as a result the shares were likely to be valued at nil. As Laws LJ summarised the claimants' case¹:

"Their [the Valuation Assumptions'] consequence is that the shares in the company fall to be valued for the purposes of compensating the deprived shareholders on the basis of a "fire sale" - a forced sale of the assets of a company in liquidation (or other form of insolvency procedure); circumstances in which, notoriously, the return obtained is very depressed. Lord Pannick says there is uncontradicted expert evidence, from Mr Ashton and Mr Katz, that on the statutory assumptions the valuer appointed under the Compensation Scheme Order would most likely conclude that the value of the shares was nil."

6. The Treasury did not file any evidence to contradict that of Mr Ashton or Mr Katz. As Laws LJ noted at paragraph 41, its response to this argument was that "if the statutory assumptions produce a nil value, that is only because the business was worthless without government support."
7. Therefore the court proceeded on the basis of uncontroverted evidence that the Withdrawal Assumption required the valuer to assume a fire sale which would depress the value of the assets sold and that, as a result, the compensation was likely to be nil:

"it would be wrong simply to write off the likely results of the valuation under the 2008 Act as yielding a nil or next to nil return without recognising that if the assumptions indeed produce a nil value, that can only be because the business is shown to be worthless without the support put in by government.... It is of course true, as was stated in Parliament and acknowledged in argument by Mr Sumption, that a fire sale depresses asset value, in some cases very greatly. The goodwill of a business so disposed of may well be worth nothing. Fixed assets, however, may largely retain their value: the Picasso in the boardroom is not worth less because the company is insolvent, though the timing of the sale may perhaps make a difference. Mortgage assets will not do so well, but are at least likely to fetch better returns than goodwill."²

8. There was no discussion of whether the fire sale was to be assumed to take place immediately before or shortly after the start of the administration, as the court was anyway assuming a nil or next to nil return. The precise timing was assumed to make no difference to the outcome.

¹ *R. ex parte SRM and others v Her Majesty's Treasury* [2009] EWCA Civ 788, enclosure 22 to Harbinger's reference notice, at paragraph 39

² *R. ex parte SRM and others v Her Majesty's Treasury*, paragraph 76. The passage is quoted by the Valuer at paragraph 109.

9. What was clear, however, was that the court proceeded on the basis that the valuer would assume a fire sale, not an administration with a long drawn-out sale of Northern Rock's assets so as to secure the best price. That is what might have happened if no financial assistance had been provided in September 2007 and that is the interpretation of the Withdrawal Assumption for which paragraph 55 of Harbinger's notice suggests the Treasury contended.
10. Had the court adopted such an interpretation, that would have made a difference to the outcome, as it would have contradicted the central plank of the claimants' case, summarised by Laws LJ above. On Harbinger's own case, it would have resulted in a substantial recovery for shareholders.
11. The court was somewhat sceptical as to whether the effect of a fire sale on the value of assets would be as dramatic as the claimants argued (and the average discount of 13.8% assumed by the Valuer perhaps justifies the court's scepticism). But the Treasury did not contend, and the court certainly did not decide the case on the basis, that there would be no fire sale and as a result the compensation would be substantial.
12. **The Treasury's evidence:** the Treasury agrees with the comments at paragraphs 86-88 of the Valuer's submission, to the effect that Harbinger has taken out of context paragraph 127 of John Kingman's witness statement. That paragraph explained why, in the absence of a satisfactory private sector solution, the only alternative to public ownership in February 2008 was some form of insolvency procedure, and why that would be unsatisfactory. It had nothing to say about how the statutory Withdrawal Assumption was to be construed.
13. The Treasury does not regard any of the other aspects of the Treasury's evidence or case in the JR Proceedings highlighted by Harbinger as at all inconsistent with the Repayment Interpretation.

Treasury Legal Advisers (SC)

17 December 2010