

To Northern Rock Shareholders

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Northern Rock Shareholders Action Group – Update No. 28

Last week a committee of the House of Commons, and the Lords, debated the Northern Rock Compensation Order. This is the regulation which will be used by the UK Government to establish the value of compensation to be offered to shareholders – it can be seen on the internet at: www.opsi.gov.uk/si/si2008/uksi_20080718_en_1

We asked our supporters to contact their members of Parliament to express their concerns on the terms of this Compensation Order and thanks to the many who did. We also made direct representations to the committee members.

In general terms the view of most politicians in these debates (from all political parties) seemed to be that the Government was right to restrict the compensation payable to shareholders, primarily on the principle that taxpayers should not be paying more, and that most shareholders were short term speculators anyway. Of course the latter was not true but unfortunately this is an allegation that has been repeatedly made in the press. There seemed to be little sympathy for the rights of shareholders, or the morality of expropriating their property without fair compensation. Even the Conservative politicians seemed to concentrate on raising technical points about the issue rather than attacking the Government's actions directly, presumably in fear that they would be seen as supporting a bail out of those "hedge funds" who had holdings in Northern Rock. This is of course a reference to SRM and RAB, and regrettably "hedge funds" are regularly demonised in the media for various reasons.

Let me simply say that I believe SRM and RAB have acted both ethically and reasonably during their involvement with Northern Rock. They offered support to the company and were prepared to subscribe for and underwrite a major rights issue. Their actions in calling for an EGM were necessary to protect their interests as shareholders and to show that shareholders were not going to be excluded from the decision making process on the future of the company. There are no grounds for criticising their actions.

The Compensation Order was passed without opposition so it is now very clear, if it was not already, that shareholders will have to resort to legal action to establish their proper rights and to gain fair redress for the confiscation of their property.

However, there were a few useful comments and issues raised in these debates which are noted below.

MP Peter Atkinson raised the complaint of one his constituents who is 80 years old and who was relying on their investment in Northern Rock shares *"to help support the rest of my life"*. Like us he raised the question of why the valuer is being told to assume the company is unable to continue as a going concern and is in administration when clearly it is a going concern and not in administration. The answer from Government Minister Angela Eagle was that these are fair assumptions because *"it is clear that Northern Rock would have been unable to secure the substantial amount of alternative funding that would have been required"* if the financial assistance provided by the Government and the Bank of England had been withdrawn.

But of course the Government did not withdraw its financial assistance and once they had made the decision to support the company it is unreasonable for them to later attempt to value it on some other basis. Valuations should be done based on the real circumstances and taking all the known factors into account, not on some artificially dictated criteria.

Mark Hoban raised an interesting issue in that he pointed out that "Administration" as defined in the relevant Act of Parliament can be used to *"rescue the company as a going concern"* as an alternative to simply protecting creditors. Therefore the valuer appointed by the Government may have to consider not simply the "liquidation" value of the business which is what everyone assumed from the terms of reference, i.e. that it would not necessarily be a "fire sale" valuation. They might instead need to consider the value of the business based on its likely recovery. The eventual answer from Angela Eagle was *"It is for the valuer to value Northern Rock shares with the assumptions that I have set out – not that it is particularly going to be wound up"*. But she later said the valuer will have to value the business as if it was a *"gone concern"*, implying it has no value of course.

How the valuer is going to reconcile these comments with valuing it *"not as a going concern"* in the Order is anyone's guess. It is certainly outside the normal principles of commercial company valuation so it is going to be enormously difficult for them to make sense of this conundrum.

Mr Hoban also raised the issue of the Granite vehicle and whether the assets/liabilities of that "associated" business would be included when valuing Northern Rock. Granite was not nationalised but was consolidated into the last set of Northern Rock accounts.

Also he raised the issue of the problem that some countries have treaties with the UK that cover the expropriation of the assets of foreign investors. Not only do those treaties cover fair compensation but any dispute on the compensation goes to an international arbitration tribunal and hence would surely fall outside the terms of the Compensation Order? Hong Kong is an example of one such country but there are many others, so residents of such countries may be compensated more favourably than the Government's intentions.

Mr Hoban really did not get any answers on the two latter points.

In the Lords, Lord Newby said that based on the assumptions proposed, then the value of the shares must be zero. He questioned why the valuer needed a staff to do it? How long would it take and how much would it cost? The answer from a Government Minister was that the valuer *"has a challenging role to play"* and that it is not going to be done in a matter of weeks – it will be long process apparently.

Other News

The Times newspaper reported that five FSA officials who were among those who supervised Northern Rock had left the organisation (that's five out of seven "supervisors"). It is known that the FSA is suffering from high staff turnover, but this certainly seems exceptional.

According to the Government budget announced this week, which contained forecasts of future UK Government borrowing, it expects the debts owed by Northern Rock to shrink to £14bn over the coming year (from about £25bn). Simon Ward, an economist at New Star, has also forecast that by aggressively shrinking the business, it could actually repay the loans by early next year. This supports what we have said all along that Northern Rock could recover relatively rapidly and repay the Government loans which is what it should have been allowed to do under its own steam.

Nominee Shareholdings

Many shareholders held their shares in stockbrokers nominee accounts. What will happen if the Government comes up with a valuation and then puts it to shareholders? Shareholders on the register would of course be able to make their own decision as to whether to accept it (they may waive their legal rights by so doing). But from a conversation with broker TD Waterhouse, what they would do with nominee holdings is to take a vote of the beneficial owners and accept or reject based on that. This again shows the problems of holding shares in a nominee account where you lose direct ownership and control of the shares, but it's certainly too late for shareholders to change in this case as the share register is effectively frozen.

Note that we would try to give some guidance to all shareholders as to what to do if this circumstance arises.

Status of Legal Action

Many shareholders are asking what is happening on the possible law suits by us and others. We hope to tell you more in the next few days on this but you can be assured that the matter is being progressed. Unfortunately lawyers don't like to rush into these things and it takes time to prepare the necessary documents and to organise affairs.

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Note that all previous "Update" notes on Northern Rock that we have issued are present on the following web site page: www.uksa.org.uk/NorthernRock.htm