# Harbinger Capital Partners v Caldwell and Another [2013] EWCA Civ 492

## By Rachel Tandy

**The Court of Appeal has ruled that the independent valuer tasked with valuing the shares in Northern Rock at the date of its nationalisation was correct to hold that those shares were worthless. The Judgment will be a blow to any shareholders who might have hoped for compensation for the bail-out. It also provides some guidance as to the correct approach to take in valuation cases generally.**

### BACKGROUND

1. On 11 September 2007, in a move described by Lewison LJ as *"the harbinger"* of the later global banking crisis, Northern Rock notified the Financial Services Authority ("**FSA**") that it might be unable to continue as a going concern. It consequently received emergency financial support from the Bank of England.

2. A total of approximately £25 billion was provided in state support over the following six months. Nevertheless, attempts to keep the bank afloat in the private sector proved futile. On 22 February 2008, Northern Rock was nationalised.

3. The Banking (Special Provisions) Act 2008 and the Northern Rock Compensation Scheme Order 2008 provided for an independent valuer to value the shares in the bank and recommend what, if any, compensation

should be paid to shareholders on nationalisation. They also dictated several statutory assumptions on which the valuation should be based.

4. Applying those assumptions, the valuer reached the conclusion, on 1 October 2010, that the shares were worthless.

5. Harbinger Capital Partners ("**Harbinger**"), a hedge fund with an interest in preference shares in Northern Rock, challenged that decision in the Upper Tribunal (Tax and Chancery Chamber). That challenge was unsuccessful. Harbinger accordingly appealed to the Court of Appeal.

## THE ISSUES

6. This case turned on a discrete point of statutory interpretation. The legislative provision under scrutiny was s. 5(4)(a) of the Banking (Special Provisions) Act 2008 ("**the Act**").

7. That section states: *"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that all financial assistance provided by the Bank of England or the Treasury to the deposit-taker in question has been withdrawn (whether by the making of a demand for repayment or otherwise)…"*

8. Section 5(4)(a) was referred to as "**the Withdrawal Assumption**." The parties were at loggerheads over its meaning. It was this point that was the touchstone for the appeal; Mummery LJ stated *"the critical question for this court is: what is the natural and ordinary meaning of the Withdrawal Assumption?"*

## THE COMPETING INTERPRETATIONS

9. Three alternative interpretations of s. 5(4)(a) were put forward.

### The Repayment Interpretation

10. The financial assistance given by the Bank of England is assumed to have been paid back, in cash, on 22 February 2008.

11. A "fire sale" of Northern Rock's assets accordingly must be presumed. In those circumstances, the need for a quick sale would override the need to obtain the best price for its assets.

12. This means that the bank would, in the hypothetical world, have needed to sell approximately £29 billion worth of assets in order to realise the £25 billion owed.

13. This interpretation was applied by the independent valuer.

### The Demand Interpretation

14. "Withdraw" in the context of s. 5(4)(a) means simply that the Bank of England has demanded repayment of the assistance provided. There is no requirement that the repayment be assumed to have been made immediately.

15. Accordingly, there is no need to presume a "fire sale." Instead, a hypothetical or run-off administration is assumed, whereby Northern Rock's assets can be sold off over time, without losing value.

16. This interpretation was one of two Harbinger proposed as alternatives to the Repayment Interpretation.

### The Repayment-In-Kind Interpretation

17. The financial assistance provided to Northern Rock by the Bank of England is all repaid on the date of nationalisation.

18. However, it is not repaid in cash, but by a transfer of assets at book value.

19. This was the second alternative interpretation put forward by Harbinger. However, it was not pursued with any vigour at the appeal hearing and the judgments consequently focused, for the most part, on the Repayment Interpretation and the Demand Interpretation.

### The impact of the Interpretations

20. Northern Rock required assistance from the Bank of England because it had liquidity problems. It was, however, balance-sheet solvent; in February 2008 its assets exceeded its liabilities by some £1.6 billion.

21. The Repayment Interpretation assumed by the independent valuer, however, depleted the book value of Northern Rock's assets. That interpretation required the valuer to assume that its assets had been sold at less than book value by some £4 billion. The effect of the Repayment Interpretation was to convert Northern Rock's substantial balance sheet surplus into a deficit of £2.44 billion. The Withdrawal Interpretation avoided that problem and therefore would have resulted in some compensation being paid to the shareholders at the date of nationalisation.

## THE JUDGMENT

22. Mummery and Beatson LJJ found in favour of the independent valuer and dismissed the appeal. Lewison LJ, dissenting, concluded that the

independent valuer's approach had been wrong in law and preferred the Demand Interpretation.

23. Lewsion LJ's judgment begins with an appraisal of what he describes as well-established valuation principles. He focuses on the "principle of reality," which provides that *"things are to be taken as they are in reality on the valuation date, except to the extent that the instrument postulating the hypothetical transaction requires a departure from reality"* ([22]). Essentially, then, he starts his reasoning from the position as it is in reality, and seeks to depart from that position only insofar as such a departure is sanctioned by the wording of the statute.

24. On that basis, he pays particular attention to the "reality" that the assistance given by the Bank of England constituted liquidity support only, and Northern Rock's balance sheet was in credit prior to the valuation process. He also notes some inconsistencies and / or problems within the wording of the legislation itself. One such problem is the reference in s. 5(4)(a) to a withdrawal having been effected *"whether by the making of a demand for payment or otherwise,"* which suggests that the making of such a demand is sufficient to amount to withdrawal. He concludes that the valuer departed to too great an extent from the real world: *"the wording of section 5(4)(a) is not clear enough to trump the reality principle so as to compel the serious of counter-factual assumptions that the valuer made"* ([50]).

25. Mummery LJ's comments focus squarely on the wording of the legislation. He concludes that *"the ordinary and natural meaning of the Withdrawal Assumption that the financial assistance "has been withdrawn" refers to an assumed repayment on the valuation date"* ([114]). In response to Lewison LJ's findings, he comments that the reality principle makes little practical difference in a case that *"turns on the interpretation of the ambit of the*

*Withdrawal Assumptions required by the wording of s. 5(4). In this case my view is that the reality principle tells us no more about the Withdrawal Assumption than is gathered from its wording, as interpreted in accordance with established principles"* ([121]).

26. Beatson LJ broadly agrees with Mummery LJ. He replies to Lewison LJ's contextual approach at [71], where he points out that another view of the "reality" of the situation is that the financial assistance provided by the Bank of England was given on "Lender of Last Resort" principles. The general concept underlying those principles is that the Bank of England should not find itself in the position where it is required to compensate shareholders. Accordingly, on any view, the "reality" could not be said to fall definitively in favour of Harbinger.

## ANALYSIS

27. Admittedly the issue in question is a discrete one. However, there are two points that can be extrapolated.

28. The first (narrow) point is that the court has reached a clear decision on the meaning of the wording of the relevant legislation. It has concluded that the valuer was correct to find that Northern Rock shares were, to all intents and purposes, worthless at the date of valuation. In those circumstances, unless Harbinger seeks to appeal to the Supreme Court, it seems evident that the former shareholders in Northern Rock have reached a dead end. They, rather than the state, have been made to shoulder the consequences of the collapse of that bank.

29. The second (broader) point is that, when required to appraise a valuation exercise, the starting point for the courts is the exact wording of the assumptions the valuer is obliged to make, and the scope of those

assumptions, rather than the context in which those assumptions must have effect.

30. The real tension in this judgment is the almost entirely contrasting approaches taken by Mummery LJ and Lewison LJ. The former examined the wording of the Withdrawal Assumption first, in order to define its ambit. He then considered the principle of reality only in relation to matters falling outside of that ambit (see, e.g., [102]). The latter essentially effected that approach in reverse, considering the ambit of the principle of reality first, and only departing from it insofar as the wording of s. 5(4)(a) expressly drew him outside of that ambit.

31. The case confirms that it is the former approach that should, ideally, form the basis of any valuation exercise. Whilst obviously the practical and contextual significance of a particular interpretation is important, that element cannot "trump" what Mummery LJ described as the *"ordinary and natural"* meaning of the words themselves. That is particularly so in a case where the "reality" of the Demand Interpretation could fall to be criticised as much – if not more so – than the "reality" of the Withdrawal Interpretation; indeed, both Mummery and Beatson LJJ commented on, for example, the difficulties presented by the former when it came to considering different types of financial assistance.

32. This alerter ends, as did Mummery LJ's judgment, with some stark words of caution. Mummery LJ warned, at [133], against the risks of "over-interpretation," commenting that *"when, in a case like this, you are faced with detailed arguments on interpretation and they range widely, there is a risk of straying further and further from the few words on which the case really turns. It is reasonable to assume that when s. 5(4) was drafted and debated in the midst of a serious crisis and under considerable pressure of time it was with*

*nothing like the amount of energy and ingenuity that have been invested by the parties in their efforts to persuade the Upper Tribunal and this court what it means."* The message to practitioners given by that passage is clear. Whilst the exact words used are important, slavish and tedious analysis of each component syllable is not. Above all else, the best approach – as is so often urged in interpretation cases – is to keep it simple.

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