

The Right Honourable George Osborne
 Chancellor of The Exchequer
 11 Downing Street
 LONDON
 SW1A 2AA

Copy to:
 Dr Vince Cable, Business Secretary
 Mr Andrew Tyrie, Treasury Select Committee Chairman

UK Shareholders' Association
 Chislehurst Business Centre
 1 Bromley Lane
 Chislehurst
 BR7 6LH
 Phone: 020-8468-1027
 Email: ukxa3@btconnect.com
 Web: www.uksa.org.uk

23 July 2010

**URGENT AND MOST IMPORTANT
 OPEN LETTER TO THE CHANCELLOR OF THE EXCHEQUER**

Dear Chancellor

RE: FAIR VALUE COMPENSATION FOR NORTHERN ROCK SHAREHOLDERS

We trust that this Letter of Appeal finds you in good health and spirits. Please consider our Appeal below, pivoted on the shared Coalition principle of "Fairness" in "The Big Society".

A. Our Appeal –Please Compensate us on a “Fair Value, Going Concern” Basis

On behalf of the 160,000 small shareholders in Northern Rock (NR) we are writing to request that the new Coalition Government review the highly unethical, unrealistic and discriminatory policy of the former Labour Government with regard to the Compensation Order Assumptions issued in February 2008 when NR was nationalised *without any* consultation or a vote of the shareholders. In our view "Confiscation" without "Compensation" is THEFT.

"Political" bias (to cover up Government incompetence) is evident in the unrealistic and unfair Assumptions that were imposed on the so called "Independent" Valuer (refer to the Compensation Order) with the clear intention of ensuring a minimum valuation and zero Compensation. We have consistently challenged the arbitrary and discriminatory Assumptions that (a) NR was "in administration", no longer a "Going Concern", and (b) all Lender of Last Resort (LOLR) facilities and loans have been withdrawn. These Assumptions were **wholly invalidated some six weeks later when the £500 Billion SLS / Inter Bank guarantees were launched in April 2008!** Even the "Independent" Valuer stated that such Assumptions were unrealistic in his Report this year.

We believe we have a Compelling Case, detailed below, for compensating Northern Rock shareholders based on a **Fair Valuation as a Going Concern with access to the facilities available to all UK banks under the Special Liquidity Scheme (SLS) and Inter Bank Guarantees (CGS) from April 2008 through to January 2012 (2014 for Guarantees).** We are simply asking for "fair" treatment consistent with the support given to the whole UK Banking sector. Let us review the facts and endeavour to gain a shared understanding of the tremendous injustice inflicted by Labour on the hard working savers, pensioners (a vast majority of NR private shareholders are pensioners), and tax payers.

B. The Legacy of Regulatory Failure and Value Destruction by Labour

1. As wholesale markets froze progressively from 7 August 2007 Northern Rock approached the FSA (8 August) and Bank of England (12 August) for assistance and LOLR facilities. It took the Tripartite over five weeks to approve **emergency** support! Mistaken advice on a EU Directive and lack of clarity on Tripartite responsibilities were key factors: **such delay in LOLR provision is unacceptable--immediate, secret loans to HBOS and RBS in 2008 contrast sharply with the inadvertent discrimination accorded to NR.** A possible friendly takeover of NR by Lloyds TSB at £3-30 per share contingent on **"stand by"** loan facilities of £30 Billion (for the combined entity) was rejected on the grounds of moral hazard. The Tripartite was responsible for the erroneous assessment of global financial markets, the impending Tsunami in wholesale and interbank credit markets, and the Systemic Effects on UK banks. Compounded by Government dithering the Tripartite ineptitude and delayed LOLR execution made a £5 - 8 Billion liquidity problem into a major crisis that resulted in the Banana Republic style Run on Northern Rock.

2. The Labour Government dithered for four days during the Run before unqualified assurances on deposits were given. The leak to the BBC went unchallenged, was not immediately clarified or reassurances given by any Tripartite body. IT driven global financial markets punished dithering, delay and uncertainty—fertile conditions for short sellers like Lansdowne who profited by over £800 million during the false market supported / created by Labour. Even the Chairman of the TSC commented that the Regulatory **Framework "was not fit for purpose"** in September 2007. Both the FSA and Bank of England accepted part responsibility after the Run. Shareholders were never allowed to seek explanations or redress from NR Directors for their mistakes.

3. The £8 Billion funding problem increased to a £25 Billion requirement also due to piecemeal policy execution and what the markets regarded as forced concessions to attract private sector bidders. Continual dithering by the Government during the months after September 2007 destroyed over £2 Billion of the embedded shareholder value. Conservative party suggestions that the Bank of England supervise operations and determine a Restructuring, and the LibDem proposal to nationalise Northern Rock (at circa £3 per share), were rejected by Labour motivated by Denial, Dogma and Obduracy. The disparate, "piecemeal" policy approach for a private sector solution for NR, with more incentives and concessions grudgingly offered by the Treasury during October 2007 to February 2008, failed to attract and retain the interest of some key bidders from the USA, the Middle East and China.

4. Electoral prospects dominated Labour's agenda, thinking and policy. Despite two private sector options the Labour Government insisted on nationalisation because Goldman Sachs valued Northern Rock at over £2.5 Billion (allowing for a 40% decline in UK house prices) and estimated Government fees and interest income at a further £500M over three years. This Valuation (£2.5 Billion) is consonant with the Central Case Projection in the Prospectus issued to private sector bidders. **The prospect of a substantial "profit" for the Government upon eventual disposal (in three years per Goldman Sachs strategic analysis) was Gordon Brown's boast several times.** Even the £150M fees squandered on consultants and advisers (primarily Goldman Sachs) would be recouped/ charged to the NR Profit & Loss Account. **This crucial factor (Goldman Sachs advice on value and prospects) explains the haste to nationalise Northern Rock in mid February 2008 –just six weeks before the £500 Billion SLS and Inter Bank Guarantees (April 2008) would have enabled NR to flourish in the private sector!** It was a win-win scenario for an incompetent and deceitful Government which compromised the rights and interests of NR shareholders.

5. Mistakes were compounded post nationalisation and further value destruction pursued ruthlessly. The imperative to quickly repay loans at any cost was assigned to the Government appointed management who were heavily incentivised on this fire sale approach and asset stripping mantra. Panic asset disposals at substantial discounts, accelerated impairments, damaging reposessions, deliberately sending the best customers to rival mortgage providers, ineffective debt collection, and continuation of 100% plus loans are evident, and all these added to losses at Northern Rock in the interests of "politically motivated" loan repayment schedules. Then Labour did a major U Turn, **drastic change of policy in**

January 2009, instructing the Rock to lend more, and maximise new business! Now there was no urgency in loan repayments: in fact delay in repayments would have the parallel benefit of extra interest income! Labour mismanagement had cumulatively destroyed £4 Billion of Value by 2009, lost the best customers, **materially increased the weighted risk of loans and asset quality in the Balance Sheet (later necessitating the “good” bank and “bad” bank split) of a UK bank with the lowest level of toxic debts!** The poor quality of interim management, confused communication, lack of credit controls and farcical oversight from the Treasury was criticised by the National Audit Office.

C. The Contradictions and Blatant Discrimination of Labour Policy.

6. The Bank of England progressively broadened the **collateral criteria** for assistance to all UK banks from October 2007. **After months of indecision and delay the huge £500 Billion Special Liquidity Scheme (three year) was launched in April 2008.** The SLS was accompanied by Inter Bank Loan Guarantees, significantly higher depositor protection, followed by large interest rate cuts to 0.5%, and £200 Billion of Quantitative Easing (QE). Proactive support from the FSA for the Alliance & Leicester takeover by Santander was reported in the Press. **Bradford and Bingley was nationalised and the Valuer instructed to determine appropriate compensation on the basis of a Going Concern!** £1.6 Billion support was provided by Labour to rescue the Dunfermline from huge property exposures. More recently the **Bank of England divulged the crucial £61.6 Billions of SECRET loans to RBS and HBOS/Lloyds! The EU Market Directive was no longer an obstacle to covert support.**

7. All the above were favourable developments from a UK banking perspective but not available to Northern Rock! Over £1 Trillion of support, subsidy, guarantees to other UK banks, underscored by 0.5% interest rates and massive QE enabled huge growth in bank margins and fees, subsidised by the taxpayer, and record bonuses for 2009! The £2.5 Billion collected by Labour from the Bonus Tax represents a pathetic share of the £25 Billion, taxpayer subsidised, profit bonanza. **The Conservative proposal to ban cash bonuses and channel the cash to credit starved businesses and households was rejected by Labour.** Most EU Governments provided support to their banks to secure financial stability and decided to relegate moral hazard in order to address the financial markets Tsunami. Yet Labour was responsible for the destruction of a thriving, provincial UK bank that was heavily dependent on efficient, sustainable wholesale markets functioning. Whereas NR was 70% reliant on wholesale funding, most other UK banks except HSBC had a dependency of 50% or more.

8. Just contrast the Lloyds TSB request for “**stand by**” facilities as a pre condition for taking over Northern Rock with the close to a Trillion of SLS, Guarantees and Quantitative Easing provided within months! Also consider that a year later the Labour government proactively supported the Lloyds TSB takeover of HBOS and waived the Competition Rules! What a contrast between the shambolic provision of LOLR to Northern Rock, the leak, and four days of dithering, with the **secret** loans of £61.6 Billion to HBOS and RBS. There is no logic or consistency in the Labour directive to value Bradford & Bingley as a Going Concern but deny this Assumption to Northern Rock which had an enviable track record of growth and profits. (and the lowest proportion of toxic derivatives and US sub prime exposure). **These Labour policy inconsistencies are tantamount to blatant Discrimination against Northern Rock.**

D. Valuation and Compensation

9. The unreal, unfair, discriminatory Terms of Reference and Assumptions imposed on Andrew Caldwell (i.e. In administration, Not a Going Concern, No state support) effectively **ruined any chance of arriving at a FAIR & INDEPENDENT VALUATION.** There is substantial evidence to contradict Andrew Caldwell's preliminary conclusion of “zero” value based on unreal Assumptions, major errors of methodology (primarily the use of “Perfect Hindsight” in the valuation process). Caldwell acknowledges that the Valuation is based on “unreal” assumptions in his Report.

10. **More importantly**, the factual evidence makes a nonsense of the zero value conclusion. At end June 2007 the value of Net Assets was some £6 per share. At end December 2007 this value had reduced to £4 per share due to excessive provisions and reserves and impairments. From a peak of £12 per share in early 2007 the market price of NR shares had declined to £6.41 by September 2007, reflecting market concerns about the Business Model dependence on global wholesale credit markets, tightening credit

costs and lower margins, and the start of the "Freeze" noted on 7 August 2007. Other benchmarks include the Lloyds TSB tentative offer in excess of £3 per share, the private sector options --pre nationalisation-- that offered shareholders an embedded value of between £2 and £4. Even the "Market Value" of Northern Rock shares was (at a very depressed level, in a false market) 96 pence immediately prior to "Confiscation" of the shares in "the national interest" on 17 February 2008.

11. Clearly any 100% bid for Northern Rock in February 2008 would have seen the shares rocket up to £5/6 for a successful bid. This is broadly equivalent to the £2.5 Billion value that Goldman Sachs advised to the Labour Government. Northern Rock shareholders seek at least £4.20 per share (market valuation convention would suggest 125% of NET ASSETS equal to £5.25 per share) being the Fair Value of Net assets at 31 December 2007. At no stage were Northern Rock shareholders consulted, allowed to vote on the options pre or post nationalisation. Confiscation "in the national interest" is only justified IF you pay a FAIR price for Northern Rock: arguably in the range of £3.50 to £6.50 per share.

E. Proposals for Resolution

12. The Liberal Conservative Coalition have recognised the need to urgently reform & unify the UK Regulatory Framework, higher Capital requirements for banks, and to reduce the systemic risks of casino banking subsidised by Government depositor guarantees. The taxation of the super profits and bonuses, and a levy to reflect the risky leverage of investment banking are under consideration. Perhaps a retrospective "Speculative Gains Tax" that penalises the profits from "Short Selling" could assist in compensating bank shareholders and reducing the public deficit! The Coalition view is that "Fairness" is one of the key pillars of the Big Society and will underpin all policy initiatives.

13. The UK justice system has failed pathetically (political sensitivity and bias prevailed) to condemn the blatant Discrimination and violation of Human Rights. The Supreme Court felt unable to adjudicate as to whether a Law is fundamentally "Fair" or Ethical, and can only assess if the "Unfair" Compensation Order was "legal" or not. Our Case is proceeding to the European Court of Human Rights. Whilst we are confident of victory, the collateral damage to the UK's reputation will be considerable. In financial terms the UK Government could face a £3 Billion liability including legal costs when the ECHR adjudicates against Labour's discriminatory, unfair policies. We therefore urge you to reconsider the Terms of the Compensation Order and reach a "Fair" settlement with the many thousands of ISA savers, pensioners, and small investors. We request that you urgently mitigate the unethical legacy of Labour and end this travesty of justice.

14. We would appreciate the opportunity to discuss the contents of this Appeal and explore the options for resolution that are available. Our meeting would be informal with no pre conditions: the objective would be damage and cost limitation. We would prefer to reach a fair and realistic agreement before thousands of victims/ primarily pensioners die during a protracted ECHR process.

We look forward to your considered reply and a constructive meeting.

Yours sincerely

Chris Hulme
Co Chair of UKSA NRSAG

Shum Ghuman
Co Chair of UKSA NRSAG

Dennis Grainger
NRSAG Member

Pradeep Chand
NRSAG Member

On behalf of the Northern Rock Shareholders Action Group