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Case No: CO/4342/4715/4351/2008

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
DIVISIONAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 13/02/2009

Before :

LORD JUSTICE STANLEY BURNTON
MR JUSTICE SILBER

- -

Between :

THE QUEEN on the applications of (1) SRM GLOBAL MASTER FUND LP (2) RAB SPECIAL SITUATIONS (MASTER) FUND LIMITED (3) DENNIS GRAINGER and others	**Claimants**
- and -	
THE COMMISSIONERS OF HER MAJESTY'S TREASURY	**Defendants**
- and –	
LEGAL & GENERAL INVESTMENT MANAGEMENT LIMITED	**Interested Party**

- -
- -

Lord Pannick QC, Matthew Collings QC and **Claire Weir** (instructed by **White & Case LLP**) for the **First Claimants**
Michael Beloff QC, **David Wolfson** and **Iain Steele** (instructed by **Nabarro LLP**) for the **Second Claimants**
Thomas de la Mare (instructed by **Edwin Coe LLP**) for **Dennis Grainger and others**
Ben Jaffey (instructed by **Legal & General Group Plc Legal Department**) for the **Interested Party**
Lord Grabiner QC, Clive Lewis QC, Javan Herberg and **Paul Nicholls** (instructed by **Slaughter and May**) for the **Defendants**

Hearing dates: 13, 14 & 15 January 2009

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Approved Judgment

Lord Justice Stanley Burnton:

1. This is the judgment of the Court to which both members of the Court have contributed.

I. Introduction

2. In these proceedings the Claimants challenge the compatibility of the legislation relating to the assessment of compensation payable to them as former shareholders of Northern Rock plc following its nationalisation in February 2008. They contend that the provisions of the legislation concerning the assessment of their compensation are unfair and incompatible with their rights under Article 1 of the First Protocol to the European Convention on Human Rights ("A1P1"). The Defendants, the Commissioners of Her Majesty's Treasury, in effect the Government, contend that the provisions of the legislation are fair and compatible with the Convention.

3. Prior to its nationalisation, the Bank of England ("the Bank") had lent over £20 billion to Northern Rock and these sums were repayable on demand. Additional financial support had been provided by the Treasury. As will be seen, the legislation requires a valuer to value Northern Rock's shares on the assumptions that all financial assistance provided by the Bank and the Treasury had been withdrawn and that no financial assistance would be provided in the future by the Bank, and that it was not, at the relevant date, a going concern. The Defendants say that this was fair and appropriate in the circumstances. The Claimants' case is that this basis of valuation was unfair: Northern Rock was, at the date of nationalisation, in fact a going concern, with a strong mortgage book and an excess of assets over its liabilities. The valuation provisions were unfairly designed to give the Government a profit beyond a fair return for the financial support it had provided and was providing to the company. Effectively, the legislative provisions deprive the shareholders of Northern Rock of that profit.

4. The Claimants do not challenge the decision to nationalise Northern Rock itself: their challenge relates to the provisions of the compensation scheme. Conversely, the Defendants do not contend that they or the Bank were precluded from giving financial assistance to Northern Rock by the provisions of the EC Treaty relating to State aid. The issue to be determined is the compatibility of the statutory compensation scheme with the Claimants' rights under AIP1.

5. The structure of our judgment is as follows. This introduction is section I. Having described the parties involved in these proceedings in section II, in section III we explain the meaning of solvency, an important concept to understand because Northern Rock was described as solvent while it was receiving public financial support until the date of its nationalisation. In section IV we set out the principles applicable to the Bank of England's role as Lender of Last Resort. Central to the issues we have to determine are the circumstances and the facts relating to the public financial support given to Northern Rock, and in section V we provide a chronology of the events leading to the decision to nationalise it. The legislation under which the company was nationalised and provision made for compensation to be determined and paid to its shareholders is summarised in section VI. The contentions of the parties are summarised in section VII. We set out A1P1 and summarise the jurisprudence of the European Court of Human Rights in section VIII. In our judgment, the essential facts on which the resolution of the issues in these proceedings depends are relatively few. We set them out in section IX. We discuss the contentions of the parties and set out our conclusions in section X, under the following headings:

(a) The position apart from the issues of (b) regulatory failure, (c) a legitimate of reasonable expectation of public financial support, (d) the Treasury's reward and profit, (e) the Tripartite Authorities treatment of other banks and (f) the procedural requirements of A1P1.

(b) The allegations of regulatory failure.

(c) Legitimate or reasonable expectation of public financial support.

(d) The allegations concerning the "subsidy" said to have been provided to Northern Rock and that the Treasury is seeking to make a profit out of nationalisation.

(e) The contention that the Government's support given to other banks shows that the compensation scheme is unfair.

(f) The submission that the compensation scheme does not satisfy the procedural requirements of A1P1.

Our final conclusion is shortly set out in section XI.

II. The parties involved

Northern Rock plc

6. Northern Rock was originally a building society. In 1997 it was converted into a public limited company, listed on the London Stock Exchange and authorised to carry on business as a bank under the Banking Act 1987. On its demutualisation, shares were issued to its existing depositors. Its core business remained residential mortgage lending. It grew to become the fifth largest UK mortgage lender and the eighth largest UK bank by market capitalisation. The events leading to its nationalisation are referred to below.

The parties to these proceedings

7. The First Claimant, SRM Global Master Fund LP ("SRM") is an investment (or hedge) fund based in the Cayman Islands. As a result of transactions between 14 September 2007 (which was the date when the Bank issued a statement that it had provided "a liquidity support facility" to Northern Rock) and 12 February 2008 it became the largest shareholder in Northern Rock, with 48,452,655 shares, amounting to 11.5% of the issued ordinary share capital.

8. The Second Claimant, RAB Special Situations (Master) Fund Ltd ("RAB") is also an investment company incorporated in the Cayman Islands. It acquired its shares in Northern Rock by transactions between 19 September 2007 and 14 February 2008. By the date of Northern Rock's nationalisation, it owned 34,444,299 shares, amounting to 8.18% of the issued ordinary share capital.

9. The Third Claimants are representative small shareholders of Northern Rock. Some acquired their shares on demutualisation; others are or were employees who acquired their shares under an approved profit share scheme or share incentive plan, or other incentive schemes, or by contributions to the company pension fund. Others

were small investors who purchased their shares on the stock exchange. Three of the small group of representative shareholders had purchased shares after the Bank had issued the statement on 14 September 2007 that it had provided financial support to Northern Rock. At the date of nationalisation there were some 150,000 small shareholders.

10. At the date of nationalisation, the Interested Party, Legal & General, held over 18 million shares in Northern Rock, amounting to about 4.3 per cent of the issued share capital. Most of the shares were the assets of pension funds and unit trusts, and were long term investments.

11. The Defendants, the Commissioners of Her Majesty's Treasury, may be regarded as the representatives of central government for the purposes of these proceedings.

The Tripartite Authorities

12. Under the Financial Services and Markets Act 2000, as a bank Northern Rock was regulated by the Financial Services Authority. As the regulator, the FSA was responsible for Northern Rock's authorisation and supervision. The statutory regulatory objectives of the FSA are:

(a) market confidence;

(b) public awareness;

(c) the protection of consumers;

(d) the reduction of financial crime.

See section 2 of the Financial Services and Markets Act 2000.

13. The Bank of England, as the UK central bank, is the bankers' bank. It is the Lender of Last Resort; and the financial assistance it provides as Lender of Last Resort is referred to as LOLR. The Bank's functions include "ensuring the stability of the monetary system as part of its monetary policy functions. It acts in the markets to deal with fluctuations in liquidity".

14. The Treasury is responsible for:

> "i. The overall institutional structure of financial regulation and the legislation which governs it …
>
> ii. informing, and accounting to Parliament for the management of serious problems in the financial system and any measures used to resolve them, including any Treasury decision concerning exceptional official operations ...
>
> iii. accounting for financial sector resilience to operational disruption within government."

15. Cooperation between the Treasury, the Bank of England and the FSA is the subject of a Memorandum of Understanding, from which the quotations in the preceding

paragraphs have been taken. Under the heading "Financial Crisis Management", paragraphs 14 and 15 of the MOU are as follows:

> "14. In exceptional circumstances, there may be a need for an operation which goes beyond the Bank's published framework for operations in the money market. Such a support operation is expected to happen very rarely and would normally only be undertaken in the case of a genuine threat to the stability of the financial system to avoid a serious disturbance in the UK economy. If the Bank or the FSA identified a situation where such a support operation might become necessary, they would immediately inform the other authorities and invoke the co-ordination framework outlined in paragraph 16 below. Ultimate responsibility for authorisation of support operations in exceptional circumstances rests with the Chancellor. Thereafter they would keep the Treasury informed about the developing situation, as far as circumstances allowed.
>
> 15. In any such exceptional circumstances, the authorities' main aim would be to reduce the risk of a serious problem causing wider financial or economic disruption. In acting to do this, they would seek to minimise both moral hazard in the private sector and financial risk to the taxpayer arising from any support operation."

III. Solvency, insolvency and liquidity

16. The Oxford English Dictionary defines "solvent" as "able to pay all one's debts or liabilities", and conversely "insolvent" as "unable to pay one's debts or discharge one's liabilities". An obsolete meaning of "solve" is to pay or to discharge. A ground for winding up a company is that it is unable to pay its debts: section 122(1)(f) of the Insolvency Act 1986. Section 123 of that Act provides:

> "(1) A company is deemed unable to pay its debts—
>
> …..
>
> (e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.
>
> (2) A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities."

Thus, for the purposes of insolvency legislation, a company may be regarded as insolvent if it is unable to pay its debts as they fall due or if its liabilities exceed its assets. The first meaning is sometimes referred to as cash flow insolvency, as in *Re Minrealm Ltd* [2007] EWHC 3078 (Ch) [2008] BCLC 14 at [27] and *Re Sigma Finance Corporation* [2008] EWCA Civ 1303 at [16]; the second meaning is commonly referred to as insolvency on a balance sheet basis, or balance sheet insolvency, as in *Ciro Citterio Menswear plc v Thakrar* [2002] EWHC 662 (Ch), [2002] 1 WLR 2217 at [45], *Re Cheyne Finance plc (in receivership) (No 1*) [2007] EWHC 2116 (Ch), [2008] BCLC 732 and *Re Sigma Finance Corporation* at [16].

17. In the context of banking, however, insolvency refers to balance sheet insolvency rather than cash flow insolvency, so that a company may be said to be solvent even though it is unable to pay its debts as they fall due. This special meaning of insolvency in the present context must be borne in mind when considering, for example, Lord George's lecture referred to below, the evidence of Professor Congdon referred to in paragraph 84 below and official statements such as that referred to at para 34 below. In this context, cash-flow insolvency may be described as a lack of liquidity on the part of a (balance sheet) solvent company; but that lack of liquidity, if sufficiently serious, will mean that the company is insolvent for the purposes of the Insolvency Act 1986, and therefore liable to be go into insolvent liquidation, and its directors would have to consider their position under section 214 of that Act.

IV. The principles on which LOLR is given

18. It is common ground that the relevant principles on which LOLR is given by the Bank of England are to be found in a well-known lecture given at the London School of Economics in 1993 by the then Governor of the Bank Mr Eddie (now Lord) George entitled *"The pursuit of financial stability"* in which he explained the factors that the Bank considers when deciding whether and how to intervene in its role as a Lender of the Last Resort and he outlined the principles that guided the Bank in making its decisions.

19. For present purposes, a critically important factor was that the Bank "[did] not see it as [its] job to prevent each and every bank from failing. The possibility of failure is necessary to the health of the financial system, as it is to the efficiency of all other economic activity." Lord George cited Bagehot:

> "Any aid to a present bad bank is the surest mode of preventing the establishment of a future good bank."

20. Lord George explained that when a bank did seem likely to fail:

> "The central bank must at least consider the option of supporting it. The Bank of England frequently does no more than that: we think about support, but we decide against it. There have in fact been nine bank closures since 1987; and the majority of them proved unable to meet all their liabilities. But there are circumstances when we may decide that, were an institution not to meet its obligations as they fell due, that would pose a serious threat to the financial system as a whole."

21. Lord George went on to say that the involvement of the Bank:

> "is not designed to give special protection to its depositors, or to safeguard the positions of its employees, nor is it based on a wish to help its shareholders or management, who should, indeed, expect to be penalised."

He explained that the support given by the Bank of England might help the bank and its various shareholders, but that this:

> "would be essentially as a by-product of meeting our wider objective. The only issues for us are (a) what effect the failure of the institution would have on the system as a whole; and (b) what should be done to protect the system from contagion.
>
> In reaching a decision on support, we take care not to be predictable. Central bankers have raised unpredictability to an art form, so that the phrase 'constructive ambiguity' has become rather popular in our circles. But it is essential that no one-no one-should expect support as a matter of course... It is, indeed true that size is an important factor in considering systemic effects. Even so, I have to say that there is nothing automatic about our acting as a lender of last resort, and even if we did decide on support no bank should assume that it would be immune from penalty."

22. He stated that "the overriding principle" is that "our support, whatever form it takes, is directed to safeguarding the financial system (and therefore preventing damage to the wider economy), not the institution itself." Mr. Ian Bond, a senior official of the Bank, states in his witness statement, correctly in our view, that this was "the overriding principle [of LOLR] mentioned several times*"* by Lord George.

23. Lord George set out some general principles applied by the Bank in deciding whether LOLR should be made available. The first was that the Bank would explore every option for a commercial situation before committing its own funds and:

> "it is only when these options have been exhausted that we will consider providing support ourselves – and even then we may decide against it, as we did in the case of British and Commonwealth Merchant Bank in 1990."

24. The second principle was that central banks were not in the business of providing public subsidies to private shareholders and that where the bank provided support it would "try to structure it so that any losses fall first on the shareholders and any benefits come first to us".

25. The third principle was that the aim of the Bank of England was to provide liquidity: "We will not, in normal circumstances, support a bank that we know at the time to be insolvent."

26. The fourth principle, which is of particular relevance to this case, is that the Bank looks for a clear exit which means that:

> "The company may be required to run down or restructure its operations, under our surveillance, to the point where it can do without our support within a given period. Making the terms of our support as unattractive as possible has the great advantage of encouraging this process."

27. The fifth principle was to keep the support from the Bank secret when it is made.

V. Events leading to the nationalisation of Northern Rock

28. Northern Rock, unlike most other banks in the United Kingdom, financed a large part of its loan book by borrowing moneys on the wholesale money market, and by the issue of bonds backed by a pool of mortgage loans, rather than by retail deposits. As a result of turbulence in the international financial markets, by August 2007 it had become impossible for it to raise sufficient money on the wholesale market. The problems in the USA associated with the securitisation of sub-prime mortgages made it impossible for Northern Rock to raise funds by securitising its own mortgage book. As Philip Price, the Chief Operating Officer of SRM, put it in his first witness statement:

> "44. The disruption to the European markets was triggered on 9 August 2007 when BNP Paribas announced the suspension of three of its asset-backed credit funds, blaming the absence of market liquidity for the suspension of the funds.
>
> 45. The result of the credit squeeze in the UK was that inter-bank and wholesale markets effectively froze; inter-bank lending stopped very suddenly and left banks, such as Northern Rock (which depended upon the availability of such funding), unable to find liquidity from their usual sources in the wholesale markets.
>
> 46. The credit squeeze which started in August 2007 has had continuing effect in Europe and worldwide."

29. The European Central Bank's injection of 94.8 billion euros into overnight money markets on 9 August 2007 is regarded by many as marking the beginning of official action in relation to the so-called credit crunch.

30. Northern Rock's assets, as valued and stated in its balance sheet, exceeded its liabilities; but because of the impossibility of borrowing in the wholesale financial markets it did not have the liquid funds to pay its current liabilities and to repay depositors, and so could not pay its debts as they fell due. On 13 August 2007 Northern Rock alerted the FSA to its liquidity problems and its doubts over the sustainability of its situation. On 3 September 2007, the Tripartite Authorities agreed in principle to provide financial support so that it could maintain its liquidity.

31. By letter dated 11 September 2007, Northern Rock's auditors, PriceWaterhouseCoopers, reported to the FSA that they had "reasonable grounds to believe that the Company may cease to be a going concern given the current significant pressure on the Group's liquidity due to its inability to undertake its normal funding programme". They added that they understood that the Group Finance Director had already informed the FSA of the situation, and that they were aware that "a potential solution involving the Bank of England [had] been proposed", but they had no knowledge of it.

32. As at 13 September 2007, no public announcement had been made as to the financial support to be provided to Northern Rock. However, as is notorious, the fact that Northern Rock had sought and was to be provided with that support became known to the BBC and was the subject of a broadcast on the evening of 13 September. As is also notorious, the leak of that information led to a run on the bank: between 14 and 17 September 2007 approximately £4.45 billion of retail deposits (approaching 20 per cent of Northern Rock's total) were withdrawn.

33. On 14 September 2007 the Bank of England provided facilities to Northern Rock. Before markets opened, the company issued a statement:

> "… Global investor appetite in the medium and long-term markets, for either senior unsecured or asset backed securities, is currently greatly reduced. ... While Northern Rock has continued to raise new funds, these have been mainly in the short term wholesale debt markets and the amounts raised have not allowed Northern Rock to refinance maturing liabilities as well as to write new business at previous levels. In view of the difficulties Northern Rock has had in accessing longer term funding and the mortgage securitisation markets, the Company has been using its cash and other liquid reserves to support the funding of its business. Northern Rock expects current market conditions to continue for some time.
>
> In light of the above, Northern Rock has concluded that it is important to ensure that additional standby liquidity arrangements are available. Accordingly, Northern Rock has agreed with the Bank of England that it can raise such amounts of liquidity as may be necessary by either borrowing on a secured basis from the Bank of England or entering into repurchase facilities with the Bank of England."

34. On the same date, the Treasury issued a press release:

> "The Chancellor of the Exchequer has today authorised the Bank of England to provide a liquidity support facility to Northern Rock against appropriate collateral and at an interest rate premium. This liquidity facility will be available to help Northern Rock to fund its operations during the current period of turbulence in financial markets while Northern Rock works to secure an orderly resolution to its current liquidity problems.
>
> The decision to authorise was made by the Chancellor on the basis of recommendations by the Governor of the Bank of England and the Chairman of the Financial Services Authority in accordance with the framework set out in the published Memorandum of Understanding between the Bank, FSA and HM Treasury.
>
> The FSA judges that Northern Rock is solvent, exceeds its regulatory capital requirement and has a good quality loan

> book. The decision to provide a liquidity support facility to Northern Rock reflects the difficulties that it has had in accessing longer term funding and the mortgage securitisation market, on which Northern Rock is particularly reliant.
>
> In its role as lender of last resort, the Bank of England stands ready to make available facilities in comparable circumstances, where institutions face short-term liquidity difficulties."

The references to "the current period of turbulence in financial markets" and to "short-term liquidity difficulties" indicate that the financial support provided to Northern Rock was then considered to be temporary.

35. On 17 September 2007, the Chancellor of the Exchequer issued a statement on financial markets. He referred to the current instability in the financial markets and said:

> "… In the current market circumstances, and because of the importance I place on maintaining a stable banking system and public confidence in it, I can announce today that following discussions with the Governor and the Chairman of the FSA, should it be necessary, we, with the Bank of England, would put in place arrangements that would guarantee all the existing deposits in Northern Rock during the current instability in the financial markets.
>
> This means that people can continue to take their money out of Northern Rock. But if they choose to leave their money in Northern Rock it will be guaranteed safe and secure."

36. On 20 September 2007, HM Treasury issued the following statement:

> "HM Treasury today confirms that the guarantee arrangements for existing deposits in Northern Rock plc would cover all accounts existing at midnight on Wednesday 19 September. This guarantee covers future interest payments, movements of funds between existing accounts, and new deposits into existing accounts. The guarantee will also cover accounts re-opened in the future by those who closed them between Thursday 13 September and Wednesday 19 September, inclusive.
>
> Since it would otherwise be unfair to other banks and building societies, the arrangements would not cover any new accounts set up after 19 September, other than re-opened accounts as set out above.
>
> In the case of wholesale market funding for Northern Rock plc, the Treasury confirmed that the arrangements would cover:
>
> Existing and renewed wholesale deposits; and

> Existing and renewed wholesale borrowing which is not collateralised."

37. The facilities that the Bank of England had provided to Northern Rock on 14 September 2007 were virtually exhausted by 9 October 2007. As a result additional facilities were required to prevent the company from collapsing, and they were granted on that date. The facilities were repayable on demand, but subject to a time limit of 12 February 2008. That date was subsequently extended to 17 March 2008, to coincide with the date by which the UK was required to submit a restructuring or liquidation plan to the European Commission. HM Treasury, on behalf of the Tripartite Authorities, confirmed that:

> "The guarantee arrangements previously announced to protect existing depositors of Northern Rock plc will be extended to all new retail deposits made after 19 September, including those made from today. These arrangements will cover all retail deposits, including future interest payments, movements of funds between accounts and term deposits for the duration of their term.
>
> These arrangements will be complemented by additional facilities through the Bank of England.
>
> The arrangements and revised facilities have been put in place at the request of Northern Rock plc. They will allow the Company to continue to pursue the full range of its strategic options.
>
> Northern Rock plc will pay an appropriate fee for the extension of the arrangements, which is designed to ensure it does not receive a commercial advantage. As previously announced, the arrangements to protect depositors of Northern Rock plc will remain in place during the current instability in the financial markets."

38. On 11 October 2007, the Chancellor gave details to the House of Commons of the extended guarantee arrangements and additional facilities for Northern Rock. They were explained in a statement:

> "To complement the Chancellor's statement today to Parliament, this sets out further details of the extension of the Government's guarantee arrangements put in place for deposits in Northern Rock plc during current instability in the financial markets and the terms of the Bank of England's additional facilities, announced on Tuesday 9 October 2007.
>
> **Guarantee arrangements for Northern Rock**
>
> At the request of Northern Rock, new guarantee arrangements were put in place from Tuesday to extend 100% cover to all new retail accounts open with the company from the date of the

> original guarantee arrangements, 19 September, for as long as the current period of financial market instability lasts. As under the original arrangements, these extended guarantee arrangements will supplement, and not replace, any compensation provided by the Financial Services Compensation Scheme, which the Financial Services Authority has recently extended to cover 100% of the first £35000 of deposits.
>
> In order for this guarantee arrangement not to provide the company with a commercial advantage, a fee (from which the Treasury will benefit) has been attached to it, set at a higher rate than the interest premium on the additional facilities outlined below.
>
> **Bank of England facilities**
>
> In order to meet these objectives, the Treasury, Bank of England and Financial Services Authority have agreed on the provision of additional facilities through the Bank of England. These facilities are uncommitted and are, therefore, not subject to any specific borrowing limit. They are repayable on demand and will incur a premium rate of interest. The interest premium will roll up and rank alongside the company's Tier II regulatory capital. The facilities are secured against all assets of the company but in view of the scale and nature of the new facilities, the Treasury has agreed to indemnify the Bank of England should the Bank of England face a deficit having previously made all reasonable endeavours to recover its claims on the company. The interest premium will therefore be passed to the Treasury."

39. Northern Rock had since September 2007 taken steps to find a solution to its predicament, which included considering selling its business. On 19 November 2007, it released a statement on the indicative expressions of interest it had received, covering a range of options for Northern Rock's business. On the same day, HM Treasury, on behalf of the Tripartite Authorities, published "a statement of principles which sets out how the Tripartite Authorities currently expect to approach proposals for the future of Northern Rock and its business, in particular considering the objectives against which the Tripartite Authorities expect to assess proposals received by Northern Rock".

> "The principles clearly state that interested parties should not assume at this stage that the current Bank of England loan facilities will be available beyond either any sale or the expiry of the facilities in February. However, the Authorities are willing to discuss any proposals made; any proposal that envisages an ongoing role for the Authorities, beyond their usual statutory and regulatory functions, will be evaluated on its merits against the Authorities' stated objectives."

40. On the same day, the Chancellor of the Exchequer made a statement in the House of Commons "to update the House on the current position with regard to Northern Rock". He said:

> "Before turning to our approach, let me deal first with the position on the guarantee arrangements to Northern Rock depositors provided by the Government and, secondly with the loan facilities provided by the Bank of England to support Northern Rock and to maintain financial stability in general. First, we have made it clear that the guarantee arrangements already announced for depositors in order to safeguard their position will remain in place during the current instability in the financial markets. These guarantee arrangements were absolutely necessary. They have not had any cost to the taxpayer because these deposits covered by the guarantee arrangements remain in the bank. As I have said before, savers are free to take their money out if that is what they want to do, but they have no need to do so. The guarantee arrangements ensure that savers' deposits are safe. The guarantee will not be removed without proper notice being given to depositors."

41. The Government had duly informed the European Commission of the measures it had taken in relation to Northern Rock. On 5 December 2007, the Commission issued a decision. The Commission concluded that the measures taken by the Government between 17 and 20 September 2007 and those announced on 9 October 2007 constituted non-notified State aid pursuant to Article 87(1) of the EC Treaty; however, the measures were compatible with the Common Market as rescue aid pursuant to Article 87(3)(c), and the Commission raised no objection to them. However:

> "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 a proof that the aid measures granted have been repaid in full and that the guarantees have been terminated."

42. On 18 December 2007, as a result of an intimation that Moody's, the rating agency, was proposing to downgrade Northern Rock's credit rating, the Treasury confirmed that the guarantee arrangements for Northern Rock described in its announcements of 20 and 21 September 2007 and 9 October 2007 were being extended, at the request of Northern Rock plc to certain unsubordinated wholesale obligations. In addition:

> "No change is being made to the guarantee arrangements in respect of retail deposits of Northern Rock plc, which remain fully protected under the announcements previously made by HM Treasury. Northern Rock plc will pay an appropriate fee for the extension of the guarantee arrangements. As previously announced, the arrangements to protect retail and wholesale depositors of Northern Rock plc will remain in place during the current instability in the financial markets. Reasonable notice,

> which will not be less than 3 months, will be given by HM Treasury of any termination of these arrangements."

43. An Extraordinary General Meeting of Northern Rock was convened by SRM in order to consider resolutions placing restrictions on the directors of Northern Rock acting without shareholder approval in respect of share issues, changes in capital structure and purchase or sale of assets. It was held on 15 January 2008. The resolutions were supported by RAB. Mr. Philip Richards, the chief executive officer of RAB, states that at the meeting, "I warned of the potential catastrophe if Northern Rock were to be nationalised". The resolutions of SRM were supported by the majority of shareholders but they did not obtain the three-quarters majority required for special resolutions.

44. On 21 January 2008 the Treasury, on behalf of the Tripartite Authorities announced:

> "a new financing structure that could be made available to Northern Rock and other interested parties, for a possible private sector solution for the entire company. This new financing structure would only be available for proposals that would protect taxpayers' interests, as well as meeting the Tripartite Authorities' other stated objectives of financial stability and the protection of consumers."

45. In a regulatory announcement issued on the same date, the Treasury stated:

> "In order to ensure that their stated objectives are met, the Tripartite Authorities have continued to plan for the full range of possible outcomes to the strategic review of Northern Rock.
>
> The preference of the Tripartite Authorities, acting in their respective capacities, is to reach agreement on a private sector solution which meets the objectives and conditions set out above. However, if no private sector solution is proposed which the Bank of England and HM Treasury, as providers of financial support to the company, and the Financial Services Authority, as its regulator, consider they can agree in light of their objectives of protecting taxpayers, promoting financial stability and protecting consumers, the Government would bring forward legislation which would empower HM Treasury, by order, to take Northern Rock into temporary public ownership. It is envisaged that any such power would be used to transfer Northern Rock's share capital, including its preference shares, into public ownership. It is anticipated that the remaining Tier 1 and Tier 2 capital instruments would continue in their existing ownership as listed securities. Holders of these capital instruments would remain at risk of first loss ahead of the Bank of England and HM Treasury as providers of secured financial support to the company. The Tripartite Authorities consider that a temporary period of public ownership would best serve their stated objectives if a private sector solution could not be agreed on terms acceptable to the

> Tripartite Authorities, acting in their respective capacities. The Tripartite Authorities do not consider that an administration of Northern Rock would meet these objectives.
>
> All of the Government's guarantee arrangements would remain in place and accordingly savers' money would remain absolutely safe. Savers and borrowers would not be affected by the company being taken into public ownership. Northern Rock would continue to operate and provide services to customers as normal. Branches, call centres, postal and internet banking would all remain open and accessible as usual.
>
> In the event of Northern Rock being brought into temporary public ownership, it would be managed on arms' length terms, as a commercial entity, by a newly appointed experienced and professional management team.
>
> The legislation brought forward would provide for the assessment by an independent valuer of compensation payable to any holder of securities transferred to HM Treasury. The principles for assessing compensation, which would be set out in the legislation brought forward, would reflect the principle that the Government should not be required to compensate shareholders for value which is dependent on taxpayers' support and the fact that public sector ownership would be an alternative to an administration of the company. *Accordingly, the compensation would be assessed by the valuer on the basis, among other things that all financial assistance to Northern Rock from the Bank of England or HM Treasury (including HM Treasury's existing guarantee arrangements) had been withdrawn and no other financial assistance (apart from Bank of England assistance on its usual terms through standing facilities or open market operations) were made available by them to Northern Rock."*

The italics are ours.

46. Between 5 and 12 February 2008, SRM bought 5.259 million shares in Northern Rock. Between 6 and 14 February 2008 RAB bought 1.64 million shares.

47. By 17 February 2008 there were only two private sector proposals for the future of Northern Rock, one put forward by what was referred to as the Virgin Consortium and one by the company's management. Both involved the continuation of public financial support to the company.

48. On 17 February 2008, the Chancellor made a statement in the House of Commons. In view of its importance we quote from it extensively:

> "…

3. The Government has now completed its review of the two detailed proposals on the table. We have made our choice after considering all proposals.

4. But in current market conditions, we do not believe that they deliver sufficient value for money for the taxpayer.

5. Our financial adviser Goldman Sachs has concluded from a financial point of view that a temporary period of public ownership better meets our objective of protecting taxpayers.

6. So the Government has therefore today decided to bring forward legislation to take Northern Rock into a period of temporary public ownership.

7. We have done so after full consultation with the Bank of England and the Financial Services Authority.

8. Northern Rock will continue operating as a bank on a commercial basis. It will be open for business as usual tomorrow morning and thereafter.

9. More importantly savers' and depositors' money remains safe and secure.

10. The Government guarantee arrangements I announced last year remain in place and will continue to do so.

11. ..

12. The bank will be run at arm's length and on a commercial basis. I will appoint Ron Sandler as Executive Chair to run the bank

…

14. The Financial Services Authority continue to assure me the bank is solvent. It believes that Northern Rock's mortgage book is of good quality. And the FSA will continue to regulate the Northern Rock.

15. We will be introducing the necessary legislation tomorrow to do that. …

…

22. Here in Britain, because of its particular business model, Northern Rock, last summer, found it increasingly difficult and then impossible to raise the billions of pounds it needed to finance its business.

23. For financial stability reasons, we decided that it was right to support Northern Rock to allow it to continue operating. It was right to protect to depositors' money and to protect the wider financial system.

24. In agreeing to that support, the Government had three objectives.

25. First, financial stability. In the then prevailing conditions, there was a serious risk that other parts of the banking system in Britain could have been destabilised.

26. It was right and necessary for the government to intervene because of the need to preserve financial stability in the system. That support was successful and prevented further contagion.

27. Secondly, the Government was also determined to safeguard depositors' money and we took action to put in place guarantee arrangements which have been successful in doing so.

28. None of the guarantees have been called and therefore there has been no cost to the taxpayer.

29. That brings me to my third objective of protecting the interests of the taxpayer.

30. We believed it was right to allow the Board and shareholders to explore every opportunity to find a private sector solution, subject to not increasing taxpayer costs.

31. While in September and October uncertainty in the market place made it difficult to attract potential buyers, in November and December the Board of Northern Rock received a number of expressions of interest.

32. And we decided to test them; we wanted to give time to shareholders and the management to find a solution.

33. But it became clear that no institution was prepared to make an offer for Northern Rock without some form of public support because of prevailing market conditions.

34. That is why the Government was prepared to consider a backstop guarantee arrangement to allow the Board and shareholders to explore a private sector solution, provided that the terms and conditions were acceptable and met the principles I set out.

35. In order to provide certainty for all interested parties and meet state aid rules, a solution had to be found by 17 March. It is not possible, nor would it be desirable to go beyond that time.

36. Two detailed proposals have been received, one from Virgin Consortium and one from Northern Rock. And they had to be considered alongside temporary public ownership.

37. ...

38. Both proposals involve a degree of risk for taxpayers and very significantly implicit subsidy from the Treasury, involving a payment below the market rate to the Government for continuation of its guarantee arrangements and for the financing we would be putting in place.

39. Each proposal has its pros and cons. The Virgin proposal, for instance, would have brought a new brand and management.

40. However, the taxpayer would only have seen any share of the private sector's return if the value of the business to its investors had reached at least £2.7bn.

41. The Board's proposal would have involved a similar level of subsidy. But it has other disadvantages, compared with Virgin, including: that it would bring in less new capital, providing less "buffer" protecting the taxpayer from risk; and, that the business would have been dependent on Government guarantees for new retail deposits for longer.

42. A subsidy on the scale required would not in the Government's judgement provide best value for money for the taxpayer, in circumstances where the private sector rather than the taxpayer would secure the vast majority of the value created over the period ahead. This would be a poor reflection of the balance of risk borne by the two sides.

43. By contrast, under public ownership the Government will secure the entire proceeds from the future sale of business in return for bearing the risks in this period of market uncertainty.

44. We could have chosen to pursue either of the two private sector options. But I have always said that I was determined to protect the taxpayers' interest.

45. It is clear that the private sector alternatives do not meet this test, when compared with public ownership.

46. Accordingly, and taking all the wider considerations into account, I have concluded that this is the right approach.

47. Moreover, it is my clear assessment that under the approach we are taking the taxpayer will see its outstanding loans to Northern Rock repaid in full, with interest – and that the business can be returned to the private sector as financial markets stabilise."

49. The power to nationalise Northern Rock was conferred on the Government by the Banking (Special Provisions) Act 2008 ("the 2008 Act"), which was passed into law on 21 February 2008. We refer to its relevant provisions below. The nationalisation of the company was effected by the Northern Rock plc Transfer Order 2008, which was made on the same date and came into force on 22 February 2008; it transferred the shares in the company to the Treasury Solicitor as nominee of the Treasury at the beginning of 22 February 2008.

50. Immediately before nationalisation, the market price of Northern Rock's shares was 90p, giving a market capitalisation of approximately £379 million.

51. The statutory instrument making provision for the determination of the compensation payable to the former shareholders of Northern Rock is the Northern Rock plc Compensation Scheme Order 2008, made on 12 March 2008. We refer to its relevant provisions below.

52. On 2 April 2008, the European Commission informed the United Kingdom that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in relation to State aid potentially incompatible with the common market. Paragraph 102 of the letter stated:

> "The decision of 5 December 2007 already established that Northern Rock is a firm in difficulty. Its situation has not improved since then. In particular, if all the rescue aid measures were withdrawn, the firm would immediately exit the market."

53. The first paragraph of the decision was as follows:

> "The Commission has accordingly decided that the measures implemented on 18 December 2007 are compatible with the EC Treaty and that if the shareholders are only compensated on the basis of an independent valuation of the company without any State support, the purchase of the shares from existing shareholders does not constitute State aid."

54. The total amount lent by the Bank of England to Northern Rock as at 31 December 2007 was some £27 billion; in addition, the Treasury had assumed contingent liability under guarantees of some £29 billion. As at 31 March 2008, £24.1 billion of the loans remained outstanding.

55. LOLR, as the name suggests, consists of loans: see, for example, Professor Congdon's first witness statement at paragraph 18. The financial support provided to Northern Rock went beyond the provision of loans by the Bank of England, and we therefore consider that it went beyond LOLR, but the question whether it did or did not do so, addressed by Professor Congdon in paragraph 37 of his first statement and by Ian Bond of the Bank of England at paragraphs 12 and 79 of his witness statement, seems to us to be inconsequential. To the extent that the financial support went beyond LOLR, it was even less predictable than LOLR itself. As far as we know, for example, there had been no previous occasion when all of the deposits of a bank had been guaranteed by the Government.

VI. The legislation

56. The 2008 Act confers power on the Treasury to make an order transferring securities issued by an authorised UK deposit-taker to, among others, its nominee. By virtue of section 2(1) read with section 2(2) of the 2008 Act, the power is exercisable by the Treasury if it considers it desirable to do so for either or both of the following purposes:

> "(a) maintaining the stability of the UK financial system in circumstances where the Treasury consider that there would be a serious threat to its stability if the order were not made;
>
> (b) protecting the public interest in circumstances where financial assistance has been provided by the Treasury to the deposit-taker for the purpose of maintaining the stability of the UK financial system."

57. Section 5 requires the Treasury to make a scheme for determining the amount of any compensation payable by the Treasury to persons who held the securities immediately before they were transferred. Section 5 (4) is as follows:

> "(4) In determining the amount of any compensation payable by the Treasury by virtue of any provision in an order under this section, it must be assumed –
>
> (a) that all financial assistance provided by the Bank of England or the Treasury to the deposit-taker in question has been withdrawn (whether by the making of a demand for repayment or otherwise), and
>
> (b) that no financial assistance would in future be provided by the Bank of England or the Treasury to the deposit-taker in question (apart from ordinary market assistance offered by the Bank of England subject to its usual terms)."

"Ordinary market assistance" is defined in subsection (5) (b). It is common ground that it does not include the financial support that had been provided to Northern Rock since September 2007.

58. By section 13(3) of the Act, a statutory instrument which contains an order under section 5 (among others) may not be made unless a draft has been laid before, and approved by a resolution of, each House of Parliament. A statutory instrument containing an order under the Act to which that subsection does not apply is subject to annulment in pursuance of a resolution of either House of Parliament.

59. The nationalisation of Northern Rock was effected by the Northern Rock plc Transfer Order 2008 made under the 2008 Act. It came into force on 22nd February 2008, and transferred all the shares in Northern Rock to the Treasury Solicitor as nominee of the Treasury with effect from the beginning of that date.

60. The Northern Rock plc Compensation Scheme Order 2008 gives effect to the compensation scheme set out in the Schedule to the Order ("The Compensation Scheme"). It requires "The amount of compensation payable to a person [to] be an amount equal to the value immediately before the transfer time of all shares in Northern Rock held immediately before the transfer time by that person". The Compensation Scheme contains provision for the appointment of an independent valuer to assess compensation, for him to make procedural rules, and for any person dissatisfied with his determination of compensation to refer the matter to the Financial Services and Markets Tribunal. No complaint is made as to these procedural provisions of the Compensation Scheme. It is the basis of valuation that is the subject of complaint. That is set out in paragraph 6 of the Compensation Scheme:

> "6**.** In determining the amount of any compensation payable by the Treasury to any person in accordance with paragraphs 3 to 5, it must be assumed (in addition to the assumptions required to be made by section 5(4) of the Act (compensation etc. for securities transferred etc.)) that Northern Rock —
>
> (a) is unable to continue as a going concern; and
>
> (b) is in administration."

VII. The contentions of the parties

61. The central complaint of the Claimants is that the restraints imposed upon the valuer of the Northern Rock shares by section 5(4) of the 2008 Act and by paragraph 6 of the Schedule to the Compensation Scheme Order will inevitably have the effect that the Compensation Scheme fails to produce a sum for the Claimants which satisfies the requirements of A1P1. An essential aspect of the Claimants' case is that a fair approach to compensation for the Northern Rock shares would have been to leave it to the independent valuer to decide the value of the Northern Rock shares as at the date of nationalisation without being required to make any assumptions.

62. It is said by the Claimants that there are no good reasons for the assumption that "all financial assistance provided by the Bank of England or the Treasury to the deposit taker in question has been withdrawn" because there was in fact no prospect whatsoever of the financial support being withdrawn at the time of nationalisation. The Claimants contend that they can rely upon the expectation that the Bank would provide LOLR support especially as Northern Rock had agreed to pay for the LOLR support by paying penal interest and fees as well as by giving security for it.

63. In response the Defendants accept that Northern Rock is receiving the benefit of public funding, that it is trading and that it is not in administration; but their case is that these facts do not answer the distinct legal question whether the assumptions lead to a means of calculation that is incompatible with A1P1. This question, according to the Defendants, is not answered by considering what may subsequently happen or has subsequently happened to Northern Rock, but by focusing on the true position between 13 September 2007 and the date of nationalisation. Throughout that period and at the date of nationalisation Northern Rock had no entitlement to financial assistance or its continuation without which it was insolvent with the consequence that the State was entitled to adopt the statutory assumptions which reflected the true

position which was that Northern Rock was not entitled to continued further assistance.

64. In response the Claimants contend that they had a legitimate or at least a reasonable expectation that Northern Rock would receive financial assistance from the Government. It is disputed by the Defendants that the Claimants had any such an expectation.

65. In addition, the Claimants contend that A1P1 contains three procedural guarantees, namely:

(a) that there must be adversarial proceedings;

(b) that such proceedings must in effect comply with the requirements of Article 6; and

(c) that such proceedings must be competent to determine all of the central issues relating to the determination of the value of the property taken and thus of the amount of fair compensation.

66. In response to this submission, the Defendants contend that the valuer appointed under The Compensation Scheme will be able to determine the central issues, which do not include those asserted by the Claimants; and they say that the cases on which the Claimants rely for their proposition are to be distinguished from this case.

67. Both sides seek to fortify their position by relying on additional matters. The Claimants contend that:

(a) The Government decided to bring Northern Rock into public ownership because it wished to make a profit from what the Claimants say was a sound and profitable business. In response, the Defendants submit that Northern Rock was not a sound business, that it was not taken into public ownership in order to secure a profit for the Defendants and that it was and is not inevitable that the Government will make a profit from Northern Rock.

(b) Regulatory failings on the part of the Bank of England, the Defendants and the Financial Services Authority in relation to Northern Rock and in relation to the credit crunch generally caused or contributed to the nationalisation of Northern Rock and mean that the Defendants cannot be permitted to profit from their own wrongs and those of other Tripartite authorities. The Defendants do not accept these criticisms but contend that they are irrelevant to the issue whether the scheme for compensating the Claimants is compatible with A1P1. It is also said that this point raises complex and difficult judgments on questions of macro-economic policy which are not appropriate issues to be resolved in judicial review proceedings.

(c) In subsequent cases in 2008 and 2009 when banks have failed or found themselves in difficulties, the Government has not resorted to nationalisation but has instead taken other steps less damaging to their shareholders which it should have taken in relation to Northern Rock. In response the Defendants contend that the lawfulness of the Compensation Scheme has to be determined by reference to the factors prevailing at the time of nationalisation in relation to Northern Rock; and that the subsequent treatment of other banks is irrelevant.

68. The Defendants also contend:

(a) States enjoy a wide margin of appreciation in relation to decisions about compensation for property taken. In consequence the courts will only intervene if the legislature's judgment about compensation was "*manifestly without reasonable foundation*". As authority for this proposition the Defendants rely on the judgment of the European Court of Human Rights in *Lithgow v UK* (1986) 8 EHRR 123. The Defendants say that the provisions of the compensation scheme cannot sensibly be criticised as being manifestly without reasonable foundation. In response the Claimants say that where a case concerns a "distinct appropriation" as opposed to one carried out in the implementation of a general policy of economic, social or political reform (as in the *Lithgow* case) the Strasbourg Court has been unwilling to find a legitimate public interest objective capable of justifying compensation which is less than the market value of the property seized.

(b) The hedge fund Claimants, SRM and RAB, invested in Northern Rock shares at a time when they knew its financial position to be precarious. They did so on the basis of their own predictions or assumptions about the Bank of England's and the Treasury's willingness to provide substantial public subsidies indefinitely for the benefit of shareholders. In fact those predictions and assumptions turned out to be incorrect. There is no obligation on the part of the Defendants to compensate those former shareholders for losses suffered by them taking a commercial risk which turns out to be unsuccessful.

(c) Both SRM and RAB bought shares in Northern Rock after the Government announcement of 21 January 2008 that if the company was taken into public ownership compensation would be assessed on the basis that all financial assistance to Northern Rock from the Bank and the Treasury had been withdrawn and that no other financial assistance would be made available. The Defendants contend that those Claimants could not at the time when purchasing those shares have had any expectation that they would receive compensation on any other basis. In response, the Claimants contend that the Compensation Scheme provides the same compensation for all shareholders irrespective of the dates when they acquired their shares or their motives for doing so. The compatibility of the Compensation Scheme cannot therefore vary with the circumstances of individual shareholders.

The Issues

69. Thus the issues we must consider are

(a) Are the statutory assumptions justified apart form the issues of (b) regulatory failure, (c) a legitimate of reasonable expectation of public financial support, (d) the Treasury's reward and profit, (e) the Tripartite Authorities treatment of other banks and (f) the procedural requirements of A1P1?

(b) Was there regulatory failure on the part of the Tripartite Authorities such as to affect the compatibility of the Compensation Scheme with A1P1?

(c) Was there a legitimate or reasonable expectation of LOLR assistance that affects the compatibility of the Compensation Scheme with A1P1?

(d) Do the Bank's and the Treasury's rewards from their provision of financial support and the profit that the Government has said will result from nationalisation affect the compatibility of the Compensation Scheme with A1P1?

(e) Does the Tripartite Authorities' treatment of other banks affect the compatibility of the Compensation Scheme with A1P1?

(f) Does the Compensation Scheme comply with the procedural requirements of A1P1?

(g) What is the margin of appreciation allowed to the Defendants, and what is its effect?

VIII. A1P1 and the jurisprudence of the European Court of Human Rights

70. A1P1 is as follows:

> "*PROTECTION OF PROPERTY*
>
> Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

71. The requirements of A1P1 have been elaborated by the European Court of Human Rights. Both the Second Claimant and the Defendants provided us with summaries of the propositions they contend to have been established by the jurisprudence of the Court. The First and Third Claimants agreed with the Second Claimant's summary. Much is common ground.

72. A1P1 comprises 3 distinct rules, of which the first is of a general nature and sets out the principle of the peaceful enjoyment of property. The second rule covers deprivation of property and subjects it to certain conditions. The third rule, which is not relevant to this application, recognises that States are entitled to control the use of property in the general interest.

73. This case concerns the second rule concerning the deprivation of property and the conditions for the deprivation. The shares in Northern Rock belonging to the plaintiffs are the relevant "possessions". The deprivation in this case is the transfer of

the shares from the shareholders to the Treasury Solicitor as the means of taking of Northern Rock into public ownership. Its lawfulness has to be assessed by a number of principles, some of which have no relevance to the issues in the present case. It is, for example, not disputed that the deprivation of the shares in this case satisfies the requirement of being "*in the public interest*".

74. The dispute in this case relates to the requirement that "there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure depriving a person of his possessions" (*Jahn v Germany* (2006) 42 EHRR 49 paragraph 93 and *Ukraine-Tyumen v Ukraine* (application no. 22603/02, 22 November 2007) paragraph 55):

> "55. The Court reiterates that an interference with the peaceful enjoyment of possessions must strike a "fair balance" between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights (see, among other authorities, *Sporrong and Lönnroth v. Sweden*, judgment of 23 September 1982, Series A no. 52, p. 26, § 69). The concern to achieve this balance is reflected in the structure of Article 1 of Protocol No. 1 as a whole, including therefore the second sentence, which is to be read in the light of the general principle enunciated in the first sentence. In particular, there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure depriving a person of his possessions (see *Pressos Compania Naviera S.A. and Others v. Belgium*, judgment of 20 November 1995, Series A no. 332, p. 23, § 38)."

75. In *Lithgow v UK* (1986) 8 EHRR 329 the Court stated:

> "120. …
>
> Clearly, compensation terms are material to the assessment whether a fair balance has been struck between the various interests at stake and, notably, whether or not a disproportionate burden has been imposed on the person who has been deprived of his possessions."

76. On the issue of the standard of compensation, the Court stated:

> "121. The Court further accepts the Commission's conclusion as to the standard of compensation: the taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate interference which could not be considered justifiable under Article 1 (P1-1). Article 1 (P1-1) does not, however, guarantee a right to full compensation in all circumstances, since legitimate objectives of "public interest", such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value

> (see the above-mentioned *James and Others* judgment, Series A no. 98, p. 36, para. 54).
>
> In this connection, the applicants contended that, as regards the standard of compensation, no distinction could be drawn between nationalisation and other takings of property by the State, such as the compulsory acquisition of land for public purposes.
>
> The Court is unable to agree. Both the nature of the property taken and the circumstances of the taking in these two categories of cases give rise to different considerations which may legitimately be taken into account in determining a fair balance between the public interest and the private interests concerned. The valuation of major industrial enterprises for the purpose of nationalising a whole industry is in itself a far more complex operation than, for instance, the valuation of land compulsorily acquired and normally calls for specific legislation which can be applied across the board to all the undertakings involved. Accordingly, provided always that the aforesaid fair balance is preserved, the standard of compensation required in a nationalisation case may be different from that required in regard to other takings of property."

77. Dependence on government financial assistance may be relevant to the assessment of the question whether compensation represents a fair balance: *Lithgow* at paragraph 162.

78. Where the decisions in question are of state legislatures in formulating and implementing economic and social policies they can be challenged only on limited grounds:

> "The court, finding it natural that the margin of appreciation available to the legislature in implementing economic and social policies should be a wide one, will respect the legislature's judgment as to what is 'in the public interest' unless that judgment be manifestly without reasonable foundation" (*James v United Kingdom* [1986] 8 EHRR 123 paragraph 46; and see *Lithgow v United Kingdom* [1986] 8 EHRR 329 paragraph 122)."

79. Nevertheless, even in such cases, the court "cannot abdicate its power of review and must determine whether the requisite balance was maintained in a manner consistent with the applicants' right to the peaceful enjoyment of their properties within the meaning of the first sentence of [A1P1]": *Scordino v Italy No 1* (2007) 45 EHRR paragraph 94.

80. Conduct on the part of the state authority which led to the confiscation of a citizen's interests may in certain circumstances be relevant to the assessment of a fair balance. For those reasons, action on the part of the state authorities which in the court's

opinion "constitutes a purposeful attempt to circumvent the rules governing the procedure for the implementation" of an applicant's right to compensation and "involves a deliberate attempt to prevent the implementation of a final and enforceable judgment" may be a material factor in assessing as a whole whether a State has complied with A1P1 (*Broniowski v Poland* (2005) 50 EHRR 495 at paragraphs 171 and 175 respectively; and see also *Beyeler v Italy* (2001) 33 EHRR 1224 at paragraphs 114 and 121). We consider the application of those principles in section X(b) below.

81. In certain circumstances, a pre-emption decision would not comply with A1P1 in the absence of adversarial proceedings that comply with principles of equality of arms enabling an argument to be presented on the issue of the inadequacy of the price paid by the State (*Hentrich v France* (1994) 18 EHRR 440 paragraph 42). There are also authorities which show that in certain circumstances adversarial proceedings must take place before an independent body which is competent to review the reasons for the measures and the relevant evidence (*Forminster Enterprises Ltd v Czech Republic* (application no. 38238/04, 9 October 2008 paragraph 69)). We consider below the application of those principles to the claim in this case.

IX. The essential facts

82. The essential facts on the basis of which we must make our decision are relatively few and may be shortly stated:

(a) Northern Rock had a good quality loan book.

(b) At all relevant times the assets of Northern Rock exceeded its liabilities. It was solvent on a balance sheet basis.

(c) However, in August or September 2007 it became insolvent in the sense that it could not pay its debts as they fell due.

(d) Government support for Northern Rock was provided because there was "a genuine threat to the stability of the financial system and in order to avoid a serious disturbance in the wider economy". It may also have been provided in order to protect depositors.

(e) The loans and guarantees provided for Northern Rock were not gratuitous. A premium rate of interest was payable on the loans, and a fee "set at a higher rate than the interest premium" charged for the guarantee arrangements provided on 9 October 2007 and later.

(f) The loans to Northern Rock provided by the Bank of England were repayable on demand. If repayment had been demanded at any time before nationalisation, the company would have been insolvent in that it would have been unable to pay its debts as they fell due.

(g) The financial support required by Northern Rock was not available from any source other than the Government.

(h) The Government may make a profit from the nationalisation of Northern Rock in addition to the price paid for the financial support.

83. Certain other points must also be made. First, and importantly, as we have already stated, there is no challenge to the nationalisation of Northern Rock: the challenge is only to the basis of valuation of the compensation to be paid to its shareholders. It follows that it is accepted that the purpose of nationalisation was one or both of the purposes set out in section 2(2) of the 2008 Act. It also follows that it is not open to the Claimants to contend that the purpose of its nationalisation was to produce a profit for the Government.

84. In paragraph 29 of his first witness statement, Professor Congdon asserted that Northern Rock was not insolvent in the sense that is relevant to the making of public policy. But it was cash-flow insolvent, and it was this insolvency that led to the Tripartite Authorities' decision in September 2007 to provide financial support; and it was this insolvency that led to its nationalisation for the statutory purposes; and these were clearly acts of public policy.

85. It also follows from the absence of any challenge to the nationalisation of Northern Rock that there is no challenge to the Government's decision to reject the private sector proposals for the future of the company. In paragraph 120 of Mr Kingman's witness statement he cited the following statement made on behalf of SRM:

> "The Virgin proposal creates unnecessary dangers of, among other things, execution, change of brand, and restructuring and is vehemently opposed by our client."

This statement would have made it difficult for the Claimants successfully to have asserted that the Government's decision was impeachable.

86. Secondly, it is common ground that the requirement of the Compensation Scheme that compensation be valued on the assumptions that Northern Rock was unable to continue as a going concern and was in administration added nothing to the assumptions required by the 2008 Act that all financial assistance provided by the Bank of England or the Treasury to the company had been withdrawn and that no such financial assistance would be provided in future. This is because, as a matter of fact, the continuation of Northern Rock as a going concern throughout the period from September 2007 to its nationalisation depended on government financial support. If that support had been withdrawn, the company would have been unable to meet its liabilities as they fell due, and would ceased to have been a going concern and would have necessarily have gone into administration (and if not would have gone into insolvent liquidation).

X. Discussion

(a) The position apart from the issues of (b) regulatory failure, (c) legitimate or reasonable expectation of public financial support, (d) the Treasury's reward and profit, (e) the Tripartite Authorities' treatment of other banks and (f) the procedural requirements of A1P1.

87. It is for the Defendant to justify the statutory provisions as to compensation.

88. In our judgment, the Claimants' case mischaracterised the legislative provisions as to compensation. On the basis that the result of the application of those provisions would probably be that the valuer would find that the value of the shares in Northern Rock at the Vesting Date was either nil or a "derisory" sum, they submitted that this was a case of expropriation without compensation, which could be justified under A1P1 only in exceptional circumstances.

89. This way of putting the Claimants' case confuses a legislative provision that provides for the payment of no compensation (or for payment of compensation that is negligible in relation to the true value of the asset taken by the state) with a provision that provides for compensation to be determined by a valuer on specified assumptions. In the latter case, the primary question that must be asked for the purposes of A1P1 is whether compensation so determined is in all the circumstances fair. If the specified assumptions are appropriate, the compensation so determined will be fair. If, in truth, the asset acquired by the state, when fairly valued, has no or negligible value, the compensation provisions are compatible with A1P1: in such a case, the fact that no, or negligible, compensation is payable results not from any unfairness in the statutory provisions, but from the lack of any value attributable to the asset in question.

90. The question is, therefore, whether the statutory assumptions result in a fair valuation of the shares of Northern Rock. In principle, and leaving aside for the moment the State's margin of discretion, in our judgment fairness requires that the valuation reflects the relevant facts and the relevant legal obligations of the State.

91. As mentioned above, the relevant facts, under this head, are undisputed. As at 12 September 2007, Northern Rock was unable to pay its debts as they fell due. The only source of funding and financial support to enable it to remain solvent in that sense was the Bank of England. No private finance was available.

92. Secondly, but for the support provided by the Bank of England in the period between 13 September 2007 and the vesting date, Northern Rock would have been unable to pay its debts as they fell due and would have had to cease to carry on business.

93. Thirdly, Northern Rock had no contractual or other private enforceable right to that financial support or to its continuation.

94. If, on 13 September 2007, the Tripartite Authorities had decided not to provide financial support, Northern Rock would have had to go into administration, if not insolvent liquidation. If nationalisation had been decided upon at that date, the fair value of the shares of the company would have been assessed on the basis that it was not a going concern: it would have been unrealistic to expect a price to be paid on the basis that it was a going concern.

95. Should it have made a difference to the assessment of fair value in February 2008 that the Bank of England did in fact provide financial support? In our judgment, the answer is No.

96. The financial support was, apart from the guarantees of deposits, in the form of on demand loans. The continued trading of the company depended on the continuance of public financial support. In other words, it was precarious. We see nothing unfair in

these circumstances in the Compensation Scheme requiring the Treasury to pay compensation on the same basis that it could fairly have paid in September 2007.

97. It follows that we do not see on what basis it can be said that it became unfair to refuse to pay compensation on the basis of a value enhanced (on the Claimants' argument) by the provision of public financial support that was unavailable elsewhere. We accept what John Kingman, the Second Permanent Secretary at the Treasury, the senior Treasury official dealing with Northern Rock from 21 September 2007, said at paragraph 150 of his witness statement:

> "… the former shareholders are not entitled to be compensated for value created or enhanced by the provision of public financial assistance. If public financial assistance were not excluded in the calculation of value, the Treasury would compensate former shareholders for value which the provision of public financial assistance had created …"

98. It is nothing to the point that the Government would not or might not in practice have refused to provide the necessary financial support or refused to continue it. That financial support was not provided or continued by reason of any private law duty owed to Northern Rock or to its shareholders. Nor, as we find, for reasons set out below, was it provided on the basis of any public law duty owed to them. It was provided in order to prevent serious damage to the banking and financial system in this country. Arguably, perhaps, it was also provided in order to avoid loss on the part of depositors. We do not see on what basis the shareholders of Northern Rock are entitled to greater compensation by reason of the performance of the public law function. The Government could, without being in breach of any private or public law duty owed to the shareholders, have withdrawn its financial support (and in particular the Bank of England could have called in its loans); if it had done so, the company would have gone immediately into administration, and the shares would have had the value that will be attributed to them under the Compensation Scheme.

Share purchases

99. There are other points to be noted at this point in our judgment. The Claimants presented a united front before us. Although the representative small shareholders were separately represented, they did not seek to distinguish their individual cases from those of the other Claimants. When asked whether the Defendants took any point on the dates of the Claimants' purchases of their shares, Lord Grabiner replied in the negative.

100. In fact, however, the circumstances of the different Claimants do differ, both in relation to the dates of their acquisitions of their shares and the circumstances of Northern Rock at those dates. With regard to those whose share acquisitions preceded 13 September 2007, it is sufficient to refer to the situation of Mr. Dennis Grainger, the first-named Claimant in the claim brought by the individual shareholders, who explained movingly in his witness statement the problems caused for him as a former Northern Rock employee by the statutory assumptions of the Compensation Scheme.

101. If our conclusions were otherwise, the merits of those such as RAB and SRM, who purchased their shares after 13 September 2007, when the difficulties of the company were well known, and even more of those who purchased their shares after the Treasury's announcement of 21 January 2008 referred to in paragraph 45 above, might be very different from those who had acquired their shares at earlier dates, and in some cases at much earlier dates. The consequences of that "catastrophe" to which Mr Richards referred at the extraordinary general meeting of the shareholders of Northern Rock on 15 January 2008 were spelt out in the Treasury announcement of 21 January 2008 (paragraph 45 above). Yet, as we stated in paragraph 46 above, RAB itself bought 1.64 million shares between 6 and 14 February 2008; and SRM bought 5.529 million shares between 5 and 12 February 2008. Clearly, they were speculating on the basis of their view that nationalisation would not take place. They must knowingly have taken the risk that nationalisation would take place on the terms that had been announced.

102. Moreover, shareholders were able to sell their shares on the London Stock Exchange at all times between 13 September 2007, when its financial difficulties became public, and the announcement of nationalisation. During that period, the price of the shares fluctuated widely. They were worth 639 pence on 13 September 2007 but their value was 132.10 pence on 1 October 2007, 273.50 pence on 10 October 2007, 74 pence on 20 November 2007 and 111 pence on 25 January 2008. Clearly, shares were purchased on the basis of speculation as to the future of the company. Mr. Price of RAB stated in terms that it "typically invests in higher risk opportunities".

103. Nonetheless, we have sympathy for the small shareholders of Northern Rock, particularly those whose shares formed part of their pension funding. However, all shareholders, large or small, professional or private, are investors in the fortunes of the company the shares of which they hold, and the small shareholders had the misfortune to hold investments in a company that by 13 September 2007 was cash flow insolvent.

(b) Regulatory failure

104. The Claimants allege:

(a) That the Bank of England was insufficiently proactive in responding to the credit squeeze: it "did not fulfil its role as lender of last resort in a timely or consistent manner" (paragraphs 57 to 72 of Mr Richards' witness statement).

(b) That the FSA failed in the exercise of its regulatory functions (paragraphs 73 to 79 of Mr Richards' witness statement).

105. Mr Richards also criticises at length the decision of the Treasury to nationalise Northern Rock and its intention to make a profit from its nationalisation. Those are not, however, regulatory failures. We address the second of these contentions elsewhere in this judgment; we have already stated that the first is not open to the Claimants.

106. We point out that the Claimants did not in their oral submissions seek to rely on the leak to the BBC on 13 September 2007 of the fact that Northern Rock had sought and

was to receive public financial support. They were correct not to do so. There is no evidence that the leak was the responsibility of anyone within the Tripartite Authorities, let alone of someone acting within the scope of his authority. The leak could have originated within Northern Rock itself or its advisers. If it had been sought to rely on the leak as an instance of regulatory failure, questions would have arisen concerning freedom of information and expression, which happily we do not have to consider.

107. For the purposes of their claim, the Claimants contended that any autonomy or independence of decision-making of the Bank of England and the FSA is irrelevant. While neither body is part of central government, they are both public authorities for the purposes of the Convention and the Human Rights Act 1998, so that their failures are attributable to the State and relevant to the assessment of compensation. The Defendants did not take issue with this contention. Clearly, each of the Tripartite Authorities is a public authority for the purposes of the Convention and the Human Rights Act 1998. We express no view as to the correctness of the proposition that it follows that for the purposes of assessing whether regulatory failure affects the compatibility of the Compensation Scheme with A1P1 they are all to be treated as one.

108. The Claimants originally sought to rely on the conclusions of the Treasury Committee of the House of Commons. However, after the judgments in *Federation of Tour Operators v Her Majesty's Treasury* [2007] EWHC 2062 (Admin) and *Office of Government Commerce v Information Commissioner* [2008] EWHC 737 (Admin) were brought to their attention, they did not press their reliance, and contented themselves with relying on the statements of the Tripartite Authorities themselves.

109. The Defendants' response to the Claimants' allegations of regulatory failure was to assert that they are irrelevant to the issue of the compatibility of the statutory compensation provisions with the Convention. They did not, however, in their oral submissions, explain why they are irrelevant, other than by asserting that the jurisprudence relied upon by the Claimants concerned very different facts.

110. It would be inappropriate, if not impossible, in these judicial review proceedings, for us to arrive at any conclusion as to the whether there was negligence on the part of the regulator. We are conscious that admissions of failure must take account of the clarity given by hindsight. For example, the statement of Mr Hector Sants, the Chief Executive of the FSA, in October 2007 is relied on as an admission of its failure. But what he said was:

> "… what I would agree with absolutely is that we did not engage in our supervised process in a way to my satisfaction with regard to the stress testing scenarios, because the stress testing scenarios which they were operating with did not envisage the set of circumstances that transpired in August, which was complete closure to them of all reasonable funding mechanisms, including the repo market. *I have to say, I do not think any reasonable professional would have anticipated that set of circumstances …*"

111. The italics are ours. There are, however, less equivocal admissions. In a speech to the FSA Retail Firms Conference on 27 February 2008, Mr Sants said:

> "Market induced problems, however, are not an excuse for any inadequacy in our regulation of firms and I would thus like to make some comments on the events surrounding Northern Rock. Having reviewed our supervisory engagement with Northern Rock prior to July 2007, I have already acknowledged that it was not of sufficient intensity and rigour, particularly with regard to challenging the company's board and executive in respect of their risk management practices and their understanding of the risks posed by their business model. Furthermore, given the importance I attach to learning lessons quickly, I commissioned an internal review of our supervision of Northern Rock in the period up to July last year. We have committed to publishing the conclusions next month. I can now say it will show that the supervision of the company did not meet the standards I would expect of the FSA, although I should also say that it is not necessarily the case that more active supervision on our part would have prevented what later occurred."

112. Whether this, and similar statements, evidence regulatory failure in the sense of a failure to do that which a reasonably competent regulator should have done in the circumstances (which may not be the same as the standard Mr Sants expected of the FSA) is a matter we do not seek to resolve. It is, we think, sufficient for present purposes to assume that the Claimants have a reasonable prospect of establishing regulatory failure. However, in our judgment, the allegations of regulatory failure do not assist the Claimants, for the reasons we give below.

113. First, the primary responsibility for the insolvency of Northern Rock lay with its management. Its management was answerable to its shareholders, who could have removed the directors and appointed other directors if they considered that the business model adopted by the company was inappropriate or unsafe. As we have already mentioned, the business model of Northern Rock placed greater reliance in its borrowing on the wholesale market than its competitors, who were more reliant on retail deposits. Thus it was more vulnerable than its competitors to the difficulties in the wholesale market in the late summer of 2007. Its business model was well-known.

114. Secondly, as we have already pointed out, if there was any failure on the part of the regulatory authorities, it was not in any duty owed to the shareholders of Northern Rock. Neither the Bank of England nor the FSA owed any duty to the shareholders. The purpose of their public law duties was the protection of depositors (in the case of the FSA) and of the health of the financial system and through it of the economy of this country. The regulators were not required to consider the position of shareholders either when deciding whether to take action or when deciding what action to take. To increase the compensation payable to shareholders by reason of any default on the part of the Tripartite Authorities would in effect be to impose a duty of care owed by them to shareholders of a regulated bank. In our judgment, this would be impermissible. So far as the FSA is concerned, we point out that the protection of

regulated persons or of their shareholders is not one of its statutory objectives. It is not suggested that the Financial Services and Markets Act 2000 imposed any relevant statutory liability on the FSA; and the decision of the Privy Council in *Yuen Kun Yew* [1988] AC 175, establishes that it owed no common law duty of care to depositors in Northern Rock; *a fortiori* it owed none to its shareholders. We see no basis for imposing any relevant duty of care on the Bank of England, and indeed the Claimants have not suggested that it or the Treasury was under any such duty.

115. Thirdly, and fundamentally, the allegations of regulatory failure cannot assist the First or the Second Claimants, or those of the small shareholders who acquired their shares after 13 September 2007 (if not an earlier date). This is because any loss of value of the shares caused by any regulatory failure had already occurred. The company was insolvent, on a cash flow basis, on that date if not before. It was a going concern only if the Government supported it. And its parlous financial condition was public: hence the run on the bank. We do not see on what basis the First Claimant, for example, can assert that fairness or A1P1 requires the compensation for their shares acquired after 13 September to include a loss of value that had occurred before they acquired them.

116. We also point out that there is no evidence before us which could lead to a finding that, but for the alleged failures, Northern Rock would have survived as a going concern, able to pay its debts as they fell due, without public financial support. In this connection we refer to the last sentence of the statement of Mr Sants cited at [111] above. But, assuming that there is reasonable prospect of the Claimants succeeding on this issue, it does not assist any of those whose shares were purchased after 13 September 2007, for the reason given in the preceding paragraph.

117. We also think it right to mention a complication in the Claimants' case, albeit one that was not referred to by the Defendants. It seems to us that a provision that regulatory failure may be taken into account in valuing the shares of Northern Rock or the compensation payable to its former shareholders would not be an aspect of valuation of property. It would be effectively an evaluation of a claim for damages. For reasons we have already given, we consider that the shareholders have no such claim.

118. We do not consider that the Strasbourg jurisprudence assists the Claimants. In *Beyeler*, the applicant, a Swiss national, had bought a Van Gogh painting in 1977 from an Italian art collector through an agent. The painting was subject to Italian legislation concerning works of historical and artistic interest, which gave the Ministry of Cultural Heritage a right of pre-emption. Although the sale was declared to the Ministry, the declaration was signed only by the seller who was unaware that the painting had been purchased on the applicant's behalf. The declaration identified the agent as the other party to the contract and did not mention the applicant as end buyer. The applicant did not declare his purchase to the Ministry until 1983 when he was intending to sell the painting to a collection in Venice. In 1988, the Ministry informed the applicant that the Italian State was interested in buying the painting. The applicant told the Ministry that he was willing to sell it to the State but the Ministry failed to respond in time and he sold it to a collection in Venice instead. The sale agreement was notified to the authorities but six months later the Ministry exercised its right of pre-emption in respect of the 1977 sale, paying the applicant the original 1977 sale price by way of compensation and thus acquiring the painting at well below its market value. The Italian courts held that the applicant's loss was a consequence of his failure to declare the sale of the property, thus rendering the sale nugatory and

entitling the State to exercise its right of pre-emption at any time. The European Court of Human Rights held that the applicant's rights under A1P1 had been infringed:

> "120 The Court considers that the respondent Government has failed to give a convincing explanation as to why the Italian authorities had not acted in 1984 in the same manner as they acted in 1988, regard being had in particular to the fact that, under section 61(2) of Law No. 1089 of 1939, they could have intervened at any time from the end of 1983 onwards and in respect of anyone "in possession" of the property (and thus without needing first to determine who the owner of the painting was). That is, moreover, apparent from the judgment of the Court of Cassation of 16 November 1995. Thus, taking punitive action in 1988 on the ground that the applicant had made an incomplete declaration, a fact of which the authorities had become aware almost five years earlier, hardly seems justified. In that connection it should be stressed that where an issue in the general interest is at stake it is incumbent on the public authorities to act in good time, in an appropriate manner and with utmost consistency.
>
> 121 That state of affairs allowed the Ministry of Cultural Heritage to acquire the painting in 1988 at well below its market value. Having regard to the conduct of the authorities between 1983 and November 1988, the Court considers that they derived an unjust enrichment from the uncertainty that existed during that period and to which they had largely contributed. Irrespective of the applicant's nationality, such enrichment is incompatible with the requirement of a 'fair balance'.
>
> 122 Having regard to all the foregoing factors and to the conditions in which the right of pre-emption was exercised in 1988, the Court concludes that the applicant had to bear a disproportionate and excessive burden. There has therefore been a violation of Article 1 of Protocol No. 1."

119. Thus the unexplained, and unjustified, delay on the part of the State had led to its acquiring the painting at less than its market value at the date of the exercise of its right of pre-emption. That is a very different case from the present, where the State contends that it has acquired the shares of the Claimants at a fair valuation (yet to be determined) of their value at the date of nationalisation.

120. *Broniowski v Poland* was similarly a case in which the applicant established that he had not received the fair value of his property. The facts of the case are somewhat complicated. After the Second World War, when the eastern border of Poland was redrawn along the Bug River, a large number of Polish citizens were repatriated from the territories beyond the river. Under international agreements, Poland had agreed to compensate repatriated persons for the loss of their property. Since 1946, those repatriated in such circumstances had been entitled to buy land from the State and have the value of the abandoned property offset against the fee for the right of

perpetual use of this land or against the price of the compensatory property. In 2004, a law modifying previous legislation came into force. Under that law, the State's obligations towards repatriated persons who had obtained some compensation were deemed to have been discharged and Claimants who had never received any compensation were awarded 15 per cent of their original entitlement, subject to a maximum amount. Relying on A1P1, the applicant claimed that, since he had received only 2 per cent of the value of the property abandoned by his grandmother after the Second World War, his entitlement to compensation had not been satisfied. His claim succeeded. His "possession", for the purposes of A1P1, was his right to compensatory property, i.e., to credit for the value of the abandoned property: see paragraphs 129 to 133 of the judgment. The conduct of the state had prevented his receiving the proper amount of that credit:

> "185 In the present case, as ascertained by the Polish courts and confirmed by the Court's analysis of the respondent State's conduct, the authorities, by imposing successive limitations on the exercise of the applicant's right to credit, and by applying the practices that made it unenforceable and unusable in practice, rendered that right illusory and destroyed its very essence."

121. The difference between that case and the present is obvious. There was a direct relationship between the acts of the state complained of and the applicant's loss, which was a deprivation of property without compensation, not a reduction in its value on account of any regulatory or similar failure in the exercise of duties not owed to the applicant, and moreover, in many cases, a reduction suffered before the present Claimants had acquired the property in question.

(c) Legitimate or reasonable expectation of financial support

122. The Claimants' case on their future expectation of financial assistance is that that they had, in the words of paragraph 5.9 of RAB's claim form, a "legitimate expectation that in common with other central banks, the Bank of England would continue to provide support to Northern Rock until such times as the temporary liquidity difficulties which Northern Rock was experiencing eased".

123. The witness statements also refer to a *reasonable* expectation of the Claimants that once LOLR had been provided, they were entitled to expect that it would remain in place with the consequence that it should be taken into account for the purpose of valuing their shares or at least the valuer should not be precluded by the terms of the statutory assumptions from considering if this was so. We do not accept the premise that there was such a reasonable expectation before 13 September 2007 or during the period between that date and nationalisation. Equally importantly, we reject the proposition that if there was such a reasonable expectation, it follows that compensation payable by the state should be increased.

124. The basis of the Claimants' case that it was reasonable to expect Northern Rock to continue to receive LOLR is to be found in the evidence of Professor Timothy Congdon, an economist with experience of the policies and operation of the Bank of England and HM Treasury, who stated that "the recognised function and

responsibility of a central bank [is] to provide LOLR assistance to a illiquid but solvent bank".

125. The Claimants in criticising the Bank first for the way it treated Northern Rock and second in showing how the Bank ought to have performed its functions in assisting Northern Rock seek to attach importance to the approach of other central banks. We are unable to derive assistance from the practice of these other central banks because, as Mr. Bond explained, the roles and functions of all such banks differ widely, and even where they have similar functions, they may nevertheless for their own reasons choose to carry them out differently. We consider that the principles applicable to the functions of the Bank as LOLR are to be found in Lord George's lecture referred to in section IV of our judgment, at paragraphs 18 to 27 above, and indeed, as we stated there, this was common ground before us.

126. Mr. Philip Richards of RAB contends that once LOLR assistance had been given, then "it is inevitably continued for so long as a bank remains solvent" and he says that this expectation was "a legitimate (that is to say a reasonable) one" (paragraph 73 and 74 of his second witness statement). Mr. Philip Price of SRM makes a similar point. These statements are supported by Mr Congdon who says in paragraphs 7 and 8 of his second witness statement:

> "The pertinent question is whether once LOLR support has been made available it is reasonable to expect that such support will remain in place. It would be utterly perverse for a central bank to provide support and then withdraw it arbitrarily."

127. The Defendants strongly dispute the contention that the Claimants had a legitimate or reasonable expectation that LOLR would continue for an unspecified period. Their case is that the statutory assumptions are appropriate.

128. In considering the issues arising under this head, it is important to distinguish between a legitimate expectation and a reasonable expectation, and to bear in mind their essential features.

129. "Legitimate expectation" is a legal term of art. A legitimate expectation has a normative element: a public authority that is the object of a legitimate expectation is under a legal duty, albeit qualified, in relation to the fulfilment of that expectation. Hence a legitimate expectation requires both the facts giving rise to the expectation and the legal conclusion that those facts impose a duty on the authority in question owed to the claimant in question. It is to that conclusion that the epithet "legitimate" refers. The duty is one that fairness requires; and the general principle on which the Court decides to interfere is that failure to honour a legitimate expectation may be an abuse of power. As Auld LJ said in *R (Bloggs 61) v Home Secretary* [2003] EWCA Civ 686 [2003] 1 WLR 2724 at [70]: "… unfairness is a necessary element of a complaint of breach of legitimate expectation, and breach of legitimate expectation is one form or aspect of abuse of power."

130. A legitimate expectation may be created by a statement made by a public authority as to its future conduct. The statement may be express, or inferred from the authority's previous consistent conduct. The statement must be clear and unequivocal. In *R*

(Bancoult) v Home Secretary (No. 2) [2008] UKHL 61 [2008] 3 WLR 955 Lord Hoffmann said:

> "60. … It is clear that in a case such as the present, a claim to a legitimate expectation can be based only upon a promise which is "clear, unambiguous and devoid of relevant qualification": see Bingham LJ in *R v Inland Revenue Comrs, Ex p MFK Underwriting Agents Ltd* [1990] 1 WLR 1545, 1569. It is not essential that the applicant should have relied upon the promise to his detriment, although this is a relevant consideration in deciding whether the adoption of a policy in conflict with the promise would be an abuse of power and such a change of policy may be justified in the public interest, particularly in the area of what Laws LJ called "the macro-political field": see *R v Secretary of State for Education and Employment, Ex p Begbie* [2000] 1 WLR 1115, 1131."

131. As we have already mentioned, in argument, the Claimants asserted that it is irrelevant to their case that there are three different governmental entities (namely the Tripartite Authorities) involved in the actions taken with regard to Northern Rock, and the Defendants did not dissent from that proposition. In the context of legitimate expectation, however, the statements of and the legitimate expectation created by one public authority are not necessarily to be treated as the statements of or the expectation binding on another: see *De Smiths' Judicial Review*, 6th edition, at paragraph 12-32:

> "The representations by a different person or authority will therefore not found the expectation. Thus representations by the police will not create a legitimate expectation about the actions of the prison service."

If the Claimants were able to point to a relevant representation, this point might have been relevant. As it is, as will be seen, they cannot, and so it is not.

132. Furthermore, since a legal duty is involved, its content must be sufficiently defined: the public authority, and the court, must be able to determine what the duty requires. It follows that the Claimants must sufficiently identify the content of their alleged expectation. It is not sufficient to contend that there was an expectation of financial support: the Claimants would have to identify the kinds, amounts, terms and duration of that support, and more: would the Government require the business of Northern Rock to be wound down, with a view to its liquidation, or finance it so that it could expand its business, or what?

133. Lastly, the Claimants have to show that the legitimate expectation was one that created a duty owed to them, rather than, for instance, to depositors who had lent money to Northern Rock. The Claimants have presented a united front, and their case does not distinguish between those who acquired their shares before September 2007 and those who did so subsequently. The Defendants do not suggest that any such distinction is to be drawn. However, as we have pointed out in paragraph 99 above, there are significant differences between the circumstances of different Claimants.

134. The Claimants' case on legitimate expectation falls at every hurdle. They have not identified any relevant statement of the Defendants, or of the Bank of England or the FSA, that financial support would be given to Northern Rock or that it would be continued. The evidence is to the contrary. In relation to the assessment of compensation itself, the evidence is inconsistent with any expectation such as that asserted by the Claimants: we refer to paragraph 45 above and to paragraphs 142 to 142 below. It is not surprising, therefore, that it was abandoned by Mr Richards of RAB in his second witness statement, where at paragraph 73 he said that he had not used the expression "legitimate expectation" in any technical legal sense, but was referring to a purely factual expectation.

135. Turning to the allegation of a "reasonable expectation", this is not now a legal term of art. We understand it to denote a purely factual expectation, with no normative content. "Reasonable" here refers to the existence of facts justifying the expectation. Reasonable expectations may affect the value of property. The value of shares quoted on the Stock Exchange of banking companies is affected, among other things, by expectations as to the conduct of the management of those companies and the future of the economy. However, those expectations do not relate to the conduct of the person who is to acquire the property in question. The expectation in this case does so refer, and in our judgment different considerations apply to it. In our judgment, the "reasonable expectation" of what the Tripartite Authorities might or might not do cannot, in the absence of a relevant legal duty, affect the fair value of Northern Rock shares for the purposes of the Compensation Scheme. To hold otherwise would be to burden the state with an obligation to pay to the shareholders value created by and dependent upon the action of the state (which in this context represents the general body of taxpayers) by the provision of public financial support to the company: see paragraph 97 above. It noteworthy that the Claimants cited no authority to us for the proposition that such an expectation should lead to an increase in the compensation payable by the state.

136. In any event, we are unable to accept that as a matter of fact there was at any time prior to nationalisation any reasonable expectation that the Bank of England would provide or *continue to* provide financial assistance to any bank. Our reasons are set out in the following paragraphs.

137. First, as we have explained, LOLR does not involve a guarantee of financial support from the Bank of England. As Lord George stated: *"There is nothing automatic about our acting as lender of last resort."* There are many instances of the Bank refusing assistance apart from the examples given by Lord George. Since the secondary banking crisis of 1973 to 1976, there have been 31 bank failures in the United Kingdom, including British & Commonwealth Merchant Bank in 1990, BCCI in 1991 and Baring Brothers in 1995. Prior to the facility granted to Northern Rock there had only been four LOLR interventions by the Bank.

138. Secondly, there is no basis for contending that once LOLR is given it will continue indefinitely: the overriding principle is that the Bank looks for a clear exit, which shows that support might well be withdrawn and that it might allow a bank to collapse. It is noteworthy that Professor Congdon in paragraph 37 of his first witness statements points out that LOLR "has to be flexible". Indeed in paragraph 12 of his second statement Professor Congdon points out that LOLR cannot be expected to remain in place indefinitely.

139. Thirdly, the agreements under which the loans were given by the Bank of England provided for them to be repayable on demand. It is settled law that where a facility letter provides that a loan is "repayable on demand", that provision prevails even though there are other provisions in the facility agreement indicating that the bank intends to make the facility available until a specific date (see for example *Lloyds Bank PLC v Lampart* [1999] 1 All ER (Comm) 161 and *Bank of Ireland v ANCD (Property Holdings) Limited and others* [2001] 2 All ER (Comm) 894). In other words, because the Bank of England's loans were repayable on demand, there could not be any legally binding assurance that support would continue.

140. Fourthly, the Claimants have not shown any certainty as to the terms of any legitimate or reasonable expectation of continued LOLR assistance. The case for RAB is stated in paragraph 5.17 of its skeleton argument that:

> "Shareholders reasonably expected that, as is common with other central banks, the Bank of England would continue to provide support until such time as the temporary liquidity problems which Northern Rock was experiencing eased."

This would have amounted to an obligation or commitment of an uncertain amount on unspecified terms for an uncertain period; yet the Claimants accept that there was no entitlement to or expectation of "long-term or indefinite support". Furthermore, the Claimants' assertions are contrary to the principle specified by Lord George when he referred to the fact that the Bank was always looking for "a clear exit". They are also contrary to Lord George's statement that the Bank's aim in providing LOLR is "to protect the system not to keep in being unviable business capacity and so interfere in the market process unnecessarily" and not to safeguard individual banks.

141. Fifthly, as noted in paragraph 99 above, SRM and RAB and some of the small shareholders bought their shares after it had been widely reported that Northern Rock had serious financial problems and was receiving substantial urgently-needed LOLR support. Their purchases of Northern Rock shares were made when it was apparent to all, and particularly to professional investors like the hedge fund Claimants (namely RAB and SRM), from statements (to which we have referred above) made by the Bank and the Treasury that without continued support Northern Rock would have been unable to survive and would have gone into administration. Those Claimants should have known (if only from Lord George's lecture) that there was no consistency or predictability in the way in which the Bank of England provided or ceased to provide LOLR support. They certainly have not established that they were entitled to expect any particular action on the part of the Bank of England or the other Tripartite Authorities. RAB and SRM made their own commercial judgments as to how long and in what way the Bank would provide LOLR support and arrange its exit strategy. Against that background, RAB and SRM made commercial decisions to retain and to increase their holdings in Northern Rock when they knew Northern Rock might be nationalised or that it might go into administration. There is no obligation to compensate former shareholders for losses suffered by reason of their taking a known commercial risk as a result of their judgment turning out to be wrong (c.f. *Jahn v Germany* (2006) 42 EHRR 49 [116]; *J.A Pye (Oxford) Ltd v UK* (2008) 46 EHRR 45 [77]).

142. Sixthly, many of the shareholders invested in Northern Rock at a time when there had been a clear public announcement that, if Northern Rock was nationalised, their shares would be valued on the basis that financial support from the Bank of England had ceased. We refer to the Treasury announcement of 21 January 2008 cited at paragraph 45 above. This is a significant point because, as noted in paragraph 46 above, the hedge-fund Claimants purchased Northern Rock shares after that date. Those who bought shares after that announcement of 21 January 2008 could not have had any reasonable expectation that in the event of nationalisation the compensation they would receive for their shares would be assessed on any other basis. They were speculating, therefore, on the Government accepting a private sector proposal for Northern Rock.

143. The *Pye* case is instructive because the Grand Chamber decided that the limitation rules applicable in England under which a squatter could extinguish the owner's right to recover the land after 12 years of adverse possession did not contravene the owners' rights under A1P1. The reasoning of the Grand Chamber was that the owners could not say that they were unaware of the legislation; and this was relevant to the proportionality of the limitation laws which extinguished the owners' rights. In any event, the limitation laws fell within the State's "wide margin of appreciation" and there was no breach of A1P1. Similarly in the present case, those who purchased shares after 21 January 2008 cannot say that they were unaware of the consequences of nationalisation.

144. We must now mention two matters which we have not overlooked in reaching these conclusions. They relate to first whether any further financial assistance would contravene the EC rules on State aid and second the Treasury's guarantee arrangements for deposits.

145. We were initially concerned whether the continued provision of financial assistance to Northern Rock would have contravened EC rules on State Aid. There have been two decisions of the European Commission on this issue, to which we referred in paragraphs 41 and 52 above. After the hearing we sent a note to counsel for the Defendants asking for clarification of their case on this matter. We were then informed that State aid would only be relevant to the Defendants case:

> "if the claimants contend that they were necessarily entitled to long-term or indefinite support or contend that they expected that it would be continue long term or indefinitely, the Defendant would contend that one among other reasons why those contentions could not be sustained is that they would not be consistent with the fact that the long-term or indefinite state aid would have to be notified to and approved by the Commission."

146. The Claimants have not suggested that there was an entitlement to or an expectation of long-term or indefinite support to Northern Rock and therefore we need not consider whether State Aid is of any relevance on this or on any other issue.

147. Turning to the guarantee arrangements announced for Northern Rock's depositors, the Treasury, in a Notice of 18 December 2007, stated that they would:

> "remain in place during the current instability in the financial markets. Reasonable notice, which will be not less than 3 months, will be given by HM Treasury of any termination of these arrangements."

Thus these guarantees too could be withdrawn at any time, subject to a relatively short period of notice. Moreover, it is clear that if the Bank of England had ceased lending money to Northern Rock as part of LOLR, the company would have gone into administration irrespective of the continuation of the guarantees. Thus the provision of guarantees to the deposit holders of Northern Rock would have been of no relevance to the shareholders of Northern Rock if LOLR had been withdrawn.

(d) Subsidy and Profit

148. There was some debate before us as to whether the financial support extended to Northern Rock prior to its nationalisation involved a public subsidy, i.e., the provision of financial support at a price lower than the market price for such support. In our judgment, it was an arid debate. It is common ground that the financial support provided by the Treasury and the Bank of England was not available elsewhere. There was no market in which such support could be obtained.

149. It may well be that the Bank of England and the Treasury regarded the price exacted from Northern Rock for those facilities as ample, or penal. It may also be that the Government expected that at some time after nationalisation Northern Rock would be sold on terms that would fully repay any outstanding government loans and discharge any outstanding guarantees and provide a surplus. Mr Kingman denies that any such profit was envisaged, although his denial does seem to be at variance with ministerial claims at the time. But the expectation or intention of the Government as to any eventual profit does not affect the fair value of the company at the date of nationalisation. The State (in other words, the taxpayer) is bearing the risk of Northern Rock being unable to meet its liabilities in the future; we do not see it as unfair that it should receive the benefits of Northern Rock's trading, if economic circumstances and other factors, including its management, now in the hands of the Government, lead to a financially successful outcome.

(e) The treatment of other Banks

150. Given our conclusions on the allegations of legitimate and reasonable expectation, we fail to see how the Government's subsequent actions in relation to other banks at other times in different circumstances have any bearing on the fairness or otherwise of the Compensation Scheme.

(f) The procedural requirements of A1P1

151. We summarised the Claimants' submissions under this head in paragraph 645 above. They were, in our judgment, the most cogent of the Claimants' contentions. Oral argument on behalf of the Claimants under this head was undertaken by Mr de la Mare, who was evidently the author of these submissions. He said:

> "Where the denial of a fact finding process has as its consequence the denial to the affected party of a means of

> seeing and testing the crucial evidence as to the real value of the assets in question so as to disable that party from making full submissions as to the cumulative substantive effect of the assumptions in question, that demonstrates that the procedure is not in accordance with law. It demonstrates it has not had an opportunity, a fair opportunity to test the fairness or otherwise of the effect of the assumptions."

152. He accepted that not every statutory assumption is incompatible with A1P1. He said:

> "It has to be an issue that is central to the exercise in question bearing in mind the civil right in question."

153. On this basis, it was submitted that the assumptions imposed on the valuer by the Compensation Scheme, which precludes the Claimants from presenting evidence or arguments to rebut them, render it incompatible with their rights under A1P1. In support of these submissions, the Claimants rely upon the decisions of the European Court of Human Rights in *Hentrich v France* (1994) 18 EHRR 440, *Capital Bank AD v Bulgaria* (2007) 44 EHRR 48, *Forminster Enterprises Ltd v Czech Republic* (9 October 2008, application no. 38238/04) and *Katikaridis v Greece* (2001) 32 EHRR 6.

154. *Hentrich* concerned a right of pre-emption exercisable in France by the Commissioner of Revenue where he considered that the price at which a purchaser had acquired land was too low. Although not expressly stated in the judgment, the purpose of the right of pre-emption was presumably to deprive a purchaser of property where the disclosed price was not the true price paid (as where part of the price is paid in cash in order for the vendor or the purchaser to avoid tax payable as a result of the sale). The applicant had purchased land, and the Commissioner had exercised the right to buy the land at the price disclosed by her. The applicant was unable to challenge the exercise of the right of pre-emption in the French courts. The European Court of Human Rights held that her rights under A1P1 had been infringed:

> "40. In Mrs Hentrich's submission, the pre-emption procedure was arbitrary as the Revenue had not given reasons for its decision and the taxpayer had not been able to know or criticise the reasons for it subsequently.
>
> 41. The Government maintained that the pre-emption measure had to comply with Law no. 79-587 of 11 July 1979 and was reviewable by the courts. Admittedly, the concept of a price being too low was imprecise, but it was to be assessed with reference to transfers of the same type in similar circumstances and the assessment could be challenged by the dispossessed owner.
>
> 42. Unlike the Commission, the Court considers it necessary to rule on the lawfulness of the interference.
>
> While the system of the right of pre-emption does not lend itself to criticism as an attribute of the State's sovereignty, the

> same is not true where the exercise of it is discretionary and at the same time the procedure is not fair.
>
> In the instant case the pre-emption operated arbitrarily and selectively and was scarcely foreseeable, and it was not attended by the basic procedural safeguards. In particular, Article 668 of the General Tax Code, as interpreted up to that time by the Court of Cassation and as applied to the applicant, did not sufficiently satisfy the requirements of precision and foreseeability implied by the concept of law within the meaning of the Convention.
>
> A pre-emption decision cannot be legitimate in the absence of adversarial proceedings that comply with the principle of equality of arms, enabling argument to be presented on the issue of the underestimation of the price and, consequently, on the Revenue's position—all elements which were lacking in the present case."

155. As can be seen, the case concerned an administrative decision that deprived the applicant of her property. Furthermore, if the market value of the property was more than she had paid for it (if, for example, she had simply made a good bargain), and therefore more than the sum she received under the pre-emption, she was suffering what was in effect a penalty. The state had not been required to justify the deprivation, and the applicant was unable to challenge the fact put forward as justifying that deprivation: whether the price she had paid was in fact "low". In the present case, quite apart from fact that the decision is legislative rather than administrative, the decision to nationalise is not challenged.

156. The Claimants relied heavily on the judgment of the Court in *Capital Bank*. The facts were as follows:

> "Following a ruling by the central Bank of Bulgaria (BNB) that the applicant bank was insolvent, the applicant had its licence revoked and two special administrators were appointed by the BNB to act in place of the applicant's board of directors. The BNB's decision to revoke the applicant's licence was not amenable to judicial review. The BNB filed a petition to wind up the applicant and the applicant was represented at the hearing by the special administrators appointed by BNB. The special administrators argued that the applicant was not in fact insolvent and this contention was supported by the prosecutor who also took part in the proceedings. The Sofia court however granted BNB's petition, declared the applicant to be insolvent, ordered that it be wound up and appointed liquidators because it held that an order revoking a bank's licence was sufficient to prove insolvency.
>
> …

> The applicant complained that, in breach of Art.6, the courts that had heard the winding-up petition had not examined whether it was in fact insolvent, and that in those proceedings it had been represented by persons appointed by, or accountable to, the BNB. Furthermore, because the applicant was not in fact insolvent, the decision to revoke its licence had not been made in accordance with the law and violated Art.1 of Protocol No.1."

157. The breach of Article 6 was perhaps obvious: the bank had been deprived of its licence and ordered to be wound up without being able to challenge before a court the assertion that it was insolvent. The Court also found that there had been a breach of A1P1:

> "132 The gist of the applicant bank's complaint was that the BNB's decision to withdraw its licence had been unlawful because the statutory conditions for doing so were not satisfied. It alleged that the BNB's findings that it had failed to pay a due debt and that its liabilities exceeded its assets, which were the two grounds for revoking a bank's licence under s.21(2) of the Banks Act of 1997, were incorrect. The Court does not consider it necessary to determine this issue, which was the subject of debate between the parties and among various domestic authorities, because its power to review compliance with national law is limited and it is not its task to take the place of the domestic courts. However, that does not dispense with the need for the Court to determine whether the interference in issue complied with the requirements of Art.1 of Protocol No.1.
>
> 133 In this connection, the Court reiterates that the first and most important requirement of Art.1 of Protocol No.1 is that any interference by a public authority with the peaceful enjoyment of possessions should be lawful: the second sentence of the first paragraph authorises a deprivation of possessions only "subject to the conditions provided for by law" and the second paragraph recognises that the states have the right to control the use of property by enforcing "laws". Moreover, the rule of law, one of the fundamental principles of a democratic society, is inherent in all the Articles of the Convention.
>
> 134 The requirement of lawfulness, within the meaning of the Convention, presupposes, among other things, that domestic law must provide a measure of legal protection against arbitrary interferences by the public authorities with the rights safeguarded by the Convention. Furthermore, the concepts of lawfulness and the rule of law in a democratic society require that measures affecting fundamental human 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. It is true that Art.1 of Protocol No.1 contains no explicit procedural requirements and

the absence of judicial review does not amount, in itself, to a violation of that provision. Nevertheless, it implies that any interference with the peaceful enjoyment of possessions must be accompanied by 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. In ascertaining whether this condition has been satisfied, a comprehensive view must be taken of the applicable judicial and administrative procedures.

135 Turning to the specific facts of the case, the Court notes that by s.21(5) of the Banks Act of 1997 the BNB's decision to revoke a bank's licence is adopted, as a matter of course, without an obligation to inform the bank of the commencement of the procedure, that is to say that the BNB is envisaging regulatory action. Nor does the BNB have to take into account the bank's representations and objections, if any. Thus, under the law as it stands at present, a bank is first officially notified of the withdrawal of its licence only after the BNB's decision has already been taken, as happened in the present case. This, combined with the lack of any subsequent possibility for administrative or judicial review of the decision and the view of the courts that examined the winding-up petition that they were bound by the BNB's determination on the question of insolvency, made it impossible for the applicant bank at any stage to state its objections to the BNB's findings of fact and mount a reasoned challenge to the BNB's conclusion that it was insolvent. Furthermore, the BNB's decision had serious and far-reaching consequences for the bank, which automatically ceased to operate as a going concern and was placed in compulsory liquidation, with all the resulting negative effects such a measure had. An act entailing such grave consequences may only be legitimate if it is adopted after, or is subject to verification in, some sort of proceedings that afford a reasonable opportunity to the bank to present its case to the competent authorities with a view to effectively challenging the revocation of its licence. However, the relevant provisions of domestic law expressly preclude such a possibility and, as a result, such proceedings were not available in the case at hand.

136 It is true that in such a sensitive economic area as the stability of the banking system the contracting states enjoy a wide margin of appreciation and that in certain situations—especially in the context of a banking crisis such as the one facing Bulgaria in 1996 to 1997—there may be a paramount need to act expeditiously and without advance notice in order to avoid irreparable harm to the bank, its depositors and other creditors, or the banking and financial system as a whole.

However, s.21(5) of the Banks Act of 1997 , which is still in force, precludes any sort of procedure in all cases, regardless of whether dispatch is important or not. By contrast, s.56(4) of the repealed Banks and Credit Business Act of 1992 , provided that when revoking a bank's licence the BNB could dispense with apprising the bank of the commencement of the procedure and with examining its representations and objections only in exigent and urgent cases. There is no indication that the situation in the present case was one where time was of the essence. Despite the fact that the revocation of the applicant bank's licence took place during a banking crisis, it does not appear that it was a matter of such urgency that any delay occasioned by some sort of formal procedure would have been unduly prejudicial. In particular, the Court notes that by the time its licence was withdrawn the applicant bank's operations had been restricted and a special administrator had been overseeing its activities for more than six months. Those measures must have significantly reduced the risk of a further dissipation of its assets pending the outcome of such a procedure.

137 As regards the potential concern of a run on the applicant bank as a result of the negative publicity which a revocation procedure might generate, the Court notes that by the time the BNB decided to withdraw the licence, the public must have already been amply aware that the bank was experiencing difficulties. Moreover, such a procedure could have been confidential and closed to the public. The procedure could also have been expedited, so as to avoid the damaging consequences of any undue delay. It could also be contemplated that, if the case was considered urgent, the BNB could have provisionally suspended the bank's licence pending the examination of the bank's objections and representations before taking its final decision. This could have also been achieved through, for instance, an internal administrative appeal.

138 There existed therefore a number of options—and the above list is not exhaustive—to attain the desired results of safeguarding the interests of the applicant bank's depositors and other creditors and protecting the stability of the banking system, by swiftly and seamlessly revoking its licence. However, the legislative framework opted for the most drastic solution—dispensing with any sort of proceedings in all cases—and there is no indication that other possibilities were considered.

139 In the light of the foregoing, the Court comes to the conclusion that the interference with the applicant bank's possessions was not surrounded by sufficient guarantees against arbitrariness and was thus not lawful within the

> meaning of Art.1 of Protocol No.1. This conclusion makes it unnecessary to ascertain whether the other requirements of that provision have been complied with. The Court thus expresses no opinion on the expediency of the supervisory and enforcement actions of the BNB in respect of the applicant bank or on the issue of whether they struck a fair balance between the bank's rights and the demands of the general interest of the community.
>
> 140 There has therefore been a violation of Art.1 of Protocol No.1."

158. We have cited from the judgment at length because of the importance attached to it by the Claimants. It should be noted that it concerned an allegedly arbitrary deprivation of property by administrative act. As we have already stated, in the present case however the decision to nationalise Northern Rock is not itself under challenge. As in *Hentrich*, the applicant in the *Capital Bank* case was precluded from having recourse to proceedings in which it could challenge the alleged justification for that administrative act. There is an obvious connection between the requirements of Article 6 and A1P1. The civil rights protected by Article 6 will often be or include "possessions", and if so any breach of Article 6 may also involve a breach of A1P1, as it did in the case of *Capital Bank.* The finding of infringement in that case can be compared with its rejection in the *Forminster Enterprises* case, where the seizure of the applicant's securities was effectively challenged in the national court: see paragraph 72 of the judgment of the European Court of Human Rights.

159. *Katikaridis* did concern the assessment of compensation payable by the State. We can take the facts from the headnote:

> "The applicants owned properties bordering on a 30 metre-wide road between Salonika and Langadas, parts of which were expropriated in July 1981, in accordance with the law, for the purpose of constructing a flyover. Legislative Decree 653/1977 section 1(3) provided for compensation. However, it created a presumption that the owners of properties on major roads benefit when such roads are widened. Those who benefit must accordingly contribute to the cost of the expropriation, by paying for an area 15 metres wide. The applicants claimed that their businesses suffered as a result of the expropriation. They stated that since the building of the flyover, their properties no longer gave onto a major road, and now gave onto a secondary road only 5–7 metres wide. Furthermore, there was no link between the secondary and main road, which now passed six metres above their properties."

160. The Court held that there had been a breach of A1P1:

> "44 The applicants alleged that the presumption created by section 1(3) of Law No. 653/1977 and the fact that the Court of Cassation had held that it was an irrebuttable one had prevented them from obtaining in the courts the compensation to which

they were entitled by virtue of a final court decision following the expropriation of part of their properties. They relied on Article 1 of Protocol No. 1 …

45 It was not contested that the applicants had been deprived of their property in accordance with the provisions of Legislative Decree No. 797/1971 and Law No. 653/1977, so that improvements could be made to a major road, and that the expropriation thus pursued a lawful aim in the public interest.

46 The applicants objected to the irrebuttable presumption that adjoining owners derived a benefit from improvements to major roads and the basis for it—everyday experience—indicated by the Court of Cassation in its judgment of 13 June 1989. They submitted that in certain decisions of the Salonika Court of Appeal and the Court of Cassation, and in the dissenting opinions of several of the Court of Cassation judges, it had been questioned whether the presumption was irrebuttable where, as here, it was evident that adjoining owners not only did not derive any benefit from the expropriation but, on the contrary, sustained a loss in the value of the remaining part of their property. They complained that the burden of expropriations for the purpose of making improvements to major roads, which benefited society as a whole, fell mainly on the shoulders of the adjoining owners. The amount of benefit derived by those owners varied from case to case and should not have been predetermined irrebuttably in a provision of general application.

…

49 The Court recognises that when compensation due to the owners of properties expropriated for roadworks to be carried out is being assessed, it is legitimate to take into account the benefit derived from the works by adjoining owners.

It observes, however, that in the system applied in this instance the compensation is in every case reduced by an amount equal to the value of an area 15 metres wide, without the owners concerned being allowed to argue that in reality the effect of the works concerned either has been of no benefit— or less benefit— to them or has caused them to sustain varying degrees of loss.

This system, which is too inflexible, takes no account of the diversity of situations, ignoring as it does the differences due in particular to the nature of the works and the layout of the site. It is “manifestly without reasonable foundation” (See, *mutatis mutandis*, *James and Others v. United Kingdom*, loc. cit., para. 46, and *Mellacher and Others v. Austria* (1990) 12 EHRR 391). In the case of a large number of owners, it necessarily upsets

> the fair balance between the protection of the right to property and the requirements of the general interest.
>
> 50 In the instant case the applicants had strong arguments to put forward in an attempt to show that the construction of a flyover near their premises, instead of increasing the value of the properties they retained, reduced their value by depriving them of direct access to the major road, which had by then been raised six metres. Moreover, the Salonika Court of Appeal had found that the applicants had sustained loss as a consequence of the works and held that the State was to pay commensurate compensation.
>
> 51 The applicants thus had to bear an individual and excessive burden which could have been rendered legitimate only if they had had the possibility of obtaining payment of the compensation in question.
>
> There has therefore been a violation of Article 1 of Protocol No. 1."

161. We have included this extensive citation in our judgment because it seems to us that it is the highpoint of the Claimants' case under this head. But the judgment is a curate's egg, for both them and the Defendants. On one hand it may be regarded as authority for the proposition that where the fairness of the compensation payable by the state depends on factual issues going to the value of the property taken or affected by the action of the state, the individual affected must be able to challenge the facts in issue before an independent tribunal, at least if he has "strong arguments to put forward" on those issues. But on the other hand the Court reiterated that the test to be applied to the legislation under challenge is whether it is "manifestly without reasonable foundation". Moreover, the Court did so in a case which did not involve measures of general social or economic policy such as nationalisation of an entire industry (*Lithgow*) or the enfranchisement of long leaseholders (*James*) or control of residential rents (*Mellacher*). This is a very high hurdle for the Claimants to surmount.

162. We do not think that the principles enunciated by the European Court of Human Rights in *Katikaridis* assist the Claimants in this case. Quite apart from the requirement for the Claimants to show that the Compensation Scheme is manifestly without reasonable foundation, they have not identified any issue of fact that in our judgment is or should be relevant to the fairness of the compensation determined under the Compensation Scheme. We refer, in particular, to paragraphs 82 to 86 above. In our judgment, all of the relevant facts are undisputed.

163. What the Claimants would like to challenge before a valuer is the requirement that the public financial assistance provided and to be provided to Northern Rock should be excluded from his consideration. But that requirement is not a fact; it is an expression of policy; and the issue is, therefore, whether the effect of that policy is to impose an individual and excessive burden on the shareholders. That is a policy decision to which the margin of appreciation applies.

164. As already appears from our judgment, we do not consider that the assumptions mandated by the Compensation Scheme result in any unfairness. The essential fact, the bottom line, is that the Claimants cannot show that they have "had to bear an individual and excessive burden". We refer to paragraph 96 above. The position of the First and the Second Claimants, and of some small shareholders, is further undermined by the circumstances in which they acquired their shares, to which we have referred in paragraph 46 above. We do not see that fairness requires the state, as representative of the taxpayer, having provided financial support to Northern Rock in addition to pay to its shareholders the added value to their shares brought about by that support, without which the Company would have ceased to be a going concern. Quite apart from the margin of appreciation which must be allowed to the legislature and the government, therefore, we would hold that there has been no infringement of the Claimants' rights under A1P1.

The margin of appreciation

165. Nonetheless, we remind ourselves that our function is one of review. It is for the legislature and the government to determine the provisions of a compensation scheme that does not impose an individual and excessive burden on those whose property has been taken. The function of the Court is to determine whether their determination exceeds the margin of appreciation recognised by the Convention.

166. In the absence of authority, we should have thought that the margin of appreciation in the present case was narrower than that applicable in cases such as *James*, *Lithgow* and *Mellacher*. The decisions made as to the public financial support provided to Northern Rock were certainly made in the exercise of responsibilities and powers concerned with broad economic and social policies. However, the decision to nationalise Northern Rock was made on narrower economic grounds, by comparing the financial benefits to the taxpayer of nationalisation with the alternatives available.

167. However, as we have already pointed out, the judgment of the European Court of Human Rights in *Katikaridis* is authority for the proposition that for the Court to find that the margin of appreciation has been exceeded it must conclude that the determination under challenge is manifestly without reasonable foundation. As will by now be apparent, and whether the relevant evidential burden is on the Defendants or on the Claimants, we are clear that the Compensation Scheme cannot be so condemned.

168. In particular, it cannot be said that either the basis of compensation, or the consequence that the shareholders do not receive compensation reflecting any value produced by or attributable to public financial assistance is without reasonable foundation, let alone manifestly so. We do not think that the implicit determination of the legislature that the Compensation Scheme does not impose "an individual and excessive burden" on the shareholders was outside even the narrowest margin of appreciation. To the contrary, there is a good argument that the excessive burden would, on the Claimants' case, be borne not by the shareholders but by the taxpayer, who, having provided financial support to Northern Rock, would then have to pay to the shareholders the value of their shares enhanced by that support. That argument is all the stronger in the case of those of the Claimants who purchased their shares after 13 September 2007 (as to which see paragraphs 7 and 8 above, and becomes

progressively stronger in relation to those who bought later, and in particular after the announcement of 21 January 2008 (see paragraph 45 above).

169. Lastly, we can see no basis for holding that A1P1 required the Government to treat small shareholders differently from professional investors such as the First and the Second Claimants, and indeed no one has suggested that there is. The shares acquired from the small investors were identical to and had the same value as the shares acquired from professional investors.

XI. Conclusion

170. As may be apparent, we have some sympathy for the position of the former long-term shareholders of Northern Rock, who doubtless believed that they had an investment in a reliable bank. Ultimately, however, they entrusted their investment to the hands of the management of the company. As it turned out, their business plan was flawed and could not survive the unprecedented circumstances of the latter part of 2007.

171. In our judgment, for the reasons set out above, none of the former shareholders has any justifiable claim against the Defendants beyond their entitlement under the Compensation Scheme. The claims for judicial review will be dismissed.